



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 QUADREXX HEDGE CAPITAL MANAGEMENT LTD.,
QUADREXX SECURED ASSETS INC., MIKLOS NAGY and TONY SANFELICE**

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

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

I. Overview

1. During the period from July 2008 up to and including January 2013 (the “Material Time”), Quadrex Asset Management Inc. (“Quadrex”) traded in securities of Quadrex, Quadrex Secured Assets Inc. (“QSA”) and limited partnerships for which Quadrex Hedge Capital Management Ltd. (“QHCM”) was the general partner. During the Material Time, Miklos Nagy (“Nagy”) and Tony Sanfelice (“Sanfelice”) were the directing minds of Quadrex, QHCM (up to November 2009 in the case of Sanfelice) and of QSA (from its incorporation in June 2011).

2. During the Material Time, Quadrex was registered as a limited market dealer (“LMD”). Quadrex’s registration as an LMD was transitioned to exempt market dealer (“EMD”) with the coming into force of National Instrument 31-103 - *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“NI 31-103”) on September 28, 2009. Quadrex was also registered as investment counsel and portfolio manager, which category transitioned to portfolio manager (“PM”) on September 28, 2009. On January 12, 2011, Quadrex became registered as an investment fund manager (“IFM”).

3. Quadrex traded in securities in reliance on exemptions to the prospectus requirements under the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the “Act”).

4. In connection with the sale of securities, Nagy and Sanfelice along with QHCM and QSA (collectively the “Respondents”) and Quadrex directly or indirectly engaged or participated in acts, practices or courses of conduct relating to securities that the Respondents and Quadrex knew or reasonably ought to have known perpetrated a fraud on investors in breach of subsection 126.1(b) of the Act.

5. During the period October 31, 2012 to January 14, 2013, Quadrex breached subsections 12.1(1) and (2) of NI 31-103 by failing to notify the Commission as soon as possible that its excess working capital was less than zero and by allowing its excess working capital to continue to be below zero.

6. In addition, on or about December 1, 2008, while Quadrex was the PM for Diversified Assets Limited Partnership (“DALP”), Quadrex knowingly caused DALP to loan Quadrex \$170,000 in breach of subsection 118(2)(c) of the Act.

7. Quadrex also failed to deal fairly, honestly and in good faith with its clients in breach of subsection 2.1(1) of Rule 31-505 - *Conditions of Registration* (“OSC Rule 31-505”).

8. As officers and/or directors of Quadrex, QSA and QHCM, Sanfelice and Nagy authorized, permitted or acquiesced in the breaches of Ontario securities law by Quadrex, QSA and QHCM. In addition, during the Material Time, Sanfelice failed to meet his obligations as Chief Compliance Officer (“CCO”) of Quadrex and Nagy failed to meet his obligations as Ultimate Designated Person (“UDP”) of Quadrex (commencing in December 2009).

II. Background

(a) Quadrex

9. Quadrex was an asset management and investment firm that was incorporated in Canada on March 12, 2003.

10. Following a compliance review of Quadrexx by Staff of the Compliance and Registrant Regulation (“CRR”) Branch of the Commission, on June 20, 2012, Quadrexx, Nagy and Sanfelice provided Staff of the Commission (“Staff”) with an undertaking that all trading in the securities of Quadrexx would cease immediately and that Quadrexx, its employees and representatives would cease trading in all securities of Quadrexx immediately.

11. On January 14, 2013, Quadrexx notified Staff that Quadrexx was capital deficient.

12. By order of the Commission dated February 6, 2013, terms and conditions were placed on Quadrexx’s registration as EMD, PM and IFM and on February 18, 2013, Quadrexx’s registration as EMD was suspended. By Commission order dated May 15, 2013, Quadrexx’s registration as PM and IFM was suspended.

13. On June 18, 2013, Quadrexx filed an assignment under section 49 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B.3, as amended.

(b) The Respondents

14. Nagy has been an officer, director and a directing mind of Quadrexx since its incorporation on March 12, 2003. Nagy was the ultimate responsible person for Quadrexx from November 25, 2004 until September 28, 2009 and the designated compliance officer for Quadrexx from May 16, 2005 to September 28, 2009. Nagy was registered as the UDP of Quadrexx from December 18, 2009 to May 15, 2013. During the Material Time, Nagy was a Chartered Financial Analyst.

15. Sanfelice has been an officer, director and a directing mind of Quadrexx since its inception on March 12, 2003 to April 1, 2013. Sanfelice was registered as the CCO of Quadrexx for each of its registration categories from December 3, 2007 to May 15, 2013. During the Material Time, Sanfelice was a Certified Management Accountant and a Certified General Accountant.

16. QHCM was incorporated in Ontario on May 22, 2007 and acted as the general partner in respect of investment products that were structured as limited partnerships. Nagy has been an

officer, director and a directing mind of QHCM since its incorporation on May 22, 2007. Sanfelice was an officer, director and a directing mind of QHCM since its incorporation on May 22, 2007 to November 24, 2009.

17. QSA is a wholly-owned subsidiary of Quadrexx that was incorporated in Canada on June 15, 2011. During the period of June 15, 2011 to March 25, 2013, Nagy was an officer and director and Sanfelice was an officer of QSA. Nagy and Sanfelice were the directing minds of QSA from June 15, 2011 to March 25, 2013. QSA was established to provide investors with a return derived from an investment in a portfolio of U.S. residential mortgage-backed securities.

III. Fraudulent Conduct

(a) Valuation of Canadian Hedge Watch Inc. (“CHW”)

18. From July 2008 to May 2009, Quadrexx sold limited partnership units of DALP (“DALP Securities”) raising approximately \$5.65 million (the “DALP Distribution”). DALP was formed under the *Limited Partnerships Act*, R.S.O. 1990, c. L.16, as amended on June 13, 2008 and was an investment product set up to invest in at least one but not more than three private equity businesses. QHCM was the general partner and Quadrexx was the PM for DALP.

19. Two offering memoranda (“OMs”) were delivered to DALP investors in connection with the DALP Distribution, an OM dated June 16, 2008 (the “First DALP OM”) and an OM dated February 28, 2009 (the “Second DALP OM”) (collectively the “DALP OMs”). The DALP OMs contained statements regarding investments to be made by DALP in CHW, a company incorporated in Ontario on January 23, 2002 that was engaged in the business of providing hedge fund data, information, reports, editorial and news to the Canadian marketplace focussing exclusively on the Canadian hedge fund market.

20. At the time of the First DALP OM, CHW was primarily owned by Nagy (with an approximate 45% interest) and Sanfelice (with an approximate 30% interest) and Nagy and Sanfelice were the directing minds of CHW.

21. The First DALP OM advised investors that if DALP raised \$5,000,000 or more, DALP would initially acquire all of the issued and outstanding shares of CHW for a maximum price of \$2.65 million. The First DALP OM further provided:

“The Partnership intends to purchase CHW shares from its existing shareholders for a total price not to exceed \$2.65 million in total. Prior to June 30, 2009, the General Partner will engage a third party “business valuator” firm to value the fair market value of CHW. The price the Partnership pays for acquiring CHW (either fully or partially) may be adjusted downward should the valuation of CHW be less than \$2.65 million.” (p. 17)

22. The Second DALP OM stated:

“The Partnership is purchasing these CHW shares from its prior shareholders for a total price of \$2,535,688 in total. The General Partner has engaged a third party “business valuator” firm, to value the fair market value of CHW. The price the Partnership will pay for acquiring all of the issued and outstanding shares of CHW \$2,535,688 for a full purchase which is at the midpoint of the valuation determined by the valuator.” (p. 17)

23. On or about December 11, 2008, CHW, rather than QHCM, engaged Deloitte & Touche LLP (“Deloitte”) to perform “an estimate of the fair market value” on CHW. Although Deloitte made clear at that time that an estimate valuation provided a lower level of assurance than a comprehensive valuation and Deloitte offered to prepare a comprehensive valuation of CHW, CHW declined that offer.

24. On or about January 19, 2009, Deloitte communicated to Sanfelice that Deloitte’s estimate was well below \$2.65 million. Rather than proceed with a valuation from Deloitte and adjust CHW’s purchase price down as indicated in the First DALP OM, CHW retained a second valuator.

25. On or about February 10, 2009, CHW retained a second valuator, HJF Financial Inc. (“HJF”), a sole practitioner, to provide “an estimate of the fair market value” of CHW.

26. HJF was given a set of CHW forecasts which, when compared to those provided to Deloitte two months earlier, reflected higher Revenue and Earnings Before Interest, Taxes, Depreciation and Amortization (“EBITDA”) for CHW for each of the forecasted years.

27. The HJF report dated February 27, 2009 (the “HJF Report”) concluded that the estimated fair market value of CHW was between \$2,099,397 and \$2,971,978 with a midpoint of \$2,535,688. HJF made clear in the HJF Report that its conclusions were based on information received from CHW management and that HJF did not independently verify any of the information provided by CHW management.

28. None of the facts referred to at paragraphs 23 to 27 above were communicated to DALP investors.

29. Based on the estimate of fair market value contained in the HJF Report, Nagy and Sanfelice each received approximately \$1,223,000 and \$819,000 respectively, from the sale of their shares in CHW to DALP.

30. As a result of the above, Nagy, Sanfelice and QHCM directly or indirectly engaged or participated in an act, practice or course of conduct relating to DALP Securities that they knew or reasonably ought to have known perpetrated a fraud on DALP investors in breach of subsection 126.1(b) of the Act and contrary to the public interest.

(b) Use of Quadrex investor funds to pay dividends to Quadrex investors

31. From March 2011 to June 2012, Quadrex issued and sold preferred shares (“Quadrex Securities”) referred to as QAM Class II cumulative redeemable retractable convertible preference shares (“QAM II”), raising approximately \$4 million (the “QAM II Distribution”).

32. Two OMs were provided to investors in connection with the QAM II Distribution: an OM dated March 8, 2011 (the “First QAM II OM”) and an OM dated May 22, 2012 (the “Second QAM II OM”) (collectively the “QAM II OMs”).

33. Pursuant to the QAM II OMs, investors were advised that QAM II paid dividends in the amount of 12% of the initial issue price of \$1,000 per annum, paid at 6% on each of June 30 and December 31 of each year, commencing on June 30, 2011. In the event that Quadrex missed any dividend payments, the QAM II OMs indicated that these dividends would be due and

payable upon redemption or retraction, together with an additional dividend payment calculated at 0.5% per month for each month the cumulative dividend is in arrears.

34. The QAM II OMs advised investors under the heading “Use of Available Funds” that assuming a maximum offering of 7,000 QAM Class II shares, net proceeds of \$6,020,000 were intended to be applied in the priority of: up to \$4,894,116 for working capital, up to \$376,435 to repay a loan owed by Quadrexx to CHW and up to \$750,000 to purchase for cancellation up to 1 million Class I preferred shares.

35. The QAM II OMs advised investors that Quadrexx’s long term goal over the next 10 years was to establish itself as a medium sized EMD, private wealth and private equity firm with combined assets under management and administration of at least \$4,000,000,000. The QAM II OMs further advised investors under the heading “Short Term Objective and How We Intend to Achieve It” that Quadrexx required working capital of \$6,020,000 to meet its short term objective to:

“expand its distribution network through hiring of additional sales force and the acquisition of financial advisory business(es) (ideally with assets under management of between \$40,000,000 and \$100,000,000).” (p. 11)

36. According to the First QAM II OM, Quadrexx had experienced losses for the years ended 2008 and 2009 and for the nine month period ended September 30, 2010. However, according to the First QAM II OM, Quadrexx projected positive EBITDA of \$1,266,000 by the end of 2012 and of \$13,764,000 by the end of 2016.

37. During the period of July 1, 2011 to May 1, 2012, Quadrexx paid dividends to investors of approximately \$1.3 million using in whole or in part funds raised from the sale of QAM II. From July 1, 2011 to June 19, 2012, Quadrexx raised \$3,175,000 from QAM II investors without advising these investors that QAM II investor funds had been and/or would be used in whole or in part to pay dividends to Quadrexx investors.

38. As a result of the above, Nagy, Sanfelice and Quadrexx directly or indirectly engaged or participated in an act, practice or course of conduct relating to Quadrexx Securities that they

knew or reasonably ought to have known perpetrated a fraud on Quadrex investors in breach of subsection 126.1(b) of the Act and contrary to the public interest.

(c) Misappropriation of QSA investor funds

39. From August 2012 to December 2012, Quadrex sold units of QSA at a price of \$1,000 per unit (“QSA Securities”) raising \$470,660.30 (the “QSA Distribution”). Each unit consisted of 20 Class A shares (valued at \$100) and a promissory note in the principal amount of \$900 (collectively a “QSA Unit”).

40. Two OMs were provided to investors in connection with the QSA Distribution, an OM dated August 31, 2012 (the “First QSA OM”) and an OM dated November 30, 2012 (the “Second QSA OM”) (collectively the “QSA OMs”).

41. QSA made representations to investors in the QSA OMs that the funds raised by the QSA Distribution would be invested in U.S. residential mortgage backed securities.

42. Pursuant to the QSA OMs, 10% of the issue price of the QSA units was payable to Quadrex by QSA (equating to \$100 per unit) on account of selling commissions and another 4% of the issue price was payable to Quadrex by QSA (equating to \$40 per unit) to compensate Quadrex for the costs of establishing QSA, compensating some of the directors of QSA and marketing the offering of the units (the “4% Cost Recovery Clause”).

43. A know-your-product document given to Quadrex’s dealing representatives and a marketing brochure given to potential investors in connection with the QSA Distribution confirmed this fee structure.

44. However, from October 2012 to December 2012, in addition to paying itself 10% of the unit price on account of commissions, Quadrex paid itself \$187,749 from the proceeds raised by the QSA Distribution without following the 4% Cost Recovery Clause which resulted in Quadrex paying itself \$168,922 more than it was entitled to pursuant to the 4% Cost Recovery Clause.

45. As a result of the above, Nagy, Sanfelice, QSA and Quadrexx directly or indirectly engaged or participated in an act, practice or course of conduct relating to QSA Securities that they knew or reasonably ought to have known perpetrated a fraud on QSA investors in breach of subsection 126.1(b) of the Act and contrary to the public interest.

IV. Failure to maintain required working capital

46. Pursuant to subsections 12.1(1) and (2) of NI 31-103, Quadrexx was required to notify the Commission as soon as possible if its excess working capital was less than zero and Quadrexx's excess working capital could not be less than zero for two consecutive days.

47. As referred to above, commencing in October 2012, Quadrexx began inappropriately paying itself fees from the QSA Distribution over and above the fees to which it was entitled under the 4% Cost Recovery Clause. This excess cost recovery inflated Quadrexx's cash position. Had Quadrexx only taken the fees it was entitled to from QSA, Quadrexx's excess working capital would have been below zero by October 31, 2012. Quadrexx did not notify the Commission that its excess working capital was less than zero until January 14, 2013.

48. As a result of the above, during the period October 31, 2012 to January 14, 2013, Quadrexx was in breach of subsections 12.1(1) and (2) of NI 31-103 which conduct was also contrary to the public interest.

V. Prohibited loan from DALP to Quadrexx

49. On December 1, 2008, Quadrexx transferred \$200,000 from DALP's bank account to CHW's bank account. On the same day, CHW transferred \$170,000 to Quadrexx. Quadrexx recorded this transfer in its accounting records as a loan from CHW. Based on CHW's bank balance on December 1, 2008, CHW would not have been in a position to loan the \$170,000 to Quadrexx without the receipt of the \$200,000 from DALP that day. The substance of these transactions was that Quadrexx, the PM for DALP, knowingly caused DALP to loan Quadrexx \$170,000, in breach of subsection 118(2)(c) of the Act (that was in force in 2008) and contrary to the public interest.

VI. Failure by Quadrexx to deal fairly, honestly and in good faith with its clients

50. Quadrexx sold DALP Securities, Quadrexx Securities and QSA Securities with knowledge of the facts referred to at paragraphs 23 to 27, 37 and 44 above and without disclosing those facts to investors. As a result, Quadrexx, as a registrant, failed to deal fairly, honestly and in good faith with its clients in breach of subsection 2.1(1) of OSC Rule 31-505.

VII. Failure by Nagy and Sanfelice to fulfill responsibilities as UDP and CCO of Quadrexx and liability as officers and directors

51. Nagy was the UDP of Quadrexx from December 18, 2009 to May 15, 2013. As Quadrexx's UDP, pursuant to section 5.1 of NI 31-103, Nagy had an obligation to supervise the activities of Quadrexx that were directed towards ensuring compliance with securities legislation by Quadrexx and individuals acting on its behalf and to promote compliance by Quadrexx and the individuals acting on its behalf, with securities legislation.

52. As a result of the conduct referred to above, during the period December 18, 2009 to January 14, 2013, Nagy breached his obligations as UDP of Quadrexx pursuant to section 5.1 of NI 31-103 and also acted contrary to the public interest.

53. Sanfelice was the CCO of Quadrexx from December 3, 2007 to May 15, 2013. As Quadrexx's CCO, pursuant to subsection 1.3(1) of OSC Rule 31-505 before September 28, 2009 and on and after September 28, 2009, pursuant to section 5.2 of NI 31-103, Sanfelice had monitoring and reporting obligations in connection with assessing and ensuring Quadrexx's compliance with securities legislation.

54. As a result of the conduct referred to above, Sanfelice breached his obligations as the CCO of Quadrexx pursuant to subsection 1.3(1) of OSC Rule 31-505 from July 2008 to September 27, 2009 and pursuant to section 5.2 of NI 31-103 from September 28, 2009 to January 14, 2013 and also acted contrary to the public interest.

55. In addition, as officers and/or directors of Quadrexx, QSA and QHCM, Sanfelice and Nagy authorized, permitted or acquiesced in the breaches of Ontario securities law by Quadrexx,

QSA and QHCM referred to above and, pursuant to section 129.2 of the Act, are deemed to have also not complied with Ontario securities law.

VIII. Breaches of Ontario Securities Law and Conduct Contrary to the Public Interest

56. The specific allegations made by Staff are:

- a. Nagy, Sanfelice and QHCM directly or indirectly engaged or participated in an act, practice or course of conduct relating to DALP Securities that they knew or reasonably ought to have known perpetrated a fraud on DALP investors in breach of subsection 126.1(b) of the Act and contrary to the public interest;
- b. Nagy, Sanfelice and Quadrex directly or indirectly engaged or participated in an act, practice or course of conduct relating to Quadrex Securities that they knew or reasonably ought to have known perpetrated a fraud on Quadrex investors in breach of subsection 126.1(b) of the Act and contrary to the public interest;
- c. Nagy, Sanfelice, Quadrex and QSA directly or indirectly engaged or participated in an act, practice or course of conduct relating to QSA Securities that they knew or reasonably ought to have known perpetrated a fraud on QSA investors in breach of subsection 126.1(b) of the Act and contrary to the public interest;
- d. Quadrex failed to notify the Commission as soon as possible that its excess working capital was less than zero and Quadrex's excess working capital was less than zero for two consecutive days in breach of subsections 12.1(1) and (2) of NI 31-103 and contrary to the public interest;
- e. Quadrex knowingly caused an investment portfolio managed by it to make a loan to Quadrex contrary to subsection 118(2)(c) of the Act (that was in force in 2008) and contrary to the public interest;
- f. Quadrex failed to deal fairly, honestly and in good faith with its clients in breach of subsection 2.1(1) of OSC Rule 31-505;

- g. Nagy and Sanfelice, as officers and directors of Quadrexx, authorized, permitted or acquiesced in the breaches by Quadrexx of subsection 126.1(b) of the Act, subsections 12.1(1) and (2) of NI 31-103, subsection 118(2)(c) of the Act that was in force in 2008 and subsection 2.1(1) of OSC Rule 31-505, and thereby, Nagy and Sanfelice are deemed to have breached subsection 126.1(b) of the Act, subsections 12.1(1) and (2) of NI 31-103, subsection 118(2)(c) of the Act that was in force in 2008 and subsection 2.1(1) of OSC Rule 31-505 pursuant to section 129.2 of the Act;
- h. Nagy and Sanfelice, as officers and directors of QHCM, authorized, permitted or acquiesced in the breach by QHCM of subsection 126.1(b) of the Act and thereby Nagy and Sanfelice are deemed to have breached subsection 126.1(b) of the Act pursuant to section 129.2 of the Act;
- i. Nagy and Sanfelice, as officers and directors of QSA, authorized, permitted or acquiesced in the breach by QSA of subsection 126.1(b) of the Act and thereby Nagy and Sanfelice are deemed to have breached subsection 126.1(b) of the Act pursuant to section 129.2 of the Act;
- j. Sanfelice breached his obligations as CCO of Quadrexx contrary to subsection 1.3(1) of OSC Rule 31-505 and, on and after September 28, 2009 contrary to section 5.2 of NI 31-103 and contrary to the public interest; and
- k. Nagy breached his obligations as UDP of Quadrexx contrary to section 5.1 of NI 31-103 and contrary to the public interest.

57. Staff reserves the right to make such other allegations as Staff may advise and the Commission may permit.

Dated at Toronto this 30th day of January, 2014