

Business

Appeal Court ruling gives 'very clear direction' on insider tipping, trading cases, experts say

By Ian Burns

(February 2, 2018, 1:30 PM EST) -- The Ontario Court of Appeal has released a decision that clarifies certain provisions of the provincial *Securities Act* for the first time, with observers saying the ruling offers a good roadmap for determining responsibility in insider trading and tipping cases.

The decision in *Finkelstein v. Ontario Securities Commission* 2018 ONCA 61, released Jan. 25, stems from proceedings the Ontario Securities Commission (OSC) initiated against five people, alleging they had breached the Act's insider trading and tipping provisions and had acted contrary to the public interest by recommending to family and clients the purchase of shares in Masonite International Corporation.

According to the OSC, Toronto lawyer Mitchell Finkelstein was working on a takeover bid involving Masonite, and informed Montreal-based investment adviser Paul Azeff about certain material facts of the bid. Azeff then spoke to a Montreal accountant, identified only as L.K., who passed on the information to Toronto investment adviser Howard Miller. Miller then conveyed the information to his colleague Francis Cheng.

All five individuals appealed the OSC's decision to the Superior Court of Justice. In *Finkelstein et al. v. Ontario Securities Commission* 2016 ONSC 7508, the court overturned the OSC's finding on Cheng, which the commission appealed. Miller sought and obtained leave to appeal the lower court's decision.

The Court of Appeal noted the case required it to consider for the first time the interpretation and application of part of the insider trading and tipping scheme in the Act, specifically the definition of a "person in a special relationship with an issuer" found in s. 76(5)(e). At issue on the appeal was the OSC panel's finding that Miller and Cheng, as recipients or "tippees" of the information, ought reasonably to have known that their respective tippers stood in a special relationship with Masonite.

Justice David Brown, who wrote the decision, said the "knows or ought reasonably to have known" requirement in s. 76(5)(e) focuses on the state of the tippee's knowledge about whether the information was conveyed to him by a person in a special relationship with an issuer, such as a director or officer in a company, or a person engaged in any professional or professional activity with the issuer such as a lawyer.

"But s. 76(5)(e) extends the chain of potential liability further by including as a proscribed source of information ... a person whom the tippee knows or ought reasonably to have known was a person or company in a special relationship with the issuer," he said. "This provision catches tippees who, themselves, convey information they have received to others."

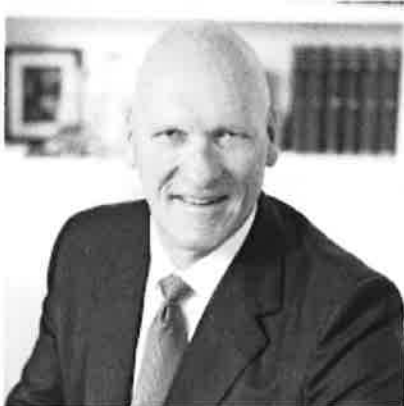
The absence of any independent verification may suggest a belief by the tippee that the information originated with a person in a special relationship, said Justice Brown. He noted such an inference becomes even stronger in the case of tippees who are market registrants.

"The OSC repeatedly has stated market registrants are well aware of the seriousness with which Canadian securities regulators view illegal tipping and illegal insider trading," he said. "As the panel properly stated, a higher standard of vigilance and inquiry must be expected from a registrant than from someone who is a retail investor."

Insider trading and tipping cases generally lack direct evidence of a tippee's state of knowledge about the relationship between this tipper and the next person on the evidence chain, said Justice Brown.

"In such circumstances, it was reasonable for the panel to identify ... groups of circumstantial evidence that could assist in drawing permissible inferences as to whether it was more likely than not that insider trading and tipping had occurred," he said.

Justice Brown said the OSC panel's decision in sum points to a consideration of certain groups of circumstantial evidence that may permit drawing a deduction, in a "logical and reasonable fashion," about Miller and Cheng's state of knowledge of the relationship between the tipper and the issuer or another person in a special relationship higher up the information chain. As a result, he accepted the OSC's conclusion that Miller and Cheng ought reasonably to have known the information they received was from a person in a special relationship with Masonite.



Fraser McDonald, Allen McDonald Swartz LLP

The court then turned its attention to the OSC's appeal of the dismissal of the case against Cheng, where the Superior Court of Justice said the OSC's panel made several factual errors in its analysis of the evidence. But Justice Brown sided with the OSC, saying the lower court "impermissibly reweighed the evidence and substituted inferences it would make for those reasonably available to the panel."

As a result, Justice Brown dismissed Miller's appeal and restored the panel's findings of liability against Cheng. He was joined by Justices Janet Simmons and Paul Rouleau in his unanimous decision.

Jennifer Lynch, senior litigation counsel with the OSC's enforcement branch, said the decision "confirms that reasonable inferences of fact are expected and necessary in proving insider tipping and trading cases, and bolsters our resolve to continue to investigate and deter this type of misconduct."

"Illegal insider tipping and illegal insider trading are harmful to honest investors and erode confidence in the capital markets," she said. "The OSC works hard to pursue these cases, which are notoriously complex and difficult to detect."

Fraser McDonald of Allen McDonald Swartz LLP said the decision has made it a lot easier to establish a chain of information in insider trading and tipping cases.

"I think the decision confirms the position [the OSC] can establish insider trading cases against people down the chain based on circumstantial evidence," he said. "And that's helpful because that's typically the kind of information they're going to have. The ability to rely on these circumstantial pieces of evidence will be of assistance in these types of cases — but hopefully they won't occur too often."



Nadia Champion, Polley Faith LLP

Nadia Champion of Polley Faith LLP said the decision will provide lawyers with “some very clear direction” on the factors that will be used in insider trading and tipping cases and as a result give some certainty on how these cases are going to be decided.

“I also think as a result of this decision it will likely be more difficult to defend these types of cases when you are acting for somebody who is the fifth or sixth person in line receiving information,” she said.

Janice Wright of Wright Temelini LLP, who represented Cheng in his appeal, did not comment on the specifics of the decision, but did say her client was “obviously disappointed with the result” and was considering the possibility of an appeal. Simon Bieber of Adair Goldblatt Bieber LLP, who represented Miller, did not reply to requests for comment.