

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

- AND -

**IN THE MATTER OF
MARK EDWARD VALENTINE**

**AMENDED AMENDED STATEMENT OF ALLEGATIONS
OF STAFF OF THE ONTARIO SECURITIES COMMISSION**

Staff of the Ontario Securities Commission (“Staff”) make the following allegations:

Background

a) Mark Valentine

1. Mark Edward Valentine was the Chairman, a Director and the largest shareholder of Thomson Kernaghan & Co. Ltd. (“TK”). He resides in Toronto, Ontario. Valentine is a Registered Representative with the Investment Dealers’ Association (“IDA”).
2. TK is a corporation incorporated pursuant to the laws of Ontario and is registered with the IDA as an Investment Dealer in the provinces of Ontario, British Columbia, Alberta and Quebec.

b) The Funds

3. Valentine is the President, Director and a shareholder of VMH Management Ltd. (“VMH”), an Ontario corporation. VMH was the General Partner of the Canadian Advantage Limited Partnership (“CALP”), an Ontario limited partnership which operated as a private investment fund.
4. 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.
5. Valentine is 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.
6. 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.
7. Collectively, CALP, CALP Offshore Fund, VC Fund and VC Offshore Fund will be referred to as the “Funds”.
8. Pursuant to written partnership agreements and offering memoranda, Valentine, acting through VMH and VC Ltd. (together, the “Management Companies”), was authorized to recommend, advise on and enter into all investments on behalf of the Funds and did so.
9. 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 these accounts.

10. Neither Valentine nor the Management Companies are registered with the Commission as Investment Counsel/Portfolio Managers.

c) Hammock Group Ltd.

11. Valentine has a beneficial interest in Hammock Group Ltd., a corporation registered pursuant to the laws of Bermuda. Hammock had a trading account at TK, and Valentine was the Registered Representative for that account. The Hammock account was not designated as a pro account on the books and records of TK.

d) Cameron Brett Chell

12. Cameron Brett Chell is a known associate of Valentine. Chell was a shareholder and the Chairman of VC Ltd., and owned and operated Chell Group Corporation (“Chell Corp.”), an internet-related company. The shares of Chell Corp. traded on the NASDAQ exchange.

13. Among other things, Chell also co-founded Jawz Inc. (“JAWZ”), an internet-related company whose shares traded on the NASDAQ exchange.

14. Chell was formerly a registered salesperson at McDermid St. Lawrence Securities Ltd. in Calgary, Alberta. In November of 1998 Chell entered into a settlement agreement with the Alberta Stock Exchange admitting to violations of the General By-Law of the Exchange and agreeing to an order that he:

- i) be prohibited against Exchange approval in any capacity for five years;
- ii) be placed under strict supervision for a period of two years following re-registration in any capacity; and
- iii) be fined \$25,000.

15. Chell is not currently a registrant of either the Alberta or the Ontario Commissions.

The “Death Spiral” Financing of JAWZ

16. In August of 2000, Valentine caused CALP to enter into a financing transaction with JAWZ.
17. In this transaction, in return for its investment, CALP acquired floorless warrants to purchase shares of JAWZ. The warrants provided that CALP 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 a TK client, or the fact that the Chairman of TK was the President of the General Partner of the holder of the “death spiral” warrants.

TK’s Financial Difficulties

a) The Trilon Loans

19. By the spring of 2001, TK was in financial difficulty. In particular, it was at least \$3,000,000 short of the risk-adjusted capital (“RAC”) that it was required by the IDA to maintain for the protection of its clients. Valentine, along with other senior officers of TK, approached Trilon Bancorp Inc. to obtain a short-term loan which would permit TK to meet its RAC requirement.

20. On March 30, 2001, Trilon advanced the sum of \$5,000,000 to TK Holdings Inc. These funds were used to purchase \$5,000,000 worth of preferred shares of TK. The loan was to be repaid in full by June 30, 2001. This transaction was properly reported to the IDA. On July 3, 2001 the loan was repaid in full.
21. In July of 2001, Valentine and other senior officers of TK approached Trilon for a further loan to assist TK in meeting its RAC requirement. Trilon agreed to provide a US\$5,000,000 loan facility with an initial advance of US\$3,000,000. The funds were advanced to Valentine personally, and the loan facility was to be repaid in full by December 31, 2001. TK guaranteed all of Valentine's obligations under the loan facility.
22. On July 31, 2001, US \$3,000,000 was advanced to Valentine, and 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. 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, and did not disclose to the IDA that it had guaranteed Valentine's entire obligation to Trilon.
23. Valentine 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 loan facility, first to January 7, 2002, and then to January 11, 2002, March 31, 2002 and finally July 15, 2002. As of that date, the amount outstanding on the loan was approximately US \$5,600,000. Valentine defaulted on the loan on July 15, 2002.

b) The Research Capital Sale

24. As the Trilon loans were not sufficient to sustain TK's financial position, by the spring of 2002, TK had entered into negotiations to sell the majority of its client accounts to Research Capital Corporation. Client accounts managed by Valentine and those

associated with him were not included in the proposed transaction. Rather, the negotiations contemplated that Valentine and his associates would continue to operate their business under the TK name after the sale.

25. In order to facilitate the sale, TK stipulated to Valentine that after March 31, 2002, the profits and liabilities of his inventory account would change from being split 50/50 between Valentine and the remainder of TK's shareholders, to being the sole liability of Valentine.

The March 28, 2002 Transactions

26. On March 28, 2002, Valentine conducted two series of transactions. Each series of transactions involved numerous trades and included trading in the Funds' accounts, in Valentine's personal accounts and in the accounts of other TK clients.
27. At the time of these transactions, the Funds were not permitted to acquire further securities due to amendments made to their partnership agreements.

a) The Chell Corp. Transaction

28. 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.
29. 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.
30. On the same date, pursuant to sell orders placed March 26, 2002, after receiving the Chell Corp. shares from CALP, Valentine effected the following transactions:

- a) Valentine sold 1,000,000 Chell Corp. shares at a price of US \$2 per share to his inventory account;
 - b) Valentine sold 375,000 Chell Corp. shares at a price of US \$2 per share from his inventory account to the VC Fund;
 - c) Valentine sold 375,000 Chell Corp. shares at a price of US \$2 per share from his inventory account to the VC Offshore Fund;
 - d) Valentine sold 250,000 Chell Corp. shares at a price of US \$2 per share from his inventory account to another TK retail client; and
 - e) 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.
31. On April 30, 2002, the VC Fund sold 200,000 shares of Chell Corp. at a price of US \$2.09 per share.
32. 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 supposedly guaranteed by the Management Companies.
33. Valentine has not provided sufficient evidence to support the validity of a loan by him to CALP of US \$360,000 in June of 2001 or a loan of US \$700,000 in January of 2002.
34. TK reported to the IDA that the Chell Corp. transactions affected its RAC by creating excess margin in Valentine's own accounts of \$1,412,189, and by creating a margin

requirement in the Funds' accounts of \$434,000. Further, the amount owing in Valentine's trader receivable account was decreased by \$717,000 (US \$450,000).

b) The IKAR Transaction

35. On March 28, 2002, CALP paid \$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.
36. Valentine claimed that the rationale for the transaction was to settle a debt that CALP owed to Hammock of \$1,582,830. 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”;

- 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;
- e) “To allow Hammock to recoup the bulk of its out of pocket cost in supporting the funds”, Valentine executed the following “solution”;
 - i) Valentine’s company VMH was the owner of the IKAR debenture which it “gifted” to Hammock;
 - ii) Hammock in turn sold the expired debenture to CALP for \$1.3 million as payment for the “debt” which CALP owed to Hammock;
 - iii) The expired debenture had value because IKAR’s principal had recently promised Valentine to make up the \$1.3 million loss by converting the IKAR debenture into shares of a new company, Patriot Energy Corporation. This promise was purportedly given because Valentine had personally made a \$250,000 private placement investment in Patriot Energy; and
 - iv) Valentine claimed that as a result, CALP was the beneficiary of a “gift” from him through VMH of the IKAR position.

37. In fact, however, Hammock did not purchase JAWZ shares from CALP but rather from Valentine’s inventory account. Therefore CALP could not have guaranteed Hammock’s

JAWZ investment, and correspondingly was not liable for Hammock's US \$386,330.70 loss in the JAWZ transaction.

38. 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.
39. 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 \$945,000.
40. The Global Path trade did not fail as delivery slips confirm the transfer of share certificates.

TK's Investigation

41. On May 7, 2002, TK's Management Committee requested an explanation from Valentine about the Chell Corp. and IKAR transactions and commenced an internal investigation into the trades.
42. On June 13, 2002, as a result of its internal investigation, TK took disciplinary actions against Valentine and suspended his employment. At that time, TK also took steps to exclude him from TK's premises.
43. On June 19, 2002, TK delivered its Investigation Report to the IDA which reported on its findings into the impugned transactions.
44. TK's investigation found:

- that the propriety of certain of the trades was “questionable”;
 - that there was “inadequate documentation” for other trades;
 - that Valentine had failed to provide any documents to support still other trades; and
 - that “the rationale was not supportable” for one entire series of trades.
45. On June 19, 2002 TK decided to reverse the Chell Corp. and IKAR transactions.

TK’s Bankruptcy

46. On July 11, 2002, TK informed the IDA that it could no longer meet its outstanding liabilities to its clients and its registration as an Investment Dealer was suspended. On the same date, the Canadian Investor Protection Fund brought a motion for an order declaring TK bankrupt and appointing Ernst & Young Inc. as the trustee of its estate. The motion was granted and a receiving order was made on July 12, 2002.

Valentine’s Breach of the Commission’s Temporary Cease Trade Order

47. On June 17, 2002, the Commission issued a Temporary Order in this matter pursuant to s. 127(1) of the *Securities Act* (the “Act”). This order suspended Valentine’s registration under Ontario securities law and ordered him to cease trading in securities until the later of fifteen days or the conclusion of a hearing under s. 127(6) of the Act.
48. On June 24, 2002, Staff issued a Notice of Hearing and Statement of Allegations in this matter.
49. On July 8, 2002, the Commission issued a further Temporary Order in this matter pursuant to s. 127(7) of the Act (the “July Order”), which extended the original Temporary Order until January 31, 2003. The July Order suspended Valentine’s

registration, removed his exemptions under the Act and required him to cease trading in securities with the exception that he was permitted to trade in certain securities for his own account if:

- (a) the securities were securities referred to in clause 1 of subs. 35(2) of the Act; or
- (b) the securities were listed and posted for trading on the Toronto Stock Exchange or New York Stock Exchange; and
- (c) Valentine did not, either directly or indirectly, own more than one percent of the outstanding securities of the issuer.

50. In the period between July 25, 2002 and August 16, 2002, Valentine traded in securities not exempted in the July Order. Specifically, between July 26, 2002 and August 16, 2002, Valentine opened an account at Refco Futures (Canada) Ltd., in Toronto, Ontario and traded in futures contracts listed on the Chicago Mercantile Exchange.

51. On August 16, 2002, after it was publicly reported that Valentine had been arrested in Germany by the United States Federal Bureau of Investigation, authorities at Refco advised Staff of the Commission of the existence of Valentine's account at Refco and he ceased trading in the account.

Conduct Contrary to the Public Interest

52. Valentine's conduct was contrary to the public interest for the reasons set out below.

a) The JAWZ Transaction

53. Valentine created a culture of conflict and non-compliance at TK and breached Ontario securities laws in respect of the JAWZ transactions by:

- a) filling multiple roles as the President of the Funds' General Partners, as the Registered Representative of the Funds' accounts, and as Chairman and controlling shareholder of TK;
- b) as a registrant and as the Chairman of TK, failing to deal fairly, honestly and in good faith with his clients contrary to s. 2.1(2) of OSC Rule 31-505 by:
 - i) motivating some TK clients to sell JAWZ shares short as a result of "death spiral financing" that he arranged and motivating other TK clients to buy and hold JAWZ shares as a result of TK's "buy" recommendation;
 - ii) failing to disclose to all TK clients that JAWZ had recently received "death spiral financing";
 - iii) failing to disclose to all TK clients that JAWZ had recently received "death spiral financing" from another TK client; and
 - iv) failing to disclose to all TK clients that companies controlled by the Chairman of TK were the General Partners of the providers of the "death spiral financing" to JAWZ.

b) The Chell Corp. Transaction

54. Valentine created a culture of conflict and non-compliance at TK and breached Ontario securities laws in respect of the Chell Corp. transactions by:

- a) playing multiple roles as the President of the Funds' General Partners, as the Registered Representative of the Funds' trading accounts, as the Chairman

and controlling shareholder of TK and as a trader in Chell Corp. shares on his own behalf in his pro and inventory accounts at TK;

b) failing to deal fairly, honestly and in good faith with his clients contrary to s. 2.1(2) of OSC Rule 31-505, by:

- i) appropriating shares belonging to a client without supportable consideration;
- ii) causing one client to provide shares to his pro account at a value of US \$1 per share and immediately thereafter selling those shares to his inventory account at a price of US \$2 per share;
- iii) causing other clients to immediately buy those shares from his inventory account at US \$2 per share;
- iv) causing a client to sell shares at US \$2.09 per share on April 26, 2002 in the face of a put agreement at US \$2.20 per share on July 1, 2002 in favour of that client;
- v) orchestrating a transaction which provided a substantial benefit to TK's Risk Adjusted Capital and to his own accounts and which had a corresponding detrimental effect on his clients' accounts;

c) breaching the fiduciary and contractual duties that Valentine owed to the unitholders of the Funds by:

- i) purportedly providing loans to the Funds;

- ii) placing shares belonging to CALP into his pro account without supportable consideration;
- iii) selling his shares of Chell Corp. to the VC Fund and the VC Offshore Fund;
- iv) selling shares of Chell Corp. to the VC Fund and the VC Offshore Fund at a price of US \$2 per share when he had obtained them at a value of US \$1 per share;
- v) entering into a put agreement to buy shares from the VC Fund;
- vi) causing the VC Fund to sell shares at a price of US \$2.09 per share on April 26, 2002 in the face of a purported put agreement to buy the same shares at a price of US \$2.20 per share beginning July 1, 2002;
- iv) unnecessarily creating a margin requirement in the Funds' accounts;

d) Valentine failed to maintain the books and records necessary to record properly the business transactions and financial affairs which he carried out in the course of the Chell Group transaction, contrary to s. 19(1) of the Act and s. 113(1) of Ont. Reg. 1015.

c) The IKAR Transaction

55. Valentine created a culture of conflict and non-compliance at TK and breached Ontario Securities laws in respect of the IKAR transaction by:

- a) playing multiple roles as the President of the Funds' General Partners, as the Registered Representative of the Funds' trading accounts, as the Chairman and controlling shareholder of TK, as the Registered Representative of Hammock's trading account, and as a beneficial owner of Hammock;

- b) failing to deal fairly, honestly and in good faith with his clients, contrary to s. 2.1(2) of OSC Rule 31-505 by:
 - i) causing his client to guarantee an investment made by another of his clients thereby placing one client's interests ahead of those of another;

 - ii) causing his client to guarantee an investment made by a company of which he is the beneficial owner, thereby putting his own interests ahead of those of his client;

 - iii) causing his client to pay valuable consideration for a worthless security to another client, thereby placing one client's interests ahead of those of another;

 - iv) causing his client to pay valuable consideration for a worthless security to a company of which he is a beneficial owner, thereby placing his own interests ahead of those of his client;

- c) breaching the fiduciary and contractual duties that Valentine owed to the unitholders of the Funds by:
 - i) causing CALP to guarantee an investment made by a company of which he is a beneficial owner;

ii) causing CALP to give valuable consideration for a worthless security to a company of which he is a beneficial owner;

d) If, as Valentine claimed, CALP agreed to reimburse any losses suffered by Hammock in its sale of shares of JAWZ, Valentine made representations that CALP would refund Hammock a portion of the purchase price of a security contrary to s. 38(1) of the Act;

e) Valentine failed to maintain the books and records necessary to record properly the business transactions and financial affairs which he carried out in the course of the IKAR transaction, contrary to s. 19(1) of the Act and s. 113(1) of Ont. Reg. 1015.

d) Other Conduct

56. Valentine failed to ensure that the terms of the second Trilon loan were properly disclosed to the IDA, as required by IDA By-law 17. This failure had the effect of hiding the poor financial circumstances of TK from the IDA.

57. Neither Valentine nor the Management Companies are registered as Investment Counsel/Portfolio Managers, but nevertheless acted as advisors to the Funds in the JAWZ, Chell Corp. and IKAR transactions as detailed above, contrary to s. 25 of the Act.

58. Valentine failed to designate the Hammock account as a pro account, contrary to IDA Policy No. 2, Section II(C)(4).

59. Valentine breached the terms of the July 2002 Temporary Cease Order contrary to s. 122(1)(c) of the Act.

60. Such additional allegations as Staff may advise and the Commission may permit.

DATED at Toronto, this 29th day of January, 2004