

## Outlook 2020: Recent Developments in Insider Trading Cases and a COVID-19 Caution from the SEC

Stephanie Voudouris

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Canadian securities regulators have continued to focus on insider trading and tipping investigations and prosecutions since the Ontario Court of Appeal endorsed the use of circumstantial evidence in early 2018.<sup>1</sup> However, a recent decision from the Ontario Securities Commission (“OSC”), released in late 2019, serves as an important reminder of the need for OSC Staff to put forward an exhaustive case when attempting to advance allegations of insider trading and tipping based entirely on circumstantial evidence.

The past year also saw the COVID-19 pandemic give rise to novel challenges for market participants and regulators in combating the increased risk of insider trading and tipping. Given the unique circumstances caused by the pandemic, regulators in the United States have warned of a surge in the number of people that may have access to material non-public information, and have reminded market participants to be mindful of their obligations to keep this information confidential and avoid any inadvertent disclosure. While Canadian regulators have yet to issue similar warnings, the same concerns remain relevant for market participants on both sides of the border during these unprecedented times.

### No Insider Trading Without Clear, Convincing, and Cogent Evidence

In October 2019, the OSC released a long-awaited decision in *Re Hutchinson*, involving allegations of insider trading and tipping against Cameron Edward Cornish, a Toronto-based professional trader with over 25 years of experience.<sup>2</sup> Commission Staff alleged that Donna Hutchinson, a former legal assistant at a Toronto Bay Street law firm, communicated material non-public information about eight potential corporate transactions to Cornish, who, in turn, communicated some of that information to his friends, Patrick Jelf Caruso and David Paul George Sidders. Staff further alleged that Cornish, Caruso, and Sidders all traded based on that material undisclosed information, in contravention of the Ontario *Securities Act*.

Staff reached a settlement with Hutchinson, where she acknowledged providing material non-public information to Cornish over a four-year period. The Commission ultimately concluded that Cornish had engaged in insider trading based largely on the direct evidence provided by Hutchinson. Cornish did not appear or testify at the hearing.

Despite these findings against Cornish, the Commission did not conclude that Cornish had tipped Caruso and Sidders, and ultimately dismissed all allegations against both respondents. Staff’s case against Caruso

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and Sidders was entirely based on circumstantial evidence. In considering the evidence, the Commission concluded that the case advanced by Staff did not rise to the necessary level of “clear, convincing and cogent evidence” that makes it more likely than not that Caruso and Sidders had engaged in insider trading. With respect to Caruso, Staff struggled to present the type of comprehensive evidence required to draw an inference of insider trading based on his trading patterns. Instead, the Commission accepted that Caruso’s trades were largely consistent with his longstanding trading strategy. For Sidders, the Commission found that there was an absence of evidence of any uncharacteristic trading or suspiciously timely communications.

This decision serves as an important reminder about the need for Commission Staff to put forward a complete set of cogent and convincing evidence when advancing allegations of insider trading and tipping, especially when asking a panel to draw factual inferences based on circumstantial evidence. It also serves to narrow the wide-ranging impact of *Finkelstein v Ontario Securities Commission*, the Ontario Court of Appeal’s 2018 decision that approved of the use of circumstantial evidence in cases involving allegations of insider trading and tipping.<sup>3</sup>

*Re Hutchinson* also follows a February 2019 decision of the OSC in *Re Cheng*, involving allegations against Frank Soave, a registered investment adviser alleged to have purchased shares of Amaya Gaming Group Inc. (“Amaya”) while in possession of material non-public information, and shortly before the announcement of an acquisition that would make Amaya the world’s largest online gaming company.<sup>4</sup>

Soave routinely received recommendations and market information from Aston Hill Asset Management Inc. (“AHAM”), a financial company that managed and administered mutual funds, private equity funds and other investment products. Shortly before the announcement of the transaction involving Amaya, John David Rothstein, an officer of AHAM, contacted Soave and suggested he buy Amaya shares based on the expected transaction. Unbeknownst to Soave, AHAM had participated in the financing of the transaction and was therefore in a special relationship with Amaya, prohibiting AHAM or any of its officers or employees from sharing material non-public information regarding Amaya.

The central issue before the OSC was whether Soave knew or ought to have known that AHAM, and Rothstein, were in a special relationship with Amaya, thereby putting Soave himself in a special relationship with the issuer and prohibiting him from trading in any Amaya shares. Based on a review of the detailed evidentiary record, the panel concluded that Soave did not in fact know that Rothstein was in a special relationship with Amaya. The panel reasoned that although Soave, as an experienced broker and registrant, was under a “higher standard of alertness,” it was not unreasonable for him to believe that the information regarding Amaya came from a portfolio manager or analyst who was following Amaya closely, and making recommendations based largely on rumors or other developments regarding a potential transaction. The panel further reasoned that the factual determination was a close question, but that where the evidence permits an inference to be drawn in either direction, Staff has not satisfied their standard of proof. Accordingly, all allegations against Soave were dismissed.

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The reasoning of the OSC in both *Re Hutchinson* and *Re Cheng* highlight the difficulty for Staff in asking that a panel draw an inference based on the available – largely circumstantial – evidence. Both decisions further reinforce the high burden on Staff to prove its case on a balance of probabilities, and based on clear, convincing and cogent evidence, when advancing allegations of insider trading and tipping.

## **SEC Warns of Heightened Risks of Insider Trading Due to the COVID-19 Pandemic**

In March of this year, the SEC (Co-Directors of the United States Securities and Exchange Commission Division of Enforcement) issued a public statement emphasizing the importance of maintaining market integrity and following proper corporate controls and procedures relating to reducing the risk of insider trading and tipping in the wake of the COVID-19 pandemic.<sup>5</sup>

While Canadian regulators have not yet followed suit, the SEC public statement is instructive for market participants on both sides of the border, as regulators in both Canada and the United States remain largely preoccupied with the extraordinary impact of the COVID-19 pandemic and the many government-led initiatives introduced to address it. As the OSC reminded market participants in its own March update on its operations in response to the COVID-19 pandemic, investor protections and regulatory requirements remain “fully in place” and remain critical to the fair and efficient operation of Ontario’s capital markets.<sup>6</sup>

In this rapidly changing environment, businesses around the world have struggled to deal with the economic impact of COVID-19. Many issuers have been forced to close or significantly alter their business models in response to the pandemic and to government regulations and initiatives aimed at limiting the spread of the virus. As noted by the SEC, undisclosed material information relating to the impact of the pandemic on business performance or operations may hold even greater value now than under normal circumstances.

Quarantine restrictions have also resulted in a significant increase in remote working, presenting unique opportunities for the intentional or unintentional dissemination of material non-public information. As noted by the SEC, a greater number of people may now have access to undisclosed material information than would have had access during pre-pandemic times. Certain issuers may also avail themselves of extensions to usual filing deadlines, requiring them to secure material non-public information for longer periods of time.

To protect themselves from the threat of an insider trading investigation or enforcement action, issuers should take this opportunity to re-evaluate their internal controls and insider trading policies to ensure that they adequately address the unique issues and challenges that may arise as a result of the COVID-19 pandemic. Issuers should also take additional steps to monitor employee compliance and clearly communicate to all employees the need to remain vigilant during these troubling times.

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## Outlook

The recent OSC decision in *Re Hutchinson* confirms that despite Commission Staff's ability to rely on circumstantial evidence, clear, convincing, and cogent evidence is still required to prove allegations of insider trading and tipping. Trading activity in advance of significant corporate transactions will continue to be heavily scrutinized by regulators, especially given the increased risks arising from the COVID-19 pandemic. Corporations and their directors, officers, and compliance officers would be well advised to prioritize robust proactive compliance regimes to detect and prevent illegal insider trading and tipping.

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<sup>1</sup> *Finkelstein v Ontario Securities Commission*, 2018 ONCA 61 [*Finkelstein*]. This long-running, high profile insider trading case involved a Toronto M&A lawyer and various other capital market participants.

<sup>2</sup> 2019 ONSEC 36.

<sup>3</sup> *Finkelstein* at para. 58.

<sup>4</sup> 2019 ONSEC 8.

<sup>5</sup> SEC, Public Statement, "Statement from Stephanie Avakian and Steven Peikin, Co-Directors of the SEC's Division of Enforcement, Regarding Market Integrity" (March 23, 2020), online: <<https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>>.

<sup>6</sup> OSC, News Release, "Update on OSC operations in response to COVID-19" (March 24, 2020), online: <[https://www.osc.gov.on.ca/en/NewsEvents\\_nr\\_20200324\\_update-osc-operations-response-to-covid-19.htm](https://www.osc.gov.on.ca/en/NewsEvents_nr_20200324_update-osc-operations-response-to-covid-19.htm)>.

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