Ontario Securities Commission
Commission des valeurs mobilières de l'Ontario
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**IN THE MATTER OF THE *SECURITIES ACT***
**R.S.O. 1990, c. S.5, AS AMENDED**

**- and -**

**IN THE MATTER OF**
**PETER GEORGE LEE**

**HEARING HELD PURSUANT TO SECTION 127 OF THE ACT**

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**SETTLEMENT HEARING RE: PETER GEORGE LEE**

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| HEARING: | Thursday, July 3, 2008 | |
| PANEL: | Suresh Thakrar | - Commissioner and Chair of the Panel |
| | David L. Knight | - Commissioner |
| COUNSEL: | Cullen Price | - for Staff of the Ontario Securities Commission |
| | Cynthia Amsterdam | - for Peter George Lee |

**ORAL RULING AND REASONS**

The following text has been prepared for the purpose of publication in the Ontario Securities Commission Bulletin and is based on excerpts of the transcript of the hearing. The excerpts have been edited and supplemented and the text has been approved by the Chair of the Panel for the purpose of providing a public record of the decision.

**Chair:**

[1] This was a hearing under sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended, (the "Act") for the Ontario Securities Commission (the "Commission") to consider whether it is in the public interest to approve a proposed settlement agreement (the "Settlement Agreement") between Staff of the Commission ("Staff") and the respondent Peter George Lee ("Lee").

[2] We have considered Staff's written submissions and the oral submissions of Staff and Lee, and we have decided to approve the Settlement Agreement as being in the public interest.

[3] This case involves inaccurate and false public disclosure. Specifically, this settlement hearing is concerned with Lee's conduct as Chief Financial Officer ("CFO") of HIP Interactive Corporation ("HIP"), which was a reporting issuer from December 1999 until July 2005, when an interim receiver was appointed over its assets and affairs. Lee, a Chartered Accountant since 1985, held the position of CFO at HIP from September 2001 until May 2005.

[4] The relevant facts in this matter are set out in the Settlement Agreement. The key points are as follows:

(a) In July 2004, HIP's Director of Purchasing advised Lee that the inventory balance was overstated in the General Ledger ("GL") by approximately $1.3 million. The overstatement primarily related to inventory that did not actually exist being recorded by new malfunctioning software ("Virtual Inventory").

(b) At no time did Lee advise HIP's Chief Executive Officer, President, Board of Directors (the "Board"), Audit Committee or auditors about the $1.3 million overstatement in inventory, despite receiving questions from the Board with respect to the increasing inventory balance during a Board meeting on August 10, 2004.

(c) Lee did not instruct anyone to correct the GL balance as at June 30, 2004. Therefore, Lee was aware that the financial statements prepared for the first quarter, ended June 30, 2004, reflected the $1.3 million overstatement.

(d) During July 2004 an additional $700,000 of Virtual Inventory accumulated, bringing the total Virtual Inventory overstatement to $2 million. At Lee's instruction, the additional $700,000 of inventory was written off in July 2004.

(e) by September 30, 2004, the end of second quarter, the GL balance was still incorrect as a result of the continuing inventory overstatement.

(f) Lee had decided that the best course of action was to eliminate the $1.3 million inventory error in the biggest quarter, being Q3 2004, where no one would notice the correction. Lee believed that if they put through the adjustment of $1.3 million in a lump sum it would be noticed and this would create a significant negative impact on the company. He therefore instructed staff to make an adjustment in the third quarter over three months.

(g) In the course of conducting the audit of HIP's financial statements, the HIP auditors had set a materiality test for the relevant time at $125,000.

(h) By writing off the inventory in October, November and December, Lee hoped to conceal the inventory overstatement over three quarters. In doing so, he knew that the Q1 and Q2 financial statements of HIP, which had been released, were materially false.

[5] In the Settlement Agreement, Lee acknowledges that:

(a) as CFO, he certified to the Commission the accuracy of HIP's interim financial statements for HIP's first and second quarters of 2004;

(b) he was aware that the interim financial statements for both quarters were inaccurate due to an inventory overstatement of $1.3 million;

(c) he signed the Management Representation letter to HIP's auditors and in this letter represented that the interim financial statements were fairly stated, while he knew that the statements of June 30, 2004 were not because of the inventory overstatement;

(d) he made further representations, which in light of the $1.3 million overstatement, were untrue, including the representation that "there are no significant and unusual transactions that have occurred…" and "there are no significant deficiencies, including material weaknesses, in the design or operation of internal controls which could adversely affect the company's ability to record, process, summarize and report financial data"; and

(e) he did not advise the CEO, Board of Directors, Audit Committee or the auditors, and instead instructed HIP employees to write off the Virtual Inventory in order to conceal the inventory overstatement.

[6] In summary, as CFO, Lee became aware of a material inventory overstatement in July 2004. Instead of advising the Board of Directors or HIP's auditors, Lee orchestrated a scheme to conceal and write off the overstatement over successive quarters.

[7] During that time period, Lee falsely certified and filed with the Commission two Certificates of Interim Filings which represented HIP's interim financial statements as accurate when, in fact, they were not.

[8] In the Settlement Agreement, Lee has admitted that his conduct in deliberately certifying false Certificates of Interim Filing violated s. 122(1)(b) of the Act.

[9] By entering into the Settlement Agreement, Lee has recognized that his conduct was contrary to the public interest, and Lee has accepted sanctions including a 15-year restriction from being a director or an officer of any reporting issuer or registrant. This restriction is designed to ensure that Lee cannot have any leadership role or hold positions of significant responsibility with registrants or reporting issuers over the next fifteen years.

[10] The Commission's mandate in upholding the purposes of the Act, as set out in section 1.1 of the Act, is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in the capital markets.

[11] Further, in accordance with section 2.1 of the Act, the Commission is guided by certain fundamental principles in pursuing the purposes of the Act, including the "requirements for timely accurate and efficient disclosure of information", which is a cornerstone principle of securities regulation (*Re Phillip Services Corp*. (2006), 29 O.S.C.B. 3971), and the "requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants".

[12] The role of the Commission in exercising its public interest jurisdiction is set out in *Re Mithras Management Ltd*:

> […] the role of this Commission is to protect the public interest by removing from the capital markets – wholly or partially, permanently or temporarily, as the circumstances may warrant – those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts, particularly under section 118 of the Act. We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing we must, of necessity, look to past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be; we are not prescient, after all. (*Re Mithras Management Ltd*. (1990), 13 O.S.C.B. 1600 at pp. 1610-1611)

[13] We are also guided by the sanctioning factors established in *Re M.C.J.C. Holding and Michael Cowpland* (2002), 25 O.S.C.B. 1133 and *Re Belteco Holdings Inc*. (1998), 21 O.S.C.B. 7743, which include:

- the seriousness of the allegations;
- the respondent's experience in the marketplace;
- the level of the respondent's activity in the marketplace;
- whether or not there has been a recognition of the seriousness of the improprieties;
- the restraint of future conduct that is likely to be prejudicial to the public interest (with reference to past conduct);
- whether or not the sanctions imposed may serve to deter not only those involved in the case being considered, but any like-minded people from engaging in similar abuses of the capital markets;
- any mitigating factors;
- the size of any profit from the illegal conduct;
- the reputation and prestige of the respondent; and
- the remorse of the respondent.

[14] It was established in *Re Sohan Singh Koonar et al*. (2002), 25 O.S.C.B. 2691, that the role of the Panel in reviewing a settlement agreement is not to substitute its own sanctions for what is proposed in the settlement agreement. Instead, the Panel should ensure that the agreed sanctions in the settlement agreement are within acceptable parameters.

[15] This is what we as a Panel have done in approving this Settlement Agreement. Considering Lee's position as stated in the Settlement Agreement, we are of the view that the sanctions set out in the Settlement Agreement are within acceptable parameters.

[16] By entering into the Settlement Agreement, Lee has recognized the seriousness of his misconduct.

[17] Lee's deliberate act of certifying false Certificates of Interim Filing with the Commission is a serious violation of securities law, and it undermines the primary goals of the Commission to achieve investor protection and fostering of fair and efficient capital markets. Disclosing false information into the market place sends the wrong signal to investors and misleads the market as a whole and this endangers the efficiency of the capital markets and damages investor confidence.

[18] As CFO, Lee occupied a position of authority, responsibility and trust with the company. He was ultimately responsible for HIP's financial reporting obligations. He abused his position and engaged in conduct contrary to the public interest, and the Commission will not tolerate such deliberate violations of securities laws by officers and directors.

[19] In previous cases, the Commission has sanctioned officers and directors for the failure to provide accurate disclosure. In the present case, a 15-year prohibition against acting as a director or officer of any reporting issuer or registrant is an adequate and significant sanction for Lee. Such a restriction is designed to ensure that Lee cannot have any leadership role or significant responsibility with either registrants or reporting issuers for the next 15 years. We find that such a prohibition adequately protects the public and serves to deter Lee and like minded individuals from engaging in similar conduct in the future.

[20] We also find that payment of an administrative penalty of $13,000 and costs in the amount of $2,000 is appropriate in this case. By entering into the Settlement Agreement, Lee eliminated the need for a full hearing, which conserves the Commission's adjudicative resources.

[21] Lee has also been sanctioned by the Disciplinary Committee of the Institute of Chartered Accountants of Ontario (the "ICAO") for the conduct that is at issue in this settlement. The Disciplinary Committee ordered publicly that Lee be reprimanded, that he pay a fine of $15,000 and costs of $10,000, and that he be suspended from membership from the ICAO for 12 months. We note that Lee recognized the seriousness of his conduct and he self-reported his misconduct to the ICAO.

[22] We also take into account the following mitigating factors: (i) Lee did not profit from his misconduct; (ii) he showed remorse for his actions; and (iii) Lee co-operated with Staff and as such ought to receive credit for doing so pursuant to OSC Staff Notice 15-702.

[23] By entering into the Settlement Agreement, Lee has recognized that his conduct was contrary to the public interest and has accepted sanctions which include that he:

(a) be reprimanded;

(b) resign all positions that he holds as a director or officer of a reporting issuer;

(c) be prohibited from becoming or acting as a director or officer of any reporting issuer for a period of 15 years commencing on the date of the Commission's order;

(d) be prohibited from becoming or acting as a director or officer of any registrant for a period of 15 years commencing on the date of the Commission's order;

(e) pay an administrative penalty of $13,000; and

(f) pay the Commission's costs of the investigation and hearing in the amount of $2,000.

[24] In conclusion, we find that together, the all the sanctions imposed in this matter provide adequate specific and general deterrence. In particular, this settlement will have consequences to Lee's personal and professional reputation and financial status.

[25] We approve the Settlement Agreement as being in the public interest.

Approved by the Chair of the Panel on August 15, 2008.

*"Suresh Thakrar"*

Suresh Thakrar