

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

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

Background

1. Mark Edward Valentine is the Chairman and largest shareholder of Thomson Kernaghan & Co. Ltd. (“TK”) and resides in Toronto, Ontario. Valentine is a Registered Representative with the Investment Dealers’ Association, and a Director and the designated Trading Officer for TK. On June 13, 2002, TK suspended Valentine and banned him from its premises.
2. TK is a corporation incorporated pursuant to the laws of Ontario and is registered with the Investment Dealers’ Association as an Investment Dealer.
3. Valentine is the President, CEO, Director and shareholder of a private company VMH Management Ltd., the General Partner which manages Canadian Advantage Limited Partnership (“CALP”), a private fund. Advantage (Bermuda) Fund Ltd. (“CALP Offshore Fund”) is a mutual fund company incorporated under the laws of Bermuda and CALP’s corresponding offshore account.

4. Valentine is the President, Director and shareholder of a private company, VC Advantage Limited, the General Partner which manages VC Advantage Fund Limited Partnership (“VC Fund”), a private fund. VC’s corresponding offshore account is VC Advantage (Bermuda) Fund Ltd. (“VC Offshore Fund”).
5. Pursuant to written agreements, Valentine acting through his management companies was authorized to recommend, advise and enter into all investments on behalf of the funds and did so.
6. Valentine is the Registered Representative at TK for the funds, which are clients of TK. The majority of unitholders of the funds are other retail clients of TK.
7. Neither Valentine nor the management companies are registered with the Commission as Investment Counsel/Portfolio Manager.
8. Cameron Brett Chell is a known associate of Valentine. Chell is a shareholder and Chairman of the general partner for the VC fund, and owns and operates Chell Group Corporation. Among other things, Chell also co-founded Jawz Inc. (“JAWZ”), an internet-related company.
9. Chell was formerly a registered salesperson at McDermid St. Lawrence Securities Ltd. in Calgary, Alberta. In November 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.
10. Chell is not currently a registrant of either the Alberta or the Ontario Commissions.

TK's Investigation

11. 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 his own accounts and in other TK client accounts. At the time, the funds were not permitted to acquire further securities pursuant to amending agreements.
12. On May 7, 2002, TK's Management Committee requested an explanation from Valentine about the trading in the funds and commenced an internal investigation.
13. 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.
14. On June 19 2002, TK delivered its Investigation Report to the IDA which reported on its findings into the impugned transactions.
15. TK's investigation found that the propriety of certain transactions were "questionable"; there was "inadequate documentation" for other transactions; Valentine had failed to provide any documents to support still other transactions; and "the rationale was not supportable" for one entire series of the two sets of transactions.

16. On June 19, 2002 TK took the remedial step of reversing the transactions made by Valentine on March 28, 2002.

The March 28, 2002, Transactions

a) The Chell Transaction

17. By early spring, 2002, the firms of TK and Research Capital had entered into serious negotiations concerning a potential sale of the majority of TK's accounts to Research Capital except Valentine's accounts and those directly associated with him. The negotiations contemplated that Valentine and his associates would continue to operate under the TK name.
18. TK's Risk Adjusted Capital was an important element in the proposed sale. In order to facilitate the sale, TK had stipulated that after March 31, 2002, the profits and liabilities of Valentine's inventory account at TK would change from being split 50/50 between Valentine and his partners, to the sole liability of Valentine.
19. On March 28, 2002, Valentine's pro account received 1,060,000 shares of Chell Group Corporation from the CALP fund without any cash payment by Valentine. Valentine claimed that the shares were to settle the repayment of US \$1,060,000 supposedly owed by CALP to him personally.
20. Valentine's explanation for CALP's debt to him was that CALP borrowed US \$360,000 from him in July 2001, and another US \$700,000 in January 2002.
21. On March 28, 2002, after receiving the Chell shares from CALP, Valentine then made the following transactions:
 - a) Valentine sold 1,000,000 Chell shares for \$2 million to his inventory account;

- b) Valentine sold 375,000 Chell shares for \$750,000 from his inventory account to VC fund;
- c) Valentine sold 375,000 Chell shares for \$750,000 from his inventory account to VC Offshore fund;
- d) Valentine sold 250,000 Chell shares for \$500,000 from his inventory account to another TK retail client;
- e) Of the \$2 million proceeds in Valentine's pro account, Valentine transferred US \$450,000 (\$717,000) to his trader receivable account to reduce his receivables to TK;
- f) The VC funds sold 200,000 shares at \$2.09 on April 26, 2002;
- g) There was a purported oral put agreement between Valentine and the VC funds at \$2.20 to the extent of 250,000 shares per quarter commencing July 1, 2002. The put was supposedly to Valentine personally and guaranteed by his management companies, VMH and VC Advantage.

22. In its Report, TK found that the following discrepancies for the Chell transaction:

The results of the investigation have indicated that there is not adequate documentation to support the receivables allegedly owing from CALP to Valentine. The propriety of the advance of \$360,000 from Valentine to CALP is questionable. Further Valentine has not provided any documentary support for an advance of an additional \$700,000 to CALP on or before March 28, 2002.

23. TK reported that the impact of the Chell transactions affected TK's Risk Adjusted Capital 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).

24. After TK's reversal of the Chell series of transactions, TK reported that the margin requirement on Valentine's accounts increased to \$1,774,899, the amount owing in Valentine's trader receivable increased by \$717,000 (US \$450,000) and the net result in the funds' accounts was an excess margin of almost \$2 million.

b) The IKAR Transaction

25. Valentine is the Registered Representative for Hammock Group Ltd., an offshore company based in Bermuda. According to SEC public filings, Valentine is the controlling shareholder of Hammock.
26. On March 28, 2002, the CALP funds paid \$1.3 million to Hammock for a defunct debenture of an inactive company, IKAR Minerals. The 1998 debenture had expired in March, 2000.
27. At the May 7, 2002, TK Management Committee meeting, Valentine claimed that the rationale for the transaction was to settle a CALP debt owing to Hammock of \$1,582,830. Valentine explained that this debt had been incurred as follows:

- a) In July, 2001, Hammock paid CALP \$537,068 for 652,573 shares of JAWZ at \$0.823. JAWZ shares were then trading at \$0.59. Valentine explained this step as Hammock helping the funds meet their margin requirements at TK. In consideration for its help, the funds guaranteed the JAWZ investment by promising that any losses Hammock may suffer from an eventual sale of JAWZ would be covered by the funds;

- b) Over the next three weeks, Hammock sold the JAWZ shares at an average price of \$0.218 generating a loss of \$386,895.54 which Valentine claimed CALP owed pursuant to its “guarantee”;
- c) In a separate transaction, Valentine explained that CALP sold short 900,000 Global Path shares to Hammock at \$1.33 for supposed net proceeds of \$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) The funds were unable to deliver the Global Path shares and now were purportedly indebted to Hammock for total of \$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 a defunct 1998 IKAR \$1.3 million debenture which it gifted to Hammock, an offshore company of which Valentine is reported to be the controlling shareholder;
 - ii) Hammock in turn sold the expired debenture to CALP for \$1.3 million as payment for the “debt” which CALP owed to Hammock as described above in sub-paragraph 27 a) to d);
 - iii) Valentine offered the following explanation of how the defunct debenture supposedly had value to the funds: IKAR’s principal had recently promised Valentine to make up the \$1.3 million loss by converting the IKAR debenture into debentures of a new

company, Patriot Energy Corporation. This promise was purportedly given because Valentine personally made a \$250,000 private placement 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.

28. In its Report, TK found that “the rationale for the transaction was not supportable”. Specifically, TK found that:

- a) Hammock did not purchase JAWZ shares from CALP but from Valentine’s inventory account. Therefore CALP could not have guaranteed Hammock’s JAWZ investment, and correspondingly was not liable for Hammock’s \$386,330.70 loss in the JAWZ investment;
- b) CALP did not sell 900,000 Global Path to Hammock but rather sold 1,000,000 shares to Valentine’s inventory account. The price and net proceeds of this transaction was not \$1.33 and \$1,196,500, respectively as Valentine claimed, but rather \$0.65 and \$635,000;
- c) Therefore, TK found that the fund owed \$635,000, not \$1,196,500 as Valentine claimed, and these monies were owing to Valentine’s inventory account, not to Hammock;
- d) Hammock did not purchase 900,000 Global Path shares at \$1.33 from CALP as Valentine claimed but rather from Valentine’s inventory account, and the price and proceeds were not \$1.33 and \$1,196,500 respectively but rather \$1.05 and \$945,000;

- e) Therefore, TK found that Hammock was owed only \$945,000, not \$1,196,500 as Valentine claimed, and Valentine's inventory was liable, not the funds; and
- f) The IKAR debenture was not converted into Patriot Energy securities.

The IDA Investigation

- 29. Staff of the IDA are conducting an investigation into the affairs of Valentine, including the two March 28, 2002 series of transactions.
- 30. The IDA has not received satisfactory information to justify or support either the Chell or the IKAR transactions.

The "Death Spiral" Financing of Jawz Inc.

- 31. In or about mid-2000, Valentine, acting through his company VMH, caused the funds to enter into a financing transaction with Jawz Inc. Jawz is a company co-founded by Chell, a business associate of Valentine and a shareholder and the Chairman of VC Advantage, the general partner for the VC funds. Jawz traded on NASDAQ as JAWZ.
- 32. For its investment, the funds acquired floorless warrants to purchase shares of JAWZ whereby the funds could receive increasing numbers of JAWZ shares as the price declined. This type of financing creates a strong incentive for the holder funds to sell securities short in a relatively illiquid market, which is often referred to as "death spiral" or "toxic financing".
- 33. After Valentine caused the funds to acquire the warrants, TK's research department issued a "buy" recommendation for JAWZ in November, 2000. TK did not disclose to all its clients the fact that JAWZ had entered into this kind of financing, that the warrants

were held by another TK client, or that the Chairman of TK was the General Partner of the holder of the “death spiral” warrants.

C Me Run Corp

34. C Me Run is a company founded by Cameron Chell and quoted on the Over the Counter Bulletin Board in the United States as CMER.
35. Valentine was the Registered Representative for certain offshore accounts, including Ashland Resources which is based in Bermuda, the beneficial owner of which is unknown. Paul Lemmon of Bermuda has trading authority for the Ashland Resources account, who is the same individual at the same address with trading authority over the Hammock account, also an offshore company based in Bermuda. According to SEC filings, Valentine is the controlling shareholder of Hammock.
36. Staff has made a preliminary analysis of Valentine’s trades in C Me Run. In 2000, the funds were a net buyer of C Me Run shares and the other side of the trades was made by the offshore accounts, including Ashland Resources so that in 2000, Ashland was a net seller. The net effect of the funds’ numerous trades of C Me Run was a loss of almost \$4.5 million, while the net effect for Ashland Resources was a trading profit of almost \$6.4 million.

Valentine’s Breach of the Commission’s Temporary Cease Trade Order made July 8, 2002

37. On June 17, 2002, the Commission issued a Temporary Order in this matter pursuant to section 127(1) of 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*.

38. On June 24, 2002, Staff issued a Notice of Hearing and Statement of Allegations in this matter.
39. On July 8, 2002, the Commission issued a further Temporary Order in this matter pursuant to section 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 subsection 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) the respondent did not, either directly or indirectly, own more than one percent of the outstanding securities of the issuer.
40. 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, the respondent opened an account at Refco Futures (Canada) Ltd., in Toronto, Ontario and traded in futures contracts listed on the Chicago Mercantile Exchange.
41. On August 16, 2002, after it was publicly reported that Valentine had been arrested in Germany by the Federal Bureau of Investigation in the United States, 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

42. Valentine's conduct was contrary to the public interest for the reasons set out below.
43. Valentine created a culture of conflict and non-compliance at TK and breached Ontario Securities laws in respect of the Chell transaction by:
- a) Valentine played multiple roles as the General Partner of the funds, Registered Representative of the funds, Chairman and controlling shareholder of TK and on his personal behalf in his pro and inventory accounts at TK;
 - b) Valentine failed to deal fairly, honestly and in good faith with his clients when he put his own interests ahead of his clients, contrary to section 2.1(2) of OSC Rule 31-505, by:
 - i) transferring shares from client accounts into his pro account without supportable consideration;
 - ii) causing one client to transfer shares to himself at US \$1 and immediately thereafter selling those shares to his inventory account for \$2 (without a put agreement oral or otherwise);
 - iii) causing other clients to immediately buy those shares from his inventory account at US \$2;
 - iv) in the face of a purported oral put agreement at \$2.20 on July 1, 2002 in favour of his client guaranteed by his companies, causing that client to sell shares at \$2.09 on April 26, 2002.

v) orchestrating a transaction which had a substantial benefit to TK's Risk Adjusted Capital and his own accounts and corresponding detrimental effect to his clients' accounts;

vi) The effect of the Chell transaction caused:

- a margin requirement in his clients' accounts of \$434,000
- excess margin in his own accounts of \$1,412,189
- reduction in his trader receivables to TK of \$717,000.

d) Valentine conducted transactions which were not prudent business practices and which did not serve his clients adequately contrary to section 1.2 of OSC Rule 31-501 by:

i) purportedly entering into loans with his own clients;

ii) transferring shares from client's accounts into his pro account without supportable consideration;

iii) causing other clients to buy shares from himself purportedly pursuant to a put agreement not made in writing; and

iv) unnecessarily creating a margin requirement in his clients' accounts;

e) Neither Valentine nor the funds are registered as an Investment Counsel/Portfolio Manager, contrary to s. 199. 2 and 3 of Ont. Reg. 1015; and

- f) Valentine failed to maintain books and records necessary to record properly the business transactions and financial affairs which he carried out, contrary to s. 113.(1) of Ont. Reg. 1015.

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

- a) Valentine played multiple roles as the General Partner of the funds, Registered Representative of the funds, Chairman and controlling shareholder of TK, Registered Representative of another client Hammock, and controlling shareholder of Hammock;
- b) Valentine failed to deal fairly, honestly and in good faith with his client, contrary to section 1.2 of OSC Rule 31-501 by:
 - i) causing his client to guarantee an investment made by another client thereby placing one client's interest over another's;
 - ii) causing his client to guarantee an investment made by a company of which he is a controlling shareholder, thereby putting his own interests ahead of his client's;
 - iii) causing his client to short sell shares to his inventory account when he knew or ought to have known the shares were not deliverable thereby putting his own interests ahead of his clients;
 - iv) causing his client to pay valuable consideration for a worthless security to another client, thereby placing one client's interest over another's; and

- v) causing his client to pay valuable consideration for a worthless security to a company of which he is the controlling shareholder, thereby placing his own interest ahead his client's.
- c) Valentine carried out transactions that were not prudent business practices and did not serve his client adequately contrary to section 1.2 of OSC Rule 31-501 by:
- i) causing one client to guarantee an investment made by another client;
 - ii) causing his client to guarantee an investment made by a company of which he is the controlling shareholder;
 - iii) causing his client to sell short shares when he knew or ought to have that the securities would not be delivered;
 - iv) causing his client to give valuable consideration for a worthless security to another client; and
 - v) causing his client to give valuable consideration for a worthless security to a company of which he is the controlling shareholder.
- d) When, as Valentine claimed, CALP agreed to make up any losses suffered by Hammock between the purchase price Hammock paid to CALP for JAWZ and the eventual price on Hammock's disposition of JAWZ, Valentine made representations that CALP would refund Hammock all or any of the purchase price of a security contrary to s. 38(1) of the Act;

- e) Neither Valentine nor the funds are registered as an Investment Counsel/Portfolio Manager, contrary to s. 199. 2 and 3 of Ont. Reg. 1015; and
- f) Valentine failed to maintain books and records necessary to record properly the business transactions and financial affairs which he carried out, contrary to s. 113.(1) of Ont. Reg. 1015.

45. Valentine created a culture of conflict and non-compliance and breached Ontario Securities laws in respect of the JAWZ transaction in the following ways:

- a) Valentine filled multiple roles as the Registered Representative of the funds, President and shareholder of the funds' General Partner, and Chairman and controlling shareholder of TK;
- b) As a Registrant and as Chairman of TK, Valentine failed to deal fairly, honestly and in good faith with clients contrary to section 2.1 of OSC Rule 31-501 by:
 - i) motivating some TK clients to short sell JAWZ as a result of "death spiral financing" which he arranged, and motivating other TK clients to buy JAWZ 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 the Chairman of the TK was the General Partner for the holder of JAWZ' "death spiral financing".

- c) As a Registrant and as the Chairman of TK, Valentine engaged in business practices that were not prudent and did not serve clients adequately as set out above in sub-paragraphs 45 (b)(i) to (iv), contrary to section 1.2 of OSC Rule 31-505.

- 46. Valentine created a culture of conflict and non-compliance and breached Ontario securities laws in respect of the C Me Run transactions in the following ways:
 - a) Valentine filled multiple roles as the Registered Representative of the funds, President and shareholder of the funds' General Partner, and Chairman and controlling shareholder of TK, and Registered Representative of offshore accounts including Ashland Resources; and
 - b) As a Registrant and as Chairman of TK, Valentine failed to deal fairly, honestly and in good faith with clients contrary to section 2.1 of OSC Rule 31-501 by carrying out trading that placed one client's interest over another's.

- 47. Valentine acted contrary to the public interest and contravened Ontario securities law in that he breached the terms of the July 2002 Temporary Cease Order contrary to s. 122(1)(c) of the Act.

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

DATED at Toronto, this 7th day of January, 2003