

# SECURITIES LITIGATION 2005

## RECENT CRIMINAL AND QUASI-CRIMINAL DEVELOPMENTS IN SECURITIES LITIGATION

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## RECENT CRIMINAL AND QUASI-CRIMINAL DEVELOPMENTS IN SECURITIES LITIGATION

### I. INTRODUCTION

The purpose of this paper is not to provide an in depth analysis of the law in this area but to raise a number of practical considerations for counsel acting in securities related matters which may have the potential to result in criminal or quasi-criminal proceedings against the client in Canada or elsewhere. This paper will canvass the following topical areas related to this area of the law:

- (1) The evolving enforcement landscape;
- (2) The recent amendments to the *Criminal Code*;<sup>1</sup> and
- (3) The consideration of various practical issues related to criminal or quasi-criminal investigations by Canadian authorities or authorities from other jurisdictions such as the United States of America.

### II. THE HISTORICAL PERSPECTIVE OF ENFORCEMENT AGENCIES IN SECURITIES RELATED LITIGATION

Since 1967, most criminal investigations were conducted by the Commercial Crime Squad of the Royal Canadian Mounted Police (“RCMP”). From then until the late 1990s, most of the criminal prosecutions brought were the result of investigations conducted by that unit of the RCMP. Prior to 1987, the Securities Commission, the Investment Dealers Association of Canada (“IDA”) and Investigative Services of the Vancouver Stock Exchange (“VSE”) were relatively inactive in terms of providing potential cases to the RCMP for investigation.

With the proclamation of the then new *Securities Act* in 1986 and the appointment of the current Chairman of the Commission, Mr. Douglas Hyndman, the Commission became more proactive in terms of pursuing perpetrators of violations of the *Securities Act*. The result of the same was that the Commission actively pursued investigations and prosecutions of those who had breached the *Securities Act*. By 1990, because of the enhanced enforcement regime of the British Columbia Securities Commission (“BCSC”), more potential criminal investigations were brought to the attention of the RCMP. Further, the new enforcement regime caused the other self-regulatory agencies, and most particularly, the VSE to become more active in the pursuit of the wrongdoing by stockbrokers. That, in turn, created a further conduit for potential investigations to be referred to the RCMP.

As a result of a number of scandals concerning VSE issuers, the provincial government appointed the Vancouver Stock Exchange & Securities Regulation Commission (the “Matkin Commission”) in May 1993. In January 1994, the Matkin Commission made a number of recommendations,

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<sup>1</sup> R.S. 1985, c. C-46.

some of which were adopted in part. The most significant to this topic was recommendation 16, which stated the following:

16. Insufficient resources for criminal prosecution (Section 9.2)

A Securities Fraud Office (SFO) should be established by the Ministry of the Attorney General for more effective prosecution of securities related offences. Resources for the SFO would be enhanced by the dedication to the SFO of all administrative penalties collected by the BCSC or the proposed Securities and Exchange Board (“SEB”). Also, the chief judge of the Provincial Court should be requested to designate a special division of the Court to try securities offences so as to increase judicial continuity and expertise in relation to the trial of securities offences.<sup>2</sup>

In 1995, after the completion of the Matkin Report, the Securities Commission together with the RCMP and provincial Crown Counsel set up the Securities Fraud Office Pilot Project (“SFO”) which consisted of a number of investigators from the RCMP, two investigators from the BCSC and several prosecutors from the provincial Crown Counsel, Vancouver Regional Office. From approximately 1996 through 1998, various alleged market crimes were pursued by the SFO. The objective of that office was to attempt to prosecute as many substantive straight-forward offences as possible, both under the *Criminal Code* and *Securities Act*.

In October, 1998, the Securities Commission opted to discontinue the funding for the project, although prosecutions arising from the project continued until approximately 2002.

From October, 1998 to December, 2003, apparently due to budget constraints and lack of resources, there have been very few if any prosecutions of any substance initiated by the market group of the RCMP save and except the Eron mortgage matter.

In the United States, recent scandals involving Enron, WorldCom, Tyco and Imclone provided the impetus to strengthen corporate governance standards and better enforce laws governing capital market activities. The United States government acted by passing the *Sarbanes-Oxley Act of 2002*<sup>3</sup> (“*Oxley Act*”) which became law on July 30, 2002. The *Oxley Act* introduced measures designed to increase corporate disclosure and accountability, create new offences and increase penalties for corporate fraud.

In the U.S., the *Securities Exchange Act of 1934* (“*Exchange Act*”) created the Securities Exchange Commission (“SEC”) which is empowered to regulate all aspects of the securities industry. As part of its Rules and Regulations, the SEC also requires periodic reporting by companies with publicly traded securities. Insiders in the U.S. who trade their own stock must still report such trades to the SEC by filing Forms 3, 4 and 5 required by Section 16 of the

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<sup>2</sup>“Restructuring for the Future: Towards a Fairer Venture Market.” The Report of the Vancouver Stock Exchange & Securities Regulation Commission, (1994) (the “Matkin Report” after the Commission’s sole Commissioner), pp. 93-95.

<sup>3</sup> United States Code Title 15, Chapter 98.

*Exchange Act*. However, the *Oxley Act* changed the reporting obligations of “insiders” (directors, officers and greater than 10% beneficial owners) of public companies under section 16(a) of the *Exchange Act* by reducing the reporting deadline for filing Form 4 to within two business days after the transaction giving rise to the change has been executed. This information then becomes available to the investing public via the SEC and the public companies’ own website. Previously, insiders did not have to report trades until the tenth day of the month following the month in which the trade occurred, meaning that an insider trade could go unreported for as many as 40 days.

In September 2002, Canadian securities regulators combined to form the Insider Trading Task Force (“Task Force”) to address illegal insider trading in Canadian capital markets. In June 2003, the Federal Government announced a coordinated strategy to strengthen enforcement and legislation against serious capital markets fraud based on strengthening the following pillars and enhancing the linkages among them by:

- Expanding the resources dedicated to investigating serious cases of capital market fraud.
- By establishing Integrated Market Enforcement Teams (IMETs) in the key financial centres of Canada;
- Providing additional resources to support prosecutions of capital market fraud offences under the *Criminal Code*;
- Proposing legislative amendments to the *Criminal Code* that would create new offences and evidence-gathering tools, toughen sentencing, and establish concurrent jurisdiction with the provinces in the prosecution of serious cases of capital market fraud.

In November, 2003 the Task Force made wide ranging recommendations concerning prevention, detection and deterrence of insider trading including a substantially different approach to the proposed *Criminal Code* amendments announced in June.

The federal government subsequently enacted additional provisions in the *Criminal Code* which include the following:

- (1) The creation of a new criminal offence of insider trading (s. 382.1);
- (2) A mechanism for issuing production orders against a variety of third parties (s. 487.012 - 015);
- (3) Protection for whistle blowers (s. 425.1); and
- (4) Aggravating circumstances for the court to consider when imposing sentences for capital market offences (s. 380.1).

These provisions will be discussed at length below.

The first IMET team in Vancouver was established in December, 2003. Since that time, a second team has been established. To date, the writer is unaware of any charges laid as a result of an IMET investigation in British Columbia, although no doubt several are currently in the hands of Crown Counsel in the charge approval process.

Concurrently with the increased regulatory enforcement by the Commission, the VSE and its successors in the late 1980's and 1990's, the enhanced regulatory regime caused British Columbia residents involved in the capital markets to look elsewhere for opportunities in more loosely regulated capital markets. By the mid to late 1990s, many Vancouver businessmen were looking to the OTC Bulletin Board and the pink sheets in the United States as providing opportunities to raise capital with less regulation and of course, to engage in conduct which violated in some instances both U.S. and Canadian law.

With the increasing presence of British Columbia residents in U.S. capital markets, particularly in the largely unregulated OTC Bulletin Board, the U.S. regulatory agencies became much more interested in the investigation of BC residents. The main actors from the U.S. side have been investigators and lawyers from the U.S. Securities & Exchange Commission ("SEC"), the U.S. Department of Justice ("DOJ") and the FBI. In order to accommodate the gathering of evidence by U.S. authorities, the Commission entered into a Memorandum of Understanding with the SEC in January 7, 1988. Further, foreign investigative agencies are able to apply to court pursuant to the provisions of the *Mutual Legal Assistance in Criminal Matters Act*, RSC 1985, c. 30 ("MLAA") for compelled interviews and production of documents by Canadian residents.

Prior to December 1999, regulation of member conduct and market conduct (trading) was shared by the exchanges and the IDA. To avoid duplication for member regulation purposes, a firm that was a member of more than one SRO was regulated by a single organization. This organization was said to have "primary audit jurisdiction". After the merger of the Alberta Stock Exchange and Vancouver Stock Exchange into the Canadian Venture Exchange ("CDNX") in November, 1999, jurisdiction for "member conduct" was transferred to the IDA for those dealers who were previously regulated by the exchanges. CDNX retained jurisdiction over trading. After the sale of the CDNX to the Toronto Stock Exchange ("TSX") and the creation of the TSX Venture Exchange, jurisdiction over "market conduct" (trading) was transferred to Market Regulation Services Inc. ("RS").

In summary, there are at least the following agencies engaged in the investigation of capital market misconduct in British Columbia:

- The RCMP (IMET);
- The Securities Commission;
- The IDA;
- RS;
- The SEC;

- The FBI; and
- The U.S. DOJ.

The above list does not include the exchanges or any other regulatory authorities attempting to gather evidence of illicit market activity in or from British Columbia, such as other provincial securities regulatory bodies.

The above agencies have competing interests and operate under different statutes, rules and regulations which in turn give rise to numerous issues for counsel when representing clients. For example, if an investigation starts as an administrative proceeding, what if any *Charter* protections are available to your client? Further, if your client is compelled to testify by the Commission, does s. 13 protect your client against the use of the transcript or documentary evidence produced in a subsequent criminal proceeding in Canada. What happens if that evidence is being gathered for use in a proceeding in the United States which has completely different constitutional protections of the right against self-incrimination? Can that compelled statement then be used in a criminal prosecution of your client in the United States at some future point?

These and other questions need to be considered when acting for a client that faces administrative and potential criminal or quasi-criminal prosecution.

### **III. QUASI-CRIMINAL SANCTIONS FOR INSIDER TRADING: PROVINCIAL LEGISLATION**

Prior to the recent amendments to the *Criminal Code* creating the criminal charge of insider trading, all insider trading prosecutions were commenced pursuant to the quasi-criminal sanctions found in the British Columbia *Securities Act* and other provincial statutes. In *R. v. Woods*, [1994] O.J. No. 392 (Ont. Ct. (Gen. Div.)), Farley, J. laid out the constituent parts of the offence of insider trading under s. 75(1) of the Ontario *Securities Act*,<sup>4</sup> (“*Securities Act*”). The legislation in Ontario is sufficiently similar to make use of Farley, J.’s description of the constituent elements of the offence. At paragraph 15 of *Woods*, *supra*, the court set out the following elements that the Crown is required to prove beyond a reasonable doubt:

1. the defendant is in a special relationship with the public company;
2. and the defendant purchases or sells securities of that public company;
3. with that defendant having knowledge of material information about that public company;
4. which material information has not been generally disclosed.

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<sup>4</sup> R.S.O., 1980, c. 466.

**A. Section 86 of the BC Securities Act**

Section 86 of the *Securities Act*<sup>5</sup> creates two offences concerning the use of insider information. The first is the act of buying or selling shares before the information is generally disclosed to the public and the second is the act of informing another person, other than in the necessary course of business, of those material facts or changes in a company's affairs.

Section 86 of the *Securities Act* states:

86 (1) A person that

(a) is in a special relationship with a reporting issuer, and

(b) knows of a material fact or material change with respect to the reporting issuer, which material fact or material change has not been generally disclosed,

must not enter into a transaction involving a security of the reporting issuer or a related financial instrument.

(2) A reporting issuer or a person in a special relationship with a reporting issuer must not inform another person of a material fact or material change with respect to the reporting issuer before the material fact or material change has been generally disclosed, unless giving the information is necessary in the course of business of the reporting issuer or of the person in the special relationship with the reporting issuer.

(3) A person who proposes to

(a) make a take over bid, as defined in section 92, for the securities of a reporting issuer,

(b) become a party to a reorganization, amalgamation, merger, arrangement or similar business combination with a reporting issuer, or

(c) acquire a substantial portion of the property of a reporting issuer

must not inform another person of a material fact or material change with respect to the reporting issuer before the material fact or material change has been generally disclosed, unless giving the information is necessary to effect the take over bid, business combination or acquisition, as the case may be.

(4) A person does not contravene subsection (1), (2) or (3) if the person proves on the balance of probabilities that, at the time of the purchase or sale referred to in subsection (1) or at the time of giving the information

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<sup>5</sup> R.S.B.C. 1996, c. 418.

under subsection (2) or (3), as the case may be, the person reasonably believed that the material fact or material change had been generally disclosed.

The *actus reus* of an offence under s. 86(1)(b) of the *Securities Act* is trading with knowledge of a material fact. The definitions of “material fact” and “material change” are found in section 1(1) of the *Securities Act*. A material fact is a fact that “could reasonably be expected to significantly affect the market price or value” of securities of the issuer. A material change, on the other hand, is “a change in the business, operations, assets or ownership of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer...”

A charge under s. 86(1) is subject to the defence, contained in s. 86(4) of the *BC Act* (proven on a balance of probabilities), that the defendant reasonably believed that the material fact or change had been generally disclosed. Note that the common law defence of reasonable mistake of fact is also available to a defendant.

It should also be noted that the section itself is not limited to purchasing and selling securities on the open market. The *Securities Act* prohibits all trading which includes a “put, call, an option or another right or obligation to purchase or sell securities of a reporting issuer.”

## **B. The “Makes Use of” Defence And It’s Removal From The Ontario *Securities Act***

Prior to 1988, the Ontario *Securities Act* contained an affirmative defence that was available to a defendant if he or she could prove that they did not “make use of” insider information when purchasing the securities. This defence was contained in s. 75(2) which stated:

No purchaser or vendor shall be found to have contravened clause 1(a) if such purchaser or vendor proves that he did not make use of knowledge of the material fact or change in purchasing or selling securities.

In *R. v. Fingold*, [1999] O.J. No. 369 (Ont. Ct. J.), Keenan, J. cited with approval Farley, J.’s comments in *Woods, supra*, at paragraph 15 that since this defence was removed from the *Act*, the offence of insider trading is now made out merely through possession of insider information that has not been disclosed:

The offence then is in essence not a question of using insider information but of buying or selling securities of a company while possessed of insider information. It seems to me that the provisions of the insider trading prohibition are intricately linked with the timely disclosure requirements. The purpose of timely disclosure is to ensure that no one makes a trading decision (or fails to make one) while not having material information which would affect that decision.

At paragraph 17, Farley, J. said

The critical aspect is not of course that insider information is in fact used to make the trading decision, but rather that a person with a special relationship with a reporting issuer cannot trade while possessed of insider information. The system is not perfect since it does not catch those situations where that person would have bought or sold but for possession of the insider information which changed the decision to a “stand pat” one.

At paragraphs 74 - 75, Farley J. discussed the "makes use of" defence and the significance of its removal from the *Act* as follows:

Woods submitted that upon removal of the "makes use of" defence the prohibition on insider trading contained in s. 75(2) became an absolutely liability offence. However it seems to me that this change had no impact on the classification of s. 75(1) as a strict liability offence. Although referred to as a defence, the "makes use of" defence helped to define the actus reus of the offence prior to the removal of this defence, the actus reus of the offence under s. 75(1) was in trading by an insider who made use of undisclosed material information. In order to commit the proscribed act the insider must not only have traded while in possession of undisclosed material information, but he would also have had to use that information in making the trade. Following the removal of the "makes use of" defence, the actus reus was broadened to include any trade made by an insider while in possession of material undisclosed information: see s. 75(1) and (2). One will appreciate the difficulty of finding evidence which would allow one to penetrate the brain of the insider to prove that the decision making process with respect to the trade in the securities made use of that insider information.

This change did not affect the degree of fault required to prove the offence; rather it changed the description of the proscribed act. Both before and after the removal of this defence, it was open to the accused to prove, on a balance of probabilities, that he used all reasonable care to ensure that he did not commit the proscribed act or that he acted under a reasonable mistake of fact. Further this "makes use of" defence was never a common law defence. All of the common law defences of due diligence and reasonable mistake of fact together with the statutory defence in s. 75(4) of the *Securities Act* and the defences created by the Regulations remain available.

In *Fingold*, supra, the court dismissed the appeal of the Securities Commission from the acquittal of the accused on charges of insider trading. The trial judge found that the accused had reason to believe that the inside information was not a material fact within the definition of the Ontario *Securities Act*. His defence was not that he did not use his knowledge of a material fact but rather

that he had a reasonable belief at the time that it was not a material fact and that he was therefore at liberty to sell his shares without violating s. 76 of the *Securities Act*.

Interestingly, Farley, J. pointed out that under existing provincial securities legislation, the critical issue is not that insider information is used to make a trading decision but that a person with a special relationship to a reporting issuer cannot trade while possessed of insider information. The provincial legislation therefore does not cover those situations where the insider would have traded but decided to maintain a “wait and see” approach once learning of the insider information.

#### **IV. RECENT AMENDMENTS TO THE *CRIMINAL CODE*: SECTIONS 382.1, 425.1, 380.1, 487.012-015 and 487.3**

##### **A. Introduction**

According to the Department of Justice’s Backgrounder,<sup>6</sup> the new provisions in the *Criminal Code* related to insider trading are the government’s response to its promise to create new federal laws and to strengthen enforcement activities concerning fraud-related offences involving the capital markets. The impetus for these changes stemmed from a perceived need to bolster investor confidence in Canadian capital markets following the recent corporate scandals that weakened investor confidence in capital markets in the United States.

Apparently, the new *Criminal Code* sections were designed to enable the Attorney General of Canada to share jurisdiction with the provinces in prosecuting fraud-related offences. According to the Backgrounder, federal involvement is intended to be “limited to a narrow range of cases that threaten the national interest in the integrity of capital markets.”<sup>7</sup>

However, the Honourable Paul Crête, a Bloc Québécois Member of Parliament, questioned whether the true motive of the federal government in enacting the new *Criminal Code* provisions was merely to encroach on the province’s jurisdiction in regulating the capital markets. As he stated while the provisions were being debated in the House of Commons in October, 2003:

For many years, the federal government, through the former Finance Minister, ... wanted to implement a Canada-wide securities commission, and thereby intervene directly in provincial jurisdiction. We have to make sure that the federal government does not achieve through the back door what it has so far failed to do through the front door.<sup>8</sup>

Skeptics may also question whether the recent *Criminal Code* amendments are merely “window dressing” which create the appearance of a federal legislative response to recent corporate scandals, when in fact prosecutions are likely to be rare.

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<sup>6</sup> “Federal Strategy to Deter Serious Capital Market Fraud,” Department of Justice, Canada, News Room, 12 June 2003.

<sup>7</sup> *ibid.*, p. 2.

<sup>8</sup> Hansard, Vol. 138, Number 136, 2nd Session, 37th Parliament (October 8, 2003), page 8332.

**B. Prohibited Insider Trading: s. 382.1(1)**

Section 382.1 of the *Criminal Code* came into force on September 15, 2004. This section created two new *Criminal Code* offences in addition to existing prohibitions against insider trading under provincial securities law and the *Canada Business Corporations Act*.

Section 382.1(1) states:

382.1 (1) A person is guilty of an indictable offence and liable to imprisonment for a term not exceeding ten years who, directly or indirectly, buys or sells a security, knowingly using inside information that they

- (a) possess by virtue of being a shareholder of the issuer of that security;
- (b) possess by virtue of, or obtained in the course of, their business or professional relationship with that issuer;
- (c) possess by virtue of, or obtained in the course of, a proposed takeover or reorganization of, or amalgamation, merger or similar business combination with, that issuer;
- (d) possess by virtue of, or obtained in the course of, their employment, office, duties or occupation with that issuer or with a person referred to in paragraphs (a) to (c); or
- (e) obtained from a person who possesses or obtained the information in a manner referred to in paragraphs (a) to (d).

Subsection 382.1(4) defines “inside information” as information about a company or a security that is not generally disclosed and could reasonably be expected to affect the security’s market price or value. This definition of “inside information” includes more information than that covered under existing provincial securities legislation.

Section 382.1 requires the Crown to prove not only that an insider had knowledge of material information when trading in the issuer’s securities, but that the insider “used” that information as well. In this way, s. 382.1 re-introduces the “use” requirement that was eliminated from the Ontario *Securities Act* in 1988.

The requirement for an element of fault is a critical component of criminal liability. This fault element is a “principle of fundamental justice” protected by Section 7 of the *Charter of Rights and Freedoms*,<sup>9</sup> (the “*Charter*”). The mental fault element requires proof of intent, recklessness, or wilful blindness.<sup>10</sup>

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<sup>9</sup> Schedule B to the Canada Act 1982 (U.K.) 1982, c. 11.

<sup>10</sup> *ibid*, p. 39.

While the legislature has ensured that the federal offence of insider trading contains the requisite element of fault in order to comply with *Charter* requirements, they may have imposed so high a burden on the Crown that the offence itself will be difficult to prove. As the Task Force reported in November 2003, “the experience with other insider trading enactments has been that ‘knowing use’ type language results in an ‘insurmountable evidentiary obstacle.’”<sup>11</sup> For a variety of reasons outlined in their report, the Task Force recommend an adaptation of the U.S. model to “avoid the challenges of a ‘knowing-use’ requirement ... and, in terms of substantive content, satisfy *Charter* requirements.”<sup>12</sup> Given the concerns expressed by the Task Force, it is unlikely we will see many prosecutions, let alone convictions for this new offence.

The maximum sentence for insider trading under s. 382.1(1) is ten years. This more than triples the sentence for the equivalent offence under existing provincial securities legislation.

### C. “Tipping”: s. 382.1(2)

Section 382.1(2) states:

(2) Except when necessary in the course of business, a person who knowingly conveys inside information that they possess or obtained in a manner referred to in subsection (1) to another person, knowing that there is a risk that the person will use the information to buy or sell, directly or indirectly, a security to which the information relates, or that they may convey the information to another person who may buy or sell such a security, is guilty of

- a) an indictable offence and liable to imprisonment for a term not exceeding five years; or
- b) an offence punishable on summary conviction.

“Tipping” involves providing insider information to a third party for that party’s benefit or the benefit of the insider. Section 382.1(2) makes it an offence for those who possess or obtain inside information to “knowingly” convey that information while also “knowing” that there is a risk that the recipient will use the information to trade a security to which the information relates or convey the information to someone else who may do so. It remains unclear however, to what extent a person must “know” that there is a risk that the information will be used in the manner described under section 381.1(2).

As an indictable offence, tipping carries a maximum prison term of five years.

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<sup>11</sup>“Illegal Insider Trading in Canada: Recommendations on Prevention, Detection and Deterrence.” Insider Trading Task Force (November, 2003), p. 39.

<sup>12</sup> *ibid*, p. 40.

**D. Whistleblower Protection: s. 425.1**

In order to encourage employees to report corporate wrongdoing, whistleblower protection laws have been developed to protect employees who do come forward from reprisals. Section 425.1 of the *Criminal Code* protects employees who provide “information” with respect to the violation of any federal or provincial law from reprisals by employers. This section prohibits an employer, anyone acting on behalf of an employer, or a person in a position of authority over an employee to take or even to threaten the employee with disciplinary action, demotion, termination of employment or to adversely affect the employee’s employment in order to force the employee to refrain from providing information to law enforcement officials about the commission of an offence by his or her employer or by an officer, employee or director of the employer. Section 425.1 also makes it a criminal offence to threaten or retaliate against an employee who has already provided such information.

It is unclear how the meaning of “information” will be determined. Theoretically, “information” could include privileged or confidential information and the employer could be charged for taking action against an employee who obtains such information and then provides it to law enforcement officials.

Under s. 425.1, the Crown may proceed either by way of indictment or summary conviction. The maxim sentence for conviction by indictment is five years imprisonment.

**E. Sentencing: s. 380.1**

Section 380.1 sets out four aggravating circumstances for the court to consider when imposing a sentence for capital market offences as follows:

- (a) the amount involved in a fraud exceeded one million dollars;
- (b) the offence adversely affected, or had the potential to adversely affect, the stability of the Canadian economy or financial system or any financial market in Canada or investor confidence in such a financial market;
- (c) the offence involved a large number of victims; and
- (d) in committing the offence, the offender took advantage of the high regard in which the offender was held in the community.

Traditionally in criminal law, a person’s reputation and status in the community or workplace are used as mitigating factors when determining sentences. However, where those who commit capital market offences under the *Criminal Code* rely on their reputation, status, employment or employment skills to carry out their crimes, these will be seen as aggravating rather than mitigating factors. The presence of these factors is intended to enable a court to impose tougher penalties in order to deter more serious offences.

**F. Production Orders: ss. 487.012-.015**

Sections 487.012 - .015 of the *Criminal Code* create new provisions that allow investigators to obtain “production orders” to compel those not under investigation to produce, at a specified time and place and in a specified form, data or documents relevant to the commission of an offence under any federal law. These provisions are new to the *Criminal Code* however, the ability to obtain similar kinds of orders already exists under the *Competition Act*.

Under s. 487, two types of production orders can be issued: general and specific. Section 487.012 enables a justice or judge to issue a general *ex parte* production order for data or documents from a third party having possession or control of such information. Section 487.012 states that before issuing such an order, a justice or judge must be satisfied that there are reasonable grounds to believe that:

- (a) an offence against this *Act* or any other Act of Parliament has been or is suspected to have been committed;
- (b) the documents or data will afford evidence respecting the commission of the offence; and
- (c) the person who is subject to the order has possession or control of the documents or data.

Section 487.013 enables specific *ex parte* production orders to be issued to banks and other entities specified under s. 5 of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* in similar circumstances to a general production order. Orders under s.487.013 relate to production of specific information such as the name or account number of an account holder, the status and type of account, and the date on which the account was opened or closed. Before issuing such an order pursuant to s. 487.013, a justice or judge must be satisfied there are reasonable grounds to suspect that:

- (a) an offence against this *Act* or any other Act of Parliament has been or will be committed;
- (b) the information will assist in the investigation of the offence; and
- (c) the institution, person or entity that is subject to the order has possession or control of the information.

Specific production orders under s. 487.013 are narrower in scope than general orders. They apply to specific types of information and to a defined group of entities having control or possession of such information. It is likely for this reason that the threshold for obtaining a specific order is lower than the threshold applicable to a general order.

Section 487.014 confirms (for “greater certainty”) that a production order is not required before law enforcement officials are entitled to request that individuals *voluntarily* provide information that is not otherwise prohibited by law from being disclosed. The necessity for s. 487.014 is

unclear. One wonders whether this section was included in order to prevent an accused from arguing that ss. 487.012 - .013 prohibits the Crown from introducing into evidence information that was disclosed voluntarily to law enforcement officials.

Section 487.015 enables the third party recipients of a production order to apply to a judge before the order expires for an exemption from production of any information referred to in the order. Once an application is made, execution of the production order will be suspended until a final decision is made in relation to the application.

A judge may grant an exemption under s. 487.015 once satisfied that:

- (a) the document, data or information would disclose information that is privileged or otherwise protected from disclosure by law;
- (b) it is unreasonable to require the applicant to produce the document, data or information; or
- (c) the document, data or information is not in the possession or control of the applicant.

Section 487.016 provides that a person may not refuse to comply with a production order on the grounds that the information ordered to be produced may incriminate them. In addition, a document obtained through a production order cannot be used as evidence in subsequent criminal proceedings (with the exception of perjury, etc.) against the individual who prepared it where the order requires the third party to prepare a document based on existing documents or data.

The necessity for s. 487.016 is unclear. The protection against self-incrimination afforded by s. 13 of the *Charter* ostensibly applies to production orders. As a result, while a person who is the subject of a production order could not refuse to comply on the ground that they may be incriminated by any information required to be produced, the protection afforded by s. 13 of the *Charter* would extend to protect a witness from being incriminated by any evidence he or she provides.

Production orders appear similar to search warrants but are likely to be more efficient and less invasive than search warrants since law enforcement officials are not required to search the premises of a third party. In addition, these orders may allow for the acquisition of information held outside Canada where it is under the control of a custodian in Canada. Furthermore, by specifying the time and place at which the material must be produced, as well as the form of the documents, such orders may speed up the investigative process.

Law enforcement officials are likely to be enthusiastic about these new orders because they offer a less intrusive procedure than general search warrants which require police to appear and expend their own resources to seize information. In fact, according to the authors of an OECD working group, the new *Criminal Code* provisions pertaining to production orders were implemented after lobbying by police forces across the country. The OECD working group reported that:

In a brief submitted to the Standing Committee on Legal and Constitutional Affairs Concerning Bill C-24 (organized crime legislation) by police agency representatives it was stated that the obtaining of search authorizations places onerous demands on police agencies, requiring the preparation of thousands of pages of documents, and in a message from the Executive Officer of the Canadian Police Association, it was stated that “a typical search warrant authorization for proceeds of crime cases could take six to eighteen months to prepare”. These delays have been attributed to legal thresholds that have been established as a result of the interpretation of section 8 of the Canadian Charter of Rights and Freedoms. The overall recommendation in the brief submitted to the Standing Committee was that due to the onerous demands placed on police agencies, there is a need to streamline the criteria for obtaining the courts’ approval. The representative of the Ontario Provincial Police who participated in the on-site meetings concurred in this assessment. He also stated that it is not unusual for an investigation to completely stall owing to these obstacles. A representative of the RCMP indicated that in his experience search warrants for complex cases involving economic crimes can take weeks or months to prepare.

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Representatives of the Attorney-General of Ontario’s office, the Ontario Provincial Police and the Toronto police stated that they have lobbied the federal government to put into place legislation on production orders, in order that search warrants are not necessary to obtain financial information. The principal advantage of this method is that the custodian of the documents is required to deliver or make them available within a certain time limit.<sup>13</sup>

University of Ottawa law professor, David Paciocco, has expressed the concern that the new *Criminal Code* provisions may have expanded the State’s investigative powers too broadly:

What we are seeing is [sic] regulatory initiatives leaking into criminal law, and the gap between regulation and criminal law narrowing. I think some of the initiatives that were taken in response to terrorism, such as compelling testimony at investigative hearings, have opened doors that weren’t open before. What happens is these incidents, like terrorism or the corporate scandals, are exploited to expand the authority of the state and to increase state access to information.<sup>14</sup>

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<sup>13</sup> “Canada: Phase 2 Report On The Application Of The Convention On Combating Bribery Of Foreign Public Officials In International Business Transactions And The 1997 Recommendation On Combating Bribery In International Business Transactions,” Working Group on Bribery in International Business Transactions (CIME), 25 March 2004, paragraphs 56 - 57.

<sup>14</sup> Schmitz, C., *Lawyer’s Weekly*, Vol. 24, No. 21, (October 8, 2004), page 1.

Mr. Paciocco added that the new law makes private individuals an “arm of the state” by forcing them to personally participate in and even finance police work.

Failure to comply with a production order is a summary conviction offence subject to a maximum fine of \$250,000 and/or imprisonment for up to six months.

**G. Non-Access Orders: s. 487.3**

Section 487.03 enables a non-access order to be issued by a judge at the time a production order is sought which prohibits access to and disclosure of any information relating to the production order. The grounds on which a non-access order can be made relate to situations that could subvert the ends of justice and include: compromising the identity of a confidential informant; compromising the nature and extent of an ongoing investigation; and prejudicing the interests of an innocent person.

**H. Search Warrants: s. 487**

It is anticipated that with increasing activity by IMET, more search warrants will be executed upon your clients. It should also be noted that the Commission itself has applied for and been granted several warrants pursuant to s. 487 of the *Code* to advance potential criminal prosecution of individuals which are targets of Commission investigations. It is not clear at this point the level to which the Commission intends to pursue criminal prosecutions under the *Code*.

It is suggested that if your client phones advising that either the RCMP or the Commission are executing a warrant at the office of your client that a lawyer be sent to the scene to ensure that the search and seizure for evidence is restricted to the parameters set forth in the warrant itself. Employees should be advised not to speak to investigators as anything said may be written down and later used against your client. Care should also be taken to ensure that privileged documents are not seized and if the police are insistent, that the documents be sealed and delivered to the Supreme Court Registry to be dealt with by a judge with respect to privilege issues.

**V. USE AND DISCLOSURE OF INFORMATION COLLECTED DURING THE COURSE OF INVESTIGATIONS BY ENFORCEMENT AGENCIES**

It is of critical importance to understand which government agency or SRO is attempting to gather information in pursuit of its investigation. Care should be taken to ensure the agency has the power to compel or otherwise obtain the evidence from the client. For example, if the Commission wishes to gather evidence from a client, the Commission can resort to the compulsory requirements under the *Act* to obtain the information. (i.e., s. 141; s. 144) Obviously, the use of compulsion from the point of view of criminal and quasi-criminal law creates constitutional issues. With respect to the RCMP and IMET, apart from obtaining search warrants or production orders, there is no compulsion to cooperate or otherwise assist in their investigation. Further, without resorting to the compulsory requirements of the *Securities Act* or the MLAA, the regulators and investigatory agencies of the United States have no ability to obtain information in Canada, other than by cooperation. The use of the compulsory requirements of the *Securities Act* and likewise the provisions of the MLAA, should result in constitutional protection for the

evidence given and documents provided. It should be noted that s. 20(2) of the MLAA provides that a court may impose conditions upon the use of evidence gathered in Canada by foreign states. Conditions should be sought when there is a potential for quasi-criminal or criminal proceedings to be instituted elsewhere.

It is more difficult to protect your client's rights when the investigation is started by the Commission. For example, where the investigation at its infancy is administrative in nature, the evidence can be used in administrative proceeding under the *Act*. Attention should be paid to the decision of the Supreme Court of Canada which rendered its decision in *Regina v. Jarvis*, [2002] 3 S.C.R. 757 in November, 2002. The *Jarvis* case is authority for the proposition that once the primary purpose of an investigation by a regulatory agency becomes an inquiry into penal liability, evidence gathered by enforcement agencies under a regulatory statute must comply with the *Charter* before the evidence becomes admissible in a criminal or quasi-criminal proceeding. The case sets out the test for the court to determine when the purpose changes from a regulatory investigation to a penal one.

At the commencement of any compulsory interview, you should ensure the record discloses that the interview is a compelled one under the provisions of the *Securities Act* by reference to the Summons to Attend Before an Investigator. A statement should also be made on the record that the client is relying upon whatever rights he or she may have under the *Charter* and under the Canada and British Columbia *Evidence Acts* respectively.

The issue of what use can be made of interviews by SROs such as the IDA and RS is much more difficult. Because neither are government organizations, it is unlikely that *Charter* protection will apply to interviews conducted by the IDA and RS. The same would be true of documents produced to those bodies. By reason of the applicable bylaws related to each, brokerage firms and registrants (approved persons) are compelled to attend by reason of their membership with the IDA or submission to the jurisdiction of RS.<sup>15</sup> Sanctions can follow from failing to cooperate with the IDA or RS. These sanctions may include a fine, suspension, expulsion or the imposition of terms and conditions on membership.

Therefore, the attendance at an interview or the provision of information is in essence not voluntary and is compelled by virtue of the fact that the person wishes to continue in that business. It should also be noted that although the IDA and RS have no ability to obtain information from non-members (such as officers or directors of public companies) the Exchange will often use its listing agreement with the company as a means to compel certain information from public companies. Care should be taken with respect to providing that information to ensure insofar as possible that information which can later be used in a prosecution is not made available to the Exchange, which may refer the same to the Commission or the RCMP.

When attending an interview on behalf of a client conducted by the IDA or RS, one should assert at the beginning of the interview that it is not voluntary, the attendance is premised on the fact of the adverse consequences would flow from non-cooperation, as well as preserving whatever

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<sup>15</sup> For example, IDA By-Law 19.5 states that a member or RR may be required to attend and give information respecting "any such matters" (presumably related to the investigation) and may be required to give a statement under oath. Rule 10.2 (2) and (3) of RS's Universal Market Integrity Rules are substantially similar.

rights the client has under the *Charter*, Canada and British Columbia *Evidence Acts* respectively. The investigator is likely a person in authority for the purposes of the traditional law on voluntariness of statements. The issue that would then fall to be determined is whether the statement was made voluntarily within the common law principles related to the admissibility of statements of an accused.

Once the production of documents and interview process is complete, the question arises as to what use can be made of the information collected. At first glance, IDA bylaws concerning disclosure of information gathered pursuant to an investigation may permit the IDA to provide information to the SEC in connection with any matter relating to compliance by a member. IDA Bylaw 16.9 states that the IDA may provide to any stock exchange, SRO, securities enforcement or regulatory authority or other organization regulating or providing services in connection with securities trading located in Canada or any other country any information obtained by the IDA and may provide other forms of assistance for surveillance, investigation, enforcement and other regulatory purposes relating to trading and securities in Canada or elsewhere. However, because it is doubtful that the U.S. DOJ can be characterized as a regulatory organization which “regulates or provides services in connection with securities trading,” this bylaw likely does not permit the IDA to provide information to the DOJ, particularly where the DOJ is investigating a criminal matter and not a regulatory matter.

A similar issue arises with respect to RS. As part of its mandate to regulate trading on Canadian equity markets to ensure that transactions are executed in compliance with trading rules, RS works together with other SROs to co-ordinate regulatory efforts. However, in fulfilling its regulatory role, RS is in possession or control of various types of information including: trading data for the marketplaces it regulates; investigative work product and analysis; and personal information of regulated persons (as defined in the Universal Market Integrity Rules) and their clients.<sup>16</sup>

Of concern for clients under investigation is RS’s mandate to share information and to co-operate with other securities commissions, other Canadian securities regulatory authorities, Canadian exchanges, other regulation service providers and other SROs.<sup>17</sup> To this end, RS has entered into agreements with other SROs to share information and has established information-sharing procedures with other entities such as the Securities Enforcement Review Committee (“SERC”) and IMET.

RS does have a Privacy Code setting out guidelines to follow to protect personal information of regulated persons that comes under RS’s control in the performance of its regulatory duties. However, RS’s Privacy Code states that it discloses personal information in order to perform its regulatory functions. Under the heading “Disclosure,” RS’s Privacy Code states:

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<sup>16</sup> “Untangling the Web of Parallel Investigations and Proceedings: Handling a Cluster of Inter-related Cases.” Presentation by Jane Ratchford, Canadian Institute 4th Annual Advance Forum on Securities Litigation (November 30, 2004), p. 4.

<sup>17</sup> RS Rule 10.13 expressly requires RS to “provide information and other forms of assistance for market surveillance, investigative, enforcement and other regulatory purposes” to self-regulatory entities, foreign SROs, securities commissions, and foreign securities commissions.

In some situations, RS must disclose personal information, whether obtained from regulated persons or from other persons, to other organizations including securities regulatory authorities, regulated market places, other self-regulatory organizations, law enforcement agencies and foreign securities regulators.”<sup>18</sup>

The recent enactment of privacy legislation by the federal and provincial governments gives rise to other complicating issues if your client is a broker or brokerage house. These issues include, which Act applies, the British Columbia or federal statute? The statutes have differing provisions with respect to who is entitled to gather evidence. What obligations does your client owe to his brokerage clients? Does your client face civil exposure in the event that information is provided in breach of either the federal or provincial Act?

Both the *Personal Information Protection and Electronic Documents Act*,<sup>19</sup> (“PIPEDA”) and the *Personal Information Protection Act*,<sup>20</sup> (“PIPA”) apply when personal information is collected, used or disclosed in the course of a commercial activity. PIPEDA applies to govern personal information collected, used or disclosed across provincial boundaries and PIPA applies to govern personal information collected, used or disclosed within provincial boundaries.

It is clear that the common law together with the provisions of PIPA will prohibit individuals and companies from disclosing confidential information concerning their clients to any person or authority without the consent of their clients or alternatively by the order of a competent authority. The IDA may have, in appropriate circumstances, the authority to compel the information if it is reasonable to believe that the breach, contravention, circumstance, conduct, fraud or improper trading practice in question may have occurred. However, there is nothing in PIPA that would appear to allow the IDA to require an individual under investigation to attend at an interview at which the SEC or the U.S. DOJ is present.

PIPA makes clear that in the absence of consent, an organization is permitted to disclose personal information only under limited circumstances. Paragraph 18(1)(c) in PIPA states:

18(1) An organization may only disclose personal information about an individual without the consent of the individual, if

(c) it is reasonable to expect that the disclosure with the consent of the individual would compromise an investigation or proceeding and the disclosure is reasonable for purposes related to investigation or a proceeding.

The term “investigation” is defined in s. 1 as follows:

“Investigation” means an investigation related to:

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<sup>18</sup> Privacy Code, Market Regulation Services Inc.

<sup>19</sup> S.C. 2000, c. 5.

<sup>20</sup> S.B.C. 2003, c. 63.

- a) breach of an agreement;
- b) contravention of an enactment of Canada or a province;
- c) a circumstance or conduct that may result in a remedy or relief being available under an enactment, the common law or in equity;
- d) the prevention of fraud, or
- e) trading in a security as defined in section 1 of the *Securities Act* if the investigation is conducted by or on behalf of an organization recognized by the British Columbia Securities Commission to be appropriate for carrying out investigations of trading and securities,

if it is reasonable to believe that the breach, contravention, circumstance, conduct, fraud or improper trading practice in question may occur or may have occurred;

However, it is unlikely the IDA has the ability to receive and subsequently disclose personal information under PIPA because the IDA is not “an organization recognized by the British Columbia Securities Commission to be appropriate for carrying out investigations of trading and securities.”

Paragraph 18(1)(j) of PIPA complicates matters even further. Section 18(1)(j) provides that in the absence of consent, an organization may only disclose personal information about an individual, if:

- (j) the disclosure is to a public body or a law enforcement agency in Canada, concerning an offence under the laws of Canada or a province, to assist in an investigation, or in the making of a decision to undertake an investigation,
  - i) to determine whether an offence has taken place; or
  - ii) to prepare for the laying of a charge or the prosecution of the offence.

Because the SEC is not a law enforcement agency in Canada, this exception will not apply to sanction disclosure by the IDA to the SEC. As a result, it is uncertain whether the IDA has the ability to receive and further disclose personal information under PIPA.

PIPEDA also provides a list of permitted exceptions for disclosure of personal information when consent is not obtained. Paragraph 7(3)(d) of PIPEDA states:

- (3) ... an organization may disclose personal information without the knowledge or consent of the individual only if the disclosure is

- (d) made on the initiative of the organization to an *investigative body*, a government institution or a part of a government institution and the organization
- (i) has reasonable grounds to believe that the information relates to a breach of an agreement or a contravention of the laws of Canada, a province or a foreign jurisdiction that has been, is being or is about to be committed, or
- (ii) suspects that the information relates to national security, the defence of Canada or the conduct of international affairs.

It is significant to note that neither the IDA nor RS are designated as “investigative bod[ies]” under the regulations enacted pursuant to PIPEDA.<sup>21</sup>

Based on the absence of the IDA and RS from the extensive list of organizations considered by the federal government to be “investigative bodies,” it would appear that this exception does not apply to the SROs. As a result, disclosure to the SEC or other foreign law enforcement agencies by either SRO of personal information collected by an individual or company under investigation may violate the SROs’ own privacy policies on the subject since such disclosures may not be consistent with applicable privacy laws. To date, this issue remains unresolved.

## **VI. CLIENT RIGHTS DURING IMET/SEC/DOJ INVESTIGATIONS**

### **A. IMET Investigations**

As previously stated, the RCMP and IMET have no power to compel anyone to cooperate with them save and except by production order or search warrant. If the client wishes to cooperate, written terms for the interview should be obtained in advance. These terms should include at least the following:

- (1) the client is not a target; and
- (2) the evidence obtained at the interview shall not be used directly or indirectly against the client in any subsequent proceeding.

### **B. The Presence of American Authorities at Regulatory Interviews**

Cross-border securities litigation is a common reality with Canadian companies listing their securities on both Canadian and U.S. exchanges. One of the issues Canadian and U.S. defence counsel should consider is how to deal with voluntary and compelled requests for information as part of multi-jurisdiction civil, regulatory and/or criminal securities related proceedings. There are significant differences in the degree to which Canadian and U.S. laws protect an individual’s right against self-incrimination. These differences pose special problems for cross-border investigations into securities-related offences.

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<sup>21</sup> Regulation Specifying Investigative Bodies, S.C., 2000 c. 5, SOR/2001-6.

Under Canadian law, the right against self-incrimination does not give a witness the right to refuse to answer questions in civil and regulatory proceedings on the basis that the answer might incriminate him or her in subsequent criminal proceedings. Instead, the individual may be compelled to answer incriminating questions but is protected against the use or derivative use of that evidence in subsequent proceedings. As long as the investigations are compelled by statute, this protection raises no issues with respect to investigations confined to Canada. However, because Canadian law is of no effect in U.S. proceedings, there is a risk that an individual's right against self-incrimination in U.S. proceedings may be compromised by compelled examinations in Canadian investigations.

### **C. Protection from Self-Incrimination in Canada: ss. 13, 7 and 11 of the *Charter***

Section 13 of the *Charter* guarantees an individual protection from self-incrimination and states that, "a witness who testifies in any proceeding has the right not to have any incriminating evidence so given used to incriminate that witness in any other proceedings, except in a prosecution for perjury or for the giving of contradictory evidence." This privilege, known as "use immunity," applies to both compelled and voluntary evidence. The production afforded by s. 13 does not require the individual to first object to questions on the basis that it may incriminate them.

Section 7 of the *Charter* has been interpreted to provide "derivative use" immunity protection against the admission of evidence in a subsequent proceeding that could not have been obtained "but for compelled testimony in a prior proceeding." In addition, an individual's evidence is not compellable if the sole or predominant purpose for seeking the evidence is to obtain incriminating evidence against the person. Furthermore, s. 7 of the *Charter* has been held to guarantee the right to remain silent before any proceeding where an individual is an accused subject to penal sanctions or which otherwise engages s. 7 of the *Charter*.

Section 11(c) of the *Charter* guarantees that "any person charged with an offence" has the right "not to be compelled to be a witness in proceedings against that person in respect of the offence." This exemption provides immunity from testifying where proceedings are undertaken or predominantly used to obtain evidence for the prosecution of the witness.

There are therefore three safeguards in Canada against self-incrimination: use immunity, derivative use immunity and an exemption from testifying under s. 11(c).<sup>22</sup> As a result, it seems clear that unless a witness is being asked to testify for the sole or predominant purpose of obtaining incriminating evidence for the prosecution of that witness, an individual is not allowed to refuse to answer questions on the ground that the answer may be incriminating.

In *British Columbia Securities Commission v. Branch*, [1995] 2 S.C.R. 3, one of the issues considered by the Supreme Court of Canada was whether individuals who might be charged with a criminal or quasi-criminal offence could be compelled to give evidence and produce documents. In this case, the B.C. Securities Commission investigated a company after trading in its shares

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<sup>22</sup> "Cross-Border Securities Litigation: Co-ordinating Defences and Investigations - Differing Rights Against Self-incrimination," Paper presented by Steve Etna at the Canadian Institute's 4th Annual Advanced Forum on Securities Litigation, Ogilvy Renault (November 29 and 30, 2004), p. 3

was stopped following an indication by the company's auditors that they were unable to confirm that the company's financial statements were prepared in accordance with generally accepted accounting principles. Two of the company's directors were issued summons' to compel their attendance for examination. When counsel for the directors advised the Commission that the investigation appeared to be preliminary to possible criminal and quasi-criminal charges against the directors and that the directors would rely upon their right to remain silent, the Commission petitioned the court for a contempt order. The directors in turn sought a declaration that the provision in the B.C. *Securities Act* that provides an investigator the power to summon witnesses and to compel their testimony violated s. 7 of the *Charter*.

The Supreme Court of Canada found that there was nothing in the record to suggest that the purpose of the summons in this case was to obtain incriminating evidence against the individual directors. The predominant purpose of the inquiry was to obtain relevant evidence for the purposes of the *Securities Act* proceeding and not to incriminate the individuals. The court went on to note that if it is shown that the only prejudice is the possible subsequent derivative use of the testimony, then the compulsion to testify will occasion no prejudice for that witness because the witness will be protected against such use by derivative use immunity.

One author has concluded that the Supreme Court of Canada's decision in *Branch, supra*, leads to the following three alternatives:

1. The evidence has no relevance other than to incriminate the witness, in which case it is not compellable;
2. The evidence has relevance to the proceeding in which the witness is called, that the predominant purpose is to incriminate the witness. In such a case, securities regulators seeking to compel the evidence must justify the potential prejudice to the witness' right against self-incrimination. A witness' right against self-incrimination will not be prejudiced if the witness has protection against use and derivative use of his or her evidence. However, if the witness can show any other significant prejudice that may arise from his or her evidence, then it should not be compellable; and
3. The evidence has other relevance to the proceeding in which the witness is called, and the predominant purpose is not to incriminate the witness. In such a case, the person will be compellable but will receive both "use immunity" and "derivative use immunity" by virtue of s. 7 and 13 of the *Charter*.<sup>23</sup>

It is not clear whether the effect of *Jarvis* effectively undermines the statement made in paragraph 3 above with respect to both use and derivative use immunity. In *Jarvis*, the information collected prior to the change of the primary purpose of the investigation was admissible against the accused.

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<sup>23</sup>ibid, pp. 5-6.

#### **D. Protection Against Self-Incrimination in the US: The Fifth Amendment**

The American approach to protection from self-incrimination differs from the Canadian approach. In the United States, a witness fearing self-incrimination can claim the Fifth Amendment and refuse to answer the question. The Fifth Amendment states that no person shall “be compelled in any criminal case to be a witness against himself.”

This difference in the law means that individuals who are compelled to give evidence in Canada may lose their Fifth Amendment protection in U.S. proceedings through the introduction into evidence in that country of testimony obtained in Canadian investigations or proceedings. As noted by Cumming J. in *Royal Trust Corp. of Canada v. Fisherman* (2000), 49 O.R. (3d) 187 (Supp. Ct. J.):

There is no definitive, controlling United States Supreme Court authority deciding the issue as to the Fifth Amendment’s application to evidence compelled by foreign officials. There is a risk that the Fifth Amendment may not apply in respect of evidence gained through foreign court proceedings ...

The introduction of the *Oxley Act* along with aggressive SEC enforcement of securities violations makes the issue of whether an individual should invoke Fifth Amendment rights during SEC investigations in criminal proceedings increasingly important. Where individuals are involved in cross-border investigations and there is a risk of criminal proceedings, both Canadian and U.S. counsel should carefully consider what the effect will be of answering questions in a Canadian investigation or proceeding on the admissibility of their answers in U.S. criminal proceedings.

There are two main issues in an inquiry into the admissibility in a U.S. proceeding of incriminating statements compelled in a Canadian proceeding:

... (1) Does the Fifth Amendment privilege apply to self-incriminating testimony or documents lawfully compelled in a foreign proceeding when sought to be based in a U.S. criminal proceeding and not obtained by foreign officials as agents for U.S. law enforcement agents; and (2) If the Fifth Amendment does apply, will the actions of the individual defendant constitute a waiver of Fifth Amendment protections (i.e. is the nature and form of the ‘compulsion’ sufficient to qualify as a voluntary waiver).<sup>24</sup>

As Cumming J. noted in *Fisherman, supra*, however, there is no definitive authority deciding this point.

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<sup>24</sup> *ibid*, p. 7

**E. Issues Arising Where the Predominant Purpose of the Interview Is To Provide Information To the SEC or U.S. DOJ For the Prosecution of a Criminal Offence.**

Recently, the IDA has made efforts to involve SEC or DOJ lawyers or investigators at IDA interviews. The presence of foreign authorities at these interviews give rise to serious concerns with respect to *Charter* protection and obligations that brokers have pursuant to the common law and the various privacy statutes.

If the predominant purpose of an interview conducted in Canada by Canadian regulatory authorities is to provide information to the SEC or U.S. DOJ for, *inter alia*, the prosecution of a criminal offence, any interview conducted by the Canadian regulatory authorities would likely breach the provisions of s. 7 and, potentially, s. 13 of the *Charter*.

The Supreme Court of Canada in *Jarvis*, *supra* held that once the predominant purpose of the inquiry is the investigation of a criminal offence, investigators must resort to traditional criminal investigatory techniques. The court stated at paragraph 98:

In summary, whenever the predominant purpose of an inquiry or question is the determination of penal liability, criminal investigatory techniques must be used. As a corollary, all Charter protections that are relevant in the criminal context must apply.

As a result of the above, it is unlikely that individuals can be compelled to attend interviews conducted by Canadian regulatory authorities at which employees of the SEC or U.S. DOJ are in attendance. While Canadian regulatory authorities will be unlikely to cooperate with requests for information by U.S. authorities for criminal prosecutions as a result of the decision in *Jarvis*, *supra*, this may not prevent the SEC and U.S. DOJ from attempting to use the IDA and RS to collect this very same information. Nevertheless, should the U.S. authorities wish to obtain such information, they should be forced by the client to follow the proper and formal channels. In other words, they should make a request to the appropriate Securities Commission to obtain evidence on their behalf or resort to the MLAA to collect evidence in Canada. In the event they follow proper channels, they may be entitled to obtain the same, and at the same time, the constitutional rights of individuals subject to investigation in Canada would be protected.

In *The Investment Dealers Association of Canada v. Gruson*,<sup>25</sup> a disciplinary hearing was held with respect to an alleged violation of By-law 19.5. The respondent, Mr. Gruson, was prepared to attend at an IDA interview but failed to do so on the basis that he objected to the presence of a U.S. regulator at the interview. The legal issue that was argued was whether a representative of the SEC was entitled to attend at and participate in an IDA interview of Mr. Gruson in the course of a properly constituted IDA investigation. The hearing panel held that the SEC personnel were not allowed to attend at the IDA interview.

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<sup>25</sup> In the Matter of Discipline Pursuant to By-law 20 of the Investment Dealers Association of Canada Re: Brian David Gruson, Ontario District Court, December 24, 2004.

Prior to objecting to the attendance of the SEC at the interview, the respondent received a letter of immunity from the SEC which was not acceptable to him. At the hearing, the IDA argued that their by-laws were broad enough to encompass the attendance of the SEC at such an interview. The IDA further argued that the respondent could not dictate who the IDA may bring to the interview to assist in the investigation, as that would hinder the IDA's ability to properly investigate complex regulatory misconduct. The respondent argued that the IDA by-laws do not expressly allow a representative of the SEC to attend and participate in an IDA interview. The respondent further argued that he had concerns as to whether his attendance would constitute an interview by the SEC and whether the respondent would be subject to U.S. legal proceedings as a result of attending the interview.

The hearing panel accepted the respondent's argument and that there were legitimate concerns as to what the SEC or other courts or tribunals in the United States might make of evidence obtained by the SEC's participation in that interview. As a result, the hearing panel held that a representative of the SEC should not be allowed to attend or take part in the respondent's interview with the IDA. In doing so, the hearing panel agreed that there were legitimate concerns about what rights of protection under the Fifth Amendment would be available at the IDA interview and later in possible proceedings in the United States.

Conversely, in *United States of America v. Shull*, [2004] B.C.J. No. 528 (B.C.S.C.), the B.C. Supreme Court considered the issue of whether s. 13 of the *Charter* applied to prevent compulsory depositions given under oath in the United States during the course of an SEC investigation from being admitted against the deponents in extradition proceedings. In this case, the United States of America sought the extradition of, inter alia, Mr. Fiessel and Mr. Shull on charges of securities fraud. At the extradition hearing, the United States relied on an affidavit which included copies of depositions given by Mr. Shull and Mr. Fiessel. The ruling was limited to the admissibility of the contested evidence.

The *Treaty on Extradition between the Government of Canada and the Government of the United States of America*<sup>26</sup> (the "*Treaty*") allows a Canadian court to admit evidence in support of an extradition request subject to that evidence being otherwise admissible under Canadian law. Both Mr. Fiessel and Mr. Shull gave depositions under oath in the United States during the course of the SEC investigation. Mr. Fiessel and Mr. Shull submitted that the depositions could not be used against them in Canadian extradition proceedings because s. 13 of the *Charter* prohibits the use of incriminating evidence gathered in other proceedings. Goepel J. cited at length from the Supreme Court of Canada decision in *R. v. Noelle*, [2002] 3 S.C.R. 433 which discussed the underlying rationale of s. 13 of the *Charter*. Goepel J. cited paragraphs 21 and 22 of Arbour J.'s decision in *Noelle*, supra, which distinguished the Canadian and American positions in regards to a witness' statutory protection against self-incrimination:

Section 13 reflects a long-standing form of statutory protection against compulsory self-incrimination in Canadian law, and is best understood by reference to s. 5 of the *Canada Evidence Act*. Like the statutory protection, the constitutional one represents what Fish J.A. called a quid pro quo: when a witness who is compelled to give evidence in a court proceeding is

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<sup>26</sup> Signed at Washington on December 3, 1971, as amended by an Exchange of Notes on June 28 and July 9, 1974.

exposed to the risk of self-incrimination, the state offers protection against the subsequent use of that evidence against the witness in exchange for his or her full and frank testimony. If the evidence proffered is less than full and frank, the witness is subject to prosecution for perjury or for the related offence of giving contradictory testimony. In the United States, a different arrangement is in place: faced with the prospect of self-incrimination, the witness can claim the Fifth Amendment, and refuse to provide the incriminating answer. The state then has to dispense with his evidence altogether. As the United States Supreme Court stated in *Malloy v. Hogan*, 378 U.S. 1 (1964), a pp. 7-8: "[T]he American system of criminal prosecution is accusatorial, not inquisitorial, and... the Fifth Amendment privilege is its essential mainstay.... Governments, state and federal, are thus constitutionally compelled to establish guilt by evidence independently and freely secured, and may not by coercion prove a charge against an accused out of his own mouth." See generally McCormick on Evidence (5th ed. 1999), vol. 1 at pp. 450-518.

Under the regime of the *Canada Evidence Act*, and now also under the Charter, a different bargain is struck. When a witness provides evidence in any proceedings, whether voluntarily or under legal compulsion, he or she cannot refuse to answer a question that may tend to incriminate the witness, but is offered protection against the subsequent use of that evidence. The question before us is the extent of that protection. To answer that question, it is important to remember its root in the *quid pro quo*. The witness, now accused, gave something in exchange for the protection. This is what makes a statement given in a judicial proceeding different from a statement to a person in authority, which is governed by rules of admissibility that are relevant to the special concerns related to that type of statement, and also different from all other out-of-court declarations and admissions.

The United States submitted that s. 13 of the *Charter* did not apply to exclude evidence at an extradition hearing because the evidence was not being tendered to incriminate but rather only to determine whether there was sufficient evidence to return the respondents to face trial in the foreign state. Goepel J. cited *Canada v. Schmidt*, [1987] 1 S.C.R. 500 in which LaForest J. concluded that s. 11 rights only apply to criminal proceedings conducted by the governments referred to in s. 32 of the *Charter* and that to extend them farther would give them extra-territorial effect. Goepel J. also cited *United States v. Dynar*, [1997] 2 S.C.R. 462, in which Corey J. and Iacobucci J. noted at page 222 that the court must exercise extreme caution in excluding foreign evidence from consideration in the extradition process on *Charter* grounds because it would be "difficult to imagine how such evidence could be excluded without indirectly applying the *Charter* extraterritorially to the foreign jurisdiction."

Goepel J. therefore held that to exclude the depositions of Mr. Fiessel and Mr. Shull would be to indirectly apply the *Charter* extra-territorially. Section 13 of the *Charter* therefore does not prohibit the introduction of depositions taken in another state because to hold otherwise would result in the requesting state being precluded from relying upon evidence that it had gathered in conformity with its own procedures that would be admissible in its own jurisdiction.

An issue remains as to whether or not counsel for a registrant who is asked to voluntarily attend an IDA interview should refuse to attend out of fears that the transcript of the proceedings may be disclosed to SEC investigators. This issue remains unresolved.

## VII. CONCLUSION

Recent corporate scandals in the United States during the last five years provided a mandate to the legislature and the judiciary in that country to take a tougher approach to securities fraud. In Canada, Parliament has ostensibly followed suit by enacting the recent amendments to the *Criminal Code* governing insider trading. One wonders however, whether the federal government will be true to its stated intention to limit involvement in what has traditionally been the sole jurisdiction of the provinces to a “narrow range of cases that threaten the national interest in the integrity of capital markets.” Sceptics may side with the Honourable Paul Crête who implored the House of Commons to “make sure that the federal government does not achieve through the back door what it has so far failed to do through the front door.” The more cynical may even question whether the recent amendments are merely “window-dressing.”

The increasing trans-national nature of securities litigation in North American capital markets means that the issues arising from the presence of American authorities at Canadian regulatory interviews will only become more prominent in the future. The protections afforded by the *Charter* to those required to provide potentially incriminating information during a regulatory investigation stops abruptly at our country’s borders while in many cases, the investigations themselves do not. As a result, defence counsel will have to be increasingly vigilant in protecting client interests whenever the involvement of a foreign state in Canadian regulatory investigations becomes a possibility.

It should be clear at this point that the recent amendments to the *Criminal Code* respecting insider trading raise a host of questions that will need to be answered in the coming years by judges in the courtrooms of this country. One thing is certain however: the enforcement landscape will continue to evolve as these and other as-yet-unforeseen issues arise in the regulation and prosecution of misconduct in Canadian capital markets and elsewhere.

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