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# NERA Expert's Testimony before the Alberta Securities Commission Helps Former Executives of Grande Cache Coal Corporation Win Dismissal of Insider Trading Allegations: *Stan, Re*, 2013 ABASC 148

## Background

On 5 December 2011, enforcement staff ("Staff") of the Alberta Securities Commission (ASC) formally issued a Statement of Allegations against several former senior executives of Grande Cache Coal Corporation ("Grande Cache" or the "Company"). Staff alleged that the senior executives (the "Respondents") engaged in illegal insider trading in mid-2008 by selling shares of the Company while in possession of undisclosed material facts. In particular, Staff alleged that, at the time of the impugned trades, Respondents knew the extent to which the volume of Grande Cache's coal production and its sales for the first quarter of its 2009 fiscal year (1 April to 30 June 2008) would be below the Company's prior guidance (the "Alleged Material Facts") and that, if generally disclosed, this information would reasonably be expected to have had a significant negative effect on the market price or value of the shares (i.e., that information constituted "material facts" as defined in the Alberta Securities Act).

## NERA's Role

NERA Vice President Bradley A. Heys was retained by counsel for the Respondents to conduct an economic analysis of the significance of the Alleged Material Facts to the value and market price of the shares of Grande Cache.

Mr. Heys demonstrated that the Alleged Material Facts would not reasonably have been expected to have a significant effect on either the value or market price of the Company's shares.

Mr. Heys observed that the Company had disclosed *prior* to the challenged trades that it expected sales of coal to be below its earlier guidance of 0.4 million tons of coal in the first quarter, but that it maintained its guidance of 1.8 million to 2.0 million tons for the full year. (It was not until the fall of 2008, when the rapid deterioration in the global economy became apparent, that the Company lowered its full-year projections.) Mr. Heys explained that additional information regarding the *extent* to which the Company would miss its first-quarter production and sales targets (that sales would only be 0.25 million tons for the first quarter) would *not* have had a significant impact on the value of the shares because the expected miss implied only a short delay in near-term anticipated cash flow, not a permanent reduction.

Staff did not introduce any expert evidence to address the issue of materiality, but argued that a 12 percent decline in the market price of the shares following the Company's first quarter earnings release (which occurred following the impugned trades) was evidence that the Alleged Material Facts were material at the time of the impugned trades. Mr. Heys explained that, contrary to the Allegations, the observed stock price decline following the first quarter earnings release was not sufficient to conclude that it would have been reasonable to expect that the public disclosure of the Alleged Material Facts at the time of the impugned trades would have had a significant effect on the stock price. Mr. Heys explained that, from an economic point of view, the analysis required to support the argument made by Staff would include an event study—a statistical analysis of stock price movements which takes into account broad market and industry effects on security prices, as well as the general volatility of the stock price. No such evidence was offered by Staff. In addition, Mr. Heys explained that even if event study analysis had been in evidence and had indicated that the stock price decline following the earnings release was statistically significant, one of the prerequisites for drawing inferences about materiality from an event study is that the market for the security must be informationally efficient. An informationally efficient market is one in which the price reflects all publicly available information and adjusts rapidly to incorporate new information.

Mr. Heys' analysis of the market for Grande Cache shares during mid-2008 identified several characteristics that were inconsistent with market efficiency. Most importantly, it demonstrated that there was not a statistically significant relationship between the release of company-specific news and the subsequent behavior of the stock price. As such, Mr. Heys explained, the decline in the stock price following the first quarter earnings release did not indicate that the public disclosure of the Alleged Material Facts at the time of the challenged trades of the Respondents "would reasonably have been expected to have a significant effect on the market price of the shares."

## The Result

Mr. Heys was accepted as an expert in economics, finance, and the valuation of securities, and provided expert testimony at a hearing before a panel of the ASC (the "Panel") in the fall of 2012. In a ruling issued on 10 April 2013, the Panel dismissed all allegations against the Respondents.

In finding that the Respondents' challenged trades did not contravene Alberta securities laws, the Panel held that the Alleged Material Facts were not undisclosed material facts within the meaning of the Securities Act. In particular, the Panel concluded that "in May 2008, there was not a probability (or indeed any reasonable expectation) that more specific disclosure of Grande Cache's missed Q1 Sales Production would have a significant effect on the GC Share price, given all the circumstances."

The Panel concluded that Grande Cache had disclosed that its coal production problems were temporary and that "sales missed in one quarter would be delayed, not lost." It found that the company's expectation that it would meet its full-year guidance was reasonable and that the "2008 financial crisis was clearly an unforeseen event that would not have been reasonably contemplated by market participants ...at the end of May 2008, or indeed until autumn 2008."

The Panel accepted Mr. Heys' opinions that the market price of the Company's shares depended significantly on expectations about future coal prices and that "expectations about future coal prices varied widely and were subject to significant uncertainty and differences of opinion." In that context, and given that the Alleged Material Facts related only to a delay in production and sales volumes, the Panel was "not satisfied that Staff...established with clear, convincing and cogent evidence that it is more likely that not the Alleged Material Facts were material facts left undisclosed within the meaning of the Act."

## Expert Involved

### Bradley A. Heys, Vice President

Mr. Heys' expertise is in the fields of business and securities valuation, financial investigations, finance, and economics. He conducts financial investigations of public companies for commercial litigation, class actions, and criminal matters, and performs valuations of business and securities for commercial litigation and tax purposes. Mr. Heys has advised clients and provided testimony for cases in both Canada and the US on issues relating to market efficiency, economic materiality, loss causation, and damages in the context of shareholder class actions, and has provided economic analysis for broker-dealer disputes. He has also conducted business and securities valuations and financial investigations for tax purposes and tax litigations in Canada. Mr. Heys is a CFA charterholder and a Certified Fraud Examiner.

## About NERA

NERA Economic Consulting (**www.nera.com**) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

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