Goodmans LLP Update

Corporate Securities Law

March 27, 2015

OSC Releases Decision in Tipping and Insider Trading Case

On March 25, 2015, the Ontario Securities Commission (OSC) released its decision in the closely watched administrative proceedings against a number of individuals including Mitchell Finkelstein, former partner of a downtown Toronto law firm, for contravening the tipping and insider trading prohibitions of the Ontario *Securities Act*. Notably, the decision represents a successful action for tipping and insider trading based almost entirely on circumstantial evidence. Historically, Canadian securities regulators have had limited success pursuing allegations of tipping and insider trading due to the lack of direct evidence of wrongdoing. The decision is a significant victory for staff of the OSC and may embolden Canadian securities regulators in pursuing future tipping and insider trading actions with the decision serving as a template for such actions. The decision also serves as a reminder to the "gatekeepers" of the public markets – including lawyers, accountants, investment bankers, officers and directors – of the importance of maintaining the confidentiality of material non-public information and the seriousness with which Canadian securities regulators will treat violations of the tipping and insider trading prohibitions.

Background

OSC staff alleged that on six separate M&A transactions between November 2004 and August 2007, Finkelstein tipped his friend, Paul Azeff, an investment advisor, about impending take-over bids in which Finkelstein or his law firm were involved. It was alleged that Azeff then passed the information on to his partner, Korin Bobrow, and that Azeff and Bobrow also passed the information on to investment advisers Howard Miller and Francis Cheng (together with Messrs. Finkelstein, Azeff and Bobrow, the "**Respondents**"). OSC staff alleged that Azeff, Bobrow, Miller and Cheng purchased large volumes of shares in the target companies for themselves, their family members and their clients based on the non-public information Finkelstein provided to Azeff. OSC staff based its case on, among other things, a pattern of telephone calls between Finkelstein and Azeff and the close temporal proximity of such calls to purchases of large volumes of the target companies' shares by Azeff, Bobrow, Miller and Cheng. As the proceedings were administrative as opposed to criminal, the OSC staff had to prove the allegations on a balance of probabilities and not on the stricter criminal standard of beyond a reasonable doubt.

The OSC Decision

The OSC held that since it was an administrative tribunal and not a criminal court, it was entitled to consider circumstantial and indirect evidence, and use such evidence to draw inferences. The OSC identified a variety of types of circumstantial evidence that may be indicia of insider trading or tipping including: (i) unusual trading patterns; (ii) the proximity of trading activity to a significant public announcement; (iii) a first time purchase of a security; (iv) abnormal concentration of trading by one brokerage firm or with one or a few brokers; and (v) the relative size of a trade compared to the particular portfolio. The OSC commented "Insider trading and tipping cases are established by a mosaic of circumstantial evidence which, when considered as a whole, leads to the inference that it is more likely than not that the trader, tipper or tippee possessed or communicated material non-public information."

The OSC concluded that Finkelstein, Azeff and Bobrow had contravened the tipping and insider trading prohibitions with regard to three of the six

transactions in question, and Miller and Cheng with regard to one of the six transactions. In reaching its decision, the OSC panel placed significant weight on the fact that high volumes of stock in the target companies were rapidly acquired following phone calls between certain of the Respondents without the Respondents having (i) any recent history of trading in the securities of the issuers, (ii) conducted material research on the issuers, or (iii) evidence of rumors in the marketplace that the issuers were take-over targets.

Notably, Miller and Cheng were found to have breached the insider trading prohibitions for one of the six transactions despite the panel's finding that they did not actually know the information they received came from a knowledgeable person in a special relationship with the issuer in question. The OSC held that Miller and Cheng were people in a special relationship with the issuer on the basis that they *ought reasonably to have known* that the information they received came from someone in a special relationship with the issuer based on the following factors, among others:

- the sophistication of both Miller and the person from whom Miller received the information;
- the specificity and detail of the information Miller received;
- neither Miller nor Cheng had researched the target issuer or conducted any due diligence and, within a very short period of time, bought a significant number of shares;
- Cheng learned of the information from Miller, who was his mentor and supervisor; and
- an email from Cheng underscoring his belief in the reliability of the information that Miller gave him.

Sanction Hearing

The hearing with respect to sanctions and costs is currently scheduled for May 21, 2015. Possible sanctions include administrative penalties of up to $1 million per contravention of Ontario securities law, bans on serving as directors or officers and bans on trading in securities. The OSC can also require the disgorgement of any profits earned by the parties as a result of their contraventions of Ontario securities law.

Please contact any member of our Corporate Securities Group to discuss the implications of the Decision.

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