

**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, December 6 and 9, 2002, and March 31, 2003

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 SANCTIONS AND REASONS

I. Background

[1] We made a decision on the merits in this matter and gave reasons on February 18, 2003, which are now reported at (2003), 26 O.S.C.B. 1617.

[2] We received written argument on sanctions from both parties and heard oral argument on March 31, 2003.

II. Decision on Sanctions

[3] We previously concluded that Costello did not comply with Ontario securities law and acted contrary to the public interest.

[4] We are of the opinion that it is in the public interest to order that:

- (i) pursuant to paragraph 3 of subsection 127(1) of the Act, the exemption contained in subsection 34(d) of the Act shall not apply to Costello for five years from the date of our order, or such lesser period as the Commission may order under section 144 of the Act;
- (ii) pursuant to paragraph 4 of subsection 127(1) of the Act, and with the terms and conditions described below pursuant to subsection 127(2) of the Act, Costello submit

to a review of his practices and procedures as an adviser during the period from November 11, 2002, being the date of the commencement of the hearing, to the date of our order (the Review Period);

- (iii) pursuant to paragraph 6 of subsection 127(1) of the Act, Costello be reprimanded; and
- (iv) pursuant to subsections 127.1(1) and (2) of the Act, Costello pay \$300,000 of the costs of the Commission in investigating his affairs and the costs of or related to conducting the hearing.

Terms and Conditions

[5] The review pursuant to paragraph 4 of subsection 127(1) of the Act shall be conducted by the executive director of the Commission or a person appointed for this purpose by him and should answer the following questions with respect to the Review Period:

- (i) Does Costello still have a website? If so, does any part of it recommend any specific securities? Does any part of it contain any other information that suggests that Costello may still be carrying on the business of advising?
- (ii) Does Costello still publish a newsletter? If so, does the newsletter actually or implicitly recommend specific securities or contain any other information that suggests that Costello may still be carrying on the business of advising?
- (iii) Does Costello still hold seminars? If so, does he actually or implicitly recommend specific securities in a manner that suggests that Costello may still be carrying on the business of advising?
- (iv) In addition to matters in evidence before us, has Costello published other materials, or undertaken practices and procedures, that suggest he may still be carrying on the business of advising?

[6] The report of the reviewer shall be filed with the Commission within two months from the date of our order.

[7] The executive director may apply to the Commission, on two days' notice to Costello, for directions or advice on any matter relevant to the review or the preparation of the report of the reviewer.

[8] We reserve the right to order, pursuant to paragraph 4 of subsection 127(1) of the Act, that Costello institute such changes as we may order based on the report of the reviewer.

III. Reasons

A. Exemptions from Registration as an Adviser

[9] Staff requested that we order that all the exemptions contained in section 34 of the Act not apply to Costello.

[10] However, the exemptions in subsections (a), (b) and (c) are not presently available to Costello and do not need to be taken away.

[11] Subsection (a) applies to a bank or similar financial institution, which Costello is not.

[12] Subsection (b) applies to a lawyer, accountant, engineer or teacher. We have already ruled that this exemption was not available to Costello.

[13] Subsection (c) applies to a registered dealer, or any partner, officer or employee thereof. If Costello becomes one of these, he will be subject to the compliance supervision rules of the dealer. We do not believe that in such a situation he should be denied this exemption.

[14] Although the exemption in subsection (d) was not available to Costello on the facts before us – his newsletters were not distributed only to subscribers for value or purchasers – he may well limit distribution of his newsletter in the future in a manner to bring himself within this exemption without registering as an adviser under the Act. In such a case, and in light of his past conduct, he should not be able to rely on the exemption for a period of time.

B. Exemption from Registration for Trading

[15] Staff requested that we order that the exemption contained in paragraph 10 of subsection 35(1) of the Act not apply to Costello, directly or indirectly, for a period of three to five years, except for trades by Costello in securities for which Costello is the direct or beneficial owner.

[16] The conduct of Costello which concerned us did not pertain to trading. Accordingly, we do not believe it appropriate to take away that exemption.

C. Review of Costello's Recent Practice and Procedures

[17] Regarding publications prepared by or connected with Costello, counsel for staff requested:

- (i) An order pursuant to paragraph 4 of subsection 127(1) of the Act that Costello submit to a review by an expert of the practices and procedures Costello follows with

respect to the content of any seminars, presentations, speeches, newsletters, mailings (including electronic mailings), written materials radio or television broadcasts, websites, or any other media which pertain to investing in securities, in whole or in part, which are given, created, prepared, produced, published, distributed, disseminated or operated by Costello, directly or indirectly (singularly or collectively the Costello Media), and institute such changes as may be ordered by the Commission.

- (ii) An order pursuant to subsection 127(2) of the Act that the review of the Costello Media be conducted at Costello's expense and that the selection of the expert and the terms of the expert's engagement be acceptable to staff. The expert would have to complete the review within reasonable time frames set by the expert and approved by staff. Costello would have to provide staff with a copy of the expert's report and recommendations. Before implementing any recommendations, the expert would have to consult with staff and thereafter provide staff with progress reports concerning the implementation of the expert's recommendations.
- (iii) In addition to any other changes recommended by the expert, an order that Costello institute the following changes to his practices and procedures immediately:
 - (a) permanently or until Costello becomes registered, Costello shall not mention, refer to or endorse, directly or indirectly, any specific securities, issuers or promoters of specific securities in the Costello Media;
 - (b) permanently, Costello must disclose in any Costello Media concerning investing in securities, in a conspicuous manner which is clear and easily understood, the identity, interest and contribution of any party which has paid any fee or given consideration of any kind to have any article, commentary or representation included in the Costello Media;
 - (c) for three to five years, or until Costello becomes registered as an adviser, whichever occurs first, Costello must state in the Costello Media, in a conspicuous manner which is clear and easily understood, that he has been sanctioned by the Commission for failing to register as a securities adviser; and
 - (d) permanently or until Costello becomes registered as an adviser, Costello must state in the Costello Media, in a conspicuous manner which is clear and easily understood, that he is not registered with the Commission to act as a securities adviser and that he is not qualified to recommend investments in specific securities.

and

- (iv) An order pursuant to subsection 127(2) of the Act that Costello be prohibited from providing the Costello Media to, on behalf of, or in conjunction with, any registrant, issuer or promoter, for a period of three to five years or until Costello becomes registered as an adviser, whichever occurs first.

[18] Counsel for Costello argued that Costello is not a market participant, and, therefore, Costello's practices cannot be reviewed under paragraph 4 of subsection 127(1) of the Act. We disagree. As a registrant, i.e. a person who ought to have been registered, he was a market participant. The review we are ordering will determine if he has ceased to be a registrant, and if not, what changes should be instituted regarding his practices and procedures.

[19] Counsel for Costello also argued that, in spite of some evidence concerning the existence of Costello's website, the website had not been updated and was not in active use, that Costello had long since ceased publishing his newsletter, and that Costello had stopped giving seminars since the hearing proceedings were commenced. However, no evidence was called to this effect.

[20] The passage of time calls for a review of Costello's practices and procedures during the Review Period before determining whether sanctions in addition to those which we are ordering today are appropriate.

[21] Counsel for Costello also argued that giving effect to staff's request would violate Costello's rights under the *Canadian Charter of Rights and Freedoms* (Charter), including the right of free speech. His argument was based in part on requests from staff which we are not giving effect to, and in part on the assumption that the review requested by staff would be an ongoing review resulting in vetting before use of materials prepared in the future by Costello.

[22] We have considered the argument carefully and are satisfied that the review we are ordering does not violate Costello's Charter rights. We have not ordered those matters requested by staff that go to things Costello might do as a financial commentator while not also in the business of advising because we likely do not have the legal ability to do so.

[23] We are not ordering Costello not to do things that would be illegal for him to do without becoming registered as an adviser, or to refrain from doing things he could do without breaching the Act. In this regard, if Costello gives advice regarding specific securities in an isolated instance at a future time, it would be appropriate for the Commission to take into account his past practices, including those at issue in this case, in determining whether at such future time he was engaging in the business of advising others. One incident would not be looked at in isolation from what he has been doing in the past.

D. Costello Seminars: Marketing or Education?

[24] Counsel for Costello portrayed his client repeatedly, including in his submissions on sanctions, as principally an educator. The evidence we heard did not support this altruistic portrayal.

[25] The evidence repeatedly showed that a principal purpose of Costello's seminars was lead generation. The standard routine described in evidence, in addition to collecting names of participants and distributing marketing material to them, incorporated various marketing techniques of which consumers/investors should be wary at "educational seminars":

- (i) Use of hyperbole – Costello used hyperbole to describe investments. For example, he would describe a tax shelter as "the best I've seen".
- (ii) Failure to discuss risk – Costello only presented the upside of investments. Risk levels and tolerance for risk were not addressed. Good educational material should be balanced and discuss both risk and reward.
- (iii) Encouraging leverage – Costello encouraged seminar participants to maximize the investment opportunity by using borrowed money. This aggressive tactic focused solely on the upside, and failed to point out that when leverage fails the investor loses, while others involved keep their fees and commissions.
- (iv) Tax-advantaged products – Costello failed to point out that tax-advantaged products must still make sense from an investment perspective, and that fees and commissions are generally large when compared to those for non tax-advantaged investments.

[26] Good educational material should be balanced and free from marketing bias. It should not serve as bait to lead the unsuspecting to specific securities or service providers.

[27] It would be a disservice to investors, and undermine the efforts of conscientious educators, for us to endorse the view presented by counsel for Costello that Costello's seminars were primarily educational in nature.

[28] As the Commission noted in *Re DeLillis* (1998), 21 O.S.C.B. 305, nothing in Ontario securities law gives the Commission authority over the actions of seminar speakers although they play a major role in securities marketing. This remains true today and limits our ability to order several matters requested by staff.

E. Factors Considered

[29] Counsel for Costello also argued that this hearing was in essence a test case and only

nominal sanctions should result. We do not agree.

[30] The test case was *Re Canadian Shareholders Association* (1992), 15 O.S.C.B. 617. Furthermore, concerns were expressed to Costello by the Saskatchewan and Alberta Securities Commissions on separate occasions, and in the case of the Saskatchewan Securities Commission, Costello broke his 1994 undertaking that he would not mention specific securities in his seminars.

[31] We do note, however, that the allegations against Costello related, for the most part, to conduct that occurred before July, 1997. Unless the review which we are ordering raises concerns based on Costello's recent conduct, we believe that the sanctions which we are ordering today are sufficient for prospective purposes. As the Supreme Court of Canada stated in *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132 at para. 45, orders under section 127 are "preventive in nature and prospective in orientation."

F. Costello's Ability to be a Director or Officer of an Issuer

[32] Staff requested that we order that Costello resign any positions which he holds as a director or officer of an issuer, and that he be prohibited from becoming or acting as a director or officer of an issuer for a period of three to five years.

[33] The conduct of Costello which concerned us did not pertain to acting as a director or officer of an issuer. Accordingly, we do not believe it necessary, in this case, to make such an order.

[34] We wish to state, however, that we were satisfied that Costello's conduct was not what we would expect of persons who also serve as directors or officers of a public company. We believe that the procedures for selecting and electing directors of public companies, and the scrutiny that boards of public companies undertake before appointing officers, will provide sufficient safeguards if in the future Costello is considered for a position as a director or officer of a public company.

G. Amendment of Section 40 of the Act

[35] During oral argument, counsel for Costello made some statements that suggested to us that he interpreted paragraph 45 of our reasons on the merits differently than we intended.

[36] We wish to clarify what we intended in paragraph 45 of our reasons on the merits. If the adviser registration requirement of the Act should be amended in the future so that it not extend to persons who do not advise on a one-on-one basis, we would still want the disclosure requirements of section 40 of the Act to be made applicable to such persons. Furthermore, whether such amendment is made or not, we believe that section 40 of the Act needs to be amended so that it applies to persons such as Costello who should have been registered as an adviser but failed to do so.

H. Costs

[37] Counsel for staff advised that the total costs of the Commission for the investigation and hearing were \$618,982.50 attributable to the time spent by Messrs. Pilkey and Corbett, plus \$29,263.17 attributable to witness expenses, an expert report and other disbursements, for a total of \$648,245.67. The bill of costs submitted by staff was prepared using the approach developed for the Commission by AssetRisk Inc., an approach which takes into account hours spent by staff counsel and investigators. This methodology was endorsed by the Commission in *Re Donnini* (2002), 25 O.S.C.B. 6225.

[38] Counsel for staff further advised as follows:

- (i) The hearing in this matter was held over four weeks and required 11.5 hearing days. A total of 18 witnesses were called, 13 by staff and five by Costello. In addition, staff had prepared and originally intended to call four additional witnesses.
- (ii) None of the 13 witnesses called by staff resided in Toronto. All of staff's witnesses were required to attend at the expense of the Commission from the following places: one from Florida, one from Calgary, one from Regina, two from Montreal, one from Ottawa, one from Windsor, five from Barrie or the surrounding area, and one from Burlington.
- (iii) All but two of staff's witnesses had to stay overnight in Toronto for at least one night to ensure their availability to testify the following day or to accommodate their travel arrangements.
- (iv) Costello did not admit any facts in advance of the hearing and with only a few exceptions, staff was required to prove all of its documentary evidence through *viva voce* testimony, even though the documents went virtually uncontested.
- (v) Although the accuracy of the information set out in appendices A, B and C to the statement of allegations (the structure of FPG, and the sales of the limited partnership units of Synlan and EnerVest) was not contested or contradicted by Costello, staff was required to produce several large volumes of documents and to call Messrs. Calderisi and Howard to prove the information summarized in those appendices.

[39] We accept staff's bill of costs as reflective of the Commission's costs in this matter.

[40] Of the three allegations made against Costello, Staff established a breach of Ontario securities law in connection with the first allegation, and conduct contrary to the public interest in connection with the second allegation. However, we do not believe that a mathematical formula of

two out of three is the proper basis for ordering costs in this case. The essence of this case was that Costello acted as an adviser without being registered, as he should have been, and did not disclose information he should have disclosed. For these activities, we found that Costello did not comply with Ontario securities law and acted contrary to the public interest.

[41] We are reluctant to limit our costs order to one half of the actual costs, since costs that are not recovered will come indirectly, through the Commission's cost recovery funding arrangements, from fees paid by other participants in the capital markets. However, in all the circumstances, and considering that staff only asked us for a \$300,000 costs order, we have determined that it is in the public interest that Costello pay \$300,000 of the Commission's costs.

Dated at Toronto this 29th day of April, 2003.

"Paul M. Moore"
Paul M. Moore

"M. Theresa McLeod"
M. Theresa McLeod

"Kerry D. Adams"
Kerry D. Adams