

## PROPOSALS FOR A SECURITIES MARKET LAW FOR CANADA: A REVIEW

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### 1. Introduction

Securities regulation in the Canadian federation is presently largely a matter of provincial law. Federal corporations legislation, while containing provisions concerning insider trading and takeover bid controls, proxy solicitation rules, and public filing of financial statement requirements, applies only to federally chartered corporations. These include some of the most important “public” (in the English sense) or “widely held” (in the American sense) corporations in the country; however, the majority of corporations in Canada are not federally, but provincially chartered. Furthermore, there are a number of securities regulation areas that are not covered by the federal provisions. Pre-eminent among these is “new issue” and “sale from control block holdings” regulations, both of which were deliberately left to the provinces [1]. Finally, the federal provisions do not provide for an administrative agency responsible for securities regulation and with discretionary powers to discharge that responsibility [2].

In 1979 the Federal Government’s Department of Consumer and Corporate Affairs, which is responsible for administration of the federal corporations legislation, published its *Proposals for a Securities Market Law for Canada* [hereinafter *Proposals*], a three-volume set of recommendations on the appropriate role of the federal government in the regulation of the securities market. The *Proposals*, which comprise a draft statute [3], explanatory commentary [4], and background papers [5], represent the culmination of six years of study and work by the authors, the consultants, and the other advisers. If they are enacted into legislation, the Canadian scene will be transformed. A federal administrative agency, the Canadian Securities Commission (CSC), will be superimposed onto the existing pattern of provincial securities commissions. And, what is more, the CSC will administer a statutory scheme as comprehensive and complex as that of the province of Ontario, which currently has the most sophisticated and influential of the provincial securities regulation schemes.

The *Proposals* do, in fact, draw much of their inspiration from the Ontario scheme [6]. They also draw extensively on the United States federal scheme of

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securities regulation, with its seven statutes and its intricate pattern of subordinate implementing legislation. In addition, they are much influenced by the American Law Institute's mammoth *Federal Securities Code* [7], a work which restates, reorganizes, and revises the American federal scheme [8].

It is noteworthy that the *Proposals* do not necessarily represent the policies of the present Canadian Government. Rather, they reflect the views of the authors and are intended to serve "as a discussion document to facilitate the formulation by the Government of Canada of its policy on the regulation of the Canadian securities market" [9]. It follows, then, that even if the *Proposals'* thrust is acceptable to the Government, the provisions themselves may be much transformed before they reach the federal parliament. In fact, the initial provincial reaction to the *Proposals* has been cool [10].

Notwithstanding this uncertainty, a basic understanding of the *Proposals* and exploration of their particular strengths and weaknesses is valuable. It is of great interest to see what might be and it is important to provide some of the comment that the *Proposals* meant to excite. Furthermore, by virtue of the overall excellence of the work that went into their drafting, and the resulting draft statute, the *Proposals* are likely to be a major influence on provincial securities regulation reform in the 1980s.

At this point, one might ask why Canada has not had a federal scheme of securities regulation long before now. This is an interesting question, especially in light of the experience, dating from the 1930s, of its southern neighbor, the United States [11]. The answer appears to lie, in large part at least, in Canadian constitutional history. Overall, the history has been one of hospitality to provincial legislative schemes which date back to the period of the first state laws in the United States. At the same time, the jurisprudence, at least until recently, has been much less favorable to a comprehensive federal scheme [12].

The case for enacting a comprehensive federal scheme now is well put in the *Proposals*: it rests on the perceived national and international character of much of Canada's securities markets. The existing mechanisms of cooperation between the provinces have worked fairly well to facilitate the adaptation of their regulatory schemes to this reality [13]. However, cooperation has not always been forthcoming. And there appear to be a number of important matters which even joint provincial power does not reach [14].

On that note the author will review the main constituents of the draft act. For convenience, those constituents will be grouped under four categories: regulation of issuers; provisions addressed to the markets in which their securities are traded; enforcement provisions ancillary to these two; and administration of the act and its coordination with existing provincial law. Since the major perspective from which this review is written is that of the issuer concerned about the regulatory burden it would face under the act, the most detailed treatment will be given to the provisions concerning regulation of issuers. This discussion will be subdivided into two parts: (1) distributions and (2) continuous disclosure.

## 2. Regulation of issuers

### 2.1. Distributions

The draft statute's provisions regulating distributions of securities apply only to situations in which sales are made in two or more provinces. This limitation is not constitutionally necessary, but it is designed to avoid the federal statute dictating standards at odds with provincial standards for sales to a province's own residents. This, in turn, is part of a larger scheme designed to advance coordination and cooperation, and to further the policy of enabling a province to establish a level of protection for its own investors where only they are directly affected.

Generally speaking, the draft statute sets up a system similar to that set up by the provincial statutes. It mandates that any person who wishes to distribute a security must first file a prospectus or a block distribution circular with the Commission.

Their contents are to be determined by CSC regulations. The registrant must then obtain a receipt for the document from the Commission. In the case of a prospectus, the Commission is empowered to deny such a receipt if "the document contains a misrepresentation or fails to disclose a material fact required [under the statute]"; if "the distribution in connection with which it is filed is deceptive"; if "an unconscionable consideration has been or is intended to be given for promotional purposes or for the acquisition of property"; if the proceeds of the distribution, together with the issuer's other resources, are insufficient "to accomplish the purpose of the distribution stated in the prospectus"; if "the past conduct of the issuer or of a person who exercises a determinative influence over its management and policies indicates that the business of the issuer is likely to be conducted in a manner that is not honest or financially responsible or that is unfair to its security-holders"; if "an expert who prepared or certified a part of the prospectus or a report used in connection with it is not acceptable to the Commission"; or if "for any other reason" the distribution is deemed by the Commission to be unfair, unjust, or inequitable [15]. In the case of a block distribution circular, only the first two and the last two standards apply. Subject to any cause for disapproval, the Commission is required to issue a receipt (signifying approval) within a reasonable time after the document is filed with it. During the period between the time of filing and the moment of approval the issuer may seek prospective purchasers by means of a preliminary prospectus, or a tombstone or other advertisement, so long as these meet standards established by the Commission.

This system could make much more expensive what is already at the provincial level a costly process that ultimately yields an often difficult-to-digest disclosure document [16]. Recognizing this problem, the *Proposals'* commentary encourages the Commission to process the prospectuses of seasoned issuers expeditiously. Both the statute and the commentary exhort the Commission to cooperate with its provincial counterparts so as to prevent unnecessary and time-consuming duplication,

and the statute allows the Commission to require that a disclosure document contain an introductory summary of its contents. In addition, the statute requires the Commission to devise regulations that "enable reporting issuers to incorporate by reference or omit information that has already been disclosed to the public or filed with the Commission" [17]; the statute also leaves room for the development of short-form prospectuses.

Defining the term "distribution" to include primarily new issues of securities and sales of securities by controlling securityholders, the statute takes the additional significant step of also including a sale of previously issued securities from out of the holdings of a so-called "sophisticated purchaser" or "prescribed group" of other non-controlling persons, "if the aggregate number of securities exceeds an amount prescribed by the Commission" [18]. In the third type of distribution, the disclosure document required is to be called "the block distribution circular". It is expected that the Commission will require less onerous disclosure for this document than it will for the prospectus required in the first two types of distribution. The rationale for including sophisticated and other non-controlling persons within the term "distribution" is that their substantial dispositions are likely to produce the sort of market grooming and sales efforts against which the distribution regulatory scheme should protect. This position has much to commend it; but the *Proposals* clearly recognize that care must be taken to prevent the imposition of undue liquidity restraints on large securityholders with the possible chilling effects that such restraints could have on institutional purchases. The block distribution extension is inserted therefore as a tentative one.

The disclosure requirements apply to all persons who wish to sell or offer for sale a security in the course of a distribution. This breadth of application makes the exemptions to the distribution regulatory scheme in the statute most important. The statute lists a large number of these and adds that other exemptions can be specified by regulation, and that issuers can apply for exemption orders for particular transactions. The specific exemptions may be grouped under two major headings: (1) transactions for which investor protection is provided otherwise, because of a pre-existing regulatory scheme, or because the investor can fend for himself, or because the risk of loss is very low; and (2) transactions for which the cost of protection, in terms of impairment of other policy objectives, is deemed to outweigh investor protection objectives. Exemptions in the first category include securities exchange takeover bids which are covered by the takeover bid regulatory scheme; situations in which banks purchase securities for their own investment; and trading in debt securities of the Government of Canada. Exemptions in the second category include situations in which the issuer issues its own or an affiliate's securities to its employees.

Those exemptions likely to be of the greatest domestic interest are those applicable to small issuers. Under the old Ontario scheme, superseded in 1979 by the present one, exemption was possible if a determination was made that the proposed issue was so confined as not to be addressed "to the public" [19]. However, the

interpretive question posed by use of this phrase proved to be as difficult in Canada as it was in the United States. Taking its cue from Securities and Exchange Commission rulemaking attempts to clarify the definition, Ontario's new scheme, after a transitional period ending in 1981, will seek to capture the flavor of the old law while reducing its uncertainties. Thus, it will replace the limitation in coverage to the "public" with an exemption for a limited offering to persons who have access to and ability to use prospectus-quality information. The *Proposals'* draft statute contains a similar limited offering exemption. However, it adds *another* such exemption which eliminates the potentially troublesome purchaser qualifications. This latter exemption, modeled after the ALI Code exemption, defines "limited offering" as a "distribution within a period prescribed by the Commission to not more than thirty-five purchasers of the securities distributed", where each purchaser agrees to file or have filed a prospectus if a sale of the securities by him "results in there being more than thirty-five owners of the securities within three years of the completion of the distribution or such other time as the Commission prescribes". In addition, there can be "no selling or promotional expenses paid or incurred except for professional services or services other than the solicitation of investors by a registrant" [20]. Draft statute exemptions for intraprovincial distributions and for securities transactions by issuers having fewer than fifty security-holders are also helpful to small issuers.

The *Proposals'* draft statute also addresses another problem that has greatly troubled regulators in both Canada and the United States: the problem of the so-called two-step distribution. This distribution is accomplished by an exempt distribution of securities to a large purchaser who, in turn, resells to persons to whom a direct distribution would have required a prospectus. In order to catch such transactions, the draft statute includes in the definition of "distribution", "a sale of a previously issued security purchased from the issuer or an underwriter of the security, other than a security of a reporting issuer that was purchased by the seller one hundred and eighty days or such other period as the Commission prescribes before the sale" [21]. The ambit of this provision is widened, however, by the definition of "underwriter" to include a person who "as principal, purchases . . . securities in furtherance of a distribution" [22]. All of this does a more certain job of dealing with the two-step distribution than the control device which had earlier been employed by regulators in Canada and the United States. This device required the purchaser under the exemption to purchase with "investment intent". However, the resultant picture under the *Proposals'* draft statute is one of intimidating complexity. And the "in furtherance of" language retains some of the uncertainty of the old investment intent element [23].

## 2.2. Continuous disclosure

The draft statute's provisions concerning continuous disclosure represent a significant development in Canadian securities regulation of this sort. This is because

they better select which issuers are to be subject to such a scheme; and they offer useful proposals for the integration of the requirements of the scheme with the distribution regulatory scheme. In their general outline the provisions resemble the existing provincial regulations on continuous disclosure and the federal business corporations legislation. Issuers subject to the provisions under the draft statute must send annual reports to all their securityholders and quarterly reports to all of them except debt securityholders; issue press releases, subject to confidentiality provisions, to publicize new developments as they occur; solicit proxies for securityholders' meetings, and include with such solicitations Commission prescribed information circulars. Insiders of issuers subject to the continuous disclosure provisions must report to the Commission their initial holdings and subsequent changes in those holdings, subject to a very useful small trade exemption. Persons who make takeover bids for the equity securities of an issuer subject to the continuous disclosure provisions must structure their bids in certain prescribed ways, and both they and the directors of the target issuer must supply offerees with information circulars. Continuous disclosure issuers desiring to repurchase their own equity securities are subject to a regulatory scheme similar to that for takeover bids. All reports to securityholders, press releases, and information circulars must not only be distributed in accordance with the relevant statutory provisions, but they must also be filed with the Commission.

The most significant departure in the draft statute's provisions from the provincial and federal provisions is the draft statute's requirement that, upon entry into the continuous disclosure system, the issuer must file with the Commission a "registration statement", in prescribed form. This form must be updated annually so that the information contained therein is current as of the end of the issuer's most recent financial year. Since such documents are most likely to be used directly by securities professionals, the form should "include 'soft data' such as earnings forecasts and plans for future development, as well as the 'hard' information contained, for example, in financial statements" [24].

Only so-called reporting issuers are subject to the continuous disclosure scheme. The term "reporting issuers" is borrowed from the Securities Act, 1978, of Ontario, where it is used for a similar purpose. In the provincial statute an issuer becomes a reporting issuer, generally speaking, either by virtue of a stock exchange listing or by the filing of a prospectus or securities exchange takeover bid circular. The *Proposals* accept the first criterion but reject the second. They maintain that the overall criterion should be "the likelihood that an active trading market will develop [in the issuer's securities] and that securities analysts will follow the security and thus disseminate the information contained in the issuer's file" [25]. It replaces the filed document qualification with one based on the attainment of three hundred or more "public securityholders".

Participation in the continuous disclosure scheme carries with it a number of benefits, expressed by the draft statute in terms of relief from the new issue regulatory scheme. For instance, disclosure requirements for the prospectuses of report-

ing issuers are expected to be designed by the CSC “to avoid unnecessary repetition of information previously filed by the issuer” [26]. Furthermore, reporting issuers that have been registered for at least one year (or for some other prescribed period) are exempt from the prospectus requirements if they are selling “limited amounts” of securities in an “open market” and in such a way as not to disturb “orderly marketing processes” [27].

It may be argued against the continuous disclosure scheme set forth in the *Proposals* that it flies in the face of data that support the hypothesis that the market prices of actively traded securities already impound all the available useful data on the issuer [28]. It may be that mandated disclosure adds nothing, or at least not enough to warrant its cost, because issuers have a self-interest in full and accurate disclosure, the securities professionals following the issuer are ferreting out data in any event, and the trading patterns of insiders may be providing additional signals to the market [29]. The *Proposals* address these data by emphasizing that, especially in Canada, they do not unequivocally support the hypothesis [30]. The *Proposals* do not consider, at least explicitly, the point that the emphasis in the literature on active trading markets might be drawn on to support the positions the *Proposals* take on the applicability of the continuous disclosure scheme, and on its integration with the new issue scheme. That is to say, investor protection accomplished by means of mandated and filed disclosure would seem to presuppose a “following” in the developing market sufficient to ensure effective use of the information thus provided.

### 3. Securities market provisions

Turning to the other regulatory area of the draft statute, perhaps the main part is that dealing with the licensing of securities market professionals, to which is allied the part dealing with their self-regulatory organizations. Separately discussed are the provisions of the draft statute dealing with securities clearance, settlement and transfer systems, and regulation of securities market behavior generally.

#### 3.1. Regulation of market actors and self-regulatory organizations

The licensing of securities market professionals has long been an important element in securities regulation in Canada. The *Proposals* accept as the objectives of such licensing requirements that securities professionals should be competent, honest, and financially responsible. Provincial legislation achieves these objectives by requiring every person who trades in a security, and who cannot qualify under an exemption, to be licensed by the appropriate regulatory authority. Such a regulatory authority typically is given very broad discretion both at the point of initial licensing and in relation to the authority’s powers to discipline, and if necessary, to revoke licenses [31]. The *Proposals* follow a similar pattern, but with some significant variations.

Perhaps the most significant variation is that the *Proposals* eliminate the necessity under the provincial schemes for a non-professional to search for an exemption from the licensing requirement. They do this by requiring only those "who carry on [an interprovincial] business as a broker or dealer" or as an "adviser" to be registered as such. Similarly, they require in the same section registration of a person who "acts as an underwriter" [32]. With respect to the latter, there is no "carrying on business" criterion because the definition of "underwriter" limits the requirement "in most cases" [33] to those engaged in the underwriting business; the exceptional case of the person who acts as a professional underwriter would act, but is not part of a business, is regulated as if he were an underwriter. The concern in this situation appears to be to bolster the draft statute's controls of two-step distributions.

One result of this change in focus of the *Proposals*' licensing requirement is that a non-professional is no longer compelled, as he is under the provincial legislation, to deal through a licensed professional in order to qualify for an exemption from the licensing requirement. However, in the course of departing from the provincial models, in which the prospectus exemptions are largely duplicated in the licensing exemptions, the draft statute has also narrowed the exemptions from its licensing requirement. Consequently, specialization in prospectus exempt transactions will not always exempt the practitioner from the need to be licensed. Given the likelihood that inexperienced investors will seek some sort of professional assistance in most securities transactions, and given the pattern of the statute's exemptions, there is no real loss of investor protection; quite possibly, there is some gain. The *Proposals*' point on this area makes excellent sense: insufficient attention appears to have been paid in the provincial schemes to the question of whether the protection of having the professionals involved licensed is inappropriate *whenever* prospectus regulation is considered to be so [34].

Historically in Canada, largely in relation to the member firms of stock exchanges, a considerable part of the responsibility for supervision of licensed professionals has been left for quite sound pragmatic reasons to self-regulatory organizations. However, the provincial legislation has not fully recognized this state of affairs; nor has it fully recognized the need to reserve to the securities regulatory agencies power to supervise the work of such organizations. The draft statute contains a set of integrated provisions which represent a significant improvement on the provincial models. In place of the provincial piecemeal approach which applies a coherent registration and continuing supervision scheme only to the stock exchanges, the draft statute requires registration of "any securities exchange", "clearing agency", or person who carries on activities "as an association of securities firms" [35]. Also, unlike the provincial models, the draft statute goes on to spell out in some detail the criteria that the Canadian Securities Commission is to use in determining who must be registered. These criteria are aimed at ensuring that the applicant has by-laws that advance the purposes of the draft statute, deal fairly with present and prospective members and with those using its facilities, and do not



unduly restrain competition. Once the organization is registered the CSC can delegate to it the administration or enforcement of any provision of the statute; the CSC can then also allocate appropriate authority among such organizations in order to avoid “unnecessary duplication” [36]. The Commission is empowered to continue supervision over such organizations and their decisions, to be sure that standards similar to those for past registration continue to be met.

Notable in all of this is the explicit direction in the statute that the Commission direct its attention not only to investor protection but also to potential anti-competitive aspects of the operations of self-regulatory organizations. In light of the tone of one recent Ontario Securities Commission decision permitting the country’s largest stock exchange, the Toronto Stock Exchange, to continue with fixed commission rates for brokerage businesses [37], it appears that there is considerable virtue in Canada to a forthright statutory direction of that sort.

### *3.2. Regulation of clearance, settlement, and transfer systems*

This part of the draft statute has no equivalent in existing provincial securities laws, or in any provincial laws. Its provisions are designed to facilitate the existing trend in Canada toward a system of deposited (“immobilized”) security certificates, as well as certificateless securities issues, with transfers to occur through book entries with the depository or clearing agency. The movement is a national one and is expected to culminate in a single nationwide clearing agency or network of clearing agencies that reflect the national character of the securities markets in this country.

The draft statute is facultative in that it expressly permits an issuer to immobilize newly issued securities certificates with a registered clearing agency, or to bypass a certificate altogether in favor of issue by book entry in its own records and those of the clearing agency, provided that the authorization of the beneficial owner is obtained and that certain documentary and recording formalities are observed. Present provincial corporations laws provide no such stamp of legitimacy for a certificateless issue and transfer system. The present approximation of it is erected on the foundation of “complex multi-party contracts” [38].

Once securities have entered the registered clearing agency system they become subject to the draft statute’s legal regime for the transfer and protection of third interests (like those of a pledgee) in securities. This regime analogizes entries in the clearing agency records (showing matching changes in its participant’s holdings) to delivery of a security certificate in bearer form from one participant to another. The issuer’s method of communication with the beneficial holders of its securities is provided for. Provisions concerning access to and rectification of a clearing agency’s records are included, as are provisions dealing with the exercise of control over a participant’s account by a beneficial owner, pledgee, or judgment creditor. The liability of the clearing agency in the case of incorrect entries is described and withdrawal of securities from the clearing agency is permitted. Immobilization of certificates held by certain kinds of institutional intermediaries is also allowed for.

### 3.3. Regulation of the securities market

The *Proposals* set forth general rules of market conduct which for the most part prescribe standards of fair dealing by registrants with clients; the draft statute also proscribes various forms of fraudulent and manipulative conduct. With respect to the former, the draft statute innovates upon existing provincial legislation; with respect to the latter, it presents a new body of law. Presently, provincial law contains fairly limited anti-fraud rules (typically, a prohibition against false statements in filings), and the federal Criminal Code contains a number of others [39]. The provisions in the draft statute are intended to replace those in the Criminal Code, and they considerably supplement the anti-fraud prohibitions of the provincial law. The draft statute goes even further beyond existing provincial law by making the anti-fraud prohibitions the basis for later schemes of both civil and criminal liability, following in this respect the model of the ALI Code.

The principal objective of the fraud and manipulation proscriptions is to prohibit all “the fraudulent and similar improper activities that may affect an investor’s decision-making” [40]. A fairly complete array of types of securities fraud, as identified by Canadian and United States securities laws, is included in the draft statute: insider trading and tipping; short selling and trading in puts and calls by insiders; representations of regulatory agency endorsement of a security; touting a security; wash trading; bucketing; churning; manipulation by trading; and short tendering. In addition, there is a residual provision similar to SEC Rule 10b-5 which prohibits a person from “engaging in deception [or making] a misrepresentation in connection with” securities trading or an inducement not to trade, in circularization of securityholders, a takeover bid, a filing or document required to be kept or sent to any person under the statute, or any kind of public announcement relating to an issuer “that is likely to induce a person to trade or not to trade a security” [41]. In its breadth of application it is probably better calculated than its Canadian statutory forebears to deal with the uncataloguable range of possibilities for securities market fraud.

### 4. Enforcement of the draft statute

Under this heading there have been grouped the draft statute’s provisions for civil liability, for administrative action by the CSC, and for criminal liability. Of these, perhaps the most significant from a domestic viewpoint are the civil liability rules.

The draft statute’s provisions on civil liability are modeled for the most part after the ALI Code. This is not to say that there are no provincial civil liability rules: there are, in relation to false statements in prospectuses and takeover circulars, insider trading, and failure to deliver prospectuses to the intended recipient as required by the law. There are matching provisions in the draft statute which draw on the provincial precedents as well as the corresponding Code provisions, while

adding some innovations of their own. However, the draft statute goes beyond the provincial precedents along two trails blazed by the ALI Code. First, it sets up express rules of civil liability with respect to continuous disclosure documents as well as market manipulation, breaches of the proxy solicitation and takeover bid requirements, and a number of other comparatively less significant matters. Second, it has a residual provision expressly authorizing courts to imply civil liability in cases of violation of a provision of the statute, a regulation promulgated pursuant to it, or a by-law of a self-regulatory organization. Additional provisions, inspired by the United States experience, deal with the liability of aiders and abettors and a registrant's failure to supervise a person who violated a provision of the statute.

It remains to be seen whether legislation like the draft statute will move civil liability to the sort of prominence in the enforcement of the securities laws that it has assumed in the United States. Canada's provincial common law civil procedure rules in the areas of class actions and costs are far less hospitable to large-scale securities litigation than those in the United States, although the trend seems to be to narrow the gap [42]. Although the draft statute does not address the procedural issues, it does address some of the problems that the securities litigation explosion in the United States has thrown up. In particular, it deals with the problem of bankrupting civil liability in the context of open market dealings; this is especially significant for any regime of civil liability that covers continuous disclosure documents. With respect to liability for negligent mis-statements in the annually updated registration statements of reporting issuers, the statute adopts the ALI Code solution of a more or less arbitrary per misrepresentation damages ceiling. The problem of perhaps too free-wheeling an implication of civil liability under a provision like Rule 10b-5 is also relevant to the draft statute because of its previously mentioned broad anti-fraud proscription and license to imply causes of action. The statute guards against the dangers of a crazy-quilt pattern of implied liability overlapping and possibly undermining the carefully defined express civil liability rules: it frames the license in limited terms and enumerates the considerations that the courts must take into account. To the extent that there are any other potential problems of excessive implication which the draft statute provision does not address, some comfort may be drawn from the fact that the Anglo-Canadian courts traditionally display a conservative approach to implication of actions based on breach of statute. It was primarily to overcome the excesses of the approach, and not to restrain the courts, that the draft statute provisions enumerating examples of fraud were included. Some relief from the traditional attitude is expected, especially in light of the direct bridge to the United States experience which the draft statute provides. But intelligent use of that same bridge in conjunction with the kernel of good sense inherent in the traditional attitude should prevent the worst of the potential problems.

The draft statute provides for enforcement methods in addition to civil liability. These resemble the methods enumerated in the provincial securities legislation. The Canadian Securities Commission is granted power to conduct investigations subject

to a number of protections for those being investigated. It is empowered to order cessation of trading in securities generally and in connection with distributions; it may also issue similar orders with respect to particular individuals the Commission believes are violating the law. This power is also subject to a number of protections for those most directly affected. The Commission may prohibit a person from dealing with any property under his/her control, and may prohibit others from dealing with property held for him/her. The Commission may seek a court order directing compliance with the law or appointment of a receiver, or permitting the bringing of an action under the statute on behalf of an issuer or securityholder, or intervening in an action under the statute. Criminal liability for breach of the statute's scheme is also provided for, with penalties graded according to the seriousness of the offense; the defendant may assert a defense of reasonable reliance on opinion of counsel.

## 5. Administration of the draft statute

In accordance with the Canadian–United States model, the draft statute sets up a regulatory agency, the Canadian Securities Commission, with responsibility for administration of the statute and with considerable discretionary power to elaborate the detail and to some extent change the contours of the regulatory scheme. On its face, the statute goes considerably beyond the provincial models in its institutional prescriptions for “open and fair” decision-making by the CSC [43]. In particular, unlike the provincial legislation it states that in the exercise of its powers to formulate delegated legislation, the CSC is required to give notice of its proposals, to afford interested parties an opportunity to make representations, and to describe the basis and purpose of the proposals and the final product. Judicial review not only of CSC decisions in particular cases but also CSC regulations is provided for. Such prescriptions do not go far beyond the provincial practice in these areas; however, what is novel is the elevation of these matters to the level of statutory provision.

One important role the CSC will play, which by its nature has no counterpart in the provincial legislation, is that of an important component of the *Proposals*' mechanism for coordinating the federal regulatory scheme with the provincial schemes. A number of substantive provisions designed to prevent undesirable overlap have already been mentioned in passing: restriction of the distribution regulatory scheme by exclusion of distributions “where all of the sales are made in the same province” [44]; restriction of the licensing scheme by exclusion therefrom of persons who carry on business as brokers, dealers, or advisers, or of persons who act as underwriters “only in one province” [45]; and the general provision in the draft statute excluding its application “to a trade that is initiated and completed in a single province otherwise than through the facilities of a registered securities exchange” [46].

In addition to these substantive exclusions, there are a number of provisions that direct the CSC to cover cases where federal and provincial regulation overlap. The CSC is required to issue a receipt for a prospectus that has already been approved by a provincial agency, although the CSC may impose on its acceptance a condition limiting distribution to the province concerned. There is a matching provision that relates to the licensing of securities market actors. The CSC is authorized to invite provincial personnel to participate as commissioners in its decision-making; and it is authorized to delegate almost any of its functions to, and accept any delegation of any of the functions of, a provincial agency pursuant to an agreement between the Government of Canada and the province concerned. Finally, the CSC is exhorted by the draft statute to “cooperate” with the provincial authorities “in order to minimize duplication of effort and maximize the protection afforded investors in Canada” [47].

## 6. Conclusion

There can be no doubt that the *Proposals* represent a *tour de force*. All the major component parts of the regulatory scheme show the benefits of the long and thoughtful gestation period that the *Proposals* underwent.

In the new issue regulation area, as elsewhere, the draft statute draws carefully on the products of the recent wave of securities reform in Canada and the United States. While the prospectus requirement has benefited from the deletion of the old requirement of public purchasers, it has not eliminated the other major source of interpretive uncertainty in the provincial legislation engendered by the desire to control two-step distributions. Perhaps the major achievement of the draft statute is its further rationalization of the intricate network of exemptions which clearly differentiates the Canadian prospectus requirement from the present or proposed United States requirement.

In the other area of greatest interest to issuers, *i.e.* continuous disclosure, the draft statute again shows the benefit of a lengthy period spent distilling the best of the Canadian–United States experience. In the restriction of the scheme to issuers for which the development of a significant professional following is most likely, the draft statute can be argued to have laid a better basis for the resulting burden and benefit than the provincial legislation. Additionally, the draft statute contains some eminently sensible provisions for the integration of the new issue and continuous disclosure schemes of regulation.

In the other areas of draft statute regulation canvassed in this review, further thought-provoking variations from the Canadian provincial models were noticed. In the area of licensing, the draft statute has a much more finely tuned requirement than the one in the provincial legislation. Similarly, in the area of self-regulation, a more coherent regulatory scheme appears in the draft statute than in the provincial legislation. In the area of clearance settlement and transfer systems the statute

has a set of provisions largely without parallel in provincial securities or other law. And with respect to direct regulation of conduct in the securities markets, there is a potentially useful general anti-fraud provision in the draft statute that is not found in the provincial schemes.

In its provisions that are ancillary to the regulatory schemes it sets up, the draft act continues in the same vein. A much more comprehensive network of civil liability rules appears there than in the provincial legislation. This network might, at least after some experience is gained with it, move civil liability into greater significance as an enforcement device in Canada than such liability has traditionally enjoyed. In relation to enforcement through other means, the draft act offers no changes of matching significance from the provincial models it follows. But it does offer some useful points of departure in details. Finally, in its prescriptions for the administrative agency set up to administer and to some extent make adaptive changes to the regulatory schemes, the draft act offers a set of legislative endorsements of the solutions concerning the powers of such agencies in the provincial sphere which now appear to be in place.

No matter how well thought out its provisions nor how extensive the allowance which it has been seen it makes for the coordination of its schemes of regulation with provincial law, the draft statute's enactment into law is hardly a foregone conclusion. Apart from any question of federal government policy, the likely political "sticking point" is the significant federal presence in what has traditionally been an area of almost exclusive provincial control that the statute represents. However, it must be admitted that it is impossible to be sure in which direction Canada's constitutional arrangements in the area of division of responsibilities will go in the present unsettled state of federal-provincial relations. And it may be that a major financial catastrophe may radically transform the political climate.

In the final analysis, it is easiest to be sure about the *Proposals'* place in securities law scholarship in Canada and in the store of useful regulatory ideas for the provinces to draw on. That place is a very significant one. Indeed, the ideas are worthy of study not only in Canada, but in all countries for which securities regulation is a concern.

## Notes

[1] Cf. Canada Business Corporations Act, Can. Stat. 1974–75, c.33, as amended by Can. Stat. 1978–79, c.9 and Can. Stat. 1978–79, c.11, Parts X, XVI, XII and XIII, and §§ 186, 261 and 262, and Canada Corporations Act, Can. Rev. Stat. 1970, c. C-32, as amended by c.10 (1st Supp.), §§ 74–78.

[2] For major treatments of current Canadian securities law, see Alboini, Ontario Securities Law (1980) and Johnston, Canadian Securities Regulation (1977). The latter is slightly out of date on the Ontario legislation.

[3] Anisman, Grover, Howard, and Williamson, Proposals for a Securities Market Law for Canada, Volume I: Draft Act (1979) [hereinafter cited as Draft Act]. For fullest understanding of each section, the draft act is best read in conjunction with its companion volumes, cited below.

[4] Anisman, Grover, Howard, and Williamson, Proposals for a Securities Market Law for Canada, Volume II: Commentary (1979) [hereinafter cited as Commentary].

[5] Department of Consumer and Corporate Affairs of Canada, Proposals for a Securities Market Law for Canada, Volume III: Background Papers (1979) [hereinafter cited as Background Papers].

[6] Ont. Stat. 1978, c.47, as amended by Ont. Stat. 1979, c.86. For a treatise on the Ontario scheme, see Alboini, *supra* note 3. The Ontario scheme seems likely to influence the reform of other provinces' legislation. See Buckley, *Small Issuers Under the Securities Act, 1978*, 29 U. Toronto L. J. 309 (1979) at 310 n.6 and text accompanying that note.

[7] American Law Institute, Federal Securities Code: Proposed Official Draft (1978) as amended by American Law Institute, Federal Securities Code: Supplement to Proposed Official Draft (1978). The mostly minor changes made in the final consolidation of the Code came too late to be taken account of in the *Proposals*. See American Law Institute, Federal Securities Code (2 volumes, 1980). The United States Securities and Exchange Commission has announced support for the proposed Code, and the SEC and the Code's Reporter have agreed on fifty-five changes in the Code before it is brought to Congress. The SEC however has cautioned that its position of support is subject to reassessment if the Code should be significantly amended during the legislative process. Securities Act Release No. 33–6242, in Fed. Sec. L. Rep. (CCH) No. 878 dated 9/24/80.

[8] For an account of the effect the Code would have on existing United States securities legislation, see Cheek, III and Hawes, *The Federal Securities Code and its Effects on Existing United States Securities Regulation*, 2 J. Comp. Corp. L. & Sec. Reg. 245 (1979).

[9] Draft Act, *supra* note 3, at viii.

[10] See Statement by the Ontario Minister of Consumer and Commercial Relations, Ont. Sec. Comm. Weekly Summ. (November 30, 1979) at 5A. *But cf.* Catherwood, *Business Speaks Out on the Constitution*, Financial Post [of Canada] (September 6, 1980) at 9. In the survey of 107 companies, 73% of the respondents favored some form of federal participation in securities regulation.

[11] The classic treatise on the United States scheme is, of course, Loss, *Securities Regulation* (2d ed., Volumes 1–3, 1961 and Supp., Volumes 4–6, 1969).

[12] Canadian constitutional history and securities regulation is admirably reviewed in Anisman and Hogg, *Constitutional Aspects of Federal Securities Regulation*, in Background Papers, *supra* note 5. The authors note: "there is no decision holding that Parliament lacks jurisdiction to enact legislation regulating the securities market". *Id.*, at 156. Two decisions rendered subsequent to preparation of the above mentioned paper indicate some worsening in the federal position. See *Rocois Construction v. Quebec Ready Mix*, [1980] 1 F.C. 184 and *Labatt Breweries of Can. Ltd. v. A.G. Can.* [1979] 30 N.R. 496 [Supreme Court of Canada].

[13] The prime example is the arrangement for cooperation in the clearance of national issues of securities. See Alboini, *supra* note 2, at 358–60.

[14] The following would probably only be enforceable within a given province: warrant backing provisions, cease trading orders, statutory scheme for takeover bids. The provinces lack jurisdiction to interfere with the status or the capacity of a federally created entity, for example, by precluding it from carrying on business in the province. Generally, limitations on provincial jurisdiction not only cast doubt on the ability of the provincial commissions to enforce their own statutes in connection with interprovincial and international transactions, but also on the ability of the provinces even acting cooperatively to enact a scheme that will satisfactorily regulate the entire securities market. The federal government is not so restricted; it may enact a regulatory scheme [otherwise within power] with extraterritorial impact. Anisman and Hogg, *supra* note 12, at 147–53 [provincial power]; 153–217 [federal power].

[15] Draft Act, *supra* note 3, at § 5.09(2).

[16] See Grover and Baillie, *Disclosure Requirements*, in Background Papers, *supra* note 5, at 443.

[17] Commentary, *supra* note 4, at 78–79.

[18] Draft act, *supra* note 3, at § 2.17(d).

[19] For a complete account, see Simmonds, *Of Prospectuses and Closed Systems: An Analysis of Some Present and Proposed Legislation in Canada and the United States*, 19 Osgoode Hall L. J. No. 1, at part IV (B) (ii) [forthcoming].

[20] Draft Act, *supra* note 3, at § 6.03(2)(a).

[21] *Id.* at § 2.17(b).

[22] *Id.* at § 2.49.

[23] See Simmonds, *supra* note 19, at Part IV (B) (iii).

[24] Commentary, *supra* note 4, at 68.

[25] *Id.* at 67.

[26] Draft Act, *supra* note 3, at § 5.05(2).

[27] Commentary, *supra* note 4, at 102–3.

[28] For a good short description of the case the data make against mandated disclosure, see Kitch, *Book Review*, 47 U. Chi. L. Rev. 394 (1980) at 397–98. For the major references and a longer treatment, see Comment, *The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry*, 29 Stan. L. Rev. 1031 (1977) at 1031 n.2 (indicating that most data come from studies of market price behavior on the New York and the American Stock Exchanges).

[29] See Comment, *supra* note 28, at 1065, 1054–56.

[30] There is also a troublesome paradox that lies at the heart of the hypothesis. See Kripke, *Where Are We on Securities Disclosure After the Advisory Committee Report?*, 6 Sec. Reg. L.J. 99 (1978) at 109. However, this paradox may be on its way to being accounted for. See Kitch, *supra* note 28, at 400.

[31] For a discussion of the legal problems that this gives rise to, see Cowan, *The Discretion of the Director of the Ontario Securities Commission*, 13 Osgoode Hall L. J. 735 (1975).

[32] Draft Act, *supra* note 3, at § 8.01.

[33] Commentary, *supra* note 4, at 131.

[34] Background Papers, *supra* note 5, at 1286–87.

[35] Draft Act, *supra* note 3, at § 9.01.

[36] Commentary, *supra* note 4, at 156.

[37] Criticized in Connelly, *Fixed Versus Negotiated Commission Rates on the Toronto Stock Exchange*, 2 Can. Bus. L. J. 244 (1977).

[38] Commentary, *supra* note 4, at 174.

[39] Criminal law is a federal responsibility in Canada.

[40] Commentary, *supra* note 4, at 215.



[41] Draft Act, *supra* note 3, at § 12.01.

[42] See Simmonds, *Directors' Negligent Mis-Statement Liability in a Scheme of Securities Regulation*, 11 Ottawa L. Rev. 633, 664 (1979). The position in Quebec as to class actions appears to have been transformed recently by Loi sur le recours collectif, Que. Stat. 1978, c.8 (facilitating class actions). So far, however, no flood of class actions has developed.

[43] Commentary, *supra* note 4, at 331.

[44] Draft Act, *supra* note 3, at § 6.05.

[45] *Id.* at § 8.07.

[46] *Id.* at § 16.01.

[47] *Id.* at § 15.12(1).

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