MILLER THOMSON LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

# CRIMINAL LAW, REGULATION & ENFORCEMENT NEWSLETTER

*February 2010*

*This Newletter is published by Miller Thomson's Criminal Law, Regulation & Enforcement Group as a service to our clients. We encourage you to forward the e-mail delivering this newsletter to anyone (internal or external to your organization) who might be interested. Complimentary e-mail subscriptions are available by contacting newsletters@millerthomson.com.*

## Inside

Canada's First Criminal Conviction for Illegal Insider Trading

Responding to Employee Crimes

Foreign Corruption: The U.S. Department of Justice Commences its Largest Prosecution to Date

## CANADA'S FIRST CRIMINAL CONVICTION FOR ILLEGAL INSIDER TRADING

*Emily Cole*
*Toronto*
*416.595.8640*
*ecole@millerthomson.com*

Canada's first criminal conviction for illegal insider trading occurred on November 6, 2009 when Justice Robert Bigelow of the Ontario Court of Justice accepted a guilty plea from Stan Grmovsek. Sentencing was delayed until January 7, 2010 to facilitate the conclusion of regulatory proceedings brought by the Ontario Securities Commission (OSC) and a civil action brought by the United States Securities and Exchange Commission (SEC) against Grmovsek and his co-accused, Gil Cornblum. Tragically, Cornblum committed suicide on October 27, 2009, a day before he was scheduled to plead guilty.

Cornblum and Grmovsek collaborated in a deliberate and prolonged illegal insider trading scheme. Cornblum and Grmovsek, who were classmates at law school, started the illegal insider trading scheme after their graduation in 1994. Cornblum sought and obtained material, non-public information about pending corporate transactions that he passed on to Grmovsek who then executed trades in the securities of the corporations involved in the corporate transactions for a profit that they split between them.

Cornblum's conduct reads a bit like a spy novel. During the time of the illegal insider trading, he worked at a number of law firms including, Sullivan and Cromwell, LLP, New York; Schulte Roth and Zabel, LLP, New York; and Dorsey, Whitney, LLP, Toronto. Cornblum received some of the material non-public information in his role as counsel to certain issuers on pending corporate transactions. In addition, he gained material non-public information through conversations with colleagues or other counsel. However, Cornblum also resorted to more clandestine-like activity to obtain material non-public information. For example, he used the night secretarial staff's temporary passwords to search for confidential information in the computer databases at the law firms that he worked for. He also conducted early morning searches through the hallways, photocopy rooms, fax machines and files of his colleagues at the firms for documents that contained confidential information about pending transactions that he was not involved in.

The illegal insider trading scheme spanned a 14 year period from 1994 to 2008, but the trading was generally conducted in two time periods: September 1996 to August 2000 and May 2004 to April 2008.

In total, Cornblum tipped Grmovsek and Grmovsek traded while in possession of material, non-public information about 46 corporate transactions involving securities that were publicly listed in Canada and the United States.

In Canada, Grmovsek was charged with three offences: (i) fraud (for trades executed before the new *Criminal Code* insider trading provisions), (ii) illegal insider trading contrary to the *Criminal Code* and, (iii) money laundering contrary to the *Criminal Code*.

Section 382.1 of the *Criminal Code* which creates the offences of insider trading and tipping was introduced in 2004. Insider trading and tipping are indictable offences punishable by a maximum prison

term of 10 years. The distinction between the *Criminal Code* offence of prohibited insider trading and the *Ontario Securities Act* offence of illegal insider trading is that the criminal offence imports a *mens rea* requirement that the individual "knowingly used inside information," whereas in the regulatory context the Crown is only required to prove that the individual was in possession of knowledge that was not generally disclosed.

On January 7, 2010, Bigelow J. sentenced Grmovsek to 39 months imprisonment on the joint recommendation of the prosecution and the defence.

In the United States, the SEC alleged that Grmovsek violated the anti-fraud provisions, including prohibitions against insider trading. On January 13, 2010, Grmovsek pleaded guilty and was convicted of one count of conspiracy to defraud the United States in the United States District Court for the Southern District of New York. He was sentenced to a term of imprisonment of time served and fined one hundred dollars.

In addition to the jail terms, Grmovsek agreed to disgorgement orders to the United States Securities and Exchange Commission (SEC) at a total of $8.5 million dollars with a waiver of all but nearly $1.5 million and to the Ontario Securities Commission (OSC) at a total of $1.03 million dollars, including $283,000.00 to the Attorney General for Ontario. Grmovsek also agreed to pay $250,000.00 in costs relating to the OSC investigation. Grmovsek traded in the US and the Canadian capital markets and the disgorgement orders reflect the proportion of profits made in each of the United States and Canada.

Justice Bigelow described the sentence against Grmovsek as "entirely appropriate and justified." Bigelow J. also noted that "it has a strong denunciatory and general deterrent effect."

The Grmovsek jail sentence exceeds the longest sentence to date in an illegal insider trading prosecution brought by the OSC under section 122 of the Ontario *Securities Act*. In 2000, Glen Harvey received a sentence of six months jail on conviction of two counts of insider trading. At that time, the maximum sentence under the *Securities Act* was two years imprisonment and/or a basic fine of $1 million dollars or in insider trading offences up to three times the profit. Harper profited $4 million dollars as a result of his illegal insider trading and the fine of $2 million dollars represented half of his profits. The current penalties available under section 122 of the *Securities Act* are five years imprisonment and/or a $5 million fine.

The OSC's settlement agreement with Grmovsek stated that Cornblum and Grmovsek provided extensive cooperation in assisting all regulatory authorities and law enforcement agencies involved in identifying the depth and breadth of the conduct at issue. In particular, it stated that many of the corporate transactions that occurred in the 1994 to 2000 period were identified by the two respondents from memory. It also noted that staff's investigation and analysis of those transactions was aided by Cornblum and Grmovsek's testimony as the records of some of the transactions particularly those with offshore components were incomplete. Although the Commission has not yet released its reasons, Grmovsek's cooperation was undoubtedly taken into consideration in meting out the sentence.

*Emily Cole recently joined Miller Thomson as Associate Counsel after several years as Senior Litigation Counsel in the Enforcement Branch of the Ontario Securities Commission. She practices securities litigation and regulation and white-collar defence. Ms Cole is admitted to practice in both Ontario and New York and has extensive experience in cross-border investigations, defence and prosecution.*

## RESPONDING TO EMPLOYEE CRIMES

*Adrienne Campbell*
*Toronto*
*416.595.2661*
*acampbell@millerthomson.com*

On occasion, employers find themselves facing a situation where an employee is suspected of having committed a criminal act such as fraud, theft, pornography, drunk driving, or assault, that has the potential to impact on the workplace, or on the employer's reputation. These actions can occur either within, or outside, the workplace.

It is settled law in Canada that not every finding of misdoing on the part of an employee is grounds for termination of employment for cause. The employer must first consider whether the wrongdoing in question forms a fundamental breach of the employment relationship for which the only proper remedy is termination of employment.

It may be tempting to handle the matter by simply terminating the employment relationship if and when the police lay charges, and then relying on the decision of the police to lay those charges and any police investigation as support for the decision to terminate. However, even where the police lay criminal charges after conducting their own investigation, this alone will not be grounds to terminate the employment relationship for cause.

In the absence of a clear finding of guilt by the criminal court, for example where the charges are dropped by the Crown, or the court finds find the former employee not guilty, the employer may have no defence to a subsequent wrongful dismissal action. This is particularly the case where there has been no independent investigation by the employer to support the decision to terminate the employment relationship. It is extremely important that in most cases the employer conduct its own independent investigation before coming to a conclusion on the appropriate disciplinary step to take.

Except in the most extreme cases, the decision to terminate employment for cause must be based on the employer's own investigation and assessment of the situation. This means that the employer or an investigator retained by the employer must meet with the employee, get a full explanation from the employee of the situation and response to any allegations, if necessary interview any witnesses, consider any extenuating circumstance, and then reach a decision on whether or not there are grounds to terminate the employment.

There is no obligation under the *Criminal Code* on employers whose employees have stolen from them to report all such matters to the police. It is often prudent to consider and balance a number of business implications before deciding whether to report the matter. For example, will involving the police act as a sufficient deterrent to other employees, particularly where the criminal act involves customers or other members of the public? Will it be necessary to involve other employees and possibly customers as witnesses in any subsequent criminal proceedings. How widely may the matter then be publicized? Even if the employer does decide to contact the police, timing is important, as once criminal charges are laid, the employer will likely find it difficult to directly interview the employee, whose lawyer will likely advise him or her not to make any statements. This will seriously interfere in the employer's ability to conduct its own investigation.

Not long ago the Ontario Court of Appeal considered whether an employer owed a duty of care to an employee who was wrongly accused after a faulty investigation conducted by a third party retained by the employer. In that case, a long time supervisor was fired, immediately handed over to the police and arrested for alleged theft and drug dealing in the workplace, based on the findings of the undercover private investigator. However, the wrong employee was fired and handed over to the police. The actual suspect had a similar name, but was much younger than this employee. The Court declined to hold the employer liable for participating in the negligent workplace investigation. However, the Court did note that, if the employer participated in a negligent investigation knowing the serious consequences of a wrongful charge of criminal conduct against the employee, there was still the possibility that such conduct could meet the requirement for a claim by the wrongfully accused employee of intentional infliction of mental distress.

Once charges have been laid, an employer is faced with whether to allow the employee to continue to work pending resolution of the charges. This will depend on the nature of the charges, and the impact they may have on the workplace and/or the employer's reputation. For example, where an employee who works in a social services or child care setting is charged with possession of pornography or other sexual related crimes, the employer has to consider its own liability of keeping the employee working pending a determination of guilt. The employer has various options, including placing the employee on a paid or unpaid leave of absence, terminating the employment relationship on a without cause basis by paying out the appropriate notice, or terminating the employment for cause.

*Adrienne Campbell is a member of our Labour and Employment Group in Toronto. In addition to providing legal services and advice to a wide range of clients in the private and public sectors, she also has extensive experience investigating complaints of inappropriate workplace conduct on behalf of employers and advising them how to handle the outcome of such investigations.*

## FOREIGN CORRUPTION: THE U.S. DEPARTMENT OF JUSTICE COMMENCES ITS LARGEST PROSECUTION TO DATE

*J. Bruce McMeekin*
*Markham*
*905.415.6791*
*bmcmeekin@millerthomson.com*

In January, twenty-two executives and employees from a number of American companies were indicted for offences contrary to the U.S. *Foreign Corrupt Practices Act* (the "*FCPA*"). The accused had allegedly conspired to pay bribes through an agent to the Minister of Defence of an unnamed African state in return for the Minister's agreement to contract with the companies for the purchase of military and law enforcement equipment. In reality, this was an "undercover" operation with the involvement of the Minister fabricated and the middleman a disguised Federal Bureau of Investigations (FBI) agent.

What is interesting about the investigation is the huge commitment of law enforcement resources when the intended bribes were relatively small – 20 *per cent* of contracts totalling $15 (U.S.) million. For the first time, U.S. law enforcement employed sophisticated undercover techniques to *detect* and *investigate* the violations. Over 120 FBI agents were on the case, executing fourteen search warrants. Another seven warrants were executed by British police.

The FCPA is the U.S. legislative response to its treaty obligations under the OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* and the *UN Convention Against Corruption*. Each breach of the *FCPA* is subject to a maximum prison sentence of 5 years. The Canadian equivalent, the *Corruption of Foreign Officials Act* ("*CFOA*") (described in our May 2008 newsletter) contains comparable provisions prohibiting Canadian business organizations and their employees, agents and consultants, from offering a benefit to a foreign public official if the purpose is to obtain or retain for the organization a business advantage. These are serious offences, providing for 5-year maximum jail terms for individuals and unlimited fines for both individuals and their employers.

Unlike the U.S., historically Canada has not committed large resources to the enforcement of the *CFOA*, although two seven-officer RCMP teams were organized in 2008 to give the legislation some teeth. However, Canadian executives would be mistaken to conclude that their Canadian residency may protect them from U.S. indictments for violations of the *FCPA*. The Act is intended to apply to foreign employees and agents of U.S. publicly held companies or companies headquartered in the U.S. Foreign nationals resident outside the U.S. have been successfully prosecuted for FCPA violations.

The tenacity of U.S. law enforcement coupled with the likelihood of greater Canadian enforcement highlights the *CFOA* and *FCPA* as areas of ongoing risk for companies operating abroad. Corporate leaders should ensure they are knowledgeable about the legislative requirements and be satisfied that they have taken the necessary steps to ensure employees involved in international transactions are properly trained and have ready access to corporate resources to assist them in ensuring their involvement with foreign officials does not offend anti-corruption legislation.

*Bruce McMeekin is a partner in the Markham office and represents companies and individuals under investigation and/or charged with regulatory and white collar criminal offences.*

## MILLER THOMSON LLP CRIMINAL LAW, REGULATION AND ENFORCEMENT GROUP


**Toronto/Markham**

Douglas Best 416.595.8588
dbest@millerthomson.com

Bryan J. Buttigieg 416.595.8172
bbuttigieg@millerthomson.com

Adrienne Campbell 416.595.2661
acampbell@millerthomson.com

David W. Chodikoff 416.595.8626
dchodikoff@millerthomson.com

Emily Cole 416.595.8640
ecole@millerthomson.com

Robert England 416.595.8566
rengland@millerthomson.com

Roderick M. McLeod, Q.C. 905.415.6707
rmcleod@millerthomson.com

J.Bruce McMeekin 905.415.6791
bmcmeekin@millerthomson.com

Andrew Roman 416.595.8604
aroman@millerthomson.com

Stuart Rudner 905.415.6767
srudner@millerthomson.com

Adam Stephens 416.595.8572
astephens@millerthomson.com

Katherine Xilinas 416.595.8165
kxilinas@millerthomson.com

**Vancouver**

Daniel L. Kiselbach 604.643.1263
dkiselbach@millerthomson.com

Donald J. Sorochan, Q.C. 604.643.1214
dsorochan@millerthomson.com

**Calgary**

Fred R. Fenwick, Q.C. 403.298.2421
ffrenwick@millerthomson.com

**Edmonton**

Daniel C.P. Stachnik, Q.C. 780.429.9761
dstachnik@millerthomson.com


Note:



**www.millerthomson.com**