BRITISH COLUMBIA SECURITIES COMMISSION
Securities Act, RSBC 1996, c. 418

Citation: Re Schouw, 2017 BCSECCOM 168 Date: 20170517

Brendan James Schouw and Hornby Residences Ltd.

Panel	Nigel P. Cave	Vice Chair
	George C. Glover, Jr.	Commissioner
	Audrey T. Ho	Commissioner
Hearing Date	May 1, 2017	
Submissions Completed	May 1, 2017	
Date of Decision	May 17, 2017	

Appearing

Jennifer Whately	For the Executive Director
Chilwin Cheng	For Brendan James Schouw and Hornby Residences Ltd.

Decision

I. Introduction

[1] This is the sanctions portion of a hearing under sections 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418. The Findings of this panel on liability made on January 24, 2017 (2017 BCSECCOM 17) are part of this decision.

[2] We found that the respondents perpetrated a fraud on one investor in the aggregate amount of $74,612 contrary to section 57(b) of the Act and that, by operation of section 168.2 of the Act, Schouw also contravened section 57(b) in connection with Hornby's contravention of section of 57(b).

[3] The parties provided written and oral submissions on the appropriate sanctions for the respondents' misconduct.

II. Position of the Parties

A. Executive Director

[4] The executive director's written submissions set out that the following orders are in the public interest in the circumstances:

(a) under section 161(1)(b) of the Act, that Schouw and Hornby permanently cease

trading in, and be permanently prohibited from purchasing, securities and exchange contracts;

(b) under sections 161(1)(d)(i) and (ii), that Schouw resign any position he holds as, and is permanently prohibited from becoming or acting as, a director or officer of any issuer or registrant;

(c) under section 161(1)(d)(iii), that Schouw and Hornby are permanently prohibited from becoming or acting as a registrant or promoter;

(d) under section 161(1)(d)(iv), that Schouw and Hornby are permanently prohibited from acting in a management or consultative capacity in connection with activities in the securities market;

(e) under section 161(1)(d)(v), that Schouw and Hornby are permanently prohibited from engaging in investor relations activities;

(f) under section 161(1)(g), that Schouw and Hornby are jointly and severally liable to pay to the Commission the $74,612 obtained as a result of their contraventions of the Act; and

(g) under section 162, that Schouw pay an administrative penalty of $125,000.

[5] During oral submissions, the executive director suggested that orders under section 161(1)(c) of the Act, which would prevent exemptions under the Act (and elsewhere in the securities regulatory regime) from being available to the respondents, would also be appropriate in the circumstances.

B. Respondents

[6] The respondents' written submissions set out that the following orders are appropriate in the circumstances:

1. **Hornby**

   (a) under section 161(1)(b) of the Act, that Hornby permanently cease trading in, and be permanently prohibited from purchasing securities and exchange contracts;

   (b) under section 161(1)(d)(iii), that Hornby is permanently prohibited from becoming or acting as a registrant or promoter;

   (c) under section 161(1)(d)(iv), that Hornby is permanently prohibited from acting in a management or consultative capacity in connection with activities in the securities market;

   (d) under section 161(1)(d)(v), that Hornby is permanently prohibited from engaging in investor relations activities; and

   (e) under section 162, that Hornby pay an administrative penalty of $75,000.

2. **Schouw**

   (a) under sections 161(1)(d)(i) and (ii), that Schouw resign any position he holds as, and is prohibited from becoming or acting as, a director or officer of a public issuer or registrant for a period of 5 years;

   (b) under section 161(1)(d)(iii), that Schouw is prohibited from becoming or acting as a registrant or promoter for a period of 5 years;

(c) under section 161(1)(d)(iv), that Schouw is prohibited from acting in a management or consultative capacity in connection with activities in the public securities market for 5 years;
(d) under section 161(1)(d)(v), that Schouw is prohibited from engaging in investor relations activities in relation to a public issuer for 5 years.

[7] During oral submissions, the respondents submitted, as an alternative position, that any orders restricting Schouw's ability to be an officer or director of an issuer (if they were not to be limited to *public* issuers), be crafted so as to limit the issuer's use of capital raising exemptions under the Act while Schouw acted as a director or officer of that issuer.

III. Analysis

A. Factors

[8] Orders under sections 161(1) and 162 of the Act are protective and preventative, intended to be exercised to prevent future harm. See *Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37.

[9] In *Re Eron Mortgage Corporation*, [2000] 7 BCSC Weekly Summary 22, the Commission identified factors relevant to sanction as follows (at page 24):

> In making orders under sections 161 and 162 of the Act, the Commission must consider what is in the public interest in the context of its mandate to regulate trading in securities. The circumstances of each case are different, so it is not possible to produce an exhaustive list of all of the factors that the Commission considers in making orders under sections 161 and 162, but the following are usually relevant:
>
> - the seriousness of the respondent's conduct,
> - the harm suffered by investors as a result of the respondent's conduct,
> - the damage done to the integrity of the capital markets in British Columbia by the respondent's conduct,
> - the extent to which the respondent was enriched,
> - factors that mitigate the respondent's conduct,
> - the respondent's past conduct,
> - the risk to investors and the capital markets posed by the respondent's continued participation in the capital markets of British Columbia,
> - the respondent's fitness to be a registrant or to bear the responsibilities associated with being a director, officer or adviser to issuers,
> - the need to demonstrate the consequences of inappropriate conduct to those who enjoy the benefits of access to the capital markets,
> - the need to deter those who participate in the capital markets from engaging in inappropriate conduct, and
> - orders made by the Commission in similar circumstances in the past.

B. Application of the factors

Seriousness of the conduct

[10] Previous decisions of this Commission have repeatedly held that fraud is the most serious misconduct found in the Act (see *Manna Trading Corp. Ltd. et al.*, 2009 BCSECCOM 595).

[11] The executive director submitted that even though the panel's finding of fraud was modest, with respect to the total amount invested by the investor (i.e. approximately $75,000 out of the total $1,000,000 invested by the investor), the misconduct was significant in that the investor was unsophisticated with respect to investing in large scale real estate development projects and that he was totally reliant upon Schouw.

[12] The respondents made a number of submissions in support of their belief that their misconduct in this case was "small scale and technical in nature" relative to other cases in which the Commission has made a finding of fraud against a respondent:

- the misconduct involved the respondents' dealing with only one investor rather than many investors;
- the funds were raised by the respondents in respect of a real business and not, as in some other cases, where the entire investment scheme was fraudulent;
- relative to the investor's total investment, the respondents' enrichment (and hence the quantum of the fraud) was relatively modest;
- the misconduct in this case was caused by a failure to disclose to the investor that his funds would be used in part to compensate Schouw for his time and labour;
- that had the investor's funds expended for Schouw's personal benefit been recorded as a salary, then there would not have been a finding of fraud; and
- the misconduct arose from poor record keeping and a lack of internal controls within the network of companies controlled by Schouw.

[13] We disagree with certain of these submissions of the respondents.

[14] Most significantly, the respondents' attempt to characterize the nature of their misconduct as technical in nature, or one in which the fault can be attributed to poor record keeping, misses the critical *mens rea* aspect of fraud that distinguishes it from other misconduct under the Act.

[15] This case was essentially about misappropriation of a portion of the funds given to Hornby by the investor and diverted for Schouw's personal purposes. We have found that Schouw knowingly diverted the funds for his own purposes and did so with the knowledge that by so doing, he was putting the investor's funds at risk. This goes significantly beyond poor record keeping and the conduct represents something far more serious than a mere "technical" contravention of section 57(b) of the Act.

[16] We do acknowledge that there was, in fact, a real business that was being pursued by the respondents and, in terms of the number of investors harmed and the quantum of the

fraud, this case is not the most serious of its kind that the Commission has dealt with. Our sanctions, set out below, take this into consideration.

Harm suffered by investors and the enrichment of the respondents

[17] The investor has lost all of the $1,000,000 that he invested with the respondents. Of that, we found only $74,612 of the amount invested was lost as a result of the respondents' fraud.

[18] What is clear is that the investor has been harmed in a manner that goes beyond the mere monetary loss of his investment. The funds that were invested came from his mother's estate and the sale of a family home. He testified as to his feelings of guilt that arise from having lost the money obtained through his mother and invested by him. He further testified to the damage to his peace of mind caused by his losses.

[19] The amount of the respondents' enrichment is quantifiable. We found that the respondents diverted $74,612 from Hornby's bank account for Schouw's personal benefit. The respondents were directly enriched by this amount.

Aggravating or mitigating factors

[20] The executive director submits that there are no aggravating or mitigating factors in this case.

[21] The respondents do not have a history of securities regulatory misconduct.

[22] The respondents say that Schouw is currently engaged in a number of significant real estate development projects and that he is performing a managerial or supervisory function with respect to those projects. The respondents say that there are many third parties who are dependent upon Schouw being able to perform these functions and that we should take this into account in crafting appropriate orders in the circumstances.

[23] We acknowledge that it is not our function to regulate the roles in which Schouw can work in the real estate industry. However, we are of the view that none of the orders that we make below fundamentally impair Schouw's ability to do so.

[24] We do not share the executive director's view that there are no aggravating circumstances in this case. One of the most troubling aspects of this case was the complete lack of proper record keeping to document the use of the investor's funds. The standard of record keeping of the respondents falls so far short of what we would expect of those who wish to participate in our capital markets that we find this to be an aggravating factor in this case. Schouw was the controlling mind and management (as both a director and officer) of Hornby and several other companies in his corporate group. His failure to maintain or produce any semblance of proper records in support of the use of proceeds of funds raised from the investor makes him a significant risk to our capital markets.

Continued participation in the capital markets/fitness to be a registrant or a director or officer of an issuer

[25] Public confidence in our capital markets is dependent on the honesty and integrity of those who participate in it. It is also axiomatic that directors and officers of issuers must act with honesty, integrity and in the best interests of the issuer. Those who commit fraud therefore pose very great risks to our capital markets and are ill-suited to act as registrants or as director or officers of issuers.

[26] As noted above, the respondents' record keeping, or lack thereof, further and significantly exacerbates our concerns about Schouw's fitness to be a director or officer of an issuer.

[27] The respondents have urged us to tailor our market prohibitions to allow Schouw to continue to act a director and/or officer of issuers in certain circumstances. Their initial submission is that he be prohibited only from acting as a director or officer of a *public* issuer for a five-year period. Alternatively, they suggested that where Schouw is an officer or director of an issuer (of any type), that issuer be prohibited from using the capital raising exemptions under the Act, again, for a five-year period.

[28] The respondents' first position on this issue would allow Schouw, on behalf of private issuers, to continue to raise money from investors and to carry out the functions of a director and officer within those issuers. We understood the alternative position to be an attempt to allow Schouw to carry out functions of a director or officer of a private issuer as long as he plays no role in capital raising activities.

[29] These submissions completely ignore the circumstances of this case. Schouw's fraudulent misconduct occurred in a private issuer. Secondly, Schouw's fraudulent misconduct was not limited to abuse in capital raising. The core of his misconduct was the fraudulent misappropriation of funds raised from an investor and then used for his personal purposes. Schouw was able to perpetrate that fraud because he was a director and officer of Hornby, a private issuer, and had control and direction, in those roles, over the funds given to the issuer by the investor. There is simply no basis to limit our concern about Schouw's fitness to be a director or officer to public issuers nor solely to capital raising activities.

Specific and general deterrence

[30] We agree with the executive director that the sanctions we impose must be sufficiently severe to ensure that both the respondents and others will be deterred from fraudulent misconduct.

Previous decisions

[31] The executive director directed us to six recent decisions of this Commission as guidance in determining the appropriate sanctions in this case: *Re Cho*, 2013 BCSECCOM 454; *Strategic Global Investments (Re)*, 2014 BCSECCOM 235; *Re Rush*, 2016 BCSECCOM 55; *Re Figueiredo*, 2016 BCSECCOM 233; *Re Spangenberg*, 2016 BCSECCOM 180; and *Re Streamline Properties Inc. et al.*, 2015 BCSECCOM 66.

[32] The respondents did not direct us to any decisions in support of the sanctions that they say are appropriate in the circumstances.

[33] In *Cho*, the respondent was found to have contravened the Act with respect to illegal distributions, misrepresentations and fraud. He raised just over $100,000 from five investors and repaid those investors approximately $60,000 as purported returns on their investments. Subsequently, a distribution of frozen funds reduced the amount still owed to investors to $20,000. The respondent's misconduct included the use of multiple fake identities. The respondent received lifetime market prohibitions, was ordered to pay approximately $20,000 under a section 161(1)(g) order and was ordered to pay to the Commission an administrative penalty of $200,000.

[34] In *Spangenberg*, the respondent was found to have contravened the Act with respect to illegal distributions and fraud. He raised just over $170,000 from seven investors. The respondent was found to have engaged in multiple elements of deceit including the altering of an analyst report and multiple elements of misrepresenting to investors his personal background. The respondent received lifetime market prohibitions, was ordered to pay the full amount raised under a section 161(1)(g) order and was ordered to pay to the Commission an administrative penalty of $225,000.

[35] In *Rush*, the respondents were found to have committed fraud and traded in securities without being registered to do so. The respondents raised approximately $73,000 from one investor and repaid that investor approximately $13,000 as purported returns on her investment. The individual respondent's misconduct included a protracted period of deceit and the impersonation of a third party in an attempt to conceal the fraudulent conduct. The respondents received lifetime market prohibitions, were ordered to pay approximately $60,000 under a section 161(1)(g) order and the individual respondent was ordered to pay to the Commission an administrative penalty of $200,000.

[36] In *Strategic Global*, the respondent was found to have committed fraud and traded in securities without being registered to do so. The respondent raised US $80,000 from three investors. The respondent was found to have raised money in support of non-existent investment opportunities. The entire money raising enterprise was a sham. No funds were ever returned to any of the three investors. The respondent received lifetime market prohibitions, was ordered to pay US $80,000 under a section 161(1)(g) order and was ordered to pay to the Commission an administrative penalty of $240,000.

[37] In *Figueiredo*, the respondents were found to have committed fraud. The respondents raised $81,000 from one investor. Approximately $23,000 was returned to the investor as purported returns of principal and interest on his investment. The respondents were found to have raised money in support of non-existent investments. The respondents received lifetime market prohibitions, were ordered to pay approximately $58,000 under a section 161(1)(g) order and the individual respondent was ordered to pay to the Commission an administrative penalty of $130,000.

[38] In *Streamline*, all of the respondents were found to have engaged in illegal distributions and one of the individual respondents (Knight) was found to have committed fraud and breached a previous order of the Commission. Knight committed fraud in connection with raising $100,000 from one investor. The investor was able to recover all of the invested funds under separate civil proceedings. Knight received lifetime market prohibitions. Knight's monetary sanctions were set out separately for his different contraventions of the Act. With respect to his fraudulent misconduct, Knight was ordered to pay an administrative penalty of $150,000. In making this order, the panel specifically noted that this administrative penalty was on the lower end of the scale as the funds raised from the investor were used in connection with a legitimate project and in a manner consistent with the investor's expectations. No order under section 161(1)(g) was made against Knight as the investor had recovered all of the invested funds.

[39] We agree with the executive director that all of the above cases offer some guidance in our sanctions decision. However, we do note that in many of the cases cited above, the funds were raised from investors in support of non-existent (or sham) investment opportunities. That is not the case in the current circumstances. In addition, several of the respondents in the cases above were also found to have forged or falsified documents in support of their fraudulent misconduct which behavior was found to be a significant aggravating factor in determining the sanctions appropriate in the circumstances. As a consequence, we think an administrative penalty on the lower end of the range suggested above is appropriate in the circumstances.

IV. Appropriate Orders

A. Market prohibitions

[40] Permanent market prohibitions are almost always appropriate for those who are found to have committed fraud.

[41] The executive director did not ask that the securities of Hornby be permanently cease traded. However, as Hornby has engaged in fraudulent misconduct, we do not think it in the public interest that its securities trade. We also understand that Hornby is currently in bankruptcy proceedings. Notwithstanding that the executive director did not ask for this order, such an order is necessary in the public interest.

[42] Schouw submits that his is one of the rare circumstances to depart from orders permanently preventing him from participating in the capital markets. He submits that his prohibitions should only last for five years and that he be allowed to act as a director or officer for private issuers (in the manner described above). We do not agree with those submissions. We think that Schouw is a substantial risk to our capital markets and that he is not fit to be a director or officer of any issuer for all of the reasons set out above.

[43] Schouw submitted that permanent market prohibitions would unfairly infringe upon his ability to earn a living in large scale real estate development projects. He further submitted that permanent market prohibitions would hinder his ability to earn money to pay any monetary sanctions that we might impose. We do not agree with either of these

submissions. Our orders will not have the effect of preventing him from earning a living in large scale real estate development projects. In fact, we were advised during oral submissions that Schouw was currently engaged in several large scale development projects and had structured his affairs in a manner that allowed him to provide managerial or consultative services to those projects. We acknowledge that the bans we impose could somewhat curtail the scope of his current activities. Given our findings regarding Schouw's misconduct, we do not consider any such curtailment to be inappropriate or unfair.

B. Section 161(1)(g) orders

[44] In *Re Michaels*, 2014 BCSECCOM 457, the panel set out some broad principles with respect to the application of orders under section 161(1)(g) of the Act:

> (a) the focus of the sanction should be on compelling the respondent to pay any amounts obtained from the contraventions of the Act;
> (b) the sanction does not focus on compensation or restitution or act as a punitive or deterrent measure over and above compelling the respondent to pay any amounts obtained from the contravention(s) of the Act;
> (c) the section should be read broadly to achieve the purposes set out above and should not be read narrowly to either limit orders;
> i. to amounts obtained, directly or indirectly by that respondent; or
> ii. to a narrower concept of "benefits" or "profits"
> although that may be the nature of the order in individual circumstances.

[45] Further, the decision set out that principles that apply to all sanction orders would also be applicable to section 161(1)(g) orders, including:

> (a) a sanction is discretionary and may be applied where the Panel determines it to be in the public interest; and
> (b) a sanction is an equitable remedy and must be applied in the individual circumstances of each case.

[46] In this case, Hornby received $74,612 (of the total $1,000,000 invested by the investor). This money was then diverted to Schouw's personal bank account and used for his personal purposes. Therefore, this amount was received by the two respondents and was clearly not used for the purposes intended by the investor. This would normally constitute circumstances in which a panel would order that that amount be paid to the Commission under a section 161(1)(g) order.

[47] However, the respondents submit that no order under section 161(1)(g) should be made in the circumstances. They point to Hornby's ongoing bankruptcy proceedings and suggest that an order of the Commission under section 161(1)(g) would inappropriately place the investor in a position of a "preferred lender" in those proceedings.

[48] There are a number of problems with this submission.

[49] First, it has no bearing on whether an order under section 161(1)(g) is inappropriate with respect to Schouw personally. We were advised that Schouw, in his personal capacity, is not in bankruptcy proceedings.

[50] Second, it was not made clear to us how an order made under section 161(1)(g) against Hornby would, in fact, create any priority for any party in Hornby's bankruptcy proceedings. Although we were not presented with any submissions as to the effect of an order made under section 161(1)(g) in a bankruptcy proceeding, we have no reason to believe such an order would have any impact on the priorities of the creditors in such a proceeding.

[51] Third, even if a section 161(1)(g) order were to have such an impact, it was not made clear to us why it would be inappropriate for someone who has been the subject of fraudulent misconduct by the bankrupt party to have such a priority.

[52] Finally, an order under section 161(1)(g) is an order that can only be enforced by the Commission and not directly by the investor. Decisions about enforcement of such an order must involve considerations of the public interest. A consideration of the impact of enforcement of such an order in a bankruptcy proceeding must be made in the public interest.

[53] The ongoing bankruptcy proceedings of Hornby are not a reason to avoid making orders under section 161(1)(g) against the respondents in this case. As the $74,612 was received by both the respondents and Hornby was controlled by Schouw at the time, our orders make the two respondents jointly and severally liable for such amount.

C. Administrative penalties

[54] The executive director asked that we make an order against Schouw for an administrative penalty under section 162 of the Act of $125,000. The executive director expressly did not seek an administrative penalty against Hornby out of concern that any such administrative penalty would ultimately be borne by the creditors of Hornby in its bankruptcy proceeding and because Hornby, at the time of its misconduct, was controlled by Schouw and was not acting independently of him in its misconduct.

[55] Astonishingly, the respondents suggested that there be no administrative penalty imposed upon Schouw and that Hornby be ordered to pay an administrative penalty of $75,000. The investor in this case is one of the creditors of Hornby and Hornby is in bankruptcy proceedings. As such, if such a penalty were actually to be paid, in whole or in part, by Hornby, it would be paid at the expense of the investor and Hornby's other creditors. The respondents' submission is therefore that the investor (among others) should suffer a further loss as a result of having been defrauded by the respondents.

[56] We agree with the executive director that there be no order under section 162 of the Act against Hornby in the circumstances.

[57] In looking at the six decisions cited to us by the executive director as guidance on appropriate sanctions, we agree that an order of $125,000 under section 162 of the Act against Schouw is in line with those decisions. The nature of Schouw's misconduct was less egregious than that of certain of the respondents described in the cited decisions in that he was engaged in a real business enterprise and he did not compound his misconduct through forgery or falsification of documents. However, Schouw's misconduct was serious and was exacerbated by his lack of proper record keeping. *Streamline* is the most analogous case that was presented to us, in which the respondent Knight received an administrative penalty of $150,000. For the purposes of both specific and general deterrence, and given the $74,612 quantum of the fraud, we think an administrative penalty of $125,000 is appropriate in the circumstances.

V. Orders

[58] Considering it to be in the public interest, and pursuant to sections 161 and 162 of the Act, we order:

1. **Hornby**
   (a) under section 161(1)(b) of the Act, that all persons cease trading permanently, and be permanently prohibited from purchasing any Hornby securities;

   (b) under section 161(1)(b) of the Act, that Hornby permanently cease trading in and be permanently prohibited from purchasing any securities or exchange contracts;

   (c) under sections 161(1)(c) and (d)(iii) to (v):

      i. that the exemptions set out in the Act, the regulations or any decision as defined in the Act, do not apply to Hornby permanently;

      ii. that Hornby be permanently prohibited from becoming or acting as a registrant or promoter;

      iii. that Hornby is permanently prohibited from acting in a management or consultative capacity in connection with activities in the securities market; and

      iv. that Hornby is permanently prohibited from engaging in investor relations activities; and

   (d) under section 161(1)(g) of the Act, that Hornby pay to the Commission $74,612.

2. **Schouw**
   (a) under section 161(1)(d)(i) of the Act, that Schouw resign any position that he holds as a director or officer of any issuer;

(b) under sections 161(1)(b), (c) and (d)(ii) to (v):

i. that Schouw cease trading in, and is permanently prohibited from purchasing, any securities or exchange contracts;
ii. that Schouw is permanently prohibited from becoming or acting as a director or officer of any issuer or registrant;
iii. that the exemptions set out in the Act, the regulations or any decision as defined in the Act, do not apply to Schouw permanently;
iv. that Schouw be permanently prohibited from becoming or acting as a registrant or promoter;
v. that Schouw is permanently prohibited from acting in a management or consultative capacity in connection with activities in the securities market; and
vi. that Schouw is permanently prohibited from engaging in investor relations activities;

(c) under section 161(1)(g) of the Act, that Schouw pay to the Commission $74,612; and

(d) under section 162 of the Act, that Schouw pay to the Commission an administrative penalty of $125,000.

[59] With respect to the amounts ordered under section 161(1)(g), the total amount payable by the respondents (on an aggregate basis) shall not exceed $74,612 and the respondents shall be jointly and severally liable to make such payments.

May 17, 2017

For the Commission

Nigel P. Cave
Vice Chair

George C. Glover, Jr
Commissioner

Audrey T. Ho
Commissioner