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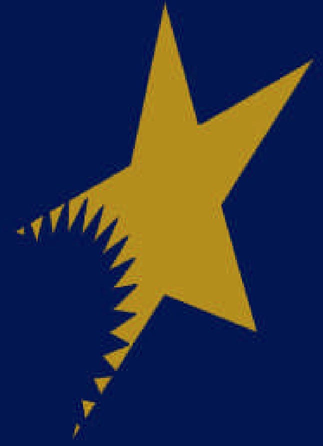
BARRISTERS & SOLICITORS LLP



Blaneys on Business

"Parliament has toughened up Canadian law on stock market fraud and insider trading and has enacted the country's first-ever legislation to protect whistleblowers."

This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial group, Alex Mesbur at 416.593.3949 or amesbur@blaney.com.

DO TOUGHER STOCK MARKET LAWS GO FAR ENOUGH TO RAISE THE CONFIDENCE OF CANADIAN AND GLOBAL INVESTORS?

Patrick J. Cummins

Parliament has toughened up Canadian law on stock market fraud and insider trading and has enacted the country's first-ever legislation to protect whistleblowers.

The question now is whether the new legislation will raise the confidence of investors both at home and abroad who may have steered clear of our capital markets for fear that our laws, and their administration, are still not up to the task of deterring tomorrow's Bre-Xs, Nortels, Enrons and WorldComs.

The new law on whistle blowing, which carries prison terms of up to five years, is designed to protect employees who report, to law enforcement officials, offences that they believe have been committed, or are being committed, contrary to any federal or provincial statute or regulation.

It is part of a set of Criminal Code amendments that took effect last September 15. The other amendments provide greater protection for investors by increasing penalties for fraud, fraud affecting the public market, market manipulation, insider trading and insider information-tipping.

Before the new laws took effect, maximum sentences for Criminal Code offences of fraud and fraud affecting the public market were 10 years in prison. Now 14 years, they take special note of the advantage perpetrators take of the "high regard" in which they are held by the community; frauds involving more than $1 million or adversely affecting economic stability, market stability or investor confidence; or involving substantial numbers of victims.

Maximum sentences for the Criminal Code offence of marketing manipulation of stock exchange transactions have been increased to 10 years in prison from five.

People convicted of criminal insider trading face a maximum penalty of 10 years in prison. Insider trading occurs when someone buys or sells securities of a company based on insider information. Insider information includes knowledge of a material fact or material change about the company that has not been disclosed generally. Insiders exposed to the risk of prosecution may include officers, directors, employees, shareholders and any other people who have a business or professional relationship with the company in question, people who obtain insider information during merger, takeover or reorganization discussions, or anybody with whom those at risk share the insider information.

Tipping of insider information is subject to a maximum penalty of five years in prison. The

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Patrick J. Cummins focuses on securities law and acts for clients in connection with mutual fund offerings and public company offerings. He provides ongoing advice to public and private companies and mutual fund companies and also services public issuers with respect to regulatory compliance, financing issues, shareholder communications and other regulated matters.

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tipping offence involves providing insider information to third parties and knowing that such third parties, or anybody to whom they might pass along the insider information, will use it to buy or sell the subject company’s securities.

Existing provincial securities legislation and federal/provincial corporate legislation already carry insider trading penalties. The new Criminal Code provisions have been designed for use in the most shocking cases.

Whether the new legislation goes far enough to help restore the confidence of stung investors remains to be seen. Months after it took effect, the Governor of the Bank of Canada was still wondering publicly, and controversially, whether Canada needs more to erase an allegedly bruised global reputation.

“This is a very common refrain that we hear when we visit markets in New York or in Boston or in London or in Europe,” David Dodge said in a speech, “a perception that somehow, this is a kind of a little bit more of a Wild West up here in terms of the degree in which rules and regulations are enforced and that perception doesn’t really help us when we go and try to raise money on foreign markets.”

ONTARIO APPEAL COURT SETS NEW CONFLICT OF INTEREST TEST FOR LAW FIRMS: COULD HAVE COST IMPLICATIONS FOR BUSINESSES

Patrick J. Cummins

A business is involved in a lawsuit. Its lawyers inadvertently come into possession of documents that belong to the other side and that are protected by solicitor and client privilege. Should those lawyers be permitted to continue with the case?

This might seem like one of those academic questions that only a professor of law could love but, in fact, it is laden with implications for business people.

Legal disputes are a fact of business life. A lawsuit that goes on for months or years inevitably produces both a close relationship between client and lawyer and a significant financial investment. If your lawyer is ordered off your case by the court for whatever reason, you lose much of the investment you have made in developing your argument and essentially all of the benefit of the respect and trust that has developed between you and your counsel.

It is not much of a stretch to imagine that, in some situations, this can be nothing less than devastating.

Insofar as the original question is concerned – should lawyers who come into possession of privileged documents belonging to the other side be allowed to continue on a case? – there has not been a clear answer historically. This is an area of the law that has been rife with ambiguity and, for the reasons cited above, potentially rife with business problems.

But now, the Ontario Court of Appeal has moved to clarify the situation by creating a generic test to determine whether a lawyer receiving privileged documents can continue to act. Before we examine the new test, the question might be asked – So what if opposing counsel gets hold of material protected by client-solicitor privilege?

Every party has the right to put its case forward in its own way. That right would be prejudiced if privileged material got into the other side’s hands. More fundamentally, your right to share everything and anything with your lawyer without

"...a lawyer who comes into possession of privileged material must be disqualified if...there is a real risk that the lawyer will use the information...to the prejudice of the other side and the prejudice cannot [otherwise] be overcome..."

fear that it could be used against you, would be destroyed.

Insofar as the new test is concerned, it basically prescribes that a lawyer who comes into possession of privileged material must be disqualified if the other side satisfies the court that there is a real risk that the lawyer will use the information obtained to the prejudice of the other side and that the prejudice cannot realistically be overcome by a remedy short of disqualification.

The nature and extent of the prejudice will vary from case to case depending on the content of the privileged information. In some instances, it may be high (substantial and pressing); in others, it may be trifling (minor and inconsequential). Manifestly, in deciding whether the remedy of disqualification is warranted, the court will wish to consider the nature and extent of the potential prejudice.

The onus lies with the moving party (who is seeking to disqualify the lawyer who came into possession of the privileged material) to establish the requisite risk of prejudice. To meet that onus, it will, initially, fall on the moving party to establish that:

(1) opposing counsel has received confidential information protected by solicitor and client privilege;

(2) the confidential information is relevant to the matter at hand; and if so,

(3) the relevant confidential information is potentially prejudicial.

Once privilege, relevance and potential prejudice have been established, the moving party will have met its initial evidentiary burden. It will then be for the opposing side to adduce evidence, if it so chooses, to rebut the moving party's evidence. That evidence is likely to take one of the following forms:

(1) The opposing side has no real knowledge or appreciation of the contents of the privileged communications because the document or documents were either not reviewed or reviewed only in a cursory fashion before being returned forthwith to the moving party and deleting or destroying any copies.

(2) The documents do not contain information protected by solicitor and client privilege.

(3) The documents, though reviewed, do not contain information that could realistically be used to prejudice the moving party.

(4) Where privileged documents containing potentially prejudicial information have been reviewed and are within the knowledge of one or more lawyers or employees of the opposing law firm, evidence establishing that all reasonable measures have been taken to ensure that the tainted person or persons have not disclosed, and will not disclose, the confidential communications to the member or members of the firm having carriage of the litigation.

(5) The existence of a remedy short of disqualification that will realistically overcome the prejudice. For example, there may be cases where the risk of prejudice can be overcome by an order preventing the disclosure and use of information contained in the privileged document or derived from it.

Whatever form the opposing evidence takes, it will of course be open to the moving party to rebut.

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The Court of Appeal added the qualifications that the above-noted test is not meant to apply in the following cases:

(1) Where the law firm at risk of disqualification has come into possession of the privileged documents through "egregious" conduct or has engaged in "egregious" conduct after obtaining them. The threshold for disqualification will be lower where egregious conduct is found.

(2) Where the law firm at risk of disqualification has been entirely passive and has come into possession of privileged documents by reason of conduct on the part of the moving party that goes beyond mere error or inadvertence. Where for example, the moving party has engaged in sharp practice or acted with reckless indifference, the remedy of disqualification may well not be available.

(3) The test is to be distinguished from the situation of moving solicitors and merging firms. In those cases, it is usually difficult, if not impossible, to know with any certainty the nature or extent of the confidential information that has been transferred. Moreover, there are likely to be nuances both about the client and the client's interests that are known because of the solicitor and client relationship and that could be used to the client's prejudice. As well, there are important policy considerations at play. Notions of disloyalty, professional unseemliness, and the fundamental concern that clients be able to speak freely with their counsel, secure in the knowledge that counsel will not disclose or take advantage of the information, are all factors that figure prominently in the case of moving solicitors and merging firms. The test for disqualification in the case of moving solicitors and merging firms has a lower threshold, reflecting as it does the above noted practical difficulties and policy considerations. ■

NEW ASSOCIATE

We are pleased to announce that Faithlyn Hemmings has joined the firm's corporate/commercial group.

Faithlyn completed her Law degree in 2003 at the University of Windsor, articled with Blaney McMurtry, and returned to the firm upon her call to the Bar in 2004.

Faithlyn can be reached at 416.593.2990 or fhemmings@blaney.com.

NEW OFFICES

Blaneys has moved! We are now located on the 15th, 16th and 17th floors of the Maritime Life Tower on the northeast corner of Yonge and Queen Streets.

Our new address is:

Maritime Life Tower
2 Queen Street East, Suite 1500
Toronto, Ontario
M5C 3G5

Our telephone and fax numbers remain the same.

We hope you can visit us soon at our new offices – we are quite proud of them.

Blaneys on Business is a publication of the Business Law Department of Blaney McMurtry LLP. The information contained in this news-letter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

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