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Insider Trading

Tips to Avoid Getting Caught Up in Enhanced
Scrutiny by Regulators

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Cautionary Note

The following provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.



Insider Trading — What is it?

- The purchase or sale of securities of a public company by a person or company in a “special relationship” with that public company with the knowledge of a material fact or material change with respect to that company that has not been generally disclosed
- Prohibited under corporate, securities and criminal law
- Includes purchase or sale of puts, calls, options, warrants and derivatives

“Special Relationship”

- Insider trading prohibition applies to those in a “special relationship” with the public company
- Larger group than just “insiders” (e.g. directors and officers) or “reporting insiders”
- Includes employees, an insider or associate of a company proposing to make a take-over bid or be a party to a business combination-like transaction with the public company and the directors, officers and employees of the proposing company – see list below
- However, regulators may determine trades to be contrary to public interest even if not in a “special relationship”

Paul Donald Decision

Facts:

- Research in Motion had been in discussions to purchase Certicom in 2007. RIM had been licensing technology from Certicom
- Discussions stalled in 2008, but Chris Wormwald continued to conduct due diligence on behalf of RIM for a potential acquisition
- In September 2008, the CEO of Certicom advised RIM that Certicom wished to restart negotiations

Paul Donald Decision

Facts:

- At a golf tournament on August 20, 2008, Paul Donald learned via a discussion with Chris Wormwald that RIM had previously engaged in confidential discussions for a potential acquisition, that it continued to be interested in acquiring the company and that the share price was undervalued based on the licensing agreements
- On the following morning of August 21, 2008, Paul Donald placed an order for \$300,000 worth of Certicom shares at \$0.05 above its current trading price, concluding trades between August 21, 2008 and September 15, 2008

Paul Donald Decision

Facts:

- In October of 2008, RIM had agreed to proceed with a negotiated transaction, and by November RIM's board had authorized a bid for Certicom
- A hostile bid for Certicom was launched on December 3, 2008, and ultimately a plan of arrangement was implemented on March 23, 2009, at approximately twice the price per share that Certicom traded at in August of 2008

Paul Donald Decision (cont'd)

Decision:

- In the context of an M&A transaction, Donald had not breached the insider trading provisions of the Ontario Securities Act as RIM was not in a special relationship with Certicom
- “Proposing”: there must have been some significant level of involvement and approval of the process at the highest corporate levels at RIM
- However, Donald’s conduct was contrary to the public interest as he (an officer of a public company) had purchased Certicom shares with knowledge of material facts that were not generally disclosed

“Generally Disclosed”

- Not defined, but has been interpreted to mean:
 - a) the information has been disseminated in a manner calculated to effectively reach the marketplace; and
 - b) public investors have been given a reasonable amount of time to analyze the information
- Posting information to website alone not likely to satisfy this requirement
- Including information in MD&A or AIF will not suffice

Material Facts and Material Changes

- Material fact:
 - fact that would reasonably be expected to have a significant effect on market price or value of securities
- Material change:
 - a **change in the business, operations or capital** that would reasonably be expected to have a significant effect on market price or value of securities
- Assessment must not be made technically or super-critically - contextual

Material Facts and Material Changes (cont'd)

- Assessment is objective, and should not be judged with hindsight
- A key test is whether the information would be important in making an investment decision

Exemptions to Insider Trading

- Both parties to trade are aware of facts:
 - Other party to the transaction was aware of the undisclosed material information
 - However, this exemption has been called into question where insiders trade with material undisclosed information
- Automatic Program:
 - Trader must prove that the purchase or sale was made pursuant to participation in an automatic dividend reinvestment plan, share purchase plan or other similar automatic plan that was entered into by the person or company prior to the acquisition of knowledge of the material information

Exemptions to Insider Trading (cont'd)

- Trader proves that the purchase or sale was made to fulfill a legally binding obligation entered into prior to acquisition of knowledge of material information
- *Ethical Walls:*
 - A person or company trading in securities with knowledge of material information is exempt from insider trading prohibition if it proves that
 - No person who made the decision to trade had actual knowledge of undisclosed material information; and
 - No advice was given with respect to the trade to the person who made or participated in making the decision to trade by the person who had actual knowledge of the undisclosed material information

Exemptions to Insider Trading (cont'd)

- “Reasonable policies and procedures” to prevent contraventions – OSC Policy 33-601
 - Educate employees
 - Containment of information by restricting access and assuring security of information
 - Restricting transactions (gray and restricted lists)
 - Compliance policies and procedures

Tipping

- A public company and those in a special relationship with that company are prohibited from informing others of material information that has not been generally disclosed, other than in the “necessary course of business”
- A person who learns of material information from a person in a “special relationship”, and knows or ought reasonably to have known of this relationship (a “tippee”) becomes a person in a “special relationship”

Tipping—“Necessary Course of Business” exemption

- Permitted to inform others of undisclosed material information if in the necessary course of business
- Can provide information to professional and financial advisors
- Exemption would not generally permit a company to selectively disclose information to an analyst or a shareholder

Tipping — Confidentiality Agreements

- Companies relying on the “necessary course of business” exemption should ensure those receiving information understand that they cannot trade in securities of the company or pass on the information
- Obtaining a confidentiality agreement is good practice, but does not itself provide exemption from tipping

Insider Trading Policies

- TSX-listed companies should have firm rule prohibiting insider trading
- TSXV-listed companies “must adopt and implement practices and procedures” relating to insider trading
- Good corporate governance to adopt a formal, written insider trading policy
- May be combined with a disclosure policy

Insider Trading Policies (cont'd)

- Generally, insider trading policies:
 - Set out insider trading and tipping prohibitions
 - Provide examples of potentially material information
 - Impose trading blackouts
 - May require pre-clearance for trades
 - Outline insider reporting requirements
 - Highlight penalties
 - May require written acknowledgment

Blackouts

- Automatic/Scheduled Blackouts
 - Usually tied to quarterly release of financial information
 - Length of blackout, and people subject to the blackout, depends on size and stage of development of the company

- Specific Blackouts
 - May be imposed due to the existence of material information that has not been generally disclosed

Penalties

- Under the *Securities Act* (Ontario)
 - Up to five years in prison and fines of up to the greater of \$5,000,000 and three times any profit made or loss avoided
 - Orders prohibiting trading in securities or acting as an officer or director of a company
- *Criminal Code*
 - Up to 10 years in prison (5 years for tipping), but requires Crown to prove insider “knowingly” used or conveyed undisclosed material information

Civil Liability

- Illegal insider trading or tipping subject to liability for damages suffered
- Accountable to reporting issuer for any benefit or advantage received or receivable

Other Prohibitions on Trading

Trading During Distributions (OSC Rule 48-501)

- Insiders are prohibited from purchasing, or inducing a person or company to purchase, securities of a public company during public or certain private distributions of those securities
- Prohibition also applies during take-over bids and business combinations where shares of the company will be issued
- Exemptions for exercise of outstanding options or if purchasing as part of the distribution

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