

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

**AND**

**IN THE MATTER OF  
FRANCIS GEORGE LEE SIMPSON**

**SETTLEMENT AGREEMENT**

**I INTRODUCTION**

1. In a Notice of Hearing to be issued, the Ontario Securities Commission (the “Commission”) will announce that it will hold a hearing to consider whether, pursuant to section 127 of the *Securities Act*, R.S.O. 1990, c. S-5, as amended (the “Act”), it is in the public interest for the Commission to make an order regarding Francis George Lee Simpson (“Simpson”) that:
  - (a) this settlement agreement be approved;
  - (b) the registration of Simpson under securities law be suspended or restricted or terminated, or that terms and conditions be imposed on his registration;
  - (c) Simpson resign all positions that he holds as director or officer of a registrant and of a reporting issuer;
  - (d) Simpson be prohibited from becoming or acting as a director or officer of a registrant and a reporting issuer; and
  - (e) Simpson be required to pay the costs of Staff’s investigation into the matters set out in this settlement agreement.

## **II JOINT SETTLEMENT RECOMMENDATION**

2. Staff of the Commission (“Staff”) agree to recommend settlement of the proceeding against Simpson in accordance with the terms and conditions set out below. Simpson agrees to the settlement on the basis of the facts set out in Part IV below and consents to the making of an order against him in the form attached as Schedule “A”.

## **III ACKNOWLEDGEMENT**

3. Staff and Simpson agree with the facts set out in Part IV herein for the purposes of this settlement agreement only.

## **IV AGREED FACTS**

### **A. Background**

#### **(a) F. G. Lee Simpson**

4. At all relevant times, Francis George Lee Simpson was the President, Chief Executive Officer and Chief Financial Officer of Thomson Kernaghan & Co. Ltd. (“TK”). Simpson was also TK’s Ultimate Designated Person (“UDP”), as defined by the Investment Dealers’ Association (“IDA”).

#### **(b) Mark Valentine**

5. At all relevant times, Mark Edward Valentine was the Chairman of TK. Valentine was also a Registered Representative licensed through TK with the IDA. In his role as TK’s President and UDP, Simpson was ultimately responsible for the supervision of all of Valentine’s trading activities at TK.

6. On December 14, 2004, Valentine executed a settlement agreement with Staff (the “Valentine Settlement Agreement”). In the Valentine Settlement Agreement, Valentine admitted that while employed at TK and supervised by Simpson, he committed several breaches of Ontario securities law, and engaged in conduct contrary to the public interest.

**(c) Thomson Kernaghan**

7. TK is a corporation incorporated pursuant to the laws of Ontario and was registered with the IDA as an Investment Dealer in the provinces of Ontario, British Columbia, Alberta and Quebec. TK’s headquarters were located in Toronto.

**(d) The Funds**

8. Valentine was the President, Director and a shareholder of VMH Management Ltd. (“VMH”), an Ontario corporation. VMH held trading accounts at TK. Valentine was the Registered Representative assigned to those accounts and held trading authority over them.
9. VMH was the General Partner of the Canadian Advantage Limited Partnership (“CALP”), an Ontario limited partnership which operated as a private investment fund.
10. Advantage (Bermuda) Fund Ltd. (“CALP Offshore Fund”) is a mutual fund company incorporated under the laws of Bermuda and is CALP’s corresponding offshore fund.
11. Valentine was the President, Director and a shareholder of VC Advantage Limited (“VC Ltd.”), an Ontario corporation. VC Ltd. was the General Partner of the VC Advantage Fund Limited Partnership (“VC Fund”), an Ontario limited partnership which operated as a private investment fund.

12. VC Advantage (Bermuda) Fund Ltd. (“VC Offshore Fund”) is a mutual fund company incorporated under the laws of Bermuda and is the VC Fund’s corresponding offshore fund.
13. Collectively, CALP, CALP Offshore Fund, VC Fund and VC Offshore Fund will be referred to as the “Funds”.
14. Pursuant to written partnership agreements and offering memoranda, Valentine, acting through VMH and VC Ltd. (together, the “General Partners”), was authorized to recommend, advise on and enter into all investments on behalf of the Funds and he did so.
15. The majority of the limited partners (unitholders) of the Funds were individual retail clients of TK. The Funds performed all of their securities transactions through trading accounts held at TK. Valentine was the Registered Representative at TK for all of these trading accounts. In his role as TK’s UDP, Simpson was ultimately responsible for the supervision of all of Valentine’s trades on behalf of the Funds.

**B. The JAWZ Transaction**

16. In the Valentine Settlement Agreement, Valentine admitted that in August of 2000, Valentine caused the Funds to enter into a financing transaction with JAWZ Inc. (“JAWZ”). JAWZ was a Canadian company whose shares traded on the NASDAQ exchange.
17. According to Valentine, in return for their investment, the Funds acquired floorless warrants to purchase shares of JAWZ. The warrants provided that the Funds would receive increasing numbers of JAWZ shares as the share price declined. This type of financing creates a strong incentive for the investor to sell securities short in a relatively illiquid market, which is often referred to as “death spiral” or “toxic” financing.

18. On November 7, 2000, TK's research department issued a research report regarding JAWZ shares which rated them as a "buy". TK did not disclose in this report, or to any of its clients holding JAWZ shares at that time, the fact that JAWZ had entered into this type of financing, the fact that the warrants were held by TK clients, or the fact that the Chairman of TK controlled the holders of the "death spiral" warrants.
19. In or about December of 2000, a retail client of TK who had purchased shares of JAWZ met with Valentine and Simpson and informed them that the firm was in a conflict of interest position in advocating the purchase of JAWZ shares by retail investors in the face of the "death spiral" warrants. In response, Valentine stated that the terms of the warrants would be modified to mitigate the Funds' incentive to sell the shares short. The warrants, however, were never amended and Valentine continued to sell JAWZ shares short through the Funds' accounts.

**C. The Trilon Loans**

20. In the spring of 2001, Simpson, Valentine and other senior officers of TK approached Trilon Bancorp Inc. ("Trilon") to obtain a short-term loan. On March 30, 2001, Trilon advanced the sum of \$5,000,000 to TK Holdings Inc (the "TK Loan"). The TK Loan required the approval of both the Executive Committee and Board of Directors of TK. The funds advanced under the TK Loan were used by TK Holdings to purchase \$5,000,000 worth of preferred shares of TK. The TK Loan was to be repaid in full by June 30, 2001. This transaction was properly reported to the IDA. On July 3, 2001, the TK Loan was repaid in full.
21. In July of 2001, Valentine approached Trilon to borrow money which he planned to use to pay off his debts to TK. Trilon agreed to provide Valentine a US\$5,000,000 loan facility with an initial advance of US\$3,000,000 (the "Valentine Loan"). The approval of the Executive Committee and Board of Directors of TK was not sought for the Valentine

Loan. The funds under the Valentine Loan were advanced to Valentine personally. The Valentine Loan was to be repaid in full by December 31, 2001.

22. Simpson, on behalf of TK, signed a guarantee of all of Valentine's obligations under the Valentine Loan.
23. On July 31, 2001, US \$3,000,000 was advanced to Valentine under the Valentine Loan. US \$816,945 (\$1,250,579.41) of this sum was placed in a trading account at TK held in the name of Trilon Securities Corp.
24. TK reported to the IDA that the \$1,250,579.41 represented a subordinated loan made by Valentine to TK. TK did not disclose to the IDA that further funds had been advanced by Trilon to Valentine. TK also did not disclose to the IDA that it had guaranteed Valentine's entire obligation to Trilon.
25. Simpson and Valentine signed the mandatory quarterly report filed with the IDA which disclosed the \$1,250,579.41 "subordinated loan", certifying that the report contained full and accurate disclosure of TK's liabilities.
26. In the Valentine Settlement Agreement, Valentine admitted that he was unable to repay the US \$3,000,000 advance by the due date of December 31, 2001. He therefore negotiated several further advances of funds and extensions of the repayment deadline under the Valentine Loan, the last of which expired on July 15, 2002. As of that date, the amount outstanding on the loan was approximately US \$5,600,000. Valentine defaulted on the Valentine Loan on July 15, 2002.

**D. The TK Report and TK's Bankruptcy**

27. On May 7, 2002, the Executive Committee of TK was informed by Marty Sims, TK's Retail Branch Manager and Executive Vice President, that Valentine had executed a

series of questionable transactions. As a result, Simpson retained outside counsel for TK and commenced an investigation into Valentine's activities (the "Investigation"). Simpson advised both the OSC and the IDA of the fact that he had commenced the Investigation.

28. On June 13, 2002, Valentine was suspended from his employment at TK for 30 days pending the final results of the Investigation. On June 19, 2002, Simpson delivered a report reflecting the results of the Investigation to the IDA (the "TK Report"). The TK Report was tendered into evidence in proceedings taken by the OSC against Valentine on June 24, 2002.
29. On July 11, 2002, Simpson informed the IDA and the Canadian Investor Protection Fund ("CIPF") that TK might not be able to meet its Risk-Adjusted Capital requirement, and its registration as an Investment Dealer was suspended. On the same date, CIPF brought a motion for an order declaring TK bankrupt and appointing Ernst & Young Inc. as the trustee of its estate. The motion was unopposed by TK and a receiving order was made by the Ontario Superior Court of Justice on July 12, 2002.

**E. The March 28, 2002 Transactions by Valentine**

30. The Valentine Settlement Agreement includes the details of two series of improper transactions that he executed on March 28, 2002, as set out below.

**(a) The Chell Corp. Transaction**

31. Chell Group Corporation ("Chell Corp.") was a Canadian company whose shares traded on the NASDAQ exchange.
32. On March 28, 2002, Valentine's pro account received 1,060,000 shares of Chell Corp. that belonged to CALP without any cash payment by Valentine. Valentine claimed that

the shares were provided to repay a debt of US \$1,060,000 owed by CALP to him personally. The shares were thus transferred at a value of US \$1 per share.

33. Valentine's explanation for CALP's debt to him was that CALP had borrowed US \$360,000 from him in July 2001, and another US \$700,000 from him in January 2002. The \$360,000 that was transferred to CALP came from the proceeds of the Trilon loan, described above.
34. Also on March 28, 2002, pursuant to sell orders placed March 26, 2002, after receiving the Chell Corp. shares from CALP, Valentine effected the following transactions:
  - (i) Valentine sold 1,000,000 Chell Corp. shares at a price of US \$2 per share to his inventory account;
  - (ii) Valentine sold 375,000 Chell Corp. shares at a price of US \$2 per share from his inventory account to the VC Fund;
  - (iii) Valentine sold 375,000 Chell Corp. shares at a price of US \$2 per share from his inventory account to the VC Offshore Fund; and
  - (iv) Valentine sold 250,000 Chell Corp. shares at a price of US \$2 per share.
35. Of the US \$2 million in proceeds in his pro account from these sales, Valentine transferred US \$450,000 (\$717,000) to his trader receivable account to reduce his liabilities to TK.
36. On April 30, 2002, the VC Fund sold 200,000 shares of Chell Corp. at a price of US \$2.09 per share. At the time, there was an agreement between Valentine and the VC Fund that Valentine would buy 250,000 shares of Chell Corp. per quarter from the VC Fund

commencing July 1, 2002 at a price of US \$2.20 per share. The agreement was purportedly guaranteed by the General Partners.

37. Valentine could not produce evidence of a loan of US \$700,000 to CALP in January of 2002. No evidence of the loan could be found in the books and records of TK that were provided to Staff.

**(b) The IKAR Transaction**

38. In the Valentine Settlement Agreement, Valentine admitted that he had a beneficial interest in Hammock Group Ltd., a corporation registered pursuant to the laws of Bermuda. Hammock had a trading account at TK. Valentine was the Registered Representative for that account. The Hammock account was not designated by Valentine as a pro account on the books and records of TK, as it was required to be.
39. On March 28, 2002, CALP paid US \$1.3 million to Hammock to purchase a debenture issued by a company named IKAR Minerals. The debenture was dated March 1998 and had expired in March of 2000.
40. Valentine stated that the rationale for the transaction was to settle a debt that CALP owed to Hammock of US \$1,582,830. The debt related to transactions in the shares of JAWZ Inc., a Canadian company whose shares traded on the NASDAQ exchange. Valentine explained that this debt had been incurred as follows:

- (a) In July, 2001, Hammock paid CALP US \$537,068 for 652,573 shares of JAWZ at a price of US \$0.823 per share. JAWZ shares were then trading at a price of US \$0.59 per share. Valentine explained this step as Hammock assisting CALP in meeting its margin requirement at TK. In consideration for its help, CALP guaranteed the JAWZ investment by

promising that any losses Hammock might suffer from its eventual sale of the JAWZ shares would be reimbursed by CALP;

- (b) Over the next three weeks, Hammock sold the JAWZ shares at an average price of US \$0.218 per share, generating a loss of US \$386,895.54 which Valentine claimed that CALP was obliged to reimburse pursuant to its “guarantee”;
  - (c) In a separate transaction, Valentine stated that CALP had sold 900,000 shares of a firm called Global Path short to Hammock at a price of US \$1.33 per share for net proceeds of US \$1,196,500. Valentine claimed that CALP made the short sale “believing that it was to receive Global Path shares as partial compensation for its JAWZ losses”; and
  - (d) CALP was unable to deliver the Global Path shares and was therefore indebted to Hammock for total of US \$1,582,830 as a result of the JAWZ guarantee and the undeliverable Global Path shares.
41. “To allow Hammock to recoup the bulk of its out of pocket cost in supporting the funds”, Valentine stated that he took the following steps:
- (a) Valentine’s company VMH was the owner of the IKAR debenture which it “gifted” to Hammock;
  - (b) Hammock in turn sold the debenture to CALP for US \$1.3 million as payment for the “debt” which CALP owed to Hammock;
  - (c) The debenture had value because IKAR’s principal had recently promised Valentine to make up the US \$1.3 million loss by converting the IKAR debenture into shares of the renamed company, Patriot Energy

Corporation. This promise was later set out in a letter addressed to Valentine by the President of Patriot Energy. This promise was purportedly given because Valentine had personally made a US \$250,000 private placement investment in Patriot Energy; and

- (d) Valentine claimed that as a result, CALP was the beneficiary of a “gift” from him through VMH of the IKAR position.
42. The evidence did not support this explanation. Hammock did not purchase JAWZ shares from CALP but rather from Valentine’s inventory account. Therefore CALP did not guarantee Hammock’s JAWZ investment, and correspondingly was not liable for Hammock’s US \$386,330.70 loss in the JAWZ transaction.
43. CALP did not sell 900,000 shares of Global Path to Hammock but rather sold 1,000,000 shares of Global Path to Valentine’s inventory account. The price per share and net proceeds of this transaction were not US \$1.33 and US \$1,196,500 respectively, but rather US \$0.65 and US \$635,000.
44. Hammock did not purchase 900,000 Global Path shares at a price of US \$1.33 per share from CALP but rather from Valentine’s inventory account. The price per share and net proceeds of this transaction were not US \$1.33 and US \$1,196,500 respectively but rather US \$1.05 and US \$945,000.
45. The Global Path trade did not fail as delivery slips confirm the transfer of share certificates.

### **Conduct Contrary to the Public Interest**

46. Simpson’s conduct was contrary to the public interest for the reasons set out below.

**A. Failure to Disclose the Valentine Loan Guarantee**

47. Simpson failed to ensure that the terms of the Valentine Loan were properly disclosed to the IDA, as required by IDA By-laws 17 and 38. This failure had the effect of presenting an inaccurate picture of TK's financial circumstances to the IDA.

**B. Failure to Supervise Valentine's Transactions**

48. Simpson failed to ensure that Valentine's handling of the Funds' business in the JAWZ, Chell Corp. and IKAR transactions was within the bounds of ethical conduct and consistent with just and equitable principles of trade, contrary to IDA Regulation 1300 and By-law 38.
49. In these transactions, Simpson failed to supervise Valentine in accordance with Ontario securities law, and failed to ensure that Valentine dealt fairly, honestly and in good faith with his clients, contrary to sections 3.1 and 2.1 of OSC Rule 31-505.
50. Simpson agrees that it is in the public interest for the Commission to make the order set out in Schedule "A" to this agreement.

**V RESPONDENT'S POSITION****A. Valentine Loan**

51. With regard to the Valentine Loan, as described in paragraphs 20 through 26, above, Simpson represents that he and the TK Executive Committee were made aware of the Valentine Loan by Valentine himself. Simpson represents that the TK Executive Committee asked Valentine on several occasions whether the Valentine Loan bound TK in any way. Simpson represents that Valentine advised the Executive Committee that TK was not bound. Simpson represents that Valentine informed him that securities held in

Valentine's pro account at TK would be pledged as security for the Valentine Loan. Simpson was asked to, and did, execute confirmations to that effect.

52. Simpson represents that he believed that he was only executing documents in connection with the pledge of Valentine's securities to Trilon. Simpson represents that, unbeknownst to him, TK's guarantee of the Valentine Loan was embedded in the documents that he executed. Simpson acknowledges that he executed these documents without reviewing them.

**B. IKAR Transaction**

53. With regard to Valentine's actions in the IKAR Transaction, as described in paragraphs 38 through 45 above, Simpson represents that he was not aware at any material time that Valentine had an interest, beneficial or otherwise, in Hammock.

**C. Cooperation With Regulatory Authorities**

54. When he became aware of the issues surrounding Valentine's conduct, Simpson responded proactively and co-operated with the OSC, IDA and CIPF. Prior to TK's bankruptcy, Simpson met regularly with the OSC, IDA and CIPF during which time he attempted to arrange for the orderly transfer of client assets from TK. Following TK's bankruptcy, Simpson continued to work for the benefit of TK's stakeholders by assisting the Receiver of TK and ensuring that all of TK's clients were made whole and that the estate of TK recovered all amounts due to it. Simpson lost a significant amount of his own funds as a result of TK's bankruptcy.

**VI TERMS OF SETTLEMENT**

55. Simpson agrees to the terms of settlement listed below.

56. The Commission will make an order:
- (a) terminating his registration under Ontario securities law;
  - (b) requiring Simpson to resign all positions that he holds as director or officer of a registrant or a reporting issuer;
  - (c) permanently prohibiting Simpson from becoming a director or officer of any registrant;
  - (d) prohibiting Simpson from becoming a director or Chief Financial Officer of a reporting issuer for a period of 5 years from the date of the order;
  - (e) requiring Simpson to pay the sum of \$50,000.00 towards the costs of Staff's investigation into the matters set out in this settlement agreement.
57. Simpson undertakes to never re-apply for registration or recognition of any kind under Ontario securities law or any other Canadian securities legislation.
58. Simpson undertakes to never seek membership in, or approval in any capacity from, the IDA.

## **VII STAFF COMMITMENT**

59. If this Settlement Agreement is approved by the Commission, Staff will not initiate any proceeding under Ontario securities law in relation to the facts set out in Part IV of this agreement, subject to the provisions of paragraph 60 below.
60. If this Settlement Agreement is approved by the Commission and at any subsequent time Simpson fails to honour the undertakings and agreements contained in paragraphs 57, 58,

and 63 of this Settlement Agreement, Staff reserve the right to bring proceedings under Ontario securities law against Simpson based on the facts set out in Part IV of this Settlement Agreement, as well as the breach of the undertakings and agreements.

## **VIII PROCEDURE FOR APPROVAL OF SETTLEMENT**

61. Approval of this Settlement Agreement will be sought at a public hearing before the Commission scheduled for a date to be agreed to by counsel for Staff and Simpson, in accordance with the procedures set out in this Settlement Agreement and the Commission's Rules of Practice.
62. Staff and Simpson may refer to any part, or all, of this Settlement Agreement at the settlement hearing. Staff and Simpson also agree this Settlement Agreement will constitute the entirety of the evidence to be submitted regarding Simpson's conduct in this matter, and Simpson agrees to waive his rights to a full hearing and appeal of this matter under the Act.
63. Staff and Simpson agree that if this Settlement Agreement is approved by the Commission, neither party will make any public statement that is inconsistent with this Settlement Agreement. Nothing in this section is intended to restrict Simpson from making full answer and defence to any civil proceeding brought against him.
64. If this Settlement Agreement is not approved by the Commission, or an order in the form attached as Schedule "A" to this Settlement Agreement is not made by the Commission, each of Staff and Simpson will be entitled to all available proceedings, remedies and challenges, including proceeding to a hearing of Staff's allegations against Simpson, unaffected by this Settlement Agreement or the settlement negotiations.
65. Whether or not this Settlement Agreement is approved by the Commission, Simpson agrees that he will not, in any proceeding, refer to or rely upon this agreement or the

negotiation or process of approval of this Settlement Agreement as the basis for any attack on the Commission's jurisdiction, alleged bias, alleged unfairness or any other remedies or challenges that may otherwise be available.

## **IX DISCLOSURE OF AGREEMENT**

66. The terms of this Settlement Agreement will be treated as confidential by both parties until approved by the Commission. The terms of this Settlement Agreement will be treated as confidential forever if this Settlement Agreement is not approved by the Commission, except with the written consent of both Simpson and Staff or as may be required by law.
67. Any obligations of confidentiality will terminate upon approval of this Settlement Agreement by the Commission.

## **X EXECUTION OF SETTLEMENT AGREEMENT**

68. This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.

69. A facsimile copy of any signature will be as effective as an original signature.

**DATED** this 15<sup>th</sup> day of August, 2005

**FRANCIS GEORGE LEE SIMPSON**

“Lee Simpson”

**F. G. Lee Simpson**

**DATED** this 12th day of August, 2005

**STAFF OF THE ONTARIO SECURITIES COMMISSION**

(Per) “Michael Watson”

Michael Watson  
Director, Enforcement Branch