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Insider trading: a first spring loading case in Québec

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On August 16 of this year, the Tribunal Administratif des Marchés Financiers (TAMF), formerly the Bureau de Décision et de Révision, rendered a decision in which it concludes, among other things, that spring loading is an offence under the *Québec Securities Act* (QSA).

The TAMF refers to the concept of spring loading as follows:

[Translation] It is essentially a financial transaction "initiated" by the officers of a reporting issuer in possession of privileged information and consists of issuing options allowing them to purchase shares of this issuer at market price, all the while knowing very well that the price of these shares would potentially increase considerably when the privileged information would be, in the relatively near future, disclosed to the public.

In this matter, the TAMF held that on January 4, 2010, when the board of directors adopted and signed the resolution authorizing NSTEIN to issue 1.2 million stock options of the company, the directors were in possession of privileged information.

According to the TAMF, the information with regard to, *inter alia*, (i) the verbal acquisition proposal of NSTEIN by OpenText presented directly to respondent Luc Filiatreault, CEO of NSTEIN, on November 27 and 28, 2009 by the principal director of OpenText and (ii) the subsequent serious steps taken by NSTEIN to respond to this proposal, were privileged. The TAMF also held that if the privileged information, known to the Board of Directors of NSTEIN on January 4, 2010 and unknown to the public, were disclosed, they would have had an impact on the decision of a reasonable investor.

The TAMF rejected the arguments invoked by the respondents in this case, including the one to the effect that the granting of options was "necessary" in NSTEIN's course of business and that, consequently, this transaction was exempted on the exception provided under section 187, paragraph 2 of the QSA. In fact, this paragraph provides that it does not constitute insider trading when both parties to a transaction, within the meaning of the QSA, are in possession of privileged information. However, the insider cannot benefit from this exception unless this transaction is necessary in the issuer's course of business.

The respondents explained that by combining the granting of options to the members of management and to certain employees with the granting of 225,000 options to the newly hired officer (Vice-President of NSTEIN), the respondents intended to restrict the public disclosure of the number of options granted to these individuals in order to protect their "sensitivity." According to the TAMF, the term "necessary" certainly does not mean "useful" or "desirable." Protecting the sensitivity (or susceptibility) of employees and directors, taking into account public interest, did not meet the criteria of necessity required under s. 187 of the QSA, concluded the TAMF.

The TAMF also rejected the argument invoked by the respondents to the effect that the

directors did not receive any benefit, monetary or other, from their decision to issue said stock options. Rather, the TAMF held that it was not required to demonstrate that an individual benefited financially from a transaction deemed illegal in order to be found guilty of insider trading.

According to the TAMF, dissuasive measures were necessary, particularly due to the lack of repentance from the respondents. The following administrative penalties were therefore imposed:

- CDN$20,000 fine for each director;
- an additional CDN$10,000 for the Chairman of the Board of Directors;
- $144,000/$72,000/$36,000 respective fines for the officers (the amounts were twice the gross profit made).

This decision is important since a Québec court acknowledges for the first time the offence of spring loading and that it interprets the words “necessary in the issuer’s course of business” provided under the second paragraph of s. 187 of the QSA. Finally, note that this decision could be subject to an appeal.