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Settlement Agreement

Michael Ernst Ruge and Chivas Hedge Fund Ltd.

Securities Act, RSBC 1996, c. 418

- ¶ 1 Michael Ernst Ruge (Ruge) and Chivas Hedge Fund Ltd. (Chivas GP) have settled the following issues with the Executive Director.

Agreed Statement of Facts

- ¶ 2 As the basis for the undertakings and orders referred to in this settlement, Ruge and Chivas GP acknowledge the following facts as correct:

Background

1. Ruge is a British Columbia resident.
2. Ruge was the sole shareholder, director and officer of Chivas GP.
3. Chivas Growth Fund Limited Partnership (Chivas LP) was a business name used by Ruge. Chivas LP has never been incorporated or registered as an entity under any British Columbia statute.
4. Ruge used Chivas GP in carrying out business activities in the name of Chivas LP as described in this settlement.
5. None of Ruge, Chivas GP, or Chivas LP has ever been registered under the Act.

Illegal Distribution

6. Chivas LP issued an offering memorandum (OM) dated October 1, 2001 for an exempt private offering of 400,000 Partnership Units at \$50 per unit to residents of British Columbia, Alberta, and Ontario.
7. The OM was prepared and issued under Ruge's direction.
8. Between December 18, 2001 and February 6, 2003, fifty British Columbia, Alberta, and Ontario investors (the Investors) purchased \$1,543,919 of Chivas LP units under the OM. Ruge also raised funds from United States investors.
9. The exemptions relied upon by Chivas LP in distributing securities under the OM were not available in respect of most of the sales to Investors.

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10. In causing the distribution of Chivas LP units under the OM, Ruge and Chivas GP:
 - (a) distributed securities without a prospectus, contrary to section 61 of the Act; and
 - (b) traded in securities without being registered, contrary to section 34 of the Act.

Fraudulent Sale of Securities

11. The OM claimed that investor funds would be placed with advisors who would be professional traders registered in British Columbia under the Act, “who were at the top of their profession”, and who would actively trade securities pursuant to specific enumerated “market neutral” and “hedged” trading strategies.
12. Almost none of the money raised by Ruge was used as contemplated by the OM.
13. Ruge placed approximately \$251,485 with individuals who were not registered under the Act. Approximately \$57,000 of this money was lost through trading.
14. Ruge used approximately \$417,000 to acquire debt or equity positions in four companies. These positions were not actively traded and were not investments that conformed to any “hedged” trading strategy. The value of these positions is now negligible.
15. Ruge used approximately \$260,000 on office expenses, most of which were not authorized by the OM.
16. Ruge placed approximately \$782,206 with companies and individuals who were affiliated with him and, also, with Ruge himself, thereby perpetrating fraud against the Investors, contrary to section 57.1 (b) of the Act.
17. Approximately \$243,402 was refunded to Investors, but there is little prospect of any additional recovery. The Investors have lost most of their money.

Misrepresentations in Offering Memorandum

18. The OM contained the following misrepresentations:

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- (a) It falsely stated that Chivas LP would operate as a hedge fund, when in fact less than 20% of Investor funds were placed in actively traded stocks.
- (b) It failed to state how most of the Investor funds would be used, and also failed to state that funds would be placed with persons and businesses affiliated with Ruge or Ruge himself.
- (c) It overstated Ruge's business experience and qualifications. It failed to disclose that Ruge had no experience as a portfolio manager or with hedge funds, had no professional qualifications, and was not registered under the Act.
- (d) It falsely stated that Chivas LP was a limited partnership under the laws of British Columbia, when, in fact, Chivas LP did not exist as any kind of registered entity.
- (e) It stated that Chivas LP would provide audited and unaudited financial statements to the Investors in a timely way when, in fact, its business practices made it impossible for this to occur. There were no separate bank accounts or record keeping for Chivas GP and Chivas LP and funds were commingled. Audited financial statements were never prepared or provided to the Investors. Unaudited financial statements were never provided to the Investors and were only prepared after British Columbia Securities Commission staff requested them. A general ledger was not prepared until Commission staff requested it.
- (f) It falsely stated that advisors would share in the same investment risk faced by Investors, when in fact none of them purchased any Chivas LP units or invested in the same entities as Chivas LP.
- (g) It falsely stated that there would be between eight and twenty different advisors, when the maximum number of advisors was only four.
- (h) It falsely stated that Ruge would select experienced advisors according to their proven ability to deliver superior returns with a minimum of risk. None of the advisors met these criteria and, far from being "at the top of their profession", they were inexperienced traders with poor or mediocre trading records. Ruge applied little, if any, diligence in selecting advisors.

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- (i) It falsely stated that Ruge would closely monitor the advisors' performance, when, in fact, Ruge did not keep track of each advisor's performance.
 - (j) The cover page of the OM contained trade logos of the Greater Victoria Chamber of Commerce, Grant Thornton LLP, the Better Business Bureau of Vancouver Island, TradeTrue Securities, SwiftTRADE Securities Inc., and the Royal Bank Financial Group. These logos were used without permission.
 - (k) The cover page of the OM indicated that Chivas LP had a United States office with a Wall Street address. This address was a mail drop only.
19. Ruge, as the operating mind behind the business name of Chivas LP and the OM, and Chivas GP, by participating in the making of the OM, made misrepresentations, contrary to section 50(1)(d) of the Act.

Misrepresentations by Ruge Personally

20. Ruge personally made the following statements to individual Investors:

- (a) He stated that Chivas LP was a hedge fund when it was not.
- (b) He stated that he monitored the advisors' performance closely when, instead, he did nothing in that regard.
- (c) He claimed that he had "cream of the crop people" in place in the New York office when, in fact, Chivas LP did not have any New York employees.
- (d) He stated that a number of people were conducting trades in the United States on behalf of Chivas LP, when there was only one.
- (e) He stated that Chivas LP had sold all of its units and reached its \$20 million cap, when the fund had only sold \$1,543,919 of Chivas LP units.
- (f) He stated that Investors could get their money back at any time, when the OM in fact did not provide for early redemption.
- (g) He claimed that Chivas LP had a rate of return of between 26% to 45% , which was not true. Rates of return were not calculated on a reliable basis, as there was no consideration of expenses, of whether shares held by Chivas LP were free trading or liquid, or if loans held by Chivas LP were being repaid or were recoverable.

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21. These statements by Ruge were misrepresentations, contrary to section 50 of the Act.

Misrepresentations in Website

22. Ruge, under the Chivas LP name, maintained an extensive website. It contained numerous misrepresentations that were the same or similar to those contained in the OM and made by Ruge personally. Ruge, as the operating mind behind the website, made misrepresentations, contrary to section 50 of the Act.

Undertakings

¶ 3 Ruge undertakes:

1. to pay to the British Columbia Securities Commission the amount of \$150,000; and
2. not to say anything, in writing or orally, which may contradict the terms of this settlement or call those terms into question.

Order

¶ 4 Ruge and Chivas GP consent to an order by the Executive Director (the Order) that:

1. under section 161(1)(a) of the Act, Ruge and Chivas GP each comply fully with the Act, the Securities Rules, and any applicable regulations, policies and guidelines;
2. under section 161(1)(b) of the Act, Ruge and Chivas GP each cease trading in and be prohibited from purchasing any securities for a period of 25 years from the date of the Order, except that Ruge may trade and purchase securities in one RRSP account held with a registered dealer to whom Ruge has first provided a copy of the Order;
3. under section 161(1)(d) of the Act, Ruge resign any position he holds as a director or officer of any issuer, and be prohibited from becoming or acting as a director or officer of any issuer, until 25 years from the date of the Order, except that Ruge may act as a director or officer of a single company whose securities are all held by him in his own name; and
4. under section 161(1)(d)(iii) of the Act, Ruge be prohibited from engaging in investor relations activities on behalf of any issuer for a period of 25 years from the date of the Order.

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Waiver

¶ 5 Ruge and Chivas GP waive any right they may have, under the Act or otherwise, to a hearing, hearing and review, judicial review or appeal related to, in connection with, or incidental to this settlement.

¶ 6 May 5, 2005

¶ 7 “M. Ruge”
Michael Ernst Ruge

“R. Abrams”)
Witness Signature)
R.S. Abrams)
Witness Name (please print))
701 West Georgia St.)
)
Vancouver, BC)
Address)
BCSC Mgr. Inv.)
Occupation)

¶ 8 May 5, 2005

¶ 9 “M. Ruge”
Chivas Hedge Fund Ltd.
(Authorized Signatory)

“R. Abrams”)
Witness Signature)
R.S. Abrams)
Witness Name (please print))
701 West Georgia St.)
)
Vancouver, BC)
Address)
BCSC Mgr. Inv.)
Occupation)

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¶ 10 May 6, 2005

“M. Eady”
Martin Eady,
Acting Executive Director

¶ 11 For Brenda M. Leong
Executive Director