Cassels

The SEC Comes to BC for a Mareva

April 12, 2023

Overview

The British Columbia Supreme Court (the Court) recently released a decision[1] granting the United States Securities and Exchange Commission (the SEC) a *Mareva* injunction against four defendants from British Columbia. The injunction was granted in connection with ongoing SEC proceedings (the US Proceeding) against the defendants before the United States District Court, District of Massachusetts (the US Court). In the US Proceeding, the SEC seeks disgorgement remedies from the defendants as well as civil monetary penalties for their roles in a "pump and dump" scheme that allegedly defrauded investors of approximately $1.3 billion. In granting the *Mareva*, the Court considered arguments relating to: breach of the defendants' Canadian and US constitutional rights; the Court's jurisdiction to grant the *Mareva*; and concerns around overlapping or duplicative orders.

The Court's decision demonstrates the ability of the SEC to seek and obtain pre-trial remedies from Canadian courts against defendants in Canada in aid of US civil proceedings.

The Allegations

In the US Proceeding, the SEC alleges that the defendants acted in concert to raise the share prices of two public companies, "Vitality" and "Arch," which were secretly controlled by the defendants' affiliates, and then to rapidly sell their shares at an artificially inflated price – a classic "pump and dump" scheme. The defendants allegedly assisted their clients in concealing their identities, thereby allowing their clients to avoid reporting and disclosure requirements applicable to large share sales and allowing them to anonymously hire stock promotors in furtherance of the "pump and dump." These services included encrypted communication devices called xPhones, and servers located in Curacao through which the defendants maintained encrypted communications. They also used a separate accounting system and offered clients the use of offshore nominee companies that could be used to hold shares.

SEC Investigation

The SEC obtained a temporary restraining order in the US Proceeding, freezing the assets of the defendants, and preliminary injunction orders against certain defendants. Additionally, under the reciprocity

rules between the British Columbia Securities Commission (BCSC) and the SEC, the BCSC issued preservation orders against the defendants.

Nonetheless, the SEC also sought a *Mareva* injunction from the Court on the basis that it is under-secured with respect to its claim for disgorgement against the defendants, and that the existing orders in place do not cover all of the assets held by the defendants.

The Decision

Jurisdiction

The defendants argued as a threshold issue that the Court does not have jurisdiction in this case to grant a free-standing *Mareva* in support of a foreign proceeding. They argued that the Court may only grant a free-standing *Mareva* injunction in circumstances where the dispute between the parties in the foreign proceeding is justiciable in the BC Court. As the US Proceeding is grounded in breaches of US securities statutes, the dispute is not justiciable in the Court.

The Court considered the law and confirmed that, in the past, a free-standing injunction sought by a non-party in British Columbia could only be granted in circumstances where the dispute between the parties in the foreign proceeding is justiciable in the Court.[2] However, the Supreme Court of Canada adopted a new approach in *Brotherhood of Maintenance of Way Employees Canadian Pacific System Federation v. Canadian Pacific Ltd.*, [1996] 2 S.C.R. 495, 136 D.L.R. (4th) 289 (S.C.C.) [*BMWE*].[3] *BMWE* states that "the courts have jurisdiction to grant an injunction where there is a justiciable right, wherever that right may fall to be determined."[4] This statement of the law has been recognized and applied by the Court.[5]

As such, the Court held it has jurisdiction to grant a *Mareva* injunction in aid of a foreign proceeding, even when the issue between the parties in the foreign proceeding is not justiciable before the Court.

Fifth Amendment of the US Constitution

The defendants argued that granting the injunction would result in skirting the protections of the Fifth Amendment of the US Constitution. The defendants invoked the Fifth Amendment in the US Proceeding to avoid financial disclosure, and argued that the *Mareva* injunction would require the defendants to produce an asset list. The Court held this argument was misconceived. The Fifth Amendment only protects from self-incrimination, not civil liability. There is no criminal proceeding in the US. The US proceeding is a civil proceeding.

Canadian *Charter* Rights

The defendants also invoked their rights against self-incrimination protected by s. 7 and 13 of the *Charter*, claiming derivative use immunity. The Court did not accede to those arguments either. There was no prospect that the defendants would be compelled to give documentary evidence in the BC proceeding that could be used against them in a future US or Canadian proceeding. The only evidence that was compellable was a list of the defendants' assets, which is a customary element of a *Mareva*. As the SEC seeks a civil injunction in aid of a US civil proceeding, the derivative use immunity provided under s.7 and 13 is not engaged. The order from the Court contemplates the SEC undertaking that the information disclosed will only be used for the purposes of the action in BC and the civil US Proceeding, which in turn prevents the use of that evidence in a subsequent criminal proceeding.

Further, the defendants claimed that their s.8 *Charter* right from unreasonable search and seizure was violated when the BC Securities Commission gathered information and shared it with the SEC. The claim that the actions by the BC Securities Commission amounted to a warrantless search was rejected by the Court. The Court found that the defendants failed to establish that a warrantless search and seizure ever took place and there was no *Charter* violation.

***Mareva* Injunction**

After dismissing the defendants' threshold arguments, the Court turned to the merits of the *Mareva*. The legal test for a *Mareva* injunction is a two-part test. It requires an applicant to establish: (1) a strong prima facie or good arguable case; and (2) in balancing the interests of the parties, to consider all the relevant factors, including: (i) the existence of exigible assets by the defendant both inside and outside the jurisdiction; and, (ii) whether there is evidence of a real risk of disposal or dissipation of those assets that would impede the enforcement of any favourable judgment to the plaintiff. The Court then weighs the evidence before it to determine if the balance of convenience favours granting the injunction.

The Court held that the SEC had a strong prima facie case on the evidence and that it was not necessary for the plaintiffs to have submitted expert evidence of foreign US law. The Court was not applying US securities law; rather it was only evaluating the plaintiff's prospects of success in the US. The Court decided the US law was similar enough and simple enough that the manifestly fraudulent behaviour of the defendants was unlawful under US securities laws. The extensive affidavit of an SEC investigator, which included at least one detailed fraudulent transaction involving each defendant, was sufficient to meet the strong prima facie case test.

The Court held that the following three factors are of particular importance in weighing the balance of convenience in this case: the presence of assets in BC; the fact that the current freezing orders in place leave the plaintiff under-secured with respect to its disgorgement claim; and the risk of dissipation of assets.

Firstly, the defendants own assets in BC – mostly real estate and vehicles. Secondly, the disgorgement amounts sought by the SEC are approximately US$70 million in total and range from around $2 million to

$20 million per defendant. The amount of assets frozen prior to the *Mareva* application was around $37 million. Finally, the Court found that the risk of dissipation of assets was high given the conduct alleged, the types of assets involved, and the general circumstances. The defendants were allegedly engaged in a complex securities fraud scheme that involved shell companies, secret encrypted communications, and a clear pattern of deceptive behaviour.

Overlapping or Duplicative Orders

The defendants argued that the BC proceeding is an abuse of process because it is duplicative of the US Proceeding. They further argued that it was impossible for them to comply with the temporary restraining order, injunctions, and preservation orders issued by the US Court and the BCSC while also complying with the *Mareva* order due to differences in the wording of the various orders. In response, the Court held that the *Mareva* order was drafted in complement, not contrary, to the existing orders and avoids any overlap between the freezing orders already in place.

Conclusion

This unique fact pattern asked the Court to decide how an application from a foreign government agency for a *Mareva* injunction against Canadian defendants should be decided when those defendants have allegedly participated in a large complex scheme to defraud investors entirely outside BC. The defendants raised interesting constitutional and jurisdictional arguments which the Court ultimately dismissed in favour of freezing the assets of the BC based defendants in aid of the SEC's US Proceeding. This decision shows that the Canadian border is not an obvious impediment to the SEC in its pursuit of alleged wrongdoers.

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[1] *United States Securities and Exchange Commission v. Sharp*, 2023 BCSC 425 (*Sharp*).

[2] *Siskina (Cargo Owners) v. Distos Compania Naviera S.A.*, [1977] 3 All E.R. 803 at 825 (H.L.).

[3] *Brotherhood of Maintenance of Way Employees Canadian Pacific System Federation v. Canadian Pacific Ltd.*, [1996] 2 S.C.R. 495, 136 D.L.R. (4th) 289 (S.C.C.) (*BWME*).

[4] *BMWE* at para 16.

[5] *Mishkin (Trustee of) v. Roddy DiPrima Ltd.*, [1996] B.C.J. No. 2660 (S.C.); *United States of America v. Friedland*, [1996] B.C.J. No. 2845 (S.C.).

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