

ALBERTA SECURITIES COMMISSION

RULING

Citation: Douglas, Re, 2011 ABASC 638

Date: 20111220

James (Jim) Douglas

Panel:

Jack C. Major, QC
Neil W. Murphy

Counsel:

Jeff E. Sharpe
for James (Jim) Douglas

Matthew J. Epp
for Richard Bruce Kowalchuk

Karen O'Keeffe
for John Herbert Holtby

Andrew Wilson
for Commission Staff

Date of Hearing:

25 November 2011

Date of Decision:

20 December 2011

I. INTRODUCTION

[1] On 3 May 2010 the Executive Director ("Executive Director") of the Alberta Securities Commission (the "Commission") ordered, under section 47(2) of the *Securities Act*, R.S.A. 2000, c. S-4 (the "Act"), that "all funds, securities, exchange contracts or other property" (the "Property") in a certain trading account (the "Account") opened in the name of James (Jim) Douglas ("Douglas") be frozen (the "Freeze Order", cited as *Re Douglas*, 2010 ABASC 195).

[2] On 11 April 2011 staff ("Staff") of the Commission issued a notice of hearing alleging that several respondents, including Douglas and John Herbert Holtby ("Holtby"), acted contrary to the Act and the public interest by engaging in certain insider trading, among other things. A hearing into the merits of Staff's allegations (the "Merits Hearing") has been scheduled to commence in May 2012.

[3] On 26 July 2011 Douglas applied to the Executive Director for revocation of the Freeze Order pursuant to section 47(6) of the Act, which application has been referred to a Commission panel pursuant to section 30.

[4] We heard Douglas's referred application on 25 November 2011. We received affidavit evidence, including an affidavit sworn by Douglas on 6 September 2011 (the "Douglas Affidavit"). We also received written and oral submissions from Douglas, Richard Bruce Kowalchuk ("Kowalchuk", to whom we had granted standing to make submissions), Holtby and Staff.

II. BACKGROUND

[5] Staff informed us that, as at 25 November 2011, the Property was valued at approximately C\$298 000 (about \$84 000 of that in cash) plus approximately US\$119 000 in cash. According to the Douglas Affidavit, the Property was valued in total at approximately C\$352 000 as at 30 April 2010 and at approximately C\$362 000 as at 31 March 2010.

[6] In the Douglas Affidavit, Douglas also deposed that the Freeze Order is "creating significant financial hardship" for him and his family; that the costs of defending himself against Staff's allegations have been "prohibitive" for him, being of "modest means" and having "significant liabilities"; and that he requires immediate access to the Property to allow him to continue to pay his legal defence costs.

[7] In April 2011 Kowalchuk and Staff entered into a Settlement Agreement and Undertaking (the "Settlement Agreement") and an Assignment Agreement (the "Assignment Agreement", and, together with the Settlement Agreement, the "Agreements").

III. ANALYSIS

[8] In making our ruling, we have considered the affidavit evidence and the submissions.

[9] Holtby's brief submissions were, in essence, that he cannot be bound at the Merits Hearing by any evidentiary findings made as a result of this interlocutory application. In short, we agree.

A. Referral Power

[10] Section 47(6) of the Act provides:

(6) On the application of a person or company directly affected by a direction given in an order made under subsection (2)(a), (b) or (c), the Executive Director may make an order revoking that direction or consenting to the release of any funds, securities, exchange contracts or other property in respect of which the order was made under subsection (2)(a), (b) or (c).

[11] Section 30 of the Act provides:

30(1) The Executive Director may at any time refer any matter to the Commission for its consideration.

(2) On the referral of a matter to the Commission under subsection (1), the Commission may conduct a hearing into the matter and may make an order in respect of the matter or by order or otherwise give any advice and direction to the Executive Director in respect of the matter that the Commission considers appropriate in the circumstances.

B. Applicable Test

[12] The Act does not prescribe a test for determining whether a freeze order should be continued, varied or revoked, but the Commission has consistently applied the three-pronged test – the so-called "Workum Test" – set out in *Re Hennig*, 2005 ABASC 425 at para. 19:

- (a) prima facie evidence of a breach of securities laws was present at the time of granting the freeze order;
- (b) it is proper to continue the freeze order to preserve property for potential claimants; and
- (c) it is in the public interest to preserve the freeze order.

[13] Staff submitted that we are not bound by the Workum Test and proposed another. However, we perceive no good reason to apply a test other than the Workum Test. We therefore address each of the three prongs of the Workum Test in turn.

C. Application of the Workum Test

1. Prima Facie Evidence of Breach of Alberta Securities Law

[14] There was, at the time the Freeze Order was granted, sworn evidence of Kowalchuk (from his 3 May 2010 investigative interview by Staff) that: the Account was opened at Holtby's request to enable Holtby to trade in securities, including shares of Eveready Inc. ("Eveready"), during trading blackouts; the Account was opened by Douglas, who was aware of the nature of the Account and had no intention of trading through the Account himself; the Account was initially funded by Holtby (\$50 000), Kowalchuk (\$40 000) and Douglas (\$10 000), but profits (or losses) from the Account were to be attributed 20% to Douglas and 40% to each of Holtby and Kowalchuk; Holtby, with knowledge of and prior to the announcement of Eveready's acquisition, solicited the purchase of Eveready shares through the Account; Douglas was aware that Holtby, his very close friend, was a director of Eveready; and, prior to the announcement of Eveready's acquisition, Douglas indicated to Kowalchuk that he (Douglas) was aware Eveready was going to be taken over, information Kowalchuk assumed Douglas learned from Holtby. We are satisfied that this constituted at the time prima facie evidence of a breach of Alberta securities laws – section 147(2) of the Act – by Douglas, linked to the Account. In so finding, we are mindful that a prima facie evidentiary threshold is a low one.

[15] Further, we discern no violations of administrative law principles in connection with the Executive Director's granting of the Freeze Order, as suggested by Douglas. To that end, we are satisfied that, in granting the Freeze Order, the Executive Director relied on an unedited transcript of Kowalchuk's 3 May 2010 investigative interview. We are also satisfied that there is nothing in the transcript of Kowalchuk's earlier – 22 March 2010 – investigative interview that would have led to a different outcome.

[16] The first prong of the Workum Test has been met – there was, at the time the Freeze Order was granted, prima facie evidence of a breach of Alberta securities laws by Douglas.

2. Preservation of Property for Potential Claimants

[17] Douglas and Kowalchuk submit, and Staff did not dispute, that in this case there are no known or identifiable potentially-wronged parties who might benefit from a continuation of the Freeze Order. However, Staff submitted that the Commission itself constitutes a proper potential claimant in cases of alleged illegal insider trading, given that, pursuant to sections 198(1)(i) and 199 of the Act, there is the potential for statutory claims by the Commission.

[18] In cases of alleged illegal insider trading the potential wrong most susceptible to identification would be that done to the Alberta capital market. And we accept that the Commission can alleviate such harm by preventing wrongdoers from profiting from their capital-market misconduct through disgorgement orders. Accordingly, in cases of alleged illegal insider trading it is proper, in our opinion, to continue freeze orders to preserve property – that linked to prima facie illegal insider trading – for the Commission, with its potential statutory disgorgement claims for the benefit of the potentially-wronged Alberta capital market. In other words, we are persuaded that the Commission itself can be and is a potential claimant under the second prong of the Workum Test in cases of alleged illegal insider trading where, as here, the property sought to be preserved is linked to prima facie illegal insider trading. The second prong of the Workum Test has been met.

3. Public Interest

[19] Douglas submitted that it is not in the public interest to continue the Freeze Order because: the totality of the evidence (including that gathered since the Freeze Order was granted) makes clear that he did not breach Alberta securities laws; the Freeze Order is causing him financial hardship and compromising his ability to defend himself against Staff's allegations; and the Freeze Order "puts into jeopardy" the very Property (largely equities) subject to it.

[20] Kowalchuk submitted that he has a claim to 40% of the Property, \$156 800 of which he has assigned to the Commission pursuant to the Agreements. He asked that the Freeze Order be varied to allow the Commission to receive the amount assigned to it under the Assignment Agreement, with any remainder from the 40% to be released to him (which would also be in accordance with the Assignment Agreement). He contended that such a variation of the Freeze Order would be giving effect to the Agreements, and that giving effect to settlement and assignment agreements is always in the public interest. Douglas told us he was prepared to accept that Kowalchuk has a 40% interest in the Property.

[21] Staff countered that it is not in the public interest to revoke or vary the Freeze Order for the benefit of Douglas because: all of the evidence gathered since 3 May 2010 is supportive of that existing at the time the Freeze Order was properly granted; the Freeze Order does not prevent Douglas from earning a livelihood or trading in any other account, so he has access to other assets for the payment of his legal defence costs; and the Property was mostly, if not entirely, derived from profits made from prima facie illegal insider trading. Staff argued that any release of the Property to Douglas to pay his legal defence costs should be in a reasonable amount, perhaps \$20 000. Staff further argued that, in the event we were to determine it is in the public interest to release some of the Property to Douglas to pay his legal defence costs, it would also be appropriate to release up to 40% of the Property to Kowalchuk sufficient to satisfy the amount assigned by him to the Commission (\$156 800).

[22] We acknowledge that the Commission's discretion to maintain an order made under section 47 of the Act should be exercised only when it is in the public interest to do so.

[23] Having reviewed all of the evidence before us, we are satisfied that there remains prima facie evidence of a breach of Alberta securities laws – section 147(2) of the Act – by Douglas linked to the Account, or by others linked to the Account opened solely in Douglas's name. This ground provides no basis for revoking or varying the Freeze Order. Indeed, the prima facie evidence strongly favours the continuation, in the public interest, of the Freeze Order in that it preserves property – the Property – linked to prima facie illegal insider trading.

[24] Further, having regard to the 2010 and 2011 valuations of the Property before us, we are not convinced that revocation or variation of the Freeze Order is justified on the basis that it puts in jeopardy the equity-laden Property subject to it.

[25] We are, however, satisfied that it is in the public interest, and consistent with principles of fairness and natural justice, that Douglas be able to retain legal counsel to assist in his defence at the Merits Hearing, and that the Freeze Order is causing, or will cause, him some financial hardship in this regard. Accordingly, we think it appropriate, and in the public interest, to vary the Freeze Order to release to Douglas \$40 000 of the Property for the sole purpose of paying his legal defence costs incurred from the date of this ruling.

[26] We are also satisfied that it is in the public interest to give effect to settlement and assignment agreements. Thus, we think it appropriate, and in the public interest, to vary the Freeze Order to release to the Commission that portion of the Property equalling the lesser of 40% of the Property and \$156 800 in full or partial payment of the amount assigned to the Commission under the Assignment Agreement, with any remainder from the said 40% to be released to Kowalchuk.

IV. RULING

[27] For the foregoing reasons, we order that the Freeze Order is varied, under section 47(6) of the Act, such that:

- \$40 000 of the Property is released to Douglas for the sole purpose of paying his legal defence costs incurred from the date of this ruling; and

- that portion of the Property equalling the lesser of 40% of the Property and \$156 800 is released to the Commission in full or partial payment of the amount assigned to the Commission under the Assignment Agreement, and the remainder from the said 40%, if any, is released to Kowalchuk.

[28] We also order that Douglas is to determine to what extent, and which of, the Property will be liquidated in order to effect the above-ordered releases of the Property.

20 December 2011

For the Commission:

"original signed by"
Jack C. Major, QC

"original signed by"
Neil W. Murphy