

Gotcha Enforcement: Securities Regulators Gone Wild

By Martin Rosenbaum* & Vanessa Ibe*

A recent decision of the Ontario Securities Commission highlighted an unfair practice used by the Commission and other regulators – the so-called "gotcha enforcement." Simply put, by this tactic regulators have laid charges against unsuspecting individuals, lawyers and corporations for violating the regulator's unannounced interpretation of a broad general law irrespective of whether or not that interpretation is sustainable or accepted as law.

In the case of Advanced Information Technologies (AiT) and Deborah Weinstein, a director and legal counsel for AiT, charges were laid against the company, Weinstein and Jude Ashe, the chief executive of AiT, for allegedly violating the material change disclosure requirements of the Ontario Securities Act. AiT and Ashe settled the charges out of court. However, Weinstein fought on.

The OSC enforcement unit alleged that Weinstein failed to advise AiT and Ashe to disclose as a material change the merger negotiations with 3M Company long before any agreement was actually reached. The enforcement unit was of the view that Weinstein should have advised AiT to file a material change report during the course of negotiations but long before any deal was considered likely or probable. The enforcement unit's reasoning was that since a deal was ultimately reached, AiT, Weinstein and Ashe had to have known that a deal was likely much earlier in the negotiations than they had reported. Weinstein's defense was that without a sufficient commitment from the other party, she could not reasonably determine at which point there was a substantial likelihood that the transaction would be completed. It was unreasonable to require her, AiT or Ashe to make such a determination prior to receiving a sufficient commitment to the transaction from 3M Company.

In its January 2008 decision, the 3-member panel of the Commission agreed and determined that Weinstein did not violate the Ontario Securities Act or its regulations. Although AiT, Weinstein and Ashe acted contrary to the enforcement unit's own peculiar interpretation of the law, they did not in fact violate the law. The Commission also stated that the burden to prove charges that impact on a professional's ability to make a living can only be discharged by proof that is "clear and convincing and based upon cogent evidence". This is somewhat higher than the regular balance of probabilities standard. The Commission determined that the enforcement unit did not satisfy this higher standard of proof.

While the January 2008 decision is helpful in clarifying when a material change has occurred (and thus when to properly notify the public and the OSC of this change), it also serves as a stark notice to regulators that the use of "gotcha enforcements" must come to an end. Not only is the use of "gotcha enforcements" against unsuspecting individuals and companies unfair and unjust, but, as in the case of Deborah Weinstein, it also unnecessarily puts an individual's professional reputation and livelihood at risk. Moreover, such conduct questions the credibility of the Ontario Securities Commission which is already under heavy criticism for its methods of pursuing alleged corporate wrongdoers.

In 2006, the Task Force to Modernize Securities Legislation in Canada released a report (the Allen Report) which addressed "gotcha enforcement" and the abuses by the Ontario Securities

Commission and other securities regulators in Canada. The Allen Report made numerous recommendations to inject a degree of certainty, due process and fairness into the enforcement of securities regulations across Canada. The Allen Report's recommendations coupled with Weinstein's resounding success over the OSC enforcement unit serve as a notice to securities regulators that their wild run with "gotcha enforcement" has to come to an end.

For more information contact Martin Rosenbaum, Lawyer, tel: 416-364-1919, e-mail mzr@rosenbaum.com or visit www.rosenbaum.com.

*Martin Rosenbaum, Lawyer, Fogler, Rubinoff LLP, Toronto

*Vanessa Ibe, finance student, University of Toronto