SECURITIES LITIGATION 2015

The Defence of Criminal Securities Enforcement Proceedings

Presented by:
David J. Martin
Martin + Associates
863 Hamilton Street
Vancouver, BC V6B 2R7

For: CLE, British Columbia, September 15, 2015

I. The Basics

A. Primary B.C. Securities Act (the Act) Offences

Section 155(1)(b) of the Act creates a variety of offences which are prosecutable in the Provincial Court pursuant to the Offence Act and that upon conviction are punishable, by virtue of s. 155(2), by a fine of not more than $3M or to imprisonment for not more than 3 years, or both. These offences include:

1. Trading or acting without Registration (s. 34)
2. Residential Solicitation (s. 49)
3. Prohibited Representations (s. 50 – 56)
4. Participating in Manipulation or Fraud (s. 57)
5. Insider Trading, Tipping and Recommending (s. 57.2)
6. Front running (s. 57.3)
7. Obstruction of Justice (s. 57.5)
8. Failure to Comply with Undertaking (s. 57.6)
9. Unauthorized trading in an exchange contract (2. 58-59)
10. Distributing without Prospectus (s. 61)
11. Failure to provide disclosure of a material change (s. 85(b)
12. Failure to file initial and subsequent insider reports (s. 87)
13. Failure of Investment manager to discharge duties honestly (s. 125)
14. Breach of Commission non-disclosure order (s. 148)
15. Making of false or misleading statement in evidence or records given under the Act (s. 168.1)

B. Primary Criminal Code Offences

The Criminal Code of Canada also creates a variety of offences punishable by prescribed fines and terms of imprisonment. In addition, Code s. 380(1.1) now creates a 2 year mandatory minimum sentence for fraud over $1M, s. 280.1(1)(a), (c1), (e) and (f) describe additional statutory aggravating factors impacting sentence, s. 380.2 permits a potential prohibition against asset management and s. 380.3 permits the making of restitution orders under s. 738 or 739. Criminal Code offences include:

1. Breach of Trust by Public Officer (s. 122)
2. False Pretences or False Statements (s. 361, 362)
3. Fraud by deceit, falsehood or other fraudulent means (s. 380(1))
4. Making of a False Entry (s. 397(1))
5. Fraudulent Manipulation of Stock Exchange Transaction (s. 382)
6. Insider Trading (s. 382.1)
7. Gaming without bona fide intention to complete (s. 383)
8. Short Sales Against Margin Accounts (s. 384)
9. False Prospectus (s. 400)
10. Conspiracy to Commit any of the above (s. 465)

C. Primary "Additional" and "Incidental" Federal Securities Market Related Offence Provisions

1. Forgery and Making a False Document (Code s. 366)
2. Trafficking or Possession of a False Document (Code s. 368)
3. Laundering Proceeds of Crime (Code s. 462.31)
4. Falsification of Books and Records (Code s. 397)
5. Bribery of Public Officials (Code s. 119-120)
6. Foreign Corrupt Practices (FCPA s. 3(2)
7. False and Misleading Representations (Competition Act s. 52(1)
8. Deceptive Telemarketing (Competition Act s. 52.1(3))
9. Pyramid Selling (Competition Act s. 55 and 55.1)
10. Destruction or Alteration of Records (Competition Act s. 65(3))
11. Tax Evasion (ITA s. 239)
12. Bankruptcy Related Offences (BIA s. 199, 200, 201(3)
13. Constructive Directors and Officers Liability (various statutes)

D. The Defence of Alleged Securities Offences

1. Procedural Defences

Of course, once a criminal prosecution is undertaken experienced white collar criminal defence counsel will pursue the traditional panoply of procedural and Charter defences, the availability of which will be defined by the manner by which the alleged offence has been identified, investigated and is prosecuted. The defence may be presented with a series of opportunities arising from the inherent complexity of the prosecution as well as the *Jarvis* and *Branch* based constraints discussed *infra*.

2. Common Law Substantive Defences to Securities Act Offences

(a) Lack of Knowledge – Reasonable Mistake of Fact
(b) Due Diligence
(c) Corporate Actor not Directing Mind
(d) Corporate Actor acting outside of the scope of duties
(e) Business Judgment

3. Common Law Substantive Defences to Criminal Code Offences:

(a) Lack of mens rea
(b) Legitimate Market Making
(c) Non Material Information

4. Statutory Defences

Although many of the Securities Act and Criminal Code offence provisions contain specific exemptions and exclusions the s. 57.2 Securities Act offence of insider trading is subject to the elaborately designed statutory defences set out in s. 57.4. Many of those defences are well described in the Alberta Court of Appeal's decision in *Walton v. Alberta* [2014] ABCA s. 273 and are also thoroughly canvassed in the OSC's decision March 24, 2015 *In the Matter of Azeff, Bobrow, Finkelstein, Miller and Cheng (Finkelstein*). The circumstances in which an indirect tippee will be subject to liability for acting upon material non public information (MNPI) derived from persons in a special relationship will continue to occupy the Courts.

In particular, the factors that will influence whether a tippee "ought reasonably to have known" that the MNPI came from a person in a special relationship are set out in Finkelstein at para. 64, and whether or not conduct is contrary to the "public interest" (the Securities Act analog to the general anti-avoidance rule contained in s. 245 of the ITA) is analyzed at para. 66 and 67. The bottom line is that the defence of every criminal allegation of insider trading will involve a nuanced analysis of complex circumstantial evidence inferences that will necessarily be assessed in the context of evolving publically available market information and dynamics.

E. Criminal Enforcement Statistics

The Canadian Securities Administrators (CSA) 2014 Enforcement Report confirms that in that year there were 4,394 reporting issuers operating in Canada with a market capitalization of $2.58T. The CSA further reports that in 2014 a total of 105 enforcement proceedings were undertaken in Canada (involving, in aggregate, 189 individuals and 92 companies), down slightly from 112 proceedings in 2013 and 145 proceedings in 2012. In 2014 there were 127 (both individual and corporate) illegal distribution, 81 fraud and 23 market manipulation proceedings commenced. Unfortunately, the CSA Report does not appear to break out the statistics related to criminal prosecutions from administrative enforcement proceedings.

Fines and administrative penalties imposed in 2014 totalled $58M and restitution, compensation and disgorgement orders totalled $65M.

II. Issues in Concurrent Criminal and Securities Investigations

In May, 2013 the OSC established its Joint Serious Offence Team (JSOT) as an enforcement partnership between the OSC, the RCMP and the OPP. In 2009 the BCSC created the Criminal Investigations Team (CIT) which investigates criminal misconduct and refers cases to Provincial Crown Counsel for prosecution. The BC CIT has now adopted a policy of prosecuting every case where the public interest criteria is met pursuant to an Enforcement Plan developed following Case Assessment. BCSC enforcement priorities include unregistered foreign financial institutions trading for BC residents, brokers concealing insider trading, market toutes and nominees concealing insider trading. Notable administrative proceedings in 2014 included enforcement actions against Bank Gutenberg AG and Gibralter Global Securities Inc. Criminal proceedings in 2014 included the relatively minor charges laid against defendants Kelly, Beiklik and Fiedler.

Issues arise when the Enforcement Division seeks to tender evidence in a criminal proceedings gathered by means of non-Charter compliant statutory document production and compulsion processes designed to support administrative proceedings. The management of this clash of processes and purposes has been comprehensively addressed in the context of the Income Tax Act in *R. v. Jarvis* [2002] 3 SCR 575 which ruling was applied in the Securities Act context in *R. v. Lan*den [2007] O.J. No. 4445 (applied in *R. v. Maitland Capital* [2010] OJ No. 5744). In *Landen*, Shamai J. of the Ontario Court of Justice articulates a "modified Jarvis" test that adopts the *Jarvis* criteria and applies it in the securities context to assess whether and when securities investigators have crossed the rubicon into an investigation with a predominantly criminal investigative purpose and thereafter must adopt Charter compliant investigative tools. No doubt both the Ontario JSOT and the BC CIT will attempt to manage their investigative methods accordingly. In turn, no doubt, similar considerations will animate the decision as to whether or not to compel any person of interest so as not to trigger the use and derivative use immunity rules imbedded in *BCSC v. Branch* [1995] 2 SCR 3.

III. Current Issues

A. Defending Against Circumstantial Evidence in Insider Trading Cases.

(1) Proper Inference vs. Improper Speculation

The *Walton* Court described the issue this way:

> [27] The Commission concluded:
>
> [463] To summarize, when drawing an inference from circumstantial evidence, we must ensure that the inference is grounded on proved, not hypothetical or assumed facts and is a reasonable one – one drawn using common sense, human experience and logic having considered the totality of the evidence and any competing inferences…
>
> As noted, where the inference drawn is available on the record, the standard of review is deferential.
>
> [28] The process of drawing inferences from facts established by the evidence is not without limits. As was said in R. v. Cavanagh, 2013 ONSC 5757 (CanLII) at para. 74: "… there comes a time when the underlying facts may be so remote that there are just too many steps or leaps in the chain of reasoning to say that a particular inference can be reasonably drawn". As is discussed infra, paras. 3-4, proof of opportunity or motive is of limited value in drawing inferences. Phraseology in the reasons such as "it would not have been unreasonable", "could be" or "might have" cause concern, as they are more indicative of speculation than inferences. The syllogism "it would not have been unreasonable", with its double negative, particularly invites speculation, or a reversal of the burden of proof, or both. It is one thing to reason: "Where there is smoke, there is likely fire' but quite another thing to reason: "There was no smoke, but it would not have been unreasonable for there to be smoke, therefore there might have been fire as well".

At paragraph 45 and 46 of *Finkelstein* the Commission said

> [45] A variety of types of circumstantial evidence can be the indicia of insider trading or tipping: (a) unusual trading patterns; (b) a timely transaction in a stock shortly before a significant public announcement; (c) a first time purchase of the stock; 7 (d) an abnormal concentration of trading by one brokerage firm or with one or a few brokers; and (e) a trade that represents a very significant percentage of the particular portfolio.
>
> [46] Motive and intent can also be weighed as facts when drawing inferences whether it is more probable than not that the alleged offences occurred.

(2) The Limited Significance of Motive and Opportunity

The role of motive and opportunity was explained at paras 31 to 34 of *Walton* as follows:

> [31] The Commission noted that Holtby knew many of the other respondents, and that some of the respondents were known to others. It also noted that there had been social events, meetings or communications between them during the relevant period of time. This evidence, at most, indicated "opportunity". Opportunity to commit an offence is mostly relevant in a negative sense; if a respondent can prove that there was no opportunity, that is compelling evidence that an offence never occurred. For example, if a respondent can prove that he never knew Holtby, or had no communications with Holtby during the relevant period, an offence of tipping or encouraging could not have been committed. Opportunity, however, has limited positive probative value. Evidence of opportunity, by itself, cannot realistically prove anything more than opportunity. Evidence of multiple meetings and communications during the relevant period does not change that; opportunity is still no more than opportunity.
>
> [32] Similar comments can be made about "motive". The Commission found that several of the respondents might have a motive to confer a benefit on others. For example, Holtby would have a motive to benefit his brother Dale. Richard Kowalchuk might have a motive to benefit his brother Randy. Dale Holtby might have a motive to benefit his daughter Tracy Kaufman. Again, motive is mostly relevant in a negative sense. If someone had no motive to confer a benefit on another person, that would make an inference of tipping or encouraging less compelling. However, as the Commission noted (reasons, para. 464), the mere presence of a possible motive proves little. That is particularly so when the motive is not specific (for example, a discrete benefit in return for a specific favour granted), but rather is general (for example, the presumed generic motive to benefit one's friends and family).

[33] Evidence of motive and opportunity generally go to identity, not to whether an offence was committed. For example, if a person dies, and a suspect had the opportunity and motive to kill him, that might be probative evidence of identity. It is not, without more, evidence of murder unless there is some indication that the death was other than accidental or natural. As the Court held in *R. v Khan* (1998), 129 Man R (2d) 32 at paras. 78-82, 113, 126 CCC (3d) 353 (CA):

78 . . . Standing by itself, however, motive neither proves nor permits an inference to be drawn that the relative was murdered. . . .

82 . . . without proof of other probative and significant facts establishing the commission of a crime, motive by Itself is not a proper basis for a conviction . . .

Opportunity and motive can have probative value, so long as there is proof that some offence has actually been committed.

[34] In these appeals there is evidence that the appellants had the "opportunity" to receive information about the material fact. There is also evidence of relationships which might support a general motive to be benevolent to others, without any specific proof of any specific motive being in play. There were admittedly trades in the shares of Eveready during the relevant period. The inference that those trades must have resulted from knowledge of the material fact, merely because of opportunity and general motive, is weak.

(3) Generalized Positive Comments vs, Prohibited Recommendation

The nuance of the analysis often required is illustrated by the *Walton* Court's discussion of prohibited recommendation, at para. 51

> [51] Just because a person in a special relationship with the issuer says something positive about the issuer would not necessarily amount to recommending or encouraging. That would be so even if the comment piqued the interest of the recipient of the information, or caused him to make further inquiries, or to purchase the security. The concept of "recommending or encouraging" must involve the conveying of opinions or information intending or knowing that it is likely that the recipient will act on that information in some way.

Thus the defence of any criminal securities insider trading case will often require robust responses to allegedly reasonable inferences arising from circumstantial evidence. Competing inferences must be supported by evidence once the legitimate inferences are separated from the chaff of speculation.

B. The CMSA

Our luncheon speaker, Professor MacIntosh, will address how the proposed federal Capital Markets Stability Act (CMSA) will change all that has been described above. Certainly the collapse of many provisions of the Criminal Code into sections 62 to 80 of Part 5 of the CMSA is very significant. The establishment of the National Authority and its accountability to the Council of Ministers obviously entails the potential for the politicization of the policy approaches to be taken by the Authority and the Chief Regulator, notwithstanding intermediation by the Board of Directors. Although there will be Deputy Chief Regulators, as one of the legislative purposes of the CMSA system is to provide "more effective enforcement", it may reasonably be expected that criminal prosecutions will become more prevalent.

C. Wiretapping Powers

The OSC has strongly recommended that its JSOT be given authority to obtain wiretap authorizations to pursue insider trading investigations. With only a limited number of insider trading criminal prosecutions against corporations and individuals, and a generally declining number of enforcement proceedings generally, it is more than arguable that the case for this change has not been made out in light of the massive violation of privacy that the legislative approval of such an approach would entail.

D. International Transfer of Evidence

Tamara Duncan and others will address the question of the interjurisdictional transfer of evidence in detail after lunch but it must be noted that the Ontario Court of Appeal misread the ratio of the SCC's decision in *USA v. Wakeling* [2014] 3 S.C.R. 549 in its decision last week in *USA v. Mathurin* [2015] ONCA 581. The full ambit of the protection embedded in Charter s. 7 and 8 in the context of the transfer of evidence which is self incriminating or which is subject to a continuing expectation of privacy has yet to be determined.

IV. Ethical Issues

A. Counsel must ensure that full production of documents is made by a client subject to an Act s. 144 summons.

B. The broad scope of the obstruction of justice provisions of s. 57.5 of the Act must be carefully considered and adhered to by all defence counsel.

C. Carefully crafted non-disclosure orders made by the Commission pursuant to the Act s. 148 must be scrupulously complied with. And note that presumptive gagging provisions still exist in other provinces (eg. Alberta Securities Act s. 45) and will continue to apply in these provinces notwithstanding that they may be inconsistent with *Shapray v. BCSC* [2009] BCCA 322.

D. All clients must be promptly and fully briefed with respect to the anti-retaliation provisions of Code s. 25.1 (repeated in proposed CMSA s. 73).

DJM
September 1, 2015