2014 BCSECCOM 457

David Michael Michaels and
509802 BC Ltd. doing business as Michaels Wealth Management Group

***Securities Act*, RSBC 1996, c. 418**

Hearing

Panel	Nigel P. Cave	Vice Chair
	George C. Glover, Jr.	Commissioner
	Suzanne K. Wiltshire	Commissioner
Hearing Date	September 30, 2014	
Date of Decision	October 31, 2014	

Appearing

Derek J. Chapman	For the Executive Director
Grant N. Smith	For the Respondents

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 a differently constituted panel of this Commission on liability, made on August 6, 2014 (2014 BCSECCOM 327), are part of this decision.

¶ 2 The Findings panel found that David Michael Michaels:

a) acted as an advisor without being registered, contrary to section 34(b) of the Act;
b) made misrepresentations, contrary to section 50(1)(d); and
c) perpetrated a fraud, contrary to section 57(b).

II Position of the Parties

¶ 3 The executive director seeks:

a) permanent bans against Michaels under subsections 161(1)(b)(ii), (c) and (d) of the Act;
b) a "disgorgement" order for Michaels to pay $65 million pursuant to section 161(1)(g) of the Act; and

c) an order for Michaels to pay an administrative penalty of $65 million pursuant to section 162 of the Act.

¶ 4 Michaels submits that any sanctions against him should be limited to:

a) bans that are not permanent (although no specific length of time was suggested) under subsections 161(b)(ii), (c) and (d) of the Act; and
b) a "disgorgement" order and an administrative penalty that are commensurate with the amount received by Michaels in commissions and fees less amounts which he invested in the same securities as his clients, the net amount being approximately $3.8 million.

III Analysis

A Factors

¶ 5 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.

¶ 6 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:
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> - the seriousness of 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

¶ 7 The Commission has consistently held that fraud is the most serious misconduct prohibited by the Act. In *Manna Trading Corp Ltd.*, 2009 BCSECCOM 595, the

Commission, at para. 18, said, "Nothing strikes more viciously at the integrity of our capital markets than fraud."

¶ 8 Not far behind fraud, in the scale of seriousness of misconduct, stands misrepresentation. Those who operate and profit in the capital markets by misstating material facts (through commission or omission), undermine the confidence of the public in one of the cornerstones of capital markets regulation, the provision of accurate and complete information for investors to make informed investment decisions.

¶ 9 Lastly, contraventions of section 34 are also inherently serious because the registration requirements of the Act are foundational for protecting investors and the integrity of the capital markets. The requirement in section 34(b) that those who advise others on investments must be registered is intended to ensure that those who seek advice are advised to invest in securities that are suitable. This case clearly illustrates the catastrophic losses that can occur where investments are made without care as to the suitability of those investments for their purchasers.

¶ 10 Here, Michaels convinced people to purchase $65 million of securities through the triumvirate of fraud, misrepresentation and unregistered advising.

¶ 11 Michaels argues that there are gradations of fraud and misrepresentation; this case being less serious than Ponzi schemes or cases where bogus securities are sold. He says that none of the funds invested were diverted for personal use or put into non-arm's length investments. He says that he invested his own money in the same investments that his clients invested in and in no case did he encourage investment in issuers that he knew were failing.

¶ 12 There is no dispute that the investments made by Michaels' clients were in actual securities and that their money went into investments in accordance with their intentions. In that sense, this is different from some cases of fraud. However, in this case, the seriousness of the misconduct is heightened by Michaels' business model, which was astonishingly predatory. He focused his marketing efforts on seniors, especially those with little or no investing experience. His marketing pitch was directed to those who were frightened for their retirement portfolios following the significant stock and bond market downturns in 2008 and 2009 and the low interest rate environment that followed.

¶ 13 Some of the issues raised by Michaels do play a role in our sanctions decision, as will be discussed below, but they are not persuasive in suggesting that the Findings in this case are anywhere other than on the absolute upper end of the scale of seriousness of misconduct by a market participant.

Harm to investors; damage to capital markets

¶ 14 Clearly Michaels' misconduct has resulted in massive harm to investors. The Findings panel concluded that securities representing $40 million of the original $65 million invested by Michaels' clients are now worthless.

¶ 15 Michaels argues that the loss for the investors may ultimately be much less than this $40 million figure. He points to some investments that have already produced a known

return. He also points to certain other investments which may yet yield a return, although that is far from certain and any such return may be well in the future.

¶ 16 With respect to the investments that have an uncertain future we would note that the opposite of what Michaels suggests may ultimately be true. The loss here may significantly exceed $40 million when all is finally known. Other than noting that $40 million of the original $65 million of investments are now worthless and that investor losses will ultimately be significant, we do not need to determine the exact amount of the losses with any greater specificity than this.

¶ 17 It is trite to say that Michaels' misconduct has done significant damage to his clients and to the reputation and integrity of our capital markets. The Findings panel heard testimony from a number of Michaels' clients whose financial futures have been ruined.

Michaels' enrichment

¶ 18 The evidence is that Michaels received $5.8 million in commissions and marketing fees for his sales efforts that involved contraventions of the Act.

¶ 19 Michaels says that in considering the question of his enrichment we should deduct $2 million, being the amount of his personal losses in the same investments that he recommended to his clients, and that his level of enrichment was also reduced because he incurred significant costs related to the maintenance and promotion of his business. In effect, he says he was enriched in the net amount of $3.8 million or less.

¶ 20 We do not agree with this submission for two reasons. First, it is apparent from the Findings that a critical element of Michaels' sales pitch for the exempt market securities that he advised his clients to purchase was his being able to say that he had personally purchased some of the same securities. On that basis alone, it would be highly cynical to deduct the amounts of his personal investments from his enrichment. Secondly, how someone chooses to spend the commissions and fees received from contraventions of the Act is irrelevant.

¶ 21 Michaels was personally enriched by his misconduct in the amount of $5.8 million.

Aggravating or mitigating factors; past misconduct

¶ 22 It is an aggravating factor that Michaels' business model was highly predatory in nature. His sales pitch was formulated to prey on investors by frightening them into purchasing highly risky securities with little or no liquidity. In addition, the average age of his clients was 72 years. Most investors of this age have little or no opportunity to earn income from work or otherwise financially recover lost amounts.

¶ 23 It is an aggravating factor that a number of Michaels' clients were advised by him to borrow money in order to purchase unsuitable investments sold to them through his fraud and misrepresentation. These clients have suffered losses not only on their investments but are now burdened with loan repayment obligations.

¶ 24 Michaels also has a significant history of regulatory disciplinary actions. He was suspended by the Investment Dealers Association of Canada (IDA) for two months in

2006 for failing to complete a required course. In 2007 he was suspended for a further two months and fined $60,000 by the IDA for engaging in off-book transactions with clients of his firm, for unregistered advising and for misleading IDA staff in their investigation.

¶ 25 Michaels cites as mitigating factors that:

a) he did not sell any securities that he knew or thought were in distress and none of the investments were fictitious;
b) he invested $2 million of his own money into these investments;
c) some of the investments still have value; and
d) he only received a commission for selling the securities and that the investors' money went to purchase securities in accordance with their intentions.

¶ 26 In our view, none of these is a mitigating factor. Generally, a mitigating factor is some positive behaviour by a respondent or a respondent's personal circumstances that should be taken into account. To say that Michaels' misconduct could have been even worse or that the consequences of his misconduct could have been even more catastrophic are not one and the same as mitigating factors. His having invested in the same securities as his clients is both irrelevant and not a mitigating factor.

Fitness to act as a registrant and continued participation in the capital markets

¶ 27 Michaels suggested that his best chance to repay any financial orders in this proceeding would come from his being allowed to participate in our capital markets again. He says that any ban from participating in our capital markets should not be permanent. This submission is astonishing.

¶ 28 Michaels has a significant history of securities markets misconduct. The Findings show that his previous suspensions from the IDA led to his restructuring his business to avoid regulatory oversight by the IDA. Previous sanctions have not deterred Michaels from misconduct; rather, they have simply led him to restructure his affairs.

¶ 29 Michaels has been found to have committed fraud under the Act. Michaels was not able to point to any decision of this Commission or a commission in any other jurisdiction in Canada in which someone having engaged in fraudulent misconduct of this magnitude has been banned from the capital markets for any period other than permanently. There is a reason for this. As noted above, fraud is the most serious misconduct contemplated by our Act.

¶ 30 In addition, Michaels' sales practices were reliant upon misrepresentations and he advised his clients without being registered. His advising without registration showed a callous disregard for the regulatory scheme designed to protect investors from making unsuitable investments. Michaels' conduct falls far below the standard we expect of our market participants. Our orders consider these factors in determining his ability to continue participation in the capital markets.

Specific and general deterrence

¶ 31 The sanctions we impose must be sufficient to ensure that Michaels and others will be deterred from engaging in similar misconduct.

C Previous Orders and Application

Orders under sections 161(1)(b)(ii), (c) and (d) of the Act

¶ 32 As noted above, in fraud cases the Commission has consistently imposed permanent orders to ban fraudsters from the capital markets. Protection of the public is of paramount importance to the public interest. The public must be protected from those who commit fraud. Michaels cited no decisions to support any bans less than permanent bans. The misconduct here was so serious that Michaels must be kept out of our capital markets permanently.

Order under section 161(1)(g) of the Act

¶ 33 Section 161(1)(g) of the Act, reads as follows:

> (1) If the commission or the executive director considers it to be in the public interest, the commission or the executive director, after a hearing, may order one or more of the following:
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> …
>
> (g) if a person has not complied with this Act, the regulations or a decision of the commission or the executive director, that the person pay to the commission any amount obtained, or payment or loss avoided, directly or indirectly, as a result of the failure to comply or the contravention;

¶ 34 Past Commission decisions have applied this section, coming to seemingly different results. There are fraud cases with multiple respondents such as *Manna Trading Corp. Ltd. (Re)*, 2009 BCSECCOM 595 and illegal distribution cases similar to *Oriens Travel & Hotel Management Corp., Alexander Anderson and Ken Chua*, 2014 BCSECCOM 352 (as it dealt with the individual respondent, Chua) where the orders under section 161(1)(g) were for the full amount obtained through contraventions of the Act. Factors such as relative levels of culpability of the respondents, inability to determine where investor funds actually went and cases where an individual respondent was the alter ego of a corporate issuer that received the investor funds were significant in these types of cases.

¶ 35 Other Commission decisions, including *Oriens* (as it dealt with the other individual respondent, Anderson), and *Pacific Ocean Resources Corporation and Donald Verne Dyer*, 2012 BCSECCOM 104, demonstrate that in other circumstances it may be inappropriate to make a section 161(1)(g) order in the total amount obtained. Where a party to a contravention of the Act does not control the issuer of the securities, has not been equally culpable with another respondent, or the funds obtained have clearly gone to a third party, the Commission may issue a section 161(1)(g) order in an amount less than the full amount obtained through contraventions of the Act.

¶ 36 In the matter before us, it is useful to set out certain principles applicable to orders under this section and then apply them to determine the appropriate sanction.

¶ 37 The decision of the Ontario Securities Commission in *Limelight Entertainment Inc.* (2008), 31 O.S.C.B. 12030 is that commission's seminal decision on the Ontario equivalent to our section 161(1)(g) and analyzed the purposive background to that

sanction. For the purposes of our decision, the following extract from the *Limelight* decision of the Ontario Securities Commission is helpful:

> **(ii) Applying the Disgorgement Remedy**
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> **47** As a background, the disgorgement remedy was added to the Act based on recommendations contained in the final report of the Five Year Review Committee, *Reviewing The Securities Act of Ontario* (the "Five Year Review Report"). That report stated that the objective of the disgorgement remedy is to deprive a wrongdoer of ill-gotten gains, reflecting the view that it would be inappropriate for those who contravene Ontario securities law to be able to retain any illegally obtained profits. (*Five Year Review Committee, "Reviewing the Securities Act (Ontario)*" Final Report (2003), at p. 218, online at www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_20030529_5yr-final-report.pdf).
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> **48** The Five Year Review Report referred to the United States Securities and Exchange Commission ("SEC") disgorgement powers and noted that the following principles have been established in SEC decisions:
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> (a) the SEC has ruled that disgorgement is "an equitable remedy designed to deprive [respondents] of all gains flowing from their wrong, rather than to compensate the victims of fraud" (*In the Matter of Guy P. Riordan*, initial Decision, 2008 SEC LEXIS 1754 at p. 68);
>
> ….

¶ 38 The decision in *Limelight* determined that the sanction should focus on amounts obtained and not on the "profits" derived from the misconduct. Subject to our comments below, we accept the principles imbedded in this background; the focus of the sanction should be on compelling the respondent to pay any amounts obtained from contraventions of the Act.

¶ 39 The Ontario Court of Appeal decision in *Fischer v. IG Investment Management Ltd.*, [2012] O.J. No. 343 (C.A.), makes clear that the purpose of the Ontario equivalent to our section 161(1)(g) is not to "empower the OSC to make orders requiring a party to make compensation or restitution or to pay damages to affected individuals." (at para. 52).

¶ 40 We agree that compensation or restitution is not the purpose of an order under section 161(1)(g). Although the Act, in section 15.1, sets out that any monies collected from an order under 161(1)(g) may be subject to a claim by those persons who have suffered loss as a result of the wrongdoer's actions, any analysis of restitution would arise under this section of the Act, not under 161(1)(g).

¶ 41 The *Oriens* decision, at para. 63, supports a broad interpretation of section 161(1)(g):

> "In making that argument, Chua is reading into section 161(1)(g) a limitation that the Commission may only order a person to pay an amount that is obtained **by that person**. We do not accept that interpretation. The section is clearly worded and there is no such limitation on a plain reading of it."

¶ 42 To summarize, these are the principles that are relevant under section 161(1)(g):

a) the focus of the sanction should be on compelling the respondent to pay any amounts obtained from the contravention(s) 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.

¶ 43 Principles that apply to all sanction orders are 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.

¶ 44 In this case, the executive director says that we should make a section 161(1)(g) order for the payment of $65 million, being the total amount of the investments made by Michaels' clients arising from his misconduct (fraud, misrepresentation and advising without registration).

¶ 45 Michaels suggests that we should make an order under this section that is more commensurate with the net $3.8 million benefit he retained from his misconduct (his commissions and fees received, less amounts he invested in the same products as were sold to his clients).

¶ 46 Applying the principles in paragraphs 42 and 43 to the order we may make in this case under section 161(1)(g), we find:

a) we have the discretionary authority to make an order for any amount up to $65 million; that is the amount that was obtained, directly or indirectly, as a result of Michaels' contraventions of the Act; this is consistent with a broad interpretation of the provision;
b) the losses of the investors as at the date of the liability hearing (being $40 million) are to be considered only for the purposes of determining whether it is in the public interest to make a section 161(1)(g) order and do not correlate to the amount of the order; this sanction is not focussed on compensation or restitution;
c) all but $5.8 million of the amounts obtained as a result of Michaels' contraventions of the Act were retained by third parties in accordance with the intentions of the investors; to make an order for an amount in excess of the $5.8 million, in this case, would be punitive and would be inappropriate in the circumstances;
d) reducing the amount of the section 161(1)(g) order to $3.8 million, as suggested by Michaels, to take into account his lost personal investments and business expenses would both limit the sanction to a narrower concept of "benefit" received by Michaels which is not appropriate and would also be inequitable in the circumstances; and

e) an order to pay $5.8 million would strip Michaels of all amounts he received personally by his misconduct and would be consistent with the broad purpose of section 161(1)(g).

Order under section 162 of the Act

¶ 47 Section 162 of the Act sets out that the panel may, if it finds that a respondent has contravened the Act and considers it to be in the public interest, make an order for an administrative penalty of not more than $1 million for each contravention.

¶ 48 The executive director says that we should impose a $65 million administrative penalty on Michaels. In the course of his contraventions of the Act, he advised his clients to purchase unsuitable investments and $65 million of securities were purchased by 484 clients. The executive director submits the number of clients would support the number of contraventions of the Act necessary for an order of this magnitude. He also cites this Commission's decision in *IAC – Independent Academies Canada Inc.*, 2014 BCSECCOM 260 and that decision's review of previous fraud cases, as support for the proposition that in fraud cases an administrative penalty of two to three times the amount raised by the fraudulent misconduct is common.

¶ 49 Michaels says that the administrative penalty should be more commensurate with the net $3.8 million that he says he benefitted from his contraventions (without suggesting a specific amount for the administrative penalty). He also says that an administrative penalty of $65 million is unrealistic in the context of his ability to ever pay the penalty and his personal circumstances. He cites the Alberta Court of Appeal decision in *Walton v. Alberta (Securities Commission)*, 2014 ABCA 273 as support for an approach to administrative penalties that is not formulaic, but rather one tied to the circumstances of the case, the respondent and his ability to pay.

¶ 50 We do not agree with the submissions of the executive director as to the quantum of the appropriate administrative penalty in the circumstances. While we agree that the number of contraventions of the Act could support an administrative penalty in the amount suggested by the executive director, we do not think it to be in the public interest to do so. The *IAC* decision and the other decisions dealing with administrative penalties in the context of fraud reviewed therein considered circumstances involving significantly smaller amounts than those found here. Two or three times the amount raised by the fraudulent misconduct would, in this case, put the administrative penalty in the range of $130 million to $195 million, an amount so excessive as to go far beyond any meaningful bounds of deterrence for Michaels or others. Even an administrative penalty of $65 million is excessive from this perspective.

¶ 51 We also do not agree that an administrative penalty in the $3.8 million range suggested by Michaels is sufficient in the circumstances. The seriousness of Michaels' misconduct and the catastrophic losses that have been suffered by the investors through his misconduct justify a significant administrative penalty. A significant administrative penalty is warranted both as a specific deterrent to Michaels who has not been deterred by the previous sanctions imposed on him, and as a general deterrent to others who would commit fraud, make serious misrepresentations or provide investment advice without

being registered to do so and callously recommend unsuitable investments to others for personal gain.

¶ 52 The appropriate starting place in this case is to look at the $5.8 million benefit that Michaels received personally from his misconduct. A two to three times multiplier of this amount, consistent with the cases reviewed in *IAC*, is appropriate in the circumstances. This will place the administrative penalty in excess of those levied in fraud cases (as described in *IAC*) where the amounts derived from the misconduct are smaller, without making the amount so large as to exceed the purposes of specific and general deterrence.

IV Orders

¶ 53 Considering it to be in the public interest, and pursuant to sections 161 and 162 of the Act, we order that:

1. under section 161(1)(b)(ii), Michaels cease trading in, and is permanently prohibited from purchasing securities, except Michaels may trade or purchase securities for his own account through a registrant, if he gives the registrant a copy of this decision;

2. under section 161(1)(c), all exemptions set out in the Act do not apply to Michaels permanently, except for those exemptions necessary to enable Michaels to trade or purchase securities in his own account;

3. under section 161(1)(d)(i), Michaels resign any position he holds as a director or officer of an issuer or registrant;

4. under section 161(1)(d)(ii), Michaels is permanently prohibited from becoming or acting as a director or officer of any issuer or registrant;

5. under section 161(1)(d)(iii), Michaels is permanently prohibited from becoming or acting as a registrant or promoter;

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

7. under section 161(1)(d)(v), Michaels is permanently prohibited from engaging in investor relations activities;

8. under section 161(1)(g), Michaels pay to the Commission $5.8 million; and

9. under section 162, Michaels pay to the Commission an administrative penalty of $17.5 million.

¶ 54 October 31, 2014

¶ 55 **For the Commission**

Nigel P. Cave
Vice Chair

George C. Glover, Jr.
Commissioner

Suzanne K. Wiltshire
Commissioner