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**IN THE MATTER OF
TEKNOSCAN SYSTEMS INC., H. SAMUEL HYAMS, PHILIP KAI-HING KUNG and
SOON FOO (MARTIN) TAM**

STATEMENT OF ALLEGATIONS

(Subsection 127(1) and Section 127.1 of the *Securities Act*, RSO 1990, c S.5)

A. OVERVIEW

1. This proceeding involves fraud and misrepresentation. TeknoScan Systems Inc. and its principals H. Samuel Hyams, Martin Tam and Philip Kung defrauded shareholders by presenting a sham transaction with no reasonable expectation of completion.

2. The Respondents informed TeknoScan investors that an acquiror had agreed to purchase up to 50% of TeknoScan's common shares, but failed to disclose numerous key facts, including that the purchaser had no funding to complete the transaction and that the Respondents had conducted next to no due diligence. Through dishonesty, deceit, and misrepresentation, the Respondents exploited TeknoScan's preferred shareholders, enticed them to convert their preferred shares to common shares, and caused them to forfeit their rights as preferred shareholders.

3. Protecting investors from unfair, improper and fraudulent practices is a fundamental tenet of Ontario securities law. Persons who mislead investors, violate investors' trust, and place investors' interests at risk undermine confidence in the capital markets.

B. FACTS

The following allegations of fact are made:

4. TeknoScan is an Ontario trace chemical detection company located in Vaughan, Ontario. TeknoScan's decisions are primarily driven by H. Samuel Hyams, President and Chief Executive Officer; Philip Kai-Hing Kung, Executive Vice-President and Chief Financial Officer; and Soon Foo (Martin) Tam, the Chair of TeknoScan's Board of Directors. During all relevant times, the Individual Respondents were directors or officers and directing minds of TeknoScan.

5. In late 2016, TeknoScan had approximately 102 shareholders holding approximately 36,533,885 Class A preferred shares of TeknoScan (**Preferred Shareholders**). Preferred Shareholders were entitled to the following:

- a. 6% cumulative dividends payable annually;
- b. quarterly royalties of 5% of the company's net revenue, not to exceed the total sum invested;
- c. warrants permitting the Preferred Shareholder to acquire common shares on a 1:1 basis to the number of shares subscribed for by the investor; and
- d. the right to require TeknoScan to redeem their preferred shares at US \$3 per share after 36 months from the purchase date.

6. On December 14, 2016, TeknoScan sent a Notice to Shareholders (the **Notice**) advising that Double Helix Management Services Ltd. intended to buy up to 50% of Teknoscan common shares at US \$20 per common share (the **Share Purchase Transaction**). The Individual Respondents authorized the Notice.

7. Double Helix was a Canadian corporation with a registered office in Ontario. It was incorporated on November 17, 2016—one month before the Notice—and dissolved on September 23, 2019. Dan Paul Davison was the sole director.

8. The Notice advised Preferred Shareholders that, if they wished to participate in the Share Purchase Transaction, they could convert all, but not less than all, of their preferred shares for common shares on a 1:1 basis. The conversion of the preferred shares as set out in the Notice was not contingent on the closing of the Share Purchase Transaction.

9. If the Preferred Shareholders elected to participate, those converted common shares could be included in the Share Purchase Transaction. Preferred Shareholders were asked to sign and complete an acknowledgement and confirmation and return it to TeknoScan no later than January 31, 2017.

10. The Preferred Shareholders were incentivized to convert because the Share Purchase Transaction as described in the Notice would have provided them with an opportunity to sell all or part of their stake in TeknoScan at a significant profit.

11. After shareholders received the Notice, Preferred Shareholders converted approximately 33,730,897 Class A preferred shares (representing 92.3% of such outstanding preferred shares at the time) to TeknoScan common shares.

12. The Respondents, however, had no reasonable basis to believe that the Share Purchase Transaction would take place.

13. The purchase of 50% of the TeknoScan common shares at US \$20 per share would have cost approximately US \$1 billion. Davison had almost no assets and limited business experience. Double Helix was incorporated in November 2016. The Respondents knew Double Helix and Davison did not have the ability to complete the Share Purchase Transaction and thus needed to

obtain funding from third-party funders (**Third-Party Funders**) whose identities and financial capacity were unknown to the Respondents.

14. The TeknoScan Board of Directors, which comprised of the Individual Respondents and a fourth member, delegated due diligence responsibilities to Kung. Kung was aware that Davison could not, on his own, complete the Share Purchase Transaction and conducted minimal due diligence into Davison and Third-Party Funders.

15. In or around July 2016, Investor A, a friend of Kung's since university, loaned 500,000 euros to Davison at Kung's request. Kung guaranteed half of the loan. The loan amount was then transferred by Investor A directly to a company in Houston, Texas—again at Kung's request—in an attempt by the Respondents and/or Davison to obtain funding from unknown third parties for the Share Purchase Transaction. Neither Davison nor Double Helix received funding from this transfer and the loan from Investor A was never repaid.

16. In or around October or November 2016, despite having no credible information regarding the funding, the Respondents set the material terms and conditions of the Share Purchase Transaction and their representatives drafted the relevant documents.

17. At most, the Respondents, together with Double Helix and Davison, had only discussed in detail an initial US \$63 million tranche whose source was unverified and unknown.

18. At the time of the Notice, TeknoScan was in poor financial condition. For the year ended June 30, 2016, TeknoScan incurred a net loss of \$3.6 million. This figure increased over the next year to \$6.0 million for the year ended June 30, 2017. Over the same period, TeknoScan's loans payable grew from \$3.6 million as at June 30, 2016 to \$8.5 million as at June 30, 2017. Meanwhile, its revenues decreased by over by 80% from \$349,000 to \$64,000.¹

¹ All figures approximate.

19. The poor financial state of TeknoScan encouraged the Respondents to cause Preferred Shareholders to convert their preferred shares to common shares. Had the Preferred Shareholders not converted their preferred shares, TeknoScan was liable to them for: (i) royalties for up to 5% of net revenues on a quarterly basis; (ii) annual discretionary dividends for up to 6% of the Preferred Shareholder's investment amount; and (iii) redemptions at \$3 per share.

20. The Notice omitted material facts that the Respondents knew or should have known. These facts included:

- a. Neither Double Helix nor Davison had the funds or the ability to complete the Share Purchase Transaction;
- b. Double Helix or Davison needed to obtain funding from a Third-Party Funder in order to complete the Share Purchase Transaction;
- c. The Share Purchase Transaction would take place in unspecified tranches at unscheduled time intervals;
- d. The Respondents had not conducted adequate due diligence on Double Helix, Davison, or Third-Party Funders;
- e. The Respondents lacked information on the identity of any Third-Party Funder;
- f. Double Helix and Davison had minimal participation in negotiating the Share Purchase Transaction;
- g. The material terms and conditions of the Share Purchase Transaction were set by the Respondents.

21. The Share Purchase Transaction ultimately did not take place. TeknoScan received no funds pursuant to the Share Purchase Transaction. Double Helix and Davison purchased no shares.

22. The Individual Respondents nonetheless declared outsized bonuses for themselves that were omitted in large part from TeknoScan's books and financial statements. For the year ended June 30, 2017—just over six months after the Notice—the Individual Respondents declared \$5.41 million in bonuses for themselves but only booked approximately \$667,000 of it on TeknoScan's financial records.

23. The representation to TeknoScan shareholders by the Respondents that Davison and Double Helix intended to purchase up to 50% of Teknoscan common shares at US \$20 per share was misleading and dishonest. Preferred Shareholders who converted their preferred shares to common shares lost rights associated with the preferred shares, including: (i) the opportunity to exercise the put option to redeem their preferred shares at US \$3 per share; (ii) their annual 6% dividend; and (iii) their quarterly royalties of 5%. The shareholders who converted were not permitted to convert back to preferred shares.

C. BREACHES OF ONTARIO SECURITIES LAW AND CONDUCT CONTRARY TO THE PUBLIC INTEREST

24. The following breaches of Ontario securities law and conduct contrary to the public interest are alleged:

- a. The Respondents directly or indirectly engaged in or participated in acts, practices or courses of conduct relating to securities that they each knew or reasonably ought to have known perpetrated a fraud on persons or companies, contrary to s. 126.1(1)(b) of the Act, by causing Preferred Shareholders to convert their preferred shares to common shares under the guise of a sham transaction, thereby losing all rights associated with those preferred shares; and

- b. The Respondents made statements that were misleading or untrue in light of the circumstances in which they were made, contrary to s. 126.2 of the Act, by representing that that Davison and Double Helix intended to purchase up to 50% of common shares of TeknoScan at US \$20 per share. It was a material omission contrary to s. 126.2 of the Act to not disclose all or some of the facts set out in paragraph 20 above;
- c. The Individual Respondents, as officers and directors of TeknoScan, authorized, permitted or acquiesced in TeknoScan's breaches of the Act above and are thereby liable for such breaches pursuant to section 129.2 of the Act; and
- d. The Respondents have engaged in activity that is contrary to the public interest.

D. ORDERS SOUGHT

25. The following orders are requested:

As against **TeknoScan**:

- a. that it cease trading in any securities or derivatives permanently or for such period as is specified by the Commission, pursuant to paragraph 2 of subsection 127(1) of the Act;
- b. that it be prohibited from acquiring any securities permanently or for such period as is specified by the Commission, pursuant to paragraph 2.1 of subsection 127(1) of the Act;
- c. that any exemption contained in Ontario securities law not apply to it permanently or for such period as is specified by the Commission, pursuant to paragraph 3 of subsection 127(1) of the Act;
- d. that it be reprimanded, pursuant to paragraph 6 of subsection 127(1) of the Act;

- e. that it be prohibited from becoming or acting as a registrant or promoter, pursuant to paragraph 8.5 of subsection 127(1) of the Act;
- f. that it pay an administrative penalty of not more than \$1 million for each failure to comply with Ontario securities law, pursuant to paragraph 9 of subsection 127(1) of the Act;
- g. that it disgorge to the Commission any amounts obtained as a result of non-compliance with Ontario securities law, pursuant to paragraph 10 of subsection 127(1) of the Act;
- h. that it pay costs of the Commission investigation and the hearing, pursuant to section 127.1 of the Act; and
- i. such other order as the Commission considers appropriate in the public interest

As against each of the **Individual Respondents**:

- j. that he cease trading in any securities or derivatives permanently or for such period as is specified by the Commission, pursuant to paragraph 2 of subsection 127(1) of the Act;
- k. that he be prohibited from acquiring any securities permanently or for such period as is specified by the Commission, pursuant to paragraph 2.1 of subsection 127(1) of the Act;
- l. that any exemption contained in Ontario securities law not apply to him permanently or for such period as is specified by the Commission, pursuant to paragraph 3 of subsection 127(1) of the Act;
- m. that he be reprimanded, pursuant to paragraph 6 of subsection 127(1) of the Act;

- n. that he resign any position he may hold as a director or officer of an issuer permanently or for such period as is specified by the Commission, pursuant to paragraph 7 of subsection 127(1) of the Act;
- o. that he be prohibited from becoming or acting as a director or officer of any issuer permanently or for such period as is specified by the Commission, pursuant to paragraph 8 of subsection 127(1) of the Act;
- p. that he resign any positions that he may hold as a director or officer of a registrant, pursuant to paragraph 8.1 of subsection 127(1) of the Act;
- q. that he be prohibited from becoming or acting as a director or officer of a registrant, pursuant to paragraph 8.2 of subsection 127(1) of the Act;
- r. that he be prohibited from becoming or acting as a registrant or promoter, pursuant to paragraph 8.5 of subsection 127(1) of the Act;
- s. that he pay an administrative penalty of not more than \$1 million for each failure to comply with Ontario securities law, pursuant to paragraph 9 of subsection 127(1) of the Act;
- t. that he disgorge to the Commission any amounts obtained as a result of non-compliance with Ontario securities law, pursuant to paragraph 10 of subsection 127(1) of the Act;
- u. that he pay costs of the Commission investigation and the hearing, pursuant to section 127.1 of the Act; and
- v. such other order as the Commission considers appropriate in the public interest.

26. The rights to amend these allegations and to make further allegations are reserved.

DATED this 23rd day of August, 2022

ONTARIO SECURITIES COMMISSION

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