



Al Rosen
Between the Lines

How to stop leaks

Make executives responsible for insider-trading tips that come from their companies

It seems we've come to accept illegal insider trading as a fact of life in our capital markets. Whether it's a corporate merger, acquisition, earnings miss or some other significant event, it's common to see someone profiting nefariously at the expense of another. Much too frequently, target stocks move prematurely ahead of acquisition announcements. The big names sometimes make the news, but there is also a constant flow of smaller deals that routinely get ignored by most.

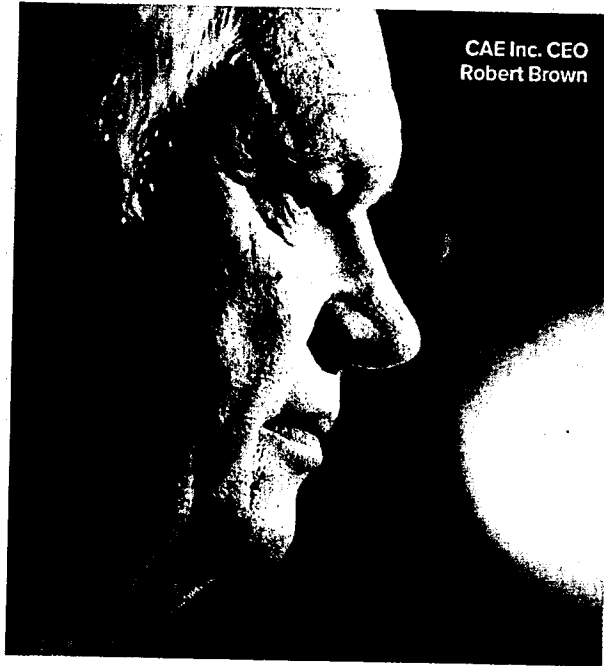
You might have noticed the Algoma (TSX: AGA) fiasco earlier this year. The steelmaker announced after the close of markets on Valentine's Day that it was in talks to be acquired by a third party. The stock was seeing lots of love before that, however, rising 24% in the prior four trading sessions. The initial talks eventually fizzled, but Algoma was still scooped up in mid-April for a significant premium.

Also noteworthy was the Zurich-based Holcim Group's announcement that it would acquire the shares it didn't already own in St. Lawrence Cement Group (TSX: STA) before the market opened on Feb. 26. The stock closed at \$40.85 that day, but rose more than 9% in the five days leading up to the announcement.

On Feb. 19, Wolfden Resources Inc. (TSX: WLF) announced that it had received a takeover offer of \$3.90 a share from Zinifex Ltd., a Melbourne, Australia-based lead and zinc producer. Wolfden shares rose 14% in the two days before the announcement. Likewise, news broke on Feb. 6 that Rockwater Capital Corp. (TSX: RCC) had hired advisers to solicit takeover bids for the company. The stock closed the previous day at \$6.50, up 14% in the prior five days, and 30% in the prior 12 days.

By the time CAE Inc. (TSX: CAE) announced it was buying Engenuity Technologies (TSX: EGY) for \$1.20 a share on Feb. 12, the stock had already risen 13% in the previous five days. When SXR Uranium One (TSX: SXR) announced it would buy UrAsia Energy (TSX: UUU) that same day, it was the recent trading volumes of the latter that seemed most irregular. The day before the announcement, UrAsia traded four-and-a-half times its normal number of shares.

To be certain, insider trading is more widespread than most investors realize. All of these cases occurred during the same three-week period in February. It's tough to pinpoint the dollar



CAE Inc. CEO
Robert Brown

Insider trading at Algoma cost shareholders probably close to \$30 million

amount of the illegal activity, but the value stolen from shareholders in the Algoma affair alone was probably close to \$30 million. The total cost to the integrity of our capital markets is, of course, much greater.

Corporate acquisitions, by nature, usually involve numerous executives, staff and outside consultants on both sides, which can represent a lot of potential loose lips. It's reasonable to think that most insider trading is done by people acting on second- and third-hand information. The cousin of the staffer at the law firm advising the purchaser who buys a few hundred shares might be a far cry from Michael Milken, but let's be certain: he's screwing over somebody. If everybody had information of the impending takeover, then nobody would be selling at a bargain price.

Unfortunately, our current regulatory system is helpless to catch such people. Recognizing that a crime took place is the easy part. Catching the perpetrator is a whole different story. Clearly, some of what

appears to be insider trading is just smart investing. Other times, it's just luck. Right there, investors who are twice or thrice removed from an insider already have good defences—and that's if anyone even comes knocking.

Another creeping problem is that some trading services are designed to tip off regular investors to situations where inside information might be at play. If one group of insiders starts buying, and another group piles on after noticing the irregular trading, the impact of the initial illegal activity is magnified. It's an ethical grey zone, to be sure, but with no apparent regulatory crackdown coming, some see it as a levelling of the playing field rather than a case of the cure worsening the disease.

Not surprisingly, regulatory responses don't focus on the common folk who profit on the latest acquisition. Rather, regulators spend the pittance they allocate themselves on pursuing company executives in hope of achieving some



Clockwise from left: Andrew Rankin (r); Holcim CEO Markus Akermann; Michael Cowpland

high-profile deterrence cases. Even then, however, the regulators have a habit of falling flat on their face.

Last November, the Ontario Securities Commission saw its 2005 tipping conviction of former M&A insider Andrew Rankin overturned. It was also denied an appeal hearing in February. Rankin was accused of tipping his friend Daniel Duic to buy stock and options in roughly 10 target companies, for gains of more than \$7 million. The judge who overturned the conviction didn't like the inconsistencies in Duic's testimony, which came as part of a deal with prosecutors that allowed him to keep more than half of his ill-gotten gains.

In October 2005, a panel of OSC commissioners dismissed charges by its staff against then chairman of ATI Technologies, K.Y. Ho, and his wife. Essentially, the commissioners didn't think its own staff could prove that the Hos acted on inside information when they gifted roughly 250,000 shares of ATI to three charities before the stock dropped nearly 50%. In this case, the Hos were accused of maximizing their tax benefit by avoiding a \$3.6-million decline in the value of the shares in May 2000.

In December 2003, the OSC eventually decided to settle with former Corel Corp. executive Michael Cowpland for \$575,000, nearly a year after his holding company was fined \$1 million. That total was only slightly more than the loss the commission estimates he avoided on share sales in 1997. No additional fines were levied, and no jail time was sought.

Even if these cases proved successful, it's questionable whether many people who profit from illegal insider trading would change their behaviour. The regulatory strategy is clear: stick to high-profile cases usually involving executives who sell shares prior to bad news being released (since these are the situations when investors feel doubly screwed).

The regular Joe who buys on an acquisition tip from a friend of a friend, knows he'll never be caught. To make serious changes would require a quantum shift in our sense of judicial procedure.

The regular Joe who buys on a tip from a friend of a friend, will never be caught

isn't always our domestic executives. Sometimes the leaks come from foreign acquirers. Nonetheless, imposing our will on foreign companies could be seen as less of a challenge, and more of an opportunity. The xenophobes among us already look for every excuse to prevent foreign entities from buying into Canada. The threat of holding up an acquisition by a foreign entity because inside information leaked from that organization, would allow us the chance to access information not otherwise available. The goal is to get the foreign firm that leaked the information to co-operate and turn over evidence of who benefited. Even if one of its own junior executives had to take the fall, it might be a reasonable cost to seal the acquisition.

In pursuing such a strategy, our regulators might gain insight into domestic parties that may also have benefited. At the least, we could trade information with foreign regulators to gain insight into who our domestic criminals are. This might seem heavy-handed, but it's also a

good opportunity to get some results for once. The current strategy of trying to deter insider trading with high-profile convictions seems ill-conceived, especially when our regulators can't secure those convictions. In short, it's time for a new approach.

Some might say that our regulators prefer as little attention as possible be paid to insider trading. After all, such crimes can impact the "confidence in the market" that our regulators seem so blindly intent on defending. Hopefully, they're not really that stupid.

Making executives responsible for insider tips that come from their companies would go a far way to cutting off the illegal information flow, and strengthening our capital markets just the same. Despite what the OSC might think, the Rankin-Duic case didn't make securing a tipping conviction impossible; the prosecutors just shouldn't have let the co-conspirator keep half his loot. ☐

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