



## Regulatory Investigations: Best Practices

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# AGENDA:

- Inspections / Audits vs. Investigations
  - Context and Significance
  - “Predominant Purpose” test
  - When is the “adversarial relationship” engaged
  - Remedies / Outcomes for your investigation

# Inspections / Audits vs. Investigations

- THE critical question in any regulatory investigation: at what point does an “inspection” or “audit” cross the line and become an “investigation”.
- The distinction is not merely semantic – the answer will determine whether documents, statements, and any other evidence derived therefrom may be used in enforcement proceedings, or may be excluded.

# Case Study: *Jarvis* – The Facts

- *Dramatis Personae*
  - Warren James Jarvis: former businessman-turned-breeder
  - Georgia Jarvis: deceased wife of Mr. Jarvis, and a prominent local artist
  - Tom Burke: Jarvis' accountant
  - Donna Goy-Edwards: CCRA auditor
  - John Moriarty: Edwards' supervisor
  - Donna Chang: CCRA investigator
  - The 9 Justices of the Supreme Court of Canada

## Case Study: *Jarvis*<sup>1</sup> – The Facts

- Key Facts:
- In early 1994, CCRA received an anonymous tip that Jarvis failed to report substantial income from the sale of his wife's paintings; the names of 6 Calgary art galleries were provided.
- Although CCRA internal policy was for such tips to be handled by the Investigations Section, the tip was instead referred to Edwards in the Audit Section.
- Edwards notified Jarvis that both his file and that of his late wife's estate had been selected for audit. A request for the production of certain relevant documents was made, with a 15-day response deadline.

<sup>1</sup>*R. v. Jarvis*, [2002] 3 SCR 757

## Case Study: *Jarvis* – The Facts

- Having had no response from Jarvis, Edwards began independent research about Mrs. Jarvis' art work in the local library. This led her to contact the 6 galleries named in the tip, and 3 additional galleries, all of which had purchased works of Mrs. Jarvis.
- From the galleries' records, Edwards determined that in 1990 and 1991, Jarvis had grossed approx. \$580K in art sales. Endorsements on the cheques yielded information about Jarvis' banking arrangements.
- Edwards, Jarvis and Burke exchanged calls. Burke/Jarvis claimed that Jarvis had netted \$111K in art sales in the relevant period, reported as farm income on his returns.

## Case Study: *Jarvis* – The Facts

- The parties arranged an April 11<sup>th</sup> meeting at Jarvis' farm to review his books and records. Edwards did not disclose that she had conducted independent research into the art sales. Edwards questioned, and Jarvis confirmed, the \$111K figure.
- Edwards also indicated that she would be accompanied by an “assistant”. In fact, Moriarty (her supervisor) attended.
- At the meeting, Jarvis was not cautioned as to his rights. He answered a variety of questions, mostly relating to art (and not farming income), provided banking information and records relating to art sales, and agreed to obtain and provide additional records.

## Case Study: *Jarvis* – The Facts

- A few weeks later, Jarvis provided most of the additional records. Edwards reviewed the materials and noted a discrepancy of \$700K between Jarvis' actual and reported income. She concluded that fraud may have occurred, and further investigation was warranted.
- Rather than completing the audit, Edwards transferred her file (and all records) to the Investigations Section. She did not contact Jarvis to notify him of this decision. Jarvis continued to provide records pursuant to the original request.
- Donna Chang in Investigations took over the file. She regularly met with Edwards to understand the case, and began preparing an Information to Obtain a Search Warrant.

## Case Study: *Jarvis* – The Facts

- Meanwhile, both Burke and Jarvis had contacted Edwards on numerous occasions for a status update. Chang instructed Edwards to “stall” in responding to these queries, and not disclose that an investigation had been commenced. Contrary to CCRA policy, these instructions were not recorded.
- Edwards generally ignored the messages from Jarvis and Burke. When Burke finally made contact, she made excuses to explain the slow progress of the audit. (CCRA policy instead provided that the taxpayer should have been informed that the case had been referred for investigation.) Senior management were informed of the responses that had been given to Jarvis, but no correction was made.

## Case Study: *Jarvis* – The Facts

- In late November 1994, a search warrant was obtained under section 487 of the *Criminal Code* and searches carried out at Jarvis' home, Burke's home/office and CCRA's Calgary office (to obtain Edwards' files). A significant volume of records was seized, and ultimately used at trial.
- In early 1995, Chang issued document production notices under the *Income Tax Act* to Jarvis' various banks, in order to compel the production of additional documents.
- Jarvis was eventually charged and prosecuted for 3 counts of making false or deceptive statements in an income tax return, and 2 counts of tax evasion (= fines plus max. 2 years prison).

## Case Study: *Jarvis* – The Law

- Regulatory investigations operate between the competing interests of the individual's rights to liberty (s. 7) and privacy (s. 8), and the state's need to regulate conduct and “put relevant evidence before the trier of fact in a search for the truth”.
- The courts recognize and generally protect a regulator's right to conduct audits or inspections to ensure conformity with legislation.
- However, when the “predominant purpose” of any inquiry becomes the determination of penal liability, regulators must give up their audit/inspection powers and use only their investigation powers, in a manner consistent with the *Charter*.

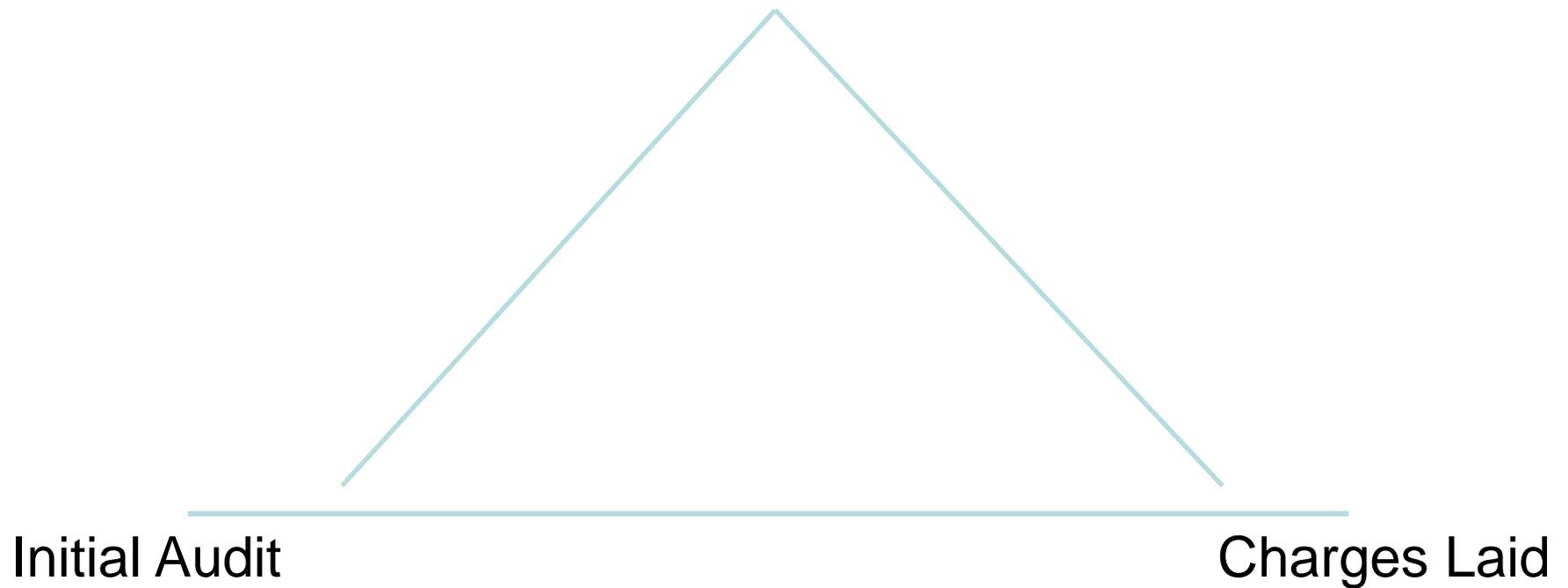
## Case Study: *Jarvis* – The Law

- Regulators will “cross the Rubicon” when the inquiry in question “engages the adversarial relationship between the [individual] and the state”.
- How do we know at what moment the dynamic shifts to trigger the “predominant purpose” test?
  - Sliding scale: somewhere between the initial audit and the laying of charges/initiation of enforcement proceedings.

## Case Study: *Jarvis* – Significance

- The results of a *Charter* violation can be devastating to enforcement proceedings:
  - Trial judge concluded that after the March 16, 1994 phone call, in which Jarvis claimed \$111K in art sales profits, Edwards moved from audit to investigation.
  - As a result, Jarvis should have been cautioned at the April 11<sup>th</sup> meeting at his farm.
  - Since he was not, any information obtained at that meeting was excluded and could not be used at trial.
  - That information was later used in the warrant application, meaning the search warrant was improperly obtained.
  - Thus, all information from the searches was also excluded.
  - Defence counsel obtained a directed verdict of acquittal.

Question: When do regulators “cross the Rubicon”?



# Case Study: *Jarvis* – The Law

- At the earliest:
  - More than “mere suspicion” – otherwise, auditors could never gather enough information to support a search warrant application “if the mere whiff of suspicion were enough to freeze auditorial fact-finding”.
  - Court notes that even where reasonable grounds to suspect an offence exist, this may not always be enough to trigger the predominant purpose test.
  - Courts “must guard against creating procedural shackles on regulatory officials”.
    - But beware the slippery slope here (see below) – the better course is to refer the matter for investigation.

# Case Study: *Jarvis* – The Law

- At the latest:
  - The laying of charges is too late – the Court notes that “it would be a fiction to say that the adversarial relationship only comes into being when charges are laid”.
  - Allowing officials to use audit powers, which carry fewer *Charter* protections, might “promote bad faith” by prosecutors (*i.e.*, delay bringing formal charges in order to continue using less restrictive audit search powers).
  - **Where all of the ingredients of the offence are “reasonably thought to have occurred”, it is “likely” that the PP test is met.**

# Case Study: *Jarvis* – The Law

- The Predominant Purpose test – Key Factors:
  1. Did the regulator have reasonable grounds to lay charges? Does the record indicate that a decision to take enforcement proceedings could have been made?
  2. Was the general conduct of the regulator consistent with the pursuit of a criminal investigation?
  3. Had the auditor transferred his/her files to the investigative branch? If the auditor believes that a matter should be sent for investigation, “a court must examine the following behaviour very closely”.
  4. Was the conduct of the auditor such that he/she was acting as an agent for the investigators?

# Case Study: *Jarvis* – The Law

- The Predominant Purpose test – Key Factors (continued):
  5. Is the evidence sought relevant to statutory compliance generally, or does it relate to guilty intent (*mens rea*) or elements of penal liability?
  6. Are there other circumstances or factors to suggest that the audit had become an investigation?
- Possible examples of “other factors”:
  - Repeat offender or past history of violations.
  - Acting on a tip as to misconduct (engages past caselaw not explicitly over-ruled by *Jarvis*).
  - Investigating a suspect industry or trade association where others have been caught.

## Case Study: *Jarvis* – The Law

- Possible examples of “other factors” (continued):
  - Looking for evidence that goes beyond mere compliance with the language of the statute to particular aggravating or mitigating factors.
- The Court in *Jarvis* stressed that no single factor in this list is determinative – what is instead required is an examination of “the totality of the circumstances” in determining whether the predominant purpose test has been met.

## Case Study: *Jarvis* – Practicalities

- SCC made various statements that are very positive for regulators in theory, but dangerous in practice:
  - The existence of reasonable grounds to believe an offence has been committed “is not a sufficient indicator” in all cases to trigger the PP test.
  - The PP test does not prevent regulators from “conducting parallel investigations” using both audit and investigative powers, provided records and information obtained using the audit powers are not used in the penal investigation.
  - Although Edwards’ behaviour was “not praiseworthy” and “at points appears deceptive” towards Jarvis, the Court held that Edwards did not “cross the Rubicon”.

## Case Study: *Jarvis* – Practicalities

- These findings raise concerns for day-to-day audit and investigations practice:
  - Lower courts are generally less forgiving – witness the trial decision in *Jarvis*, where most of the records and information was excluded and the judge ordered acquittal.
  - Much of Edwards' behaviour, even before the transfer of the case to the Investigations Branch, appears to arguably fall within the Court's PP test.
  - Parallel investigations are especially dangerous and invite attack from defence counsel; if used, ethical walls and scrupulous record-taking (unlike in *Jarvis*) are essential.

## Case Study: *Jarvis* – Practicalities

- There has since been considerable debate by lower courts in the application of these wide-ranging statements.
  - At the outer edge, *R. v. Chahine-Badr* (Ont CJ, 2003): Even where CCRA suspects or has reasonable grounds to believe that tax evasion has occurred, it may employ the vehicle of an audit and use the audit powers under the Act, to clear or support the alleged wrongdoing. The audit may be lead-driven and lead-focused. There is no requirement that the auditor be up front or make full disclosure to the tax-payer. The auditor may pass his findings and any documentation received on to investigators who may use them in furtherance of an ensuing investigation into criminal liability.
  - But see, e.g., *R. v. Borg* (Ont CJ, 2007), where these statements from *Jarvis* and *Chahine-Badr* were cited by counsel but deflected by the court, which instead held that the CRA inspector's evidence was not credible and that her predominant purpose was to build a criminal case against the accused.

## Case Study: *Jarvis* – Practicalities

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## Case Study: *Jarvis* – Practicalities

- Ask yourself:
  - Was *Jarvis* a typical regulatory compliance case?
  - Would the Court's decision have been different if the case did not involve a wealthy individual that appeared to have hidden more than \$700K in income from the tax authorities?
  - What will the result be in more borderline cases?
  - What is the true cost, in dollars, management time and distraction, public relations, and respect for and integrity of a regulatory regime, of litigating a borderline case?
  - Should the success or failure of your case depend on how well your investigators perform under cross-examination?

## Case Study: *Jarvis* – Timeline

- February 1994: CCRA informs Jarvis of audit.
- August 1997: Provincial court judge enters directed verdict of acquittal for Jarvis.
- 1998: CCRA appeal to Alta Q.B. granted; new trial ordered.
- 2000: Alta C.A. denies Jarvis' appeal.
- November 2002: SCC denies Jarvis' appeal.
- February 2005: retrial of Jarvis with formerly excluded records and statements allowed – Jarvis acquitted.
  - Terrible outcome for the integrity of regulatory regime.
  - Never underestimate the poisoning effects of delay in a contested case.

## Applying *Jarvis* – Further Examples

- Where there is no shift from inspection/audit to investigation, the *Jarvis* rule does not apply (*R. v. Nolet*, SCC 2010; police spot inspection of vehicle leading to discovery of drugs did not cross the Rubicon as the context did not change).
- Where general purpose of regulator is criminal enforcement, very likely that any use of audit/inspection powers is at risk (*Ellingson v. MNR*, FCC 2005; evidence gathered by special branch of CRA working in joint operations with RCMP excluded, as intention was to send *all* evidence to RCMP).



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