Securities Law Newsletter
March 2015
Westlaw Canada

OSC CONTINUES ENFORCEMENT INITIATIVES WITH WHISTLEBLOWER PROPOSAL

Ralph Shay, Dentons Canada LLP

Introduction

In September 2014, the United States Securities Exchange Commission (SEC) startled the legal and financial world with its headline-grabbing announcement of an expected award in excess of US$30 million to a whistleblower who had provided information that led to a successful SEC enforcement action. The interest generated by the size of the award was somewhat amplified in Canada by the knowledge that the Ontario Securities Commission (OSC) had for three years indicated that it was examining the prospect of introducing its own whistleblower program. The OSC has now taken the first concrete step in this direction, but the restrictions currently under consideration may not generate the level of participation by informants that has been experienced by the SEC under its program.

The Consultation Paper

As one of a number of enforcement initiatives, the OSC has published OSC Staff Consultation Paper 15-401 – *Proposed Framework for an OSC Whistleblower Program*. The OSC is requesting comments on its proposal by May 4, 2015. The introduction of a whistleblower program was mentioned in a 2011 OSC staff notice as one of the possible courses of action the OSC was examining to improve the timing and effectiveness of the enforcement function. The other initiatives identified in that notice, including the permitting of no-contest settlements, were implemented in March 2014 through amended and retitled OSC Staff Notice 15-702 – *Revised Credit for Cooperation Program.*

The proposed whistleblower program is patterned largely on the program adopted by the SEC in 2011. In its 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program, the SEC disclosed that it received 10,193 whistleblower tips from the inception of the program in August 2011 to September 30, 2014, the end of the SEC's fiscal year, and that the SEC had authorized awards to 14 whistleblowers during that time. Some observations on the OSC proposal are set out below.

Circumstances In Which An Award May Be Granted

To be eligible for an award under the program, a whistleblower would have to report conduct that resulted in a contested or settlement proceeding under section 127 of the *Securities Act* (Ontario), which provides for public interest orders by the OSC. There are several types of orders the OSC can issue under section 127, including the imposition of an administrative penalty of up

to $1 million for each failure to comply with Ontario securities law and disgorgement to the OSC of money made as a result of the non-compliance. A monetary sanction or an agreed settlement payment would be a prerequisite for a whistleblower award.

In theory, a whistleblower could be disqualified from receiving an award, no matter how serious the offence reported, simply by OSC staff choosing to seek an alternative remedy to section 127, such as an application to the court for sanctions under section 128 of the *Securities Act* or a quasi-criminal or criminal prosecution. In practice, section 128 is rarely used, and it would be open to OSC staff to proceed under section 127 in addition to pursuing a prosecution. It would also be reasonable to expect that OSC staff would generally pursue a section 127 proceeding in a meritorious whistleblower situation so as not to discourage use of the program. However, the fact that a section 127 proceeding is not automatic, even if it appears that a securities-related offence clearly has occurred, could enter into the risk-reward analysis for a potential whistleblower considering whether to come forward.

Award Amount

Whistleblowers would be eligible for an award of up to 15% of the total monetary sanctions awarded (excluding cost awards) or settlement payments in a proceeding in which total sanctions or settlement payments exceeded $1 million. A cap of $1.5 million is being considered. Subject to those limits, an award to a whistleblower would be discretionary; OSC staff would recommend the amount and a panel of OSC commissioners would make the final decision. It is proposed that no reasons for the decision would be provided and that there would be no right of appeal. Unlike in the SEC program, payment to the whistleblower would not be contingent on collection of the sanction monies, but would only occur upon final resolution of the matter, including any appeals.

These limitations may give at least some whistleblowers pause, especially those who perceive that whistleblowing would carry some risk. Assuming there is a section 127 proceeding and a finding of wrongdoing, there is no assurance that the result will be a monetary sanction at all, let alone one that exceeds $1 million. Once that hurdle is overcome, the uncertainty of the entirely discretionary amount to be awarded comes into play. To add to that uncertainty is the proposal that whistleblower award payments would come from the OSC's fund that holds monetary recoveries from sanctions or settlements, the amounts of which would vary from year to year. The $1.5 million cap may be a disincentive for some. Also of concern may be the delay inherent in appeal proceedings. An award to the whistleblower in a strongly contested matter could conceivably take several years.

Culpable Whistleblowers

A person who was a participant in the wrongdoing to which the whistleblower information pertained would not be disqualified from an award under the whistleblower program. The level of culpability would be a relevant factor in determining whistleblower eligibility or the amount of the award. While culpable persons may be in a position to provide uniquely valuable information, it is questionable as to whether an award to those persons would be palatable from a public perception standpoint, particularly if culpable persons ultimately were to benefit from their misconduct or fare better financially than their victims as a result of the OSC proceedings.

Internal Reporting

In the consultation paper, OSC staff encourages internal reporting to the organization's compliance personnel as a first step before reporting to the OSC, and the steps a whistleblower had taken to report misconduct internally is on a list of factors that would be considered by the OSC in determining the amount of a whistleblower award. While the encouragement of internal reporting is understandable from a regulatory perspective, the benefits may not seem as apparent to a potential whistleblower.

The proposed whistleblower program contemplates that only "original information", which is information the OSC does not already have, will generate a potential award. A potential whistleblower who first reports information internally risks the OSC subsequently learning of the misconduct from the whistleblower's organization or another whistleblower, thereby removing the "original information" status. The consultation paper anticipates that if the whistleblower, after reporting internally, subsequently reports to the OSC due to a failure by the organization to respond, the OSC will consider the timing of the initial reporting to determine who provided the information first, and it may be possible for more than one person to qualify as a whistleblower. It is not specifically stated whether the potential whistleblower who first reported internally would be eligible for an award if the organization did respond by taking corrective action and reporting to the OSC.

One might expect that a person anticipating a possible life-changing payout from the whistleblower program would be deterred from reporting internally within the organization by the risk that someone else would report the information to the OSC first. Despite the possibility of remaining eligible for an award in that circumstance, there may be issues around meeting the evidentiary burden of establishing that the internal report predated any other person's report and was the cause of the misconduct first being discovered by the organization or the OSC. Nevertheless, the SEC reported in its 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program that of the award recipients under its program who were current or former employees of the organizations on which they reported, over 80% raised their concerns internally to their supervisors or compliance personnel before reporting to the SEC.

Confidentiality

Under the proposal, the OSC would use all reasonable efforts to keep confidential a whistleblower's identity as well as information that could reasonably be expected to reveal the whistleblower's identity. There would, however, be exceptions, including, among others, where disclosure is required to be made to a respondent in connection with a section 127 proceeding to permit a respondent to make full answer and defence. Given the exceptions, some whistleblowers may perceive as tenuous their ability to maintain confidentiality

The proposal allows for anonymous whistleblowing through legal counsel. The identity of the whistleblower would have to be disclosed to the OSC before an award was made, so that the OSC could confirm the whistleblower's eligibility under the program. Presumably, the exceptions to confidentiality would apply to whistleblowers who initially report anonymously.

Retaliation

The consultation paper recognizes that protection from retaliation is an essential component of a whistleblower program. Employees currently have some whistleblower protection from their employers under section 425.1 of Canada's *Criminal Code,* which covers the reporting of both federal and provincial offences, but the OSC would understandably want to have the ability to enforce anti-retaliation measures through the more flexible section 127 proceedings. It is proposed that the anti-retaliation measures would be brought about through amendments to the *Securities Act* which would make retaliation an offence and also provide whistleblowers with a civil right of action.

For the Cooperative Capital Markets Regulatory System currently proposed by the federal government and five provinces, including Ontario, the consultation drafts of the underlying legislation – the Capital Markets Stability Act and the Provincial Capital Markets Act – both contain anti-retaliatory provisions to protect whistleblowing employees but not a right of civil action. However, at the present time, a securities regulatory whistleblower program involving a financial incentive is solely an Ontario proposal.

Timing of Implementation

Since legislative amendments are required for the anti-retaliatory measures essential to the overall proposal, implementation of the whistleblower program would not be expected shortly after the comment period ends in May, even if comments are favourable and the proposal does not change substantially. There is also the possible complication of the Cooperative Capital Markets Regulatory System and the finalization of its uniform legislation, the timing of which may overlap with Ontario's intended implementation of the whistleblower legislation. If that is the case, the necessity to obtain agreement among the participating jurisdictions may cause an additional delay.