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SELLING OR BUYING SHARES IN THE FACE OF COVID-19: AM I INSIDER TRADING?

On February 13, 2020 United States Senator Richard Burr (R-NC) sold between \$628,000 and \$1.72M worth of securities. There is an allegation Senator Burr did so after receiving confidential classified information as part of daily briefings on the potential impact of the Corona virus.¹

Allegations of insider trading² have also recently extended to other U.S. Senators, as well as certain industry figures who sold shares prior to the market melt down, thus avoiding large losses in their portfolios.

All of this raises the question: what exactly constitutes insider trading in the face of a pandemic and its consequent economic fall out? Securities laws in Canada fall under Provincial jurisdiction.^{3,4} However, virtually all common law provinces have roughly equivalent insider trading, tipping, and recommending prohibitions.

For example, section 147(3) of the *Alberta Securities Act*⁵ states:

No person or company in a special relationship with an issuer shall purchase or sell securities of the issuer with the knowledge of a material fact or material change with respect to the issuer that has not been generally disclosed.

Inside that seemingly straightforward prohibition are a number of specific sub-requirements:

1) The person or company trading must be in a *special relationship* with the issuer. People in a special relationship include directors, officers or employees of the issuer in question. It can also include those with no affiliation with the issuer whatsoever, but who learn of a material or fact or material change from someone *they know or ought to know are themselves in a special relationship with the issuer.*⁶

¹ See an example of the reporting of the issue at <https://www.propublica.org/article/senator-richard-burr-ethics-investigation-stock-trading-coronavirus>
² Strictly speaking trading by an insider is not unlawful. However, we use the more common understanding of "insider trading", which is the unlawful activity we describe in this paper.
³ *Reference re Securities Act (Canada)*, 2011 SCC 66
⁴ In addition to the prohibitions set out in the various Provincial Securities Acts, insider trading is also a Criminal Code offence: *Criminal Code*, RSC 1985, c C-46 s. 382.1
⁵ RSA 2000, c S-4
⁶ *Securities Act*, s. 9. See *Finkelstein v. Ontario Securities Commission*, 2018 ONCA 61 at paras 54 and 55, *Walton v Alberta (Securities Commission)*, 2014 ABCA 273 at para 15.

This is what makes trading on a (unlawful) tip you receive from a known (or reasonably suspected) insider unlawful. Interestingly, there is no theoretical end to the potential chain of liability that could arise. Even the tenth, twentieth or hundredth person in a tipping chain could be found liable so long as they knew, or ought to have known, when placing their trade, that the original source of the information was someone in a special relationship with the issuer.

2) The information must be *material*. This is defined in the Act to mean information that “would reasonably be expected to have a significant effect on the market price or value of the securities”.⁷ It is a market-focused concept that is to be determined objectively, from the perspective of a reasonable investor.⁸

3) The information must not be *generally disclosed*. This is not a defined term in the *Securities Act*, but has been held to mean “information being disseminated so as to reach a general audience not limited to the particular reporting issuer and those in a special relationship with it, but including the market (if any) for the particular securities.”⁹

Insider trading in Canada is a strict liability offence.¹⁰ That is to say, it is illegal to trade in the securities in question while in possession of the inside information, *even if you do not use or rely on that information*. Motivation and intent behind a trade are irrelevant.

The reason insider trading is unlawful was stated, for example in *Re Holtby*¹¹ as follows:

Illegal insider trading, informing and recommending or encouraging are illegal activities because they give certain capital-market participants an unfair informational advantage concerning a reporting issuer's securities, which could be used – and in this case was – to the detriment of unwitting others selling or purchasing such securities to or from them.

Note the informational advantage has to be *unfair*. There is no prohibition on trading with superior or more extensive information, so long as it was acquired fairly. This generally means the information was acquired from sources available to everyone in the market.

So with that in mind, let's come back to main question. You just sold \$1M in shares in ABC Co. the day before the market collapsed. Did you insider trade? To answer, ask yourself:

1) At the time of the trade was I in a special relationship with ABC Co.? Was I a director, officer or employee? Was I in any of the other categories of “special person” as defined in the *Securities Act*? Or, did I receive information of a material fact or material change from someone I know, or reasonably ought to know, who was in a special relationship with ABC Co.?

⁷ Securities Act, s. 1(gg) “material fact”

⁸ *Stan, Re*, 2013 ABASC 148 at paras 222-223

⁹ *Kapusta, Re*, 2011 ABASC 322 at para 235

¹⁰ *R. v. Woods*, 1994 CarswellOnt 1080 (Gen. Div.) (leave to appeal refused 1994 CarswellOnt 1081 (C.A.)),

¹¹ *Holtby, Re*, 2013 ABASC 273 at para 42 [varied *Walton v Alberta (Securities Commission)*, 2014 ABCA 273]

2) Did I trade with knowledge of a material fact or material change with respect to ABC Co.? Note we did not say to ask yourself “did I trade ‘relying on’ that knowledge”, merely whether you had the information at the time of the trade. In this regard, the potential impacts of COVID-19 beg the question whether the information was specifically “with respect to” ABC Co., or merely broad knowledge of the virus’ potential impact on the market overall.¹²

3) Is the material fact or material change something that is not generally disclosed to the public? In terms of trading relating to COVID-19, this is likely the key issue. General knowledge of the potential negative impact of the virus is not “undisclosed” information and so would not trigger the prohibition. If your only source of information was the newspaper, for example, you are fine. However, specific confidential internal reports of ABC Co. that detail the specific risks or impact of the virus to ABC Co. with information unknown to the general public would potentially meet this definition.

If you answered “yes” to all of these questions, then yes, you may be an insider trader, and had best call us right away.

In our next installment, we will discuss what you can do as an investor if you believe the insiders of a company in which you are invested have been unlawfully insider trading.

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¹² See for example *Re Calcalley Petroleum Inc.*, 2015 ABASC 568 paras 245 - 252