

**IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, c. S.5, AS AMENDED**

- AND -

**IN THE MATTER OF
BRIAN K. COSTELLO**

Hearing: November 11-15, 18-20, 28 and December 6 and 9, 2002

Panel: Paul M. Moore, Q.C. - Vice-Chair (Chair of the Panel)
M. Theresa McLeod - Commissioner
Kerry D. Adams, FCA - Commissioner

Counsel: Hugh Corbett - For the Staff of the
Scott Pilkey Ontario Securities Commission
Rob Del Frate

Joseph Groia - For Brian K. Costello
Janice Wright

DECISION ON THE MERITS AND REASONS

The Proceeding

[1] This proceeding was a hearing under sections 127 and 127.1 of the *Securities Act* (the Act) in the matter of Brian K. Costello. The hearing commenced on November 11, 2002 and continued on November 12-15, 18-20 and 28, 2002, and on December 6 and 9, 2002.

[2] Today, we announce our decision on the merits and the reasons for it. After we have heard further submissions from counsel as to appropriate sanctions, we will decide what order, if any, should be made in the public interest. Following that decision, we will issue reasons for our decision on sanctions.

The Allegations

[3] In their statement of allegations, staff alleged that orders under sections 127 and 127.1 would be in the public interest because:

- (i) Costello acted as an “adviser” without being registered in accordance with section 25(1)(c) of the Act, by engaging in conduct which amounted to recommending the purchase of specific securities to attendees at his seminars, readers of his newsletters, and listeners of his radio segments, and by offering his opinion to them on the investment merits of those specific securities;

- (ii) Costello engaged in this conduct without disclosing that he held an interest in a company that would benefit financially from the sale of those specific securities or that he received fees for publishing articles in his newsletters which recommended those specific securities, contrary to section 40 of the Act and the public interest; and
- (iii) Costello engaged in conduct which constituted “trading” in securities without being registered in accordance with subsection 25(1)(a) of the Act, by carrying out acts directly or indirectly in furtherance of trades of specific securities by way of his seminars, radio segments, and the articles published in his newsletters.

Witnesses

[4] We heard from the following witnesses: Lou Calderisi and John Howard from THE Financial Planning Group (FPG); five sales representatives of FPG; four attendees of Costello’s seminars who purchased the limited partnership units of Synlan Securities Corporation or EverVest Resource Management Ltd. mentioned by Costello at the seminars; James Carr, the editor of Costello’s newsletters; Barbara Shourounis from the Saskatchewan Securities Commission; Charles Skipper, a lawyer at Fogler, Rubinoff LLP, the firm that advised FPG on its business model; Bruce Hammond, a consultant to FPG; Joseph MacDonald, a former executive of Mackenzie Mutual Funds, which co-sponsored events with FPG; Hugo Valente, an officer of FPG ServiceCo, the company into which the net profits of FPG flowed; and Rebecca Cowdery, the manager of the regulatory reform group within the Ontario Securities Commission’s investment funds team.

Facts

[5] Brian Costello is a financial author, radio personality, investment commentator and seminar speaker. In December, 1992, he signed a letter agreement establishing FPG through The Height of Excellence Financial Planning Group, Inc. (FPG FundsCo) and DPM Securities Inc. (FPG SecuritiesCo). They were registrants under the Act and carried on business as FPG. The net profits of the two registrants flowed into The Height of Excellence Financial Group Inc. (FPG ServiceCo), a non-registrant, of which Costello was the chairman and in which he held a 47.5% stake. This business structure was devised as a means of allowing Costello to participate in the control of FPG without having to become qualified as an officer or director of a registrant. However, in the agreement, he undertook to become registered.

[6] Until approximately July, 1997, Costello gave investment seminars on behalf of FPG. For each seminar, FPG paid Costello a speaking fee of approximately \$5,000 plus expenses. At no time was Costello registered under the Act as an adviser.

[7] A typical Costello seminar consisted of two parts. During the first part, Costello made general comments about the current state of the economy, interest rates, general market trends and political matters. During the second part, Costello discussed tax savings and investment strategies, which on several occasions included discussing specific securities.

[8] Whether in the course of his introductory remarks or elsewhere in his seminars, Costello would tell his audience that he was not licensed to sell securities, did not take clients, and that they should consult a registered adviser.

[9] At the material time, Costello also published a monthly investment newsletter. He charged FPG \$0.50-\$1.00 per copy. FPG made these newsletters available free of charge to clients and prospects, including attendees of Costello's seminars. Costello would tell seminar attendees that they were entitled to a free copy of the newsletter, and that if a copy was not included in their seminar package, they could obtain one by indicating interest on the seminar response card provided to attendees.

[10] On several occasions in his seminars and newsletters, Costello mentioned specific limited partnership units of Synlan or EverVest. He referred to them as investments in very favourable terms, saying such things as "the best I've seen". He created the impression that he was very positive about these securities for investment purposes. Articles in his newsletter described the Synlan securities as being liquid, hard assets, and real property. Points made at some seminars about Synlan securities were similar, if not identical, to the points made about Synlan in the copy of Costello's newsletter available at the seminar.

[11] In his newsletters and a radio broadcast, Costello also specifically mentioned securities of Retrocom Growth Fund Inc., with which Costello had a longstanding relationship.

[12] Costello did not meet one-on-one with potential investors, including any who were considering investing in securities mentioned during his seminars.

[13] At the seminars in which he referred to Synlan, Costello would tell the audience, either directly or through a question Costello put to the attending branch manager of FPG, that Richard Smith, the president and secretary of Synlan would conduct a follow-up seminar for those interested in the Synlan units. Anyone interested in attending a Smith seminar could indicate that on their seminar response card. After each Costello seminar, the cards would be sorted and divided among the local sales representatives of FPG.

[14] The Smith seminars that followed Costello seminars, usually within a week or so, were arranged in advance, and often were held within the same building as Costello seminars. Costello did not attend the Smith seminars, but Smith made reference to Costello frequently. The seminar package for Smith seminars included either an entire issue of a Costello newsletter containing an article endorsing Synlan limited partnership units, or a copy of a positive Synlan article on its own. Smith expressly referred to the article during his seminars.

[15] Most articles in Costello's newsletters were prepared by James Carr. On the inside cover of each newsletter, Costello was identified as its publisher. Costello's name was prominently displayed on the masthead, above a photograph of Costello and a list of his accomplishments. Costello spoke to Carr each month to discuss articles for the upcoming issue. Carr put Costello's thoughts into writing. When Carr required further information, he would phone Costello for details. Draft articles were forwarded to Costello for his review, but Costello never requested changes to the draft newsletters. Costello's silence gave Carr every reason to believe that the newsletter accurately reflected Costello's views.

[16] We found as a fact that the articles without a byline gave the reader the impression that they came from Costello himself, or at the very least, expressed Costello's views.

[17] The promoters of the Synlan and EnerVest limited partnership units were Richard Smith and Peter Streukens, respectively. Synlan and EnerVest paid fees to have articles written by Smith and Streukens, respectively, appear in the newsletter. Smith and Streukens contacted Carr to arrange this. Costello did not disclose in his newsletter that articles in the newsletter regarding limited partnership units of Synlan or EnerVest, which appeared without a byline, were paid advertisements. He allowed the views of the promoters to appear as his own views.

[18] The eight-page newsletter often contained at least one page of paid text, and up to three or four pages during the peak season for sales connected with registered retirement savings plans (RRSPs). For example, the January, 1998 edition of the newsletter contained an article promoting Retrocom as one of three labour-sponsored investment funds "which we feel offer good long-term growth potential." Retrocom and the two other funds mentioned each wrote their portion of the article and paid \$500 to have it published. No disclosure was made of the compensation received for its inclusion.

[19] Although the newsletters were used at the Costello and Smith seminars organized by FPG, the newsletters never disclosed Costello's interest in FPG ServiceCo or that he was entitled to remuneration derived from the activities of FPG, including sales by FPG FundsCo and FPG SecuritiesCo of securities recommended by Costello. Costello also did not disclose this at his seminars. He only said that he founded FPG and handpicked its advisers.

[20] From June, 1995 to July, 1996, FPG ServiceCo held a minority equity interest in EnerVest. During this time, articles in Costello's newsletters recommended limited partnership units of EnerVest, but Costello's indirect interest was not disclosed.

[21] Costello did no direct trading as part of his business. Whenever attendees of Costello's seminars later purchased Synlan or EnerVest securities, the attendees did so after dealing with or through others who were registered as advisers or dealers under the Act. Some of the trades in question occurred months or even more than a year after the attendees heard Costello mention the securities at a Costello seminar.

[22] In 1994 and 1995, the Saskatchewan Securities Commission (SSC) received complaints that Costello was making what amounted to recommendations of specific limited partnership units in the course of his seminars, without being registered. Costello was advised that he was prohibited from discussing specific securities in his seminars without being registered, even by way of example. Costello met with SSC officials in 1994, and undertook not to mention specific securities in his seminars. He broke that undertaking in 1995, resulting in a second round of complaints. Valente went to speak to SSC officials and later communicated to Costello or other senior personnel of FPG that the SSC's position was that Costello was not to "talk product", *i.e.* refer to specific securities, without becoming registered as an adviser. Based on the evidence, we concluded that officers of FPG would have made Costello aware of the concerns expressed by the SSC in 1995 even if Valente had not himself spoken directly to Costello. Indeed, they did raise with Costello again the issue of his becoming registered under securities laws.

[23] Concerns were also expressed to Costello separately by staff of the Alberta Securities Commission.

Adviser Registration

[24] Costello was not registered as an adviser. An issue in dispute was whether Costello acted as an adviser as defined in the Act.

[25] Under the Act, Costello was an adviser if he engaged in, or held himself out as engaging in, the business of advising others as to the investing in or the buying or selling of securities. The trigger for registration as an adviser is not doing one or more acts that constitute the giving of advice, but engaging in the business of advising.

[26] Accordingly, we first had to decide whether Costello engaged in acts of advising. If he did, then we had to determine whether through those acts, Costello was engaged in the business of advising.

[27] This was a difficult case on this issue given the unique facts. This case required us to apply our knowledge and expertise on methods of advising which can vary enormously.

Did Costello provide advice?

[28] Providing mere financial information as to specific securities does not constitute the giving of advice, but providing an opinion on the wisdom or value or desirability of investing in specific securities does: *Re Canadian Shareholders Association* (1992), 15 O.S.C.B. 617 (*Canadian Shareholders*).

[29] In *Lowe v. Securities and Exchange Commission*, 472 U.S. 181 (1985), a 'one-on-one'

relationship involving the giving of advice on specific securities to specific individuals was found to be required to qualify as the giving of advice under U.S. law. Such a direct, one-on-one relationship with an investor is not required to qualify as the giving of advice under Ontario law: *Canadian Shareholders* at 657.

[30] Counsel for Costello questioned whether the interpretation of “adviser” in *Canadian Shareholders* was too board. We considered that and concluded that the clear intention of the Act was to define “adviser” broadly, and then to provide exceptions in limited circumstances that were not met in the case before us.

[31] Based on the evidence, we found that Costello gave advice as to the wisdom or value of investing in securities of Synlan and EnerVest on several occasions in his seminars and in his newsletters. In response to a question put to counsel for Costello, counsel conceded that a particular Retrocom radio spot constituted the giving of advice. We therefore concluded that Costello provided advice.

[32] The fact that Costello always stated that he did not himself take clients and stated that investors should always consult independent advisers or other registrants did not mean that he could not have been giving advice, and therefore, could not have been acting as an adviser under the Act.

[33] In his closing argument, counsel for Costello raised for the first time a constitutional question: that staff’s suggested interpretation of the definition of “adviser” in the Act – applying to anyone advising on a non-investor-specific basis – if adopted by the Commission, would result in a violation of the *Canadian Charter of Rights and Freedoms*. As the required notices to argue a constitutional question were not given, we did not take the constitutional question into account in deciding this case.

Was Costello engaged in the business of advising?

[34] *Re Maguire* (1995), 18 O.S.C.B. 4623 is relevant to the question of whether Costello was engaged in the business of advising. In that case, this Commission adopted the approach of the British Columbia Securities Commission in *Re Donas*, [1995] 14 B.C.S.C.W.S. 39 (*Donas*). The *Donas* approach is the proper one under our Act: if Costello offered advice in a manner that reflected a business purpose, then he was engaged in the business of advising. In *Re Hrapstead*, [1999] 15 B.C.S.C.W.S. 13, the British Columbia Securities Commission determined that in assessing whether Hrapstead offered advice in a manner that reflected a business purpose, one needed to look no further than the commissions Hrapstead stood to receive.

[35] Isolated incidents of giving advice on specific securities would not have been enough to persuade us that Costello offered advice in a manner that reflected a business purpose. However, considering the totality of the evidence in this particular case, including Costello’s newsletter articles on Synlan, EnerVest and Retrocom, the use of his newsletters at his seminars, the fact that Smith seminars were arranged in advance of Costello seminars and were announced when Costello spoke

about Synlan at his seminars, we concluded that the necessary business purpose was present, and that he was therefore engaged in the business of advising. Costello's arrangements with FPG to put on seminars and to benefit indirectly from revenue from sales of products by FPG were additional indicia of the necessary business purpose.

Were any adviser exemptions available to Costello?

[36] There might well have been an educational component to what Costello did. However, the teacher exemption from adviser registration contained in section 34(b) of the Act was not available to Costello. His principal occupation was not that of a teacher. His recommendations of specific securities were an integral part of his business as a financial speaker and commentator.

[37] Because Costello offered advice in a manner that reflected a business purpose, and did not have an exemption from the requirement to register as an adviser, he was required to be registered as an adviser. By not doing so, he violated section 25(1)(c) of the Act.

Disclosure of Interests in Securities Referred To

[38] Section 40 of the Act requires every registered adviser to ensure that every publication of the adviser in which the adviser recommends that a specific security be purchased, sold or held contain, in a conspicuous position, full and complete disclosure of any financial or other interest that the adviser directly or indirectly has in the sale or purchase of any securities referred to. The disclosure obligation expressly includes any commission or other remuneration that the adviser has received, or may expect to receive, from any person or company in connection with any trade in such securities, and any financial arrangement relating to such securities that the adviser has with any person or company.

[39] Costello failed to disclose in his newsletters that articles relating to securities of Synlan or EnerVest, which appeared without a byline, were paid for by Smith or Streukens, the respective promoters of the securities. The same was true for articles about Retrocom.

[40] It was inappropriate for Costello to allow the views of promoters of Synlan, EnerVest or others to appear as his own views in articles in his newsletters, and not to disclose that they were paid advertisements.

[41] Costello's newsletters never disclosed his interest in FPG ServiceCo or that FPG ServiceCo was entitled to remuneration derived from the activities of FPG, including sales by FPG FundsCo and FPG SecuritiesCo of securities recommended by Costello.

[42] From June, 1995 to July, 1996, FPG ServiceCo held an interest in EnerVest. During this time, articles in Costello's newsletters contained positive references to EnerVest, but Costello's indirect

interest in EnerVest was not disclosed. Although the interest of FPG ServiceCo in EnerVest was relatively small, and turned out to be relatively insignificant, it was still material at the relevant time because it could have later turned out to have been more significant than it eventually was to him.

[43] Section 1(1) of the Act defines a “registrant” as “a person or company registered or required to be registered under this Act”. Section 40 of the Act, however, does not apply to a “registrant” but to a “registered adviser”. Therefore, technically, section 40 does not cover a person who is a “registrant” but not a “registered adviser” because of a failure to register.

[44] Accordingly, Costello’s failure to disclose his many conflicts did not constitute a breach of section 40 of the Act. However, his failure to make the full, complete and conspicuous disclosure that he would have been required to make had he not failed to become registered as an adviser was contrary to the public interest.

[45] If in the future, the Act were to be amended to narrow the requirement for registration to apply only where there was one-on-one advice to an investor, we would nevertheless want the conflict of interest disclosure provisions to apply to anyone giving advice, even if not registered. Indeed, we hope that section 40 will be amended in this regard.

Registration to Trade in Securities

[46] Those who conduct any trade in a security are required to be registered, regardless of whether or not they are engaged in the business of trading. A trade in a security is defined to include any act, solicitation or conduct directly or indirectly in furtherance of a trade. The essence of staff’s third allegation is that Costello engaged in acts, solicitations or conduct directly or indirectly in furtherance of actual trades.

[47] There is no bright line separating acts, solicitations and conduct indirectly in furtherance of a trade from acts, solicitations and conduct not in furtherance of a trade. Whether a particular act is in furtherance of an actual trade is a question of fact that must be answered in the circumstances of each case. A useful guide is whether the activity in question had a sufficiently proximate connection to an actual trade.

[48] Staff argued that the relevant actual trades in Synlan securities involved persons who attended Costello’s seminars. Some of these trades occurred months or even more than a year after the Costello seminars in question. In each case, the attendees took further steps through persons registered as advisers or dealers before trading occurred.

[49] Costello told his audience that he did not take clients. He referred his audience to others who were registered. He did not meet one-on-one with investors. In our opinion, his activities, including

his use of seminar response cards as a method of finding new clients for FPG, were insufficiently proximate to the actual trades that ultimately occurred to constitute acts, solicitations or conduct indirectly in furtherance of the actual trades.

[50] Had we determined that Costello's activities were directly or indirectly in furtherance of actual trades, the registration exemption in section 35(1)(10) of the Act would have been available to him, as those trades were conducted through registrants. In our view, if the ultimate trade is exempted from registration, so too is any act, solicitation or conduct in furtherance of that trade.

[51] Under section 206 of Regulation 1015, registration exemptions contained in section 35(1) of the Act are not available to a market intermediary, except in respect of certain specified trades. A trade exempted by virtue of section 35(1)(10) is not one of the specified trades.

[52] However, section 206 of the Regulation would not have taken away Costello's exemption under section 35(1)(10) of the Act. A market intermediary is someone engaged in the business of trading. Costello did no direct trading as part of his business. A person can be engaged both in the business of trading and the business of advising, but even if we had found that Costello's conduct amounted to acts, solicitations or conduct in furtherance of actual trades, this would not have led us to find in the particular facts of this case that he was engaged in the business of trading.

Conclusion

[53] We have determined that Costello's failure to become registered as an adviser contravened section 25(1)(c) of the Act; that his failure to make full, complete and conspicuous disclosure of his many conflicts of interest was contrary to the public interest; and that his activities did not constitute acts, solicitations or conduct indirectly in furtherance of actual trades.

[54] We look forward to hearing the submissions of counsel on what order, if any, we should make in the public interest.

Dated at Toronto this 18th day of February, 2003.

“Paul M. Moore”
Paul M. Moore

“M. Theresa McLeod”
M. Theresa McLeod

“Kerry D. Adams”
Kerry D. Adams