Legislative Summary **LS-458E**

BILL C-46: AN ACT TO AMEND THE CRIMINAL CODE (CAPITAL MARKETS FRAUD AND EVIDENCE-GATHERING)

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LEGISLATIVE HISTORY OF BILL C-46

HOUSE OF COMMONS		SENATE	
Bill Stage	**Date**	**Bill Stage**	**Date**
First Reading:	12 June 2003	First Reading:	5 November 2003
Second Reading:	8 October 2003	Second Reading:	
Committee Report:	29 October 2003	Committee Report:	
Report Stage:	3 November 2003	Report Stage:	
Third Reading:	5 November 2003	Third Reading:	

Royal Assent:

Statutes of Canada

N.B. Any substantive changes in this Legislative Summary which have been made since the preceding issue are indicated in **bold print.**

Legislative history by Peter Niemczak

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BILL C-46: AN ACT TO AMEND THE CRIMINAL CODE (CAPITAL MARKETS FRAUD AND EVIDENCE-GATHERING)*

Introduced on 12 June 2003, Bill C-46 proposes amendments to the *Criminal Code* aimed at strengthening measures to investigate, prosecute and deter capital markets fraud. The bill proposes to meet this objective by:

- creating a new *Criminal Code* offence of improper insider trading;
- providing whistleblower protection to employees who report unlawful conduct;
- increasing the maximum sentences for existing fraud offences and establishing a list of aggravating factors to aid the courts in sentencing;
- allowing the courts to issue production orders to obtain data and documents from persons not under investigation; and
- establishing concurrent federal jurisdiction to prosecute certain capital market fraud cases.

Along with the legislative measures proposed in Bill C-46, the federal government announced that it will create a number of Integrated Market Enforcement Teams (IMETs) composed of RCMP officers, federal lawyers and other investigators such as forensic accountants to deal with capital markets fraud cases. Located in Toronto, Vancouver, Montréal and Calgary, these teams, which are scheduled to become operational over the next two years, will work with securities regulators as well as provincial and local police forces.

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* Notice: For clarity of exposition, the legislative proposals set out in the bill described in this Legislative Summary are stated as if they had already been adopted or were in force. It is important to note, however, that bills may be amended during their consideration by the House of Commons and Senate, and have no force or effect unless and until they are passed by both Houses of Parliament, receive Royal Assent, and come into force.

BACKGROUND

Bill C-46 is part of the federal government's response to the recent spate of corporate scandals that have plagued the United States and weakened investor confidence in capital markets around the world. Scandals associated with companies such as Enron, WorldCom, Tyco and ImClone have precipitated calls to strengthen corporate governance standards and better enforce laws governing capital markets activities.

Governments have responded to the fallout from these events by moving to improve corporate governance, enhance auditor independence, increase corporate accountability, facilitate shareholder oversight of corporate activities and increase penalties for wrongdoing. The United States was first off the mark with the *Sarbanes-Oxley Act of 2002*.(1) Signed into law on 30 July 2002, *Sarbanes-Oxley* introduced far-reaching measures designed to heighten corporate disclosure and accountability, improve auditor oversight and independence, create new offences and increase penalties for corporate fraud.

In Canada, the federal and provincial governments (as well as securities regulators) share responsibility for enforcing laws pertaining to corporate and securities activities. Consequently, both levels of government have been moving to confront the governance and regulatory issues raised by these recent corporate scandals and their concomitant impact on investor confidence. Ontario, for example, has enacted new legislation and the Ontario Securities Commission has issued draft rules relating to the role and composition of audit committees, certification of corporate financial statements by chief executive officers and chief financial officers, and requirements for the financial statements of publicly traded companies to be audited by a firm in good standing with the Canadian Public Accountability Board.

At the federal level, the September 2002 Speech from the Throne acknowledged that efforts would have to be made to bolster investor confidence in Canadian capital markets. The federal government pledged to review and change relevant federal laws and strengthen enforcement activities, where necessary.(2) Following on this commitment, the 2003 federal Budget stated that the government would "introduce new legislation to modernize offences,

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(1) Public Law 107-204.

(2) Speech from the Throne 2002, 30 September 2002; available on-line at: http://www.sft-ddt.gc.ca/vnav/06_2_e.htm.

permit targeted evidence-gathering, and signal the seriousness of corporate fraud offences through tailored sentencing structures."(3)

Bill C-46 is the government's legislative response to this commitment.(4)

DESCRIPTION AND ANALYSIS

A. Concurrent Jurisdiction

Clause 1 of Bill C-46 amends the definition of Attorney General in the *Criminal Code* to give the Attorney General of Canada concurrent jurisdiction with provincial Attorneys General to prosecute certain capital markets fraud cases, including those currently outlined in sections 380 (fraud), 382 (market manipulation) and 400 (distributing false prospectuses, statements or accounts) of the Code, as well as the proposed new offence of illegal insider trading (proposed section 382.1).

According to Department of Justice background information on the bill, the federal government will work to coordinate activities with the provinces in relation to such cases by establishing prosecution protocols. Furthermore, federal involvement in this area is expected to be limited to cases that "threaten the national interest in the integrity of capital markets."(5)

B. Increasing Penalties for Existing Fraud Offences

Clause 2 increases the maximum prison sentences for the existing offences of fraud and fraud affecting the public market under section 380 of the *Criminal Code* from 10 to 14 years.

Under clause 4, the maximum term of imprisonment for market manipulation offences is increased from 5 to 10 years. Covered in section 382 of the Code, market manipulation involves practices that create a market for securities that has little or no bearing on their actual value. It includes activities such as wash sales, where there are a purchase and sale

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(3) Government of Canada, Budget 2003, Budget Plan, Chapter 7; available on-line at: http://www.fin.gc.ca/budget03/bp/bpc7e.htm.

(4) The federal government is also examining the need for new corporate governance standards under the *Canada Business Corporations Act*.

(5) Department of Justice, Backgrounder, "Federal Strategy to Deter Serious Capital Market Fraud," June 2003, p. 2; available on-line at: http://www.canada.justice.gc.ca/en/news/nr/2003/doc_30928.html.

but no change in the beneficial ownership of a security; and matched orders, where a purchase order and a sale order for a security, of substantially the same size and at substantially the same time and same price, are entered by either the same person or two different persons.

New section 380.1 (clause 3) establishes four aggravating circumstances that a court can consider when imposing a sentence for market fraud offences. These are as follows:

- the amount involved in the fraud exceeded $1 million;
- the offence adversely affected (or had the potential to adversely affect) the stability of the Canadian economy or financial system or any financial market in Canada or investor confidence in such a market;
- large numbers of victims were involved; and
- the perpetrator took advantage of his or her elevated status or reputation in the community in committing the offence.

The presence of these factors will enable a court to impose tougher penalties.

C. New Offences – Insider Trading/Threats and Retaliation Against Employees

1. Insider Trading

Section 382.1 of the Code, added by clause 5 of Bill C-46, creates new criminal offences with respect to prohibited insider trading and tipping inside information.

Improper insider trading is already prohibited under the *Canada Business Corporations Act* and under provincial securities law. This new *Criminal Code* offence is intended to deal with the most egregious cases that merit stiff criminal penalties.

Insider trading is commonly understood to refer to the purchase or sale of securities when using material non-public information that could affect the price of such securities. It also covers "tipping" such information – providing inside information to a third party for that party's benefit or the benefit of the insider.

Subsection 382.1(4) defines "inside information" as information about a company or a security that has not been generally disclosed and could reasonably be expected to affect the security's market price or value. Persons subject to prosecution include those who possess inside information because they:

- are a shareholder of the company issuing the security (referred to as the issuer);
- have a business or professional relationship with the issuer;
- obtained the information in the course of a proposed merger, takeover or reorganization of the issuer;
- obtained the information in the course of their employment, duties, or office with the issuer or an entity referred to above; or
- received the information from a person who obtained it by virtue of the positions or relationships mentioned above.

The offence will carry a maximum term of imprisonment of up to 10 years.

Under subsection 382.1(2), tipping – knowingly conveying inside information to another person when one knows there is a risk that the person may use the information to buy or sell a security or convey that information to another person who will trade in the security – can be treated as an indictable or a summary conviction offence. As an indictable offence, tipping carries a maximum prison term of five years.

2. Whistleblower Protection

Employees often play an important role in revealing corporate misdeeds. However, employees who blow the whistle on corporate malfeasance and corruption may experience demotion, dismissal from their jobs or other forms of retaliation.

In order to encourage employees to come forward in such circumstances, whistleblower protection laws have been developed to protect employees from acts of reprisal. Whistleblower protection is not new to Canadian law. Whistleblowing provisions are found in health and safety or environmental laws and in the federal *Competition Act*.

Bill C-46 adds a further dimension to whistleblower protection by creating a general criminal offence in relation to employer reprisals against employees who provide information with respect to the violation of any federal or provincial law.

Clause 6 of Bill C-46 adds a new section 425.1 to the *Criminal Code* making it a criminal offence for an employer, anyone acting on behalf of an employer or a person in a position of authority over an employee to take or to threaten the employee with disciplinary action, demotion, termination of employment or to adversely affect the employee's employment in order to force the employee to refrain from providing information to law enforcement officials about the commission of an offence by his or her employer or by an officer, employee or director of the employer.

Section 425.1 also extends the criminal offence to threats or retaliation against an employee who has already provided information.

Criminal proceedings for a section 425.1 offence can be initiated by way of indictment or summary conviction; if by indictment, the maximum term of imprisonment is five years.

In the United States, the *Sarbanes-Oxley Act of 2002* also includes whistleblower protection for employees. Employees of publicly traded companies have the right to make a civil claim against employers that engage in retaliatory action. Available remedies to such employees include compensatory damages, back pay with interest and special damages.(6) In addition, the Act imposes criminal penalties against companies or individuals who "knowingly, with intent to retaliate, take any action harmful to any person," including interfering with employment, for providing "truthful information" to a law enforcement official relating to the commission of a federal offence. Such retaliation is subject to a maximum of 10 years' imprisonment and substantial fines.(7)

D. Evidence-Gathering – Production Orders

Clause 7 adds provisions to *Criminal Code* that will allow investigators to obtain "production orders" to compel persons not under investigation (third parties) to produce, at a specified time and place and in a specified form, data or documents (or to prepare and produce a document based on data or documents) relevant to the commission of an alleged offence under any federal law. Although new to the Code, the ability to obtain similar kinds of orders already exists under the *Competition Act*.

Production orders will likely prove to be a useful investigative tool. Although issued in circumstances similar to those under which a search warrant would be issued, production orders may be less invasive than a search warrant since law enforcement officials would not be required to search the premises of the third party. Also, such orders allow for the acquisition of information held outside Canada where it is under the control of a custodian in Canada. Furthermore, by specifying the time and place at which the material must be produced, as well as the form of the documents, such orders may speed up the investigative process.

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(6) *Sarbanes-Oxley Act of 2002*, s. 806 codified as 18 U.S.C. s. 1514A.

(7) Section 1107 of the *Sarbanes-Oxley Act of 2002* amending 18 U.S.C. s. 1513.

Clause 7 provides for two types of production orders – general and specific.

Proposed section 487.012 provides for the issuance of a general *ex parte* production order for data or documents from a third party having possession or control of such information. Before issuing such an order, the court must be satisfied that there are reasonable grounds to believe that:

- an offence under federal law has been or is suspected to have been committed;
- the documents or data will provide relevant evidence; and
- the person to whom the order applies has possession or control of the documents or data.

Proposed section 487.013 provides for specific *ex parte* production orders to be issued to banks and other entities specified under section 5 of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (largely other types of financial institutions and persons who deal with financial instruments)[8] in much the same circumstances as a general production order. These orders, however, relate to production of specific information such as the name or account number of an account holder, the status and type of account and the date on which the account was opened or closed.

Before issuing such an order, the court must be satisfied that there are reasonable grounds to suspect that:

- an offence under federal law has been or will be committed;
- the information will assist in the investigation of the offence; and
- the institution or entity to which the order is addressed has possession or control of the information.

Applying to specific types of information and to a defined group of entities having control or possession of such information, specific production orders are narrower in scope than general orders. Furthermore, the threshold for obtaining a specific order is lower than the comparable threshold applicable to a general order. For example, to obtain a general order,

(8) Section 5 entities include: foreign banks, credit unions, caisses populaires, life insurance companies, trust and loan companies, securities dealers, investment counsellors, foreign exchange dealers and casinos.

the issuer must be satisfied that there are reasonable grounds to believe that an offence has been or is suspected to have been committed and that the documents or data will afford evidence relating to the commission of the offence. By contrast, to obtain a specific order, the issuer must be satisfied that there are reasonable grounds to suspect that an offence has been or will be committed and that the information requested will assist in the investigation of the offence.

Section 487.014 confirms that production orders are not required in order for law enforcement officials to ask a person to voluntarily provide information that the person is not otherwise by law prohibited from disclosing.

Section 487.015 allows third-party recipients of a production order to apply to the court before the order expires for an exemption from producing any information referred to in the order. Execution of the production order will be suspended in respect of such information until a final decision is made in relation to the application.

Persons to whom a production order applies cannot refuse to comply with the order on the ground that they may be incriminated by any information they are required to produce. But where an order requires the third party to prepare a document based on existing documents or data, that document cannot be used as evidence in subsequent criminal proceedings (except for perjury, giving misleading evidence or fabricating evidence) against the individual who prepared it (section 487.016).

The penalties for failure to comply with a production order are set out in section 487.017. A summary conviction offence, non-compliance is subject to a maximum fine of $250,000 and/or imprisonment for up to six months.

E. Other

Clause 8 amends section 487.3 of the *Criminal Code* by providing that a court order can be made at the time a production order is sought prohibiting access to and disclosure of any information relating to the production order. Set out in section 487.3, the grounds on which a non-access order can be made relate to situations that could subvert the ends of justice and include compromising an investigation, or the identity of a confidential informant, and prejudicing the interests of an innocent person.

This amendment brings production orders under the provisions that currently apply to warrants and other similar access and search orders. Applications to terminate or vary non-access orders will also apply in relation to production orders.

Clause 9 provides that Bill C-46 will come into force by order of the Governor in Council.

COMMENTARY

According to the Minister of Justice, Bill C-46, which fulfills commitments made in the 2002 Speech from the Throne and the 2003 federal Budget, will help to "better detect, prosecute, and, most importantly, deter serious capital market fraud."

The bill has been put forward as part of Canada's response to the series of corporate scandals in the United States that have adversely affected investor confidence in capital markets. Those corporate scandals aside, however, there has been a long-standing perception that enforcement and prosecution of capital markets fraud in Canada have been weak and ineffective. Vigorous enforcement and strong penalties, therefore, are seen as important signals to investors.

Bill C-46 will be compared with the related provisions of the U.S. *Sarbanes-Oxley Act*, considered by some to be the baseline standard against which reforms should be measured.

Since *Sarbanes-Oxley* became law, there has been an ongoing debate about whether Canada should adopt similar rules. Some believe that much of *Sarbanes-Oxley* is useful and appropriate. Others, however, argue that aspects of that law are complicated and expensive to implement and constitute an overreaction to the series of events that precipitated its quick passage by Congress. This criticism, however, is confined largely to the non-criminal portions of the law.

The reaction to Bill C-46 has been generally positive. Many believe it is an important step toward deterring corporate crime, improving enforcement and actively engaging the federal government in the deterrence and prosecution of capital markets fraud.

There may be concerns, however, that the penalties to be meted out under the bill, although stiffer than those currently available, are not tough enough.