

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

Citation: Re Schouw, 2017 BCSECCOM 17

Date: 20170124

Brendan James Schouw and Hornby Residences Ltd.

Panel	Nigel P. Cave George C. Glover, Jr. Audrey T. Ho	Vice Chair Commissioner Commissioner
Hearing Dates	July 18, 19 and 22, 2016 August 2, 2016 October 25, 2016	
Submissions Completed	October 25, 2016	
Date of Findings	January 24, 2017	
Appearing		
Jennifer Whately	For the Executive Director	
Chilwin Cheng	For Brendan James Schouw and Hornby Residences Ltd.	

Findings

I. Introduction

- [1] This is the liability portion of a hearing under sections 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418.
- [2] In a notice of hearing issued November 6, 2015 (2015 BCSECCOM 406), the executive director alleged that:
- a) the respondents perpetrated a fraud on one investor contrary to section 57(b) of the Act; and
 - b) Brendan James Schouw, as a director of Hornby Residences Ltd., authorized, permitted or acquiesced in Hornby's contravention of section 57(b) and therefore contravened section 57(b) by virtue of the operation of section 168.2 of the Act.
- [3] During the hearing, the executive director called two witnesses, a Commission investigator and the investor ("HS"), tendered documentary evidence and made written submissions.

- [4] At the commencement of the hearing, the executive director clarified and amended the notice of hearing. The notice of hearing says that the alleged fraud relates to an investment by HS of \$1,000,000 into Hornby and, in particular, that Schouw spent approximately \$453,155 of those funds on expenses unrelated to the project that HS was told by the respondents would be the use of proceeds. The executive director amended the notice of hearing and reduced the \$453,155 amount to \$439,821.93.
- [5] The respondent Schouw testified at the hearing and also tendered documentary evidence and made written submissions.

II. Background

- [6] Schouw is a resident of Vancouver, British Columbia. He has never been registered under the Act. He is a real estate developer. He is and was at the relevant time the sole director of Hornby. He is also and was at the relevant time the sole director of Grace Residences Ltd. and Homer Residences Ltd. Drake Residences Ltd. is another company that is connected to Schouw, although its incorporation information and who its directors and officers are and were at the relevant time were not made clear to us.
- [7] Hornby is a British Columbia company that was incorporated on January 25, 2007. Hornby was incorporated by Schouw in connection with a proposed real estate development project known as the Artemisia project.
- [8] Grace is a British Columbia company that was incorporated on March 15, 2001.
- [9] Homer is a British Columbia company that was incorporated on January 26, 2005.
- [10] Schouw testified that although Grace, Drake and Homer were originally incorporated in connection with previous real estate development projects, they morphed into entities that provided services to his various companies and projects, including the Artemisia project. In the case of Grace and Drake, these companies were the employers of his staff and the entities that retained third party contractors that assisted him in his various projects. Homer, among other things, is the entity that owned or leased office space that was utilized by Schouw's various corporate entities.
- [11] HS is a resident of British Columbia. He was left a family inheritance and received proceeds of the sale of a family home and was interested in investing \$1.25 million of those funds in the Vancouver real estate market. HS was introduced to Schouw in the fall of 2009 through a mutual acquaintance.
- [12] HS and Schouw both testified during the hearing and gave similar, in part, and, in part, diverging evidence of what occurred during a meeting between HS and Schouw. HS and Schouw agree that there was only one face to face meeting between the two of them prior to HS agreeing to invest \$1.25 million with Schouw and his companies.

- [13] HS says that during the meeting, Schouw:
- a) told him he would need to invest his funds for two years;
 - b) said that he would earn 18% simple interest per year on his invested funds;
 - c) said he would personally guarantee the repayment of the invested funds;
 - d) did not indicate that there were any risks associated with the investment;
 - e) told him that the funds invested would be used for demolition, city planning permissions and permits and for construction, specifically at the Artemisia project;
 - f) told him that at the completion of the Artemisia project HS would have the option of having his investment repaid or using the investment proceeds as a credit towards the purchase of a unit in the Artemisia development; and
 - g) in response to HS' concern about putting all of the \$1.25 million in one development project, suggested that HS could put \$1 million in the Artemisia project and put \$250,000 into Homer which was developing another project.
- [14] We found HS to be a credible witness. However, it was clear that he was an unsophisticated investor in large-scale real estate projects.
- [15] Schouw testified that while he remembered meeting with HS, he did not remember many of the specific details of the conversation that occurred. He did, however, take issue with HS' testimony in two key respects.
- [16] Schouw said that he did discuss with HS some of the risks associated with an investment in real estate development. Schouw said that it was his universal practice, when meeting with potential investors who were not experienced with real estate development, to discuss certain key risks including, as one example, the impact on the investment and the project in the event that he unexpectedly passed away.
- [17] Schouw also disputed HS' testimony that he indicated that the investment would be used for **construction** of the Artemisia project versus being used for the **development** of the project. Schouw described that in his view there was a clear difference between pre-construction activities, i.e. development, and actual construction. Common parlance might mix these two phases together but in large-scale real estate projects there was a clear distinction.
- [18] In particular, Schouw testified that there was a clear difference in financing associated with these two phases. He explained that unsecured funding of the type provided by HS would be used by him and his companies in order to advance the project up to the point

of commencement of construction at which point well-established construction lenders would provide secured construction loans for the project. Schouw testified that, although he could not remember the exact details of his conversation with HS on this point, he would have described the use of funds in the context of development of the project and would not have described the funds as being used for construction purposes.

- [19] As will be discussed later, although we received extensive submissions from the parties on the question of whose evidence we should believe with respect to whether risks were discussed at this meeting, it is not necessary for us to make a finding on this issue. The allegations of fraud brought by the executive director are not founded upon the question of risk disclosure (or failure to disclose risks).
- [20] Although we found HS to be a credible witness, we do prefer the evidence of Schouw to that of HS on the issue whether HS was told during this meeting that his invested funds were to be used for “construction” of the Artemisia project. The Artemisia project was a large real estate development project and one that was to require significant funds for construction. Schouw’s description of the financing arrangements for this sort of project was credible and consistent with commercial practice. We do not think it likely that Schouw would have explicitly suggested that the funds were to be used as part of the Artemisia project’s construction financing.
- [21] Although we prefer Schouw’s evidence on this point, that is not to say that we find that HS was not truthful in his testimony. It is entirely possible that, having been told by Schouw that the funds were to be used for development of the project, HS may have assumed or formed an impression that his funds would be used for construction costs.
- [22] On November 17, 2009, HS invested a total of \$1.25 million in Schouw’s companies. Of that total, \$1 million was advanced to Hornby and \$250,000 was advanced to Homer. Other than as will be discussed below, the \$250,000 invested in Homer is not relevant to this hearing.
- [23] The respondents gave HS an investment certificate and a conversion certificate to document his \$1 million invested in Hornby.
- [24] The investment certificate provided for 18% simple interest to accrue annually and that the maturity date of the investment would be November 13, 2013. The maturity date was therefore four years and not the two years that was discussed by the parties during the meeting. The investment certificate was guaranteed by both Hornby and Schouw personally. The investment certificate was unsecured.
- [25] The investment certificate has a section headed “Funds deposited with Hornby Residences Ltd” that reads, in part, as follows:

The Principal Sum may be used, at the sole discretion of Hornby Residences Ltd., for purposes relating to the acquisition and improvement of land and premises located in the Downtown South neighbourhood of Vancouver, British Columbia.

- [26] Schouw testified that Downtown South was a term used by the City of Vancouver and referenced an area of the downtown core. Included within that core were several real estate development projects that Schouw had historically worked on, was working on during the relevant time period or was considering working on during the relevant time period.
- [27] The evidence of HS was that, although they originally discussed a two-year term, it was unilaterally changed by Schouw to four years.
- [28] The conversion certificate's purpose was to record HS' option to convert his investment proceeds at the completion of the Artemisia project into a unit in the development. That certificate provides that the conversion value was to be \$1,350,000 plus all accrued interest at the time of conversion. HS testified that he did not know why the conversion value was \$1,350,000 plus all accrued interest rather than the original \$1million invested plus all accrued interest. Schouw testified that the difference was intended as an extra inducement (or benefit) to have the investor convert the investment into a unit rather than request a cash repayment.
- [29] The \$1 million invested by HS in Hornby was deposited into a Hornby account. At the time of the deposit, the balance in the account into which the funds were deposited was just over \$5,000.
- [30] Over the next six weeks, all of the funds from this Hornby account were paid out, either directly to third parties or into accounts in the name of Grace or Schouw (personally).
- [31] Commission investigators reviewed the accounts of Hornby, Grace and Schouw collectively, as there were a number of intercorporate transfers. Those investigations confirmed that during the period from the deposit of the funds into the Hornby account (November 18, 2009) through until December 31, 2009:
- 95% of the funds deposited into the Hornby account during this period (the Hornby account having started this period with a nominal balance) were the investment funds from HS,
 - just under \$500,000 of the funds from the Hornby account were transferred to a Grace account,
 - the \$500,000 deposited into the Grace account from the Hornby account represented approximately 84% of the funds in Grace's account during this time period,

- approximately \$290,000 was transferred to Schouw's personal account or withdrawn by him personally during this period (\$100,000 of this amount was redeposited to the Hornby account in January 2010), and
- the approximately \$190,000 net amount deposited into Schouw's personal account from the Hornby account represented 99% of the funds in Schouw's personal account during this time period.

[32] The following payments were made from the Grace account during this time period:

- \$150,006 to a law firm in trust, and
- approximately \$221,000 to various individuals.

[33] The following payments were made from Schouw's personal account during this time period:

- \$14,000 by cheque to Charlie Film Productions Inc. with a reference to "NPH-499 Drake St. Deposit",
- three cheques in the amount of \$18,500 each, to one individual, two of which referred to "NPH advance Dec 1/09; Jan 1/10 rent",
- approximately \$78,000 to various individuals, and
- \$5,112 for Schouw's personal mortgage.

[34] The payments that the executive director alleges as fraudulent are as follows:

- the approximately \$150,000 paid to a law firm in trust,
- approximately \$215,000 of the \$221,000 paid to various individuals from the Grace account,
- the four cheques totaling \$69,500 referencing "NPH" on them paid from Schouw's personal account, and
- the \$5,112 personal mortgage payment from Schouw's personal account.

[35] With respect to the use of HS' proceeds, Schouw testified as follows:

General Business Structure

- by the time of the relevant period for this hearing, Schouw had adopted a business model that included having a separate company established for each separate development project
- the project specific company would hold the ownership of whatever interest Schouw (in the global sense) held with respect to property ownership or rights to acquire the real property associated with the project

Hornby, Drake, Grace and James Schouw & Associates Inc.

- a company called James Schouw & Associates Inc. was Schouw's personal management company and that company provided design management services to his projects
- Drake, used by Schouw in completing a previous project, employed his payroll employees during the relevant time period
- Drake provided services (i.e. those employees) to Schouw's other projects including Hornby and the Artemisia project
- Grace was also a company used by Schouw in completing a previous project
- Grace developed its own management and consultant arrangements and Grace provided services (i.e. those managers and consultants) to Schouw's other projects, including Hornby and the Artemisia project
- during the relevant time period, Schouw estimated that 70-80% of the resources of Drake and Grace were deployed in connection with the Artemisia project
- Hornby never hired directly any employees or key management contractors; all of these services were provided to Hornby by a combination of Drake, Grace and Schouw's personal management company
- Hornby's principal role in the structure was to hold title to the real estate interests underlying the Artemisia project
- Hornby did enter into some contracts directly for services from third parties but the majority of these arrangements were provided by some combination of Drake and Grace
- Schouw gave the following testimony about the role of his personal management company, Drake and Grace at the time:

Q To the best of your memory how many employees in the pre-construction phase did Hornby Residences have?

A Hornby never had any employees.

Q How about contractors?

A Nothing significant in terms of what I characterize as management or administrative contractors. One could say that James Schouw & Associates and affiliates which include Drake and Grace really were those contractors, but there would be some. There are certainly contract payments from Hornby directly to some, but generally speaking the core management resources were actually essentially subcontracted to the existing entities that had the development management and administrative and design machinery, human resource machinery which is Drake and Grace.

[*Commission hearing transcript July 22, 2016, p. 20*]

Budgets, Spreadsheets and Financial Statements

- the Artemisia project had a detailed budget which was updated periodically throughout the development process (January 2009 and March 2010 versions were tendered as exhibits)
- Schouw tendered into evidence spreadsheets that he called representative and not exhaustive of the intercompany and third party services and intercompany payments with respect to the Artemisia project during the period January 2009 through February 2010
- the spreadsheets were generated for the purposes of the hearing (i.e. they were not documents that were made contemporaneously during the period in question) but were generated from historical bookkeeping files in accounting software that Schouw testified were in the possession of the affiliated group of companies since the relevant time period
- there were no financial statements or any underlying documentation submitted in evidence for any of Hornby, Grace, Drake, Schouw's personal management company, or Schouw that cover the relevant time period
- Schouw and his management company were providing financing to Drake during the relevant time period

Payments from the Grace Account

- with respect to the \$150,000 payment to a law firm, Schouw testified that two individuals lent \$100,000 to Grace to allow it to continue with its operations
- as part of a subsequent real estate transaction wherein Schouw purchased a condominium from these same individuals, a total of \$400,000 was owed to these two individuals (\$150,000 (being the original \$100,000 plus interest and other charges) from the original loan and \$250,000 new debt)
- Schouw personally guaranteed the \$400,000 amount owing and Schouw gave a personal mortgage to the two individuals
- the \$150,000 payment was on account of amounts owing on that loan arrangement
- with respect to \$221,000 paid by Grace to certain individuals (\$215,000 of which, the executive director characterizes as repayments to previous Grace and Hornby investors), Schouw challenged whether all of these third party payees were previous Grace investors – he said that certain of these individuals received payments in their capacity as contractors for services provided; some of the amounts were repayments of Artemisia project investors and, although some were Grace investors, these Grace investors had provided short term investments in Grace to allow it to carry on business.

Payments from Schouw's Personal Account

- the "NPH" referred to on the face of the four cheques from Schouw's personal account referred to a penthouse apartment that was not Schouw's personal residence at the time of the payments
- Schouw, through his management company, was involved in the management of rentals of the penthouse apartment

- the property management arrangement was a business arrangement for the benefit of the consolidated group of companies
- the cheque for \$14,000 made out to a film production company was the return of a deposit amount for a rental of that apartment for a celebrity
- the three cheques of \$18,500 each were payments to the owner of the penthouse apartment on account of rent for the next tenant as part of the property management arrangement
- the payment of approximately \$5,000 was a payment on Schouw's personal mortgage.

- [36] Other than the budgets and spreadsheets described above, there were no contracts, invoices or any other documentation tendered in evidence in support of the business arrangements described by Schouw.
- [37] We did not find Schouw to be a very credible witness. His testimony at the hearing was far different from that during his compelled interview under oath with Commission staff in June and July 2015. During those interviews, he was able to offer little explanation, even in a general sense, and even less in detail for why payments might have been made from the Hornby account to any other company in Schouw's affiliated group or to any third party. Even if we found him credible, his testimony during the hearing was similarly vague on details, without being able to attribute dollar amounts to various payments purportedly made and only describing the flow of funds in a general sense.
- [38] Notwithstanding this, as noted above, we did prefer his evidence with respect to whether HS was told that his funds would be used for construction of the Artemisia project. We also accept Schouw's evidence as to his general business structure at the relevant time. We do accept that Hornby was to be a limited purpose vehicle whose primary purpose was to hold the real property associated with the Artemisia project and that Grace, Drake, and Schouw's personal management company were contracted by Hornby to actually carry out the development of the project. It is clear that the executive director implicitly accepts that this was Schouw's business structure, at least with respect to Grace, as the executive director has not challenged a number of the expenditures made by Grace out of the funds provided to it by Hornby as being an improper use of proceeds.
- [39] We did not find Schouw's spreadsheets or testimony with respect to the various expenditure amounts persuasive. By his own evidence, the spreadsheets were meant to be illustrative only of the kinds of expenditures (and therefore implicitly services) that were incurred by the various entities in connection with the Artemisia project. They were not full accounting records. There were no invoices or contracts or any other documentation to support these spreadsheets. Schouw's own testimony lacked specificity and clarity. At best, it can be said to have painted a broad overview of his business practices but did not provide persuasive answers as to why certain payments were made or how certain money had been spent.

- [40] At times during his testimony, Schouw made general vague references to the affiliated group doing work for Hornby in developing the Artemisia project as including himself personally. He was inconsistent in describing the affiliated group in this way. Schouw made submissions that he was entitled to payment from Hornby because of services he personally provided to Hornby. However, Schouw gave no specific evidence about any services he provided personally to Hornby or to Hornby subcontracting any services to him personally. There were no records to support this submission. We do not find Schouw credible on this point. We do not find that he was providing services directly to Hornby.
- [41] Commission staff spoke with one of the two individuals who ultimately received the \$150,000 paid to a law firm. That individual confirmed that the payment was received as partial settlement of a lawsuit filed against Schouw and others with respect to the failure to repay a mortgage.
- [42] The notice of hearing alleges that the \$150,000 was a payment to satisfy a personal legal judgment against Schouw. The evidence clearly establishes that it was a payment made in partial satisfaction of a settlement of a legal claim brought against Schouw and others. For our purposes, we do not think anything material turns on this difference. Although the notice of hearing was wrong on the specifics of the payment, we do not see that the respondents were prejudiced during our hearing as a result. The respondents clearly had notice that this payment was part of the executive director's allegations of fraud against them and were obviously prepared to and did deal with this payment both in the evidentiary portion of the hearing and in submissions.
- [43] Ultimately, Schouw and his companies ran into financial difficulties. This resulted in their interests in the Artemisia project being transferred to a third party. Although the Artemisia project was eventually completed by the third party, HS has not been repaid his \$1 million invested in Hornby and it was generally acknowledged that that money has been lost.

III. Positions of the Parties

[44] The executive director's position is that the respondents committed a fraud and thereby breached section 57(b) of the Act:

- a) when Schouw told HS that his funds would be used for the construction of the Artemisia project and by failing to tell HS that \$439,821.93 of his investment would be used for purposes unrelated to the Artemisia project including:
 - (i) the partial repayment of a previous debt that resulted in a lawsuit against Schouw;
 - (ii) payments to investors in a previous project or earlier investors in the Artemisia project; and
 - (iii) a mortgage payment for Schouw's personal residence or rent payments on behalf of other parties unrelated to the construction or development of the Artemisia project; and
- b) when Schouw personally guaranteed HS' principal and interest and provided assurances about HS' option to purchase a unit in the Artemisia project, when Schouw knew or ought to have known that he had no ability to fulfil any such guarantee or assurances.

[45] The respondent argues that there is no evidence that the respondents misused HS' funds, rather that the evidence establishes that the respondents:

- a) never represented that the investment was safe;
- b) never represented that they would use the funds from the investment in any specific manner; and
- c) used HS' funds in a way that was consistent with the ordinary business of real estate development wherein other related entities provided services to Hornby and HS' funds flowed to those entities as payment for those services.

[46] The respondents further argue that there is no evidence of Schouw having the *mens rea* for fraud. Instead, they argue that all the evidence supports the notion that Schouw believed the Artemisia project would proceed successfully and that HS would receive his promised return.

IV. Analysis and Findings

A. Applicable Law

Standard of Proof

[47] The standard of proof is proof on a balance of probabilities. In *F.H. v. McDougall*, 2008 SCC 53, the Supreme Court of Canada held:

49 In the result, I would reaffirm that in civil cases there is only one standard of proof and that is proof on a balance of probabilities. In all civil cases, the trial judge must scrutinize the relevant evidence with care to determine whether it is more likely than not that an alleged event occurred.

[48] The Court also held (at paragraph 46) that the evidence must be “sufficiently clear, convincing and cogent” to satisfy the balance of probabilities test.

[49] This is the standard that the Commission applies to allegations: see *David Michael Michaels and 509802 BC Ltd. doing business as Michaels Wealth Management Group*, 2014 BCSECCOM 327, para. 35.

Fraud

[50] Section 57(b) states

A person must not, directly or indirectly, engage in or participate in conduct relating to securities . . . if the person knows, or reasonably should know, that the conduct

...

(b) perpetrates a fraud on any person.

[51] In *Anderson v. British Columbia (Securities Commission)*, 2004 BCCA 7, the British Columbia Court of Appeal cited the elements of fraud from *R. v. Theroux*, [1993] 2 SCR 5 (at page 20):

... the *actus reus* of the offence of fraud will be established by proof of:

1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim’s pecuniary interests at risk.

Correspondingly, the *mens rea* of fraud is established by proof of:

1. subjective knowledge of the prohibited act; and
2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim’s pecuniary interests are put at risk).

Liability under 168.2(1)

[52] Section 168.2(1) of the Act states that if a corporate respondent contravenes a provision of the Act, an individual who is an employee, officer, director or agent of the company also contravenes the same provision of the Act, if the individual “authorizes, permits, or acquiesces in the contravention”.

[53] There have been many decisions which have considered the meaning of the terms “authorizes, permits or acquiesces”. In sum, those decisions require that the respondent have the requisite knowledge of the corporate contraventions and have the ability to influence the actions of the corporate entity (through action or inaction).

B. Analysis

Actus Reus

[54] As noted above in the description of the facts, the parties spent considerable time during the evidentiary portion of the hearing and in their submissions on liability on the issue of whether the respondents discussed the risks of an investment in real estate development with HS.

[55] Given how the executive director has framed the *actus reus* of the allegations of fraud in this case, we do not see this evidence, or more broadly this issue, as relevant. The executive director has not alleged in either formulation of the *actus reus* of fraud in this case, a failure to properly describe the risks of HS’ investment in the Artemisia project. As a consequence, we have not considered the evidence and the submissions of the parties on this issue.

[56] We can also summarily address the executive director’s allegation of fraud which is based on the following:

Schouw personally guaranteed HS’ principal and interest and provided assurances about HS’ option to purchase a unit in the Artemisia project, when Schouw knew or ought to have known that he had no ability to fulfil any such guarantee or assurances.

[57] This suggestion is not to be found anywhere in the notice of hearing. Frankly, there was little or no evidence in support of this allegation entered during the hearing. The executive director submits that the respondents’ failure to maintain proper records should allow us to infer that the respondents had no basis to be determining or keeping track of the economic returns of the project. Further, the executive director submits that this absence of recordkeeping means that the respondents had no basis to arrive at an 18% interest rate on the investment or even to determine at any given time how much was collectively owing to investors.

[58] We do not agree that we can make these inferences from this absence of proper recordkeeping. Schouw’s guarantees and promises of returns were made at the time of HS’ investment. Subsequent lack of recordkeeping does not prove knowledge by the respondents that these promises, when made, were incapable of being fulfilled. Schouw’s testimony endeavoured to explain at length why he and his companies were unable to complete the Artemisia project. This evidence had little relevance to the heart of the fraud allegations in this matter. The essential issues in this case relate to whether the respondents’ use of HS’ funds within six weeks of his investment was fraudulent.

- [59] We agree that one of the troubling aspects of this case is the almost complete lack of proper documentation associated with the use of proceeds associated with HS' investment, an absence that should not be condoned by this Commission for those who would like to access financing from our capital markets. However, that absence is not sufficient to support the evidentiary finding that the Artemisia project was uneconomic or that the respondents knew or ought to have known that investors' funds could not be returned. Nor can we do so from the *post facto* perspective that the respondents were not able to successfully complete the Artemisia project. We cannot make a finding of fraud against either of the respondents on this aspect of the executive director's allegations.
- [60] That leaves the central allegation of this case, which is that the respondents misappropriated certain of HS' invested funds.
- [61] There are elements of this allegation that are not contested by the respondents. They agree that section 57 of the Act is engaged by the impugned conduct, as they agree that the respondents issued a security to HS in return for \$1million. They also agree that HS' invested funds were, within a brief period of time, dispersed by Hornby to third parties. The respondents say the executive director's allegation fails as he has failed to prove on a balance of probabilities that the purpose of those payments and the use by those third parties of those funds was inconsistent with what HS was told would be the use of those funds or contrary to the terms of the investment certificate or conversion certificate. In particular, the respondents say that although the executive director can prove that certain of HS' funds were paid to third parties, the executive director is merely speculating about the reason for those payments and the use to which those resources were put.
- [62] The first part of the analysis is to determine what the prohibited act was in support of finding the *actus reus* of fraud. The deceit or other fraudulent means alleged in this case is that HS was told one thing about the use of his funds but a portion of his investment was used in a different manner. This requires us to make a determination of what HS was told would be the use of proceeds of his \$1 million investment.
- [63] The respondents suggest that the use of HS' proceeds was not to be limited to the Artemisia project. They point, in part, to the contents of the investment certificate, which suggested that Hornby had the discretion to use the funds on projects within the Downtown South area. We do not agree with this submission.
- [64] There is no dispute in the evidence that HS intended to and did invest a total of \$1.25 million with Schouw and his group of companies. HS testified, and this was not disputed by other evidence, that in response to a question about diversification of his investment he was told that he could put \$250,000 into another of Schouw's companies. HS did end up investing \$250,000 with another of Schouw's companies. The only purpose of splitting the funds in this way would be to attribute HS' investment to different projects. This investment structure is inconsistent with how the respondents suggest we should interpret the investment certificate, which they say allowed for the use of HS' funds across any of Schouw's projects in the Downtown South area.

- [65] HS testified that during his meeting with Schouw the discussion was focused on the Artemisia project. This was not contested by Schouw during his evidence.
- [66] Schouw's submissions that the use of proceeds described in the investment certificate implied a broad intended use across multiple projects are inconsistent with his own testimony of his business practice at that time, which was to incorporate a separate corporate entity to hold title to each separate real estate project. Schouw's evidence was that Hornby was formed to hold the Artemisia project, and that project only, for development.
- [67] We find that Schouw represented to HS that his \$1 million investment was to be used in connection with the Artemisia project. We also find that it was not represented to him that it was to be a general investment in Schouw's real estate development business.
- [68] As noted above, we prefer Schouw's evidence that the use of funds was not to be limited to construction of the Artemisia project. We find that the funds were to be used more generally for development (or pre-construction work) of the project.
- [69] Having made a finding of what was represented to HS about the use of proceeds of his investment, the question becomes whether the funds were utilized in a manner that was inconsistent with that representation (i.e. to form the deceit or other prohibited act of the *actus reus* of fraud) and whether HS suffered deprivation as a consequence.
- [70] The executive director points to three different kinds of expenditures and says that these are unrelated to the Artemisia project:
- a) the \$150,000 paid by Grace as partial settlement of the lawsuit;
 - b) the approximately \$215,000 paid by Grace to third parties, which the executive director says were repayments to previous investors in Grace or earlier investors in Hornby; and
 - c) the approximately \$75,000 paid by Schouw for his personal mortgage, and in relation to the penthouse management.
- [71] Schouw's evidence and/or submissions with respect to these three expenditure groups is as follows:
- a) that the \$150,000 was effectively the payment of a receivable of Grace, personally guaranteed by Schouw, in respect of invested funds, which funds were utilized by Grace in its operations, included providing services to Hornby on the Artemisia project;

- b) disputed that all of the \$215,000 reflected a repayment of previous Grace or Hornby investors, in that certain of the third party payments were made to consultants and others who provided services to Grace and that those services were then contracted to Hornby;
- c) that portion of the \$215,000 that was a repayment of Grace and previous Hornby investors, can also be viewed as a payment of the receivables of Grace for prior investments in Grace which allowed Grace to carry out its operations, including providing services to Hornby on the Artemisia project;
- d) Schouw was entitled to personal compensation for services to the Artemisia project and that the payment of his personal mortgage should be viewed as a payment made out of his personal entitlement or compensation for services; and
- e) the cheques to the film promotion company and for rent were all part of a property management business that was run by Schouw, the proceeds of which were for the benefit of the corporate group, including Grace, which provided services to the Artemisia project.

[72] Schouw submits that the onus of proof falls on the executive director and that the executive director has not satisfied, on a balance of probabilities, that any of HS' invested funds were used in a manner that was inconsistent with what the respondents represented orally or in the investment certificate and conversion certificate would be the use of proceeds.

[73] Schouw is, of course, correct about the onus of proof.

[74] The evidence is clear that:

- a) just under \$500,000 of the funds invested by HS into Hornby were transferred almost immediately to a Grace account;
- b) approximately \$190,000 (after a subsequent return of some of these funds) of the funds invested by HS into Hornby were transferred almost immediately into Schouw's personal account.

[75] The reason for the above transfers of funds is not clear from the evidence. There is not one piece of specific evidence (e.g. debt certificate or contracts) that sheds any light on why the funds, in those amounts, should have been paid to Grace or Schouw.

[76] However, we have accepted Schouw's evidence that Grace, Drake and Schouw's personal management company were providing services to Hornby during the relevant time with respect to the Artemisia project. That provides a *prima facie* explanation of why funds would have been transferred from Hornby to Grace. The executive director

has implicitly conceded this point as he does not allege that all of the \$500,000 transferred to the Grace account represents an improper use of HS' funds.

- [77] There is no evidence whether this transfer of almost \$500,000 was a payment by Hornby for historical services performed with respect to the Artemisia project, for future services or for some other reason. If it was a payment by Hornby to Grace for historical services performed in connection to the Artemisia project then whatever Grace did with the money thereafter would be irrelevant.
- [78] We do know that after Grace received this money it then repaid a number of its obligations (the \$150,000 lawsuit amount and the \$215,000 paid to individuals). We do not know if the funds originally provided to Grace that created these obligations were used by Grace in respect of the Artemisia project or not. In reality, the total lack of invoices and records and the lack of temporal understanding of when services were performed by third parties to Grace and Grace to Hornby lead us to the conclusion that we have no evidence whether this \$500,000 from HS' investment funds can be said to have been used in connection with the development of the Artemisia project. We have very grave doubts that all of these funds were used for the Artemisia project as, by Schouw's own testimony, Grace was only devoting 70-80% of its efforts to that project at the relevant time. However, having grave doubts and determining, on a balance of probabilities, that the money was used inappropriately are two different things. The executive director has failed in satisfying the onus of proof with respect to this aspect of his allegations.
- [79] This finding does not mean that we are not troubled by Schouw's explanation that these funds were used to pay receivables of the corporate group that existed at the time of HS' investment. Viewed in its most favourable light, his explanation is that a significant portion of HS' funds were being used to pay debts incurred prior to the date of HS' investment where the proceeds of those debts were used in connection with developing the Artemisia project. There is no evidence of the disclosure of this to HS. However, a failure to disclose the existence of debt obligations is not how the executive director's case has been framed.
- [80] With respect to the net \$190,000 that was paid by Hornby into Schouw's personal bank account, that payment is not consistent with our findings about who was providing services to Hornby at the relevant time. We have accepted Schouw's evidence that Schouw's personal management company, Grace and Drake were providing services to Hornby. We have not found that Schouw personally provided any services to Hornby or that Hornby subcontracted any services to Schouw personally.
- [81] As a result, there is no *prima facie* explanation that is consistent with the representation of the use of proceeds to HS of why this money should have been paid by Hornby to Schouw personally.

[82] In fact, Schouw's evidence about the money Hornby paid him personally was that any such amount was a repayment of money he had provided to Drake. During his testimony and in his spreadsheets, Schouw suggested generally that he and his management company had provided funds to Drake. His testimony on this point in response to his counsel's question was as follows:

Q What's interesting, Mr. Schouw, just to basically close out before the afternoon adjournment, what's interesting to note, Mr. Schouw, is that the Executive Director has asserted that these payments made to investors who are not direct investors of Hornby was part of the alleged fraud. Why was it appropriate for payments to be made to these investors of Grace during this time period?

A The funds -- the funds that were paid ultimately from Hornby to James Schouw & Associates and affiliates, which is me, it's Grace, it's Drake and Homer Street, they're all compliant with the project budget always, and so any of the money that flowed to Grace in its looking after its business obligations, if I may be frank, would be like me paying your bill and if at that point it was legitimately earned I wasn't -- you know, I'm not sure how it's relevant what happens after that, but all of the payments that went out were well within, well within the boundaries of the -- of the budget or budgets, ongoing budgets that Hornby maintained in order to do this. And to a large degree one thing that I recognize is that a fair amount of that was anything paid to me personally, which I don't think is anywhere near as much as might be represented, to a large degree is compensating what I had been funding to the staff of Drake which was working on Hornby, and regardless of whether we look at all the companies of one group or individually as contractors of each other, either way those payments were as far as I'm concerned entirely legitimate, never even considered that they were not, provided that I was working within the budget and I was absolutely doing that.

[*Commission hearing transcript July 22, 2016, pp. 116-118*]

[83] This explanation is consistent with Hornby owing money to Drake for work it was doing for Hornby. It would explain why Schouw may have been entitled to receive money personally from Drake. However, it does not explain why Hornby would owe money directly to Schouw.

[84] Notwithstanding that we cannot see a justification (consistent with the funds being used for the development of the Artemisia project) for Hornby to have paid \$190,000 to Schouw personally, the executive director has not alleged that all \$190,000 was improperly spent. Therefore, we are left to consider only the approximately \$75,000, in aggregate, paid directly to Schouw, which he then used to make a payment on his personal mortgage and for the penthouse management.

- [85] These payments were clearly unrelated to the Artemisia project. Schouw's own testimony was that they were not related to the Artemisia project. The best that he could do to connect them in any manner to the Artemisia project was to say that the proceeds of the property management arrangements were for the benefit of the corporate group. That evidence is not credible given all of these payments were run through his personal account and the lack of any corroborating evidence.
- [86] HS was told his funds were to be used for the development of the Artemisia project. The evidence is unequivocal that \$75,000 of HS' funds were directly diverted to Schouw personally and then, almost immediately, spent by him on his mortgage and a property management business totally unrelated to the Artemisia project. We find that this amount was spent in a manner that was not consistent with the representations that were made to HS. We find that a reasonable person would objectively view this as an improper diversion of HS' funds and we find that this conduct was deceitful or some other fraudulent means within the *actus reus* definition within *Anderson*.
- [87] We also find that the evidence establishes deprivation. Seventy-five thousand dollars of HS' investment was diverted from its investment purpose. Those funds were both put at risk and ultimately lost.

Mens Rea

- [88] We find that the evidence establishes the *mens rea* of fraud in this case. The \$75,000 in payments all came from his personal bank account. Schouw would have known that these payments were made and that they were being made in a manner that was not consistent with what had been promised to HS about the use of his funds.
- [89] Schouw also would have had knowledge of the deprivation. He would have known that HS' funds were being put at risk by paying them to third parties in the manner that they were. Schouw submits that he had an honest belief that the Artemisia project would be successful and that HS would receive his investment back and gain his return. The fact that you honestly believe that you will ultimately be able to pay an investor back is not a rebuttal to the fact that at the time of payment of these funds Schouw would have known that these funds were being diverted and thereby put at risk.
- [90] We therefore find that that the respondents perpetrated a fraud on HS in the amount of \$74,612 contrary to section 57(b) of the Act.

Section 168.2 liability

- [91] The executive director alleges that Schouw is liable for Hornby's contravention of section 57(b) pursuant to the operation of section 168.2 which says that a director or officer is liable for a corporation's misconduct if it permitted or acquiesced to the corporation's misconduct.

[92] Schouw is the sole officer and director of Hornby. All of the authority for Hornby's actions was directed by Schouw. Schouw admitted that he made all of the relevant decisions in issue regarding Hornby's actions. There is no doubt that Schouw permitted or acquiesced to Hornby's misconduct in this case.

[93] We find that by operation of section 168.2, Schouw also contravened section 57(b) of the Act in connection with Hornby's contravention of section 57(b).

Conclusion

[94] We find that the respondents perpetrated fraud on one investor in the aggregate amount of \$74,612 contrary to section 57(b) of the Act.

[95] We direct the parties to make their submissions on sanction as follows:

By February 16, 2017 The executive director delivers submissions to the respondents and to the secretary to the Commission.

By March 2, 2017 The respondents deliver response submissions to the executive director and to the secretary to the Commission.

Any party seeking an oral hearing on the issue of sanctions so advises the secretary to the Commission. The secretary to the Commission will contact the parties to schedule the hearing as soon as practicable after the executive director delivers reply submissions (if any).

By March 9, 2017 The executive director delivers reply submissions (if any) to the respondents and to the secretary to the Commission.

January 24, 2017

For the Commission

Nigel P. Cave
Vice Chair

George C. Glover, Jr
Commissioner

Audrey T. Ho
Commissioner