



Ontario
Securities
Commission

Commission des
valeurs mobilières
de l'Ontario

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**IN THE MATTER OF
VERNON RAY FAUTH**

**STATEMENT OF ALLEGATIONS
(Subsections 127(1) and 127(10) of the *Securities Act*, RSO 1990 c S.5)**

1. Staff of the Enforcement Branch (**Staff**) of the Ontario Securities Commission (the **Commission**) elect to proceed using the expedited procedure for inter-jurisdictional proceedings as set out in Rule 11(3) of the Commission's *Rules of Procedure*.

A. OVERVIEW

2. In its decision on the merits dated November 8, 2018 (the **ASC Merits Decision**) of a panel of the Alberta Securities Commission (**ASC**) found that Vernon Ray Fauth (**Fauth** or the **Respondent**):

(a) engaged in unregistered dealing, without an exemption from that requirement, contrary to section 75(1)(a) of the *Alberta Securities Act*, RSA 2000, c. S-4 (the **Alberta Act**);

(b) made misleading statements, contrary to section 92(4.1) of the *Alberta Act*; and

(c) perpetrated a fraud, contrary to section 93(b) (now section 93(1)(b)) of the *Alberta Act*.

3. Fauth solicited investments in Espoir Capital Corporation (**Espoir**) and informed investors that their funds would be used to make certain types of secured investments that would generate returns of 10.5% or 8% per annum. Contrary to those representations,

investment funds were either diverted to other businesses Fauth owned, controlled or managed, or used to make payments to other investors.

4. The conduct for which Fauth was sanctioned occurred between October 2006 and September 2014 (the **Material Time**).
5. On June 24, 2019, the ASC Panel issued an Order against Fauth (the **ASC Sanctions Decision and Order**) that imposes sanctions, conditions, restrictions or requirements upon him.
6. Staff are seeking an inter-jurisdictional enforcement order reciprocating the Alberta Order pursuant to paragraph 4 of subsection 127(10) of the Ontario *Securities Act*, RSO 1990, c S.5 (the **Act**).

B. FACTS

Staff make the following allegations of fact:

(i) The Respondent and Related Companies

7. At the time of the ASC Merits Decision, Fauth was a resident of Calgary, Alberta. Fauth was registered with the Mutual Fund Dealers Association at one point but has not been registered with the ASC in any capacity since December 31, 2003.
8. Fauth has never been registered with the Commission in any capacity.
9. Fauth was the founder, sole director and majority shareholder of Fauth Financial Group Ltd. (**Fauth Financial**), a corporation formed in Alberta that was licensed to sell insurance and mutual funds. Fauth Financial offered financial and estate planning services, as well as investment advice and opportunities for clients to invest in various products which included insurance and mutual funds.
10. Fauth was also a director and second-largest shareholder of FairWest Energy Corporation (**FairWest**), a publicly traded oil and gas company listed on the TSX Venture Exchange. It was federally incorporated on August 18, 2005, and registered in Alberta on August 29,

2005. In 2009, Fauth became the interim Chief Executive Officer (**interim CEO**) of Fairwest. In this role, he raised money for the corporation and tried to find a third party to purchase the company while searching for a permanent replacement for the role of CEO. The company was unsuccessful and made an application under the *Companies' Creditors Arrangement Act* in December 2012. Fauth resigned as both director and as interim CEO in February 2013.

11. Fauth also had interests in and control over a number of oil and gas companies that were associated in business with FairWest. This included several limited partnerships and their incorporated general partners. Fauth was a director, officer, and shareholder of the general partners either directly or indirectly.
12. Espoir was incorporated in Alberta as a numbered company in October 2002 and changed its name to Espoir shortly thereafter. Fauth was the founder, sole shareholder, and director and officer of the corporation. Fauth also had sole signing authority over Espoir. Fauth used Espoir to raise funds from the public for re-investment in other opportunities that would generate investment returns. Only Fauth raised funds for Espoir and dealt with its investors. Funds were raised through the issuance of debentures and promissory notes (collectively, the **Espoir Investments**).

(ii) *The Espoir Investments*

13. From November 2002 to November 2012, Espoir issued approximately \$15 million in debentures the “unsecured subordinated debentures” and the “Series II Secured” debentures (collectively, the **Espoir Debentures**), to over 70 investors in Alberta, British Columbia and Ontario.
14. From November 2002 to March 2009, Espoir offered the “unsecured subordinated debentures” (the **Unsecured Debentures**). Most of the Unsecured Debentures paid 10.5% per annum, a few of them that were issued in late March 2009 had an interest rate of 8% per annum. All Unsecured Debentures matured in three years.
15. Beginning in around 2010, Espoir was unable to repay the Unsecured Debentures as they matured. Consequently, Fauth asked the Unsecured Debenture holders to enter into

amending agreements (**Debenture Amendments**), which reduced the interest rate of most of the Unsecured Debentures from 10.5% to 8%, modified the payment of interest to occur on a quarterly basis, and extended the term of the debentures (usually for an additional three years). Fauth told investors that the reduction in interest was necessary because Espoir did not wish to foreclose on mortgages it was invested in during the real estate market downturn because it did not want to take control of impaired assets it could not sell.

16. From November 2009 to November 2012, Espoir offered the “Series II Secured” debentures (**Secured Debentures**), with a three-year term and paid interest quarterly at 8% per annum, to investors. The subscription agreement for the Secured Debentures stated, “[t]he Debenture is a secured obligation of [Espoir]”.
17. Despite the difference in name, the Respondent indicated that the Unsecured Debentures and Secured Debentures were essentially the same, and only differed in the date of issue and interest rate. While the Respondent asserted that the Espoir Debentures were secured by the assets in Espoir, the ASC Panel found that the assets were not secured by agreement or registration.
18. Investors in the Espoir Debentures were told that their investment was “safe and secure” and that there was “either no risk or else a very low risk anyone would suffer a loss”. Investors believed that their funds would be invested in real estate and secured by that real estate. One witness understood that the only difference between the Secured Debentures and Unsecured Debentures was that the former was “tied to one secured asset” while the latter was a pooled investment attached to “more than one asset.” This was corroborated by the promotional materials and correspondence Fauth provided to investors.
19. In 2012, Espoir raised \$545,000 by issuing promissory notes (**Espoir Notes**) to 5 investors. Four of the Espoir Notes were issued with a two-year term and paid 8% interest per annum. The fifth Espoir Note was issued with a three-and-a-half-month term and paid 8% interest per annum.

20. Despite Fauth's assurances to the investors of the Espoir Debentures and Espoir Notes (collectively, the **Espoir investors**) that their investment was safe and secured by real estate, the reality was that the Espoir investors' funds were primarily invested and loaned to Fauth, members of the Fauth family, or other entities controlled by Fauth and his family. Espoir's transactions with these non-arm's length parties were undocumented and were either unsecured or undersecured.
21. Money raised from Espoir investors was also used to repay other Espoir investors in the manner of a Ponzi scheme.
22. By mid-2013, Espoir ceased its interest payments to Espoir investors. As of December 31, 2014, Espoir owed its investors over \$12.3 million. It is unlikely that these funds will ever be repaid to investors in the foreseeable future.

(iii) Breaches of the Alberta Act

23. The ASC Panel found that:
 - (a) From approximately September 28, 2020 to November 19, 2012, Fauth breached section 75(1)(a) of the Alberta Act, by acting as a dealer in Espoir securities while not registered to do so and without an exemption from that requirement;
 - (b) From approximately October 6, 2006 to November 19, 2012, Fauth breached sections 92(4.1) of the Alberta Act by making representations with respect to Espoir securities he knew or reasonably ought to have known were materially misleading, untrue, or omitted facts that were required to be stated or necessary to make the statements not misleading, and which would reasonably be expected to have a significant effect on the market price or value of Espoir securities; and
 - (c) From approximately January 1, 2009 to September 30, 2014, Fauth breached s.93(b) of the Alberta Act by engaging or participating in an act, practice or course of conduct relating to Espoir securities that he knew or reasonably ought to have known perpetrated a fraud on Espoir investors.

(iv) The ASC Sanctions Decision and Order

24. The ASC Sanctions Decision and Order imposed the following sanctions upon Fauth:

- (a) pursuant to section 198(1)(d) of the Alberta Act, Fauth must resign from any positions he holds as a director or officer (or both) of any issuer, registrant, investment fund manager, recognized exchange, recognized self-regulatory organization, recognized clearing agency, recognized trade repository, designated rating organization or designated benchmark administrator;
- (b) pursuant to section 198(1)(b), (c), (e) and (e.3) of the Alberta Act, Fauth is permanently prohibited from:
 - i. trading in or purchasing any security or derivative, and from relying on any exemptions contained in Alberta securities laws;
 - ii. becoming or acting as a director or officer (or both) of any issuer or other person or company that is authorized to issue securities, registrant, investment fund manager, recognized exchange, recognized self-regulatory organization, recognized clearing agency, recognized trade repository, designated rating organization or designed benchmark administrator; and
 - iii. acting in a management or consultative capacity in connection with activities in the securities market;
- (c) pursuant to section 198(1)(i) of the Alberta Act, Fauth must pay to the ASC disgorgement in the amount of \$2,585,414.87;
- (d) pursuant to section 199 of the Alberta Act, Fauth must pay to the ASC an administrative penalty of \$400,000; and
- (e) pursuant to section 202 of the Alberta Act, Fauth must pay costs to the ASC in the amount of \$250,000.

C. JURISDICTION OF THE ONTARIO SECURITIES COMMISSION

25. Fauth is subject to an order of the ASC imposing sanctions, conditions, restrictions or requirements upon him.
26. Pursuant to paragraph 4 of subsection 127(10) of the Act, an order made by a securities regulatory authority, derivatives regulatory authority or financial regulatory authority, in any jurisdiction, that imposes sanctions, conditions, restrictions or requirements on a person or company may form the basis for an order in the public interest made under subsection 127(1) of the Act.
27. Staff allege that it is in the public interest to make an order against the Respondent.
28. Staff reserve the right to amend these allegations and to make such further and other allegations as Staff deem fit and the Commission may permit.

D. ORDER SOUGHT

29. Staff request that the Commission make the following inter-jurisdictional enforcement order, pursuant to paragraph 4 of subsection 127(10) of the Act:
 - (a) Against Fauth that:
 - i. pursuant to paragraph 2 of subsection 127(1) of the Act, trading in any securities or derivatives by Fauth cease permanently;
 - ii. pursuant to paragraph 2.1 of subsection 127(1) of the Act, the acquisition of any securities by Fauth is prohibited permanently;
 - iii. pursuant to paragraph 3 of subsection 127(1) of the Act, any exemptions contained in Ontario securities law do not apply to Fauth permanently;
 - iv. pursuant to paragraphs 7, 8.1 and 8.3 of subsection 127(1) of the Act, Fauth resign any positions he holds as a director or officer of an issuer or registrant;

- v. pursuant to paragraphs 8, 8.2 and 8.4 of subsection 127(1) of the Act, Fauth is prohibited permanently from becoming or acting as a director or officer of any issuer or registrant;
 - vi. pursuant to paragraph 8.5 of subsection 127(1), Fauth is prohibited permanently from becoming or acting as a registrant or promoter; and
- (b) such other order or orders as the Commission considers appropriate.

DATED at Toronto this 19th day of October, 2020.

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