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THE ONTARIO SECURITIES COMMISSION AS AN ADMINISTRATIVE TRIBUNAL

BRIAN P. BELLMORE*

In this paper the nature and source of an administrative agency's adjudicative and rule-making power will be examined, the manner in which the Ontario Securities Commission carries out its duties under the Securities Act analysed, an alternative approach utilised by the Securities and Exchange Commission in the United States examined, and possible improvements in the Ontario Commission's administration by adoption of this method, considered. The merits or demerits of Commission policy will not be discussed as this study is confined to an examination of the manner in which that policy is administered.

I. *The Nature of the Administrative Agency*

In performing their various functions, administrative agencies act as arms not only of the executive, but of the legislature and the judiciary. In the first capacity they carry out tasks which, in early days, were performed personally by department heads. This is the day-to-day work of the agency. In the second aspect they adopt regulations which have much the same effect as statute law. In the third instance, they interpret and apply established legal norms and engage in court-like adjudicatory processes.

The Ontario Securities Commission has not resorted to the rule-making process in any significant degree, favouring the adjudicative approach to implement the legislation. However, these adjudications have not been extensively reported,¹ and those which are often do not contain any specific policy principles which indicate the factors relevant in interpreting and exercising the statutory power. The unsatisfactory result is that a great deal of Commission policy is unstated and unknown to the financial industry which it regulates. This is illustrated in the dilemma which a lawyer who is quite active in the field of securities regulation faced recently when retained to act for a mutual fund. After gathering together all the law on mutual funds, the decisions and statements of policy by the Commission, he found they covered only a small portion of the field. The major part of the law was contained in unpublished "departmental policy" which was

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¹ See Baillie, J. W., *The Protection of the Investor in Ontario*, 8 Can. Pub. Admin., 172 at 250.

quite flexible and indefinite. We may commence, then, with the proposition that whether the Commission chooses the adjudicative or rule-making approach, the industry requires, and may have a right to know, exactly what the policies are.

The source of these two approaches is in the discretionary power of the tribunal. It is conferred on an agency when the Legislature feels there ought to be some law to deal with a certain problem but cannot decide in detail just what it should be. Therefore, it adopts a statute declaring the general objectives which should be accomplished and then grants to the agency a discretion to work out the best ways to accomplish those objectives.

There are two types of administrative discretion:

(1) The agency may have power to adopt substantive rules having the force of law and compelling or prohibiting specified practices on the part of that class of persons mentioned in the regulations. In this instance the agency exercises a quasi-legislative function in that it utilises the same sort of discretionary powers as those of the Legislature and goes through similar preliminary steps to making the regulation as the Legislature (i.e., it holds hearings and receives submissions of interested parties before exercising the discretion). The question whether the Ontario Securities Commission has been delegated such power under the Act will be discussed later in the paper.

(2) The agency may be given a vague indefinite standard to apply in the adjudication of individual cases—e.g., registration is only granted to an applicant for a licence to sell securities if, in the opinion of the Director, he is suitable for registration.² In this adjudication the legal status or the legality of acts and practices of named parties to the hearing are determined.

Neither approach is specified to be followed by the Commission in the legislation. Thus, it should be able to choose between these two approaches, or reject both in favour of a more informal means of regulation. Some of the less formal methods of administration are:

- (i) The “lifted eyebrow” backed by a veiled threat of prosecution, non-renewal of a licence, publicity, delisting, rejection of prospectus;
- (ii) Private rulings (or the advisory opinion) which may or may not be binding on the agency; and
- (iii) Speeches and press releases announcing policy.

Although the Commission from time to time has resorted to all of these methods, in this paper the discussion will be focused on the more formal adjudicative and rule-making procedures.

A brief review of the background of the Commission and the areas in which it acts reveals a certain maturation in the regulation of the financial industry over the past twenty years. Following World War II when modern securities legislation was just taking effect in Canada, the job of the administrator was to put the most blatant offenders in jail or out of the securities business and to halt the worst

² The Securities Act, S.O. 1966, c. 142.

fraud schemes. Today this negative objective of prevention of fraud is joined with the new objectives of the Commission to equip the investor with more information to permit him to make a better choice by evaluating investments more accurately.

II. *Areas Where the Commission Adjudicates*

Generally, the Commission operates in four main areas: in the granting or denial of registration of traders, acceptance or rejection of prospectuses for filing, denial of the use of exemptions from filing, and in the determination of the existence of primary distributions. Until the present, the Commission has rejected rule-making in favour of a case-by-case adjudication of each question, although there are indications that the former will be resorted to more frequently in the future.

III. *The Adjudicative Procedure of the O.S.C.*

An adjudication by the Commission will result from either one of two preliminary procedures. The Commission may itself make an order to investigate under section 21 where it appears probable that a person or company has violated the Act or the Criminal Code, or an individual may make an application for a direction, order or ruling by the Commission as provided by the Act.³ In the former a report is in all cases made by the investigator, while in the latter an investigation by the Commission staff may or may not be conducted.

When the report is received the Director makes the initial decision in the matter after the person or company affected has been given a hearing at which they may be represented by counsel. There is a right of appeal from the Director's decision to the full Commission which in practice constitutes a new hearing in which the Director's decision, investigator's report and new evidence is considered. A final right of appeal lies to the Ontario Court of Appeal.

In the initial investigation stage of this adjudicative process the Act gives broad powers of search and seizure to the Commission. The investigator may examine the affairs, property, documents and business relations of the person or company under investigation within the scope of the original order. He may summon and enforce the attendance of witnesses to compel them to give evidence under oath and require production of documents.⁴ A person who refuses to appear or produce records in his custody is liable to be committed for contempt by a judge of the Supreme Court as if in breach of an order of that court.⁵

The extent of these powers may give rise to a problem involving the privilege against self-incrimination by a person compelled to attend as a witness at the investigation. Under the present Act, no person can refuse to answer any question on any ground of privilege. By invoking the protection of the Canada Evidence Act,⁶ the witness can prevent the use of his reply in a subsequent criminal proceeding. Similarly,

³ *Id.*, note 2, ss. 7(2), 19(5), 61(2).

⁴ *Id.*, note 2, s. 21(3).

⁵ *Id.*, note 2, s. 21(4).

⁶ R.S.C. 1952, c. 307, s. 5.

section 9(1) of the Ontario Evidence Act⁷ compels a witness to answer incriminating questions while providing that such answers shall not be used against him in any civil proceeding or in any proceeding under any Act of the Legislature. It is submitted that the protection of these two Acts does not extend to prosecutions under the Ontario Securities Act. The federal Act cannot apply to offences created by a provincial statute and the provincial Act only excludes from later proceedings incriminating answers compelled by "this section [7(1)], or any Act of the Parliament of Canada". However, the witness in an investigation authorized under the present Securities Act is compelled to answer by section 21(3) of that Act and not by section 7(1) or any federal Act.

There has been a significant change in the new legislation. The specific denial of a claim of privilege has been replaced by a general delegation of power to the investigator which includes the same power to summon and compel witnesses as that vested in the Supreme Court in the trial of civil actions. Failure to answer questions or produce documents as required by the investigator makes the person liable to contempt proceedings. Since the investigator is now clothed with the power of a Supreme Court officer, it may be contended that his power to compel witnesses has the same source as that of the courts in civil trials—the Ontario Evidence Act—and therefore the person who is investigated is protected under section 7(1). But this is not clear from the wording and the courts may strictly construe the section holding that the Securities Act still confers the power.

Thus, where an investigator calls upon a person suspected of an offence to answer incriminating questions under oath, that person must answer or be in contempt, and those answers may be used in a subsequent prosecution for a breach of the Securities Act which could result in a fine of up to two thousand dollars and/or imprisonment for up to one year.⁸ These answers may also give rise to prosecution under the Criminal Code. In view of the fact that these penalties are more severe than those for many criminal offences, and that the incriminating answer may give rise to a prosecution under the Criminal Code, it is submitted that section 21(4) abrogates the common law rule expressed in the maxim *nemo tenetur seipsum accusare*. In the recent Supreme Court of Canada case, *Batary v. Attorney-General for Saskatchewan*, Cartwright J., speaking for the majority, held that:

any provincial legislation purporting to abrogate or alter the existing rules which protect a person charged with crime from being compelled to testify against himself, is legislation in relation to the Criminal Law including the Procedure in Criminal Matters and so within the exclusive legislative authority of the Parliament of Canada under head 27 of section 91 of the British North America Act.⁹

If provincial legislation cannot compel a person charged with crime to give evidence tending to incriminate him, *a fortiori* it cannot compel a person who has not even been charged to give evidence

⁷ R.S.O. 1960, c. 119, s. 7.

⁸ *Supra*, note 2, s. 136.

⁹ [1965] S.C.R. 465 at 478.

which may result in the laying of a charge against him under the Code. Thus, the *Batary* case indicates that section 21(4) may be *ultra vires*, as legislation relating to criminal procedures insofar as it compels a person to answer incriminating questions which could result in prosecutions under the Criminal Code.

The Legislature in the Evidence Act has recognized this problem in relation to other quasi-criminal matters created by provincial statutes, and while compelling the person to answer, has precluded the use of those answers against him in a later prosecution. Securities proceedings remain unique in denying this protection. It seems contrary to the principles of natural justice that a person being investigated should be deprived of the protection against self-incrimination. The Bill of Rights, although it has no effect in the area of provincial legislation, recognized this and provided that no law of Canada shall be construed so as to authorize a tribunal, commission, board or other authority to compel a person to give evidence if he is denied protection against self-incrimination.¹⁰ Legislative change which would ensure this protection would assist rather than handicap the investigator as it would probably result in less evasive and misleading answers, and would remove an ethical conflict facing counsel for the witness who must balance his duty to his client with his undertaking never to counsel a violation of the law. Therefore, a change of the wording in section 21(4), which would clearly indicate that the investigator derives his power to compel witnesses from section 7(1) of the Evidence Act, seems desirable.

The investigative procedure has also been criticized for not complying with the requirements of natural justice. There is no difficulty in this respect if the results of the investigation are just the basis of a decision to hold a hearing. However, Williamson, in his book on Securities Regulation, argues that where a decision as to an individual's rights is based on the report of the investigator, that person should be protected during the investigation by the same safeguards proper to the decision-making process itself.¹¹ These would include notice to the person being investigated of the investigator's intent to examine certain witnesses, and also the opportunity to be present and cross-examine. Under the new legislation, a person giving evidence at an investigation may be represented by counsel and may inspect and copy documents seized by the investigator from him.¹² But there is no right to be present, represented by counsel or cross-examine when other witnesses are giving evidence, nor is there any right to inspect documents seized from other witnesses.

Mr. Williamson's argument has merit in view of the fact that the results of the investigation are produced at the hearing in the form of documents without any oral testimony against the individual being adduced. This procedure results from the provision in the Act that the Director or the full Commission on review is not bound by the best

¹⁰ 1960 (Can.), c. 44, s. 2(d).

¹¹ Williamson, Peter T., *SECURITIES REGULATION IN CANADA* (Univ. of Toronto Press, 1960), 229-232.

¹² *Supra*, note 2, ss. 21(5), (7).

evidence rule.¹³ Consequently, the individual at the hearing is confronted with the problem of rebutting evidence without an opportunity to cross-examine the witnesses against him or to inspect inculpatory documents seized from others. (With respect to the latter, the Commission, as a matter of practice, allows the individual to examine the evidence against him immediately prior to the hearing though there is no duty to do so in the statute.) In view of the natural tendency all administrative tribunals have of relying heavily on the evidence gathered by their own staff of investigators, the individual begins the hearing burdened with an onus of refuting this evidence, which is made more difficult by the absence of cross-examination and prior inspection of evidence against him sufficient for the preparation of an adequate rebuttal. In such a circumstance, the investigation and decision-making are practically inseparable.

There are two main arguments against Williamson's proposals of cross-examination during investigation. It would seriously delay and impede the investigation which in the area of securities regulation could result in great damage to the public. Also, an investigation under this Act is not a judicial or quasi-judicial function, but rather an administrative one designed merely to gather information on the basis of which the Commission or the Attorney General can decide to proceed.¹⁴ There is no obligation in law on the administrator in performing such a function to follow any of the dictates of natural justice.

The arguments for and against cross-examination and prior inspection of evidence are well taken and, in such a case, a compromise is submitted. Since delays and the *St. John* case render Williamson's proposals unacceptable to the Commission, two changes at the hearing stage of the proceedings may produce a similar result. Firstly, in accord with the principle of natural justice enunciated in *Re Allison and the Court of Referees*,¹⁵ the person investigated should be provided with meaningful notice of the hearing which, in addition to time and place, should include the issues and allegations which he must face. Perhaps the present practice of furnishing the person with a copy of the results of the investigation shortly before the hearing could be extended to two weeks in advance of the hearing date.

Secondly, because the constant appearances before the tribunal of staff investigators can result in bias in favour of their evidence, the members of the tribunal should strive to eradicate any predispositions they might have, and bring to the adjudication of the issue an impartial mind which neither consciously or unconsciously imposes any onus on the person investigated to rebut the evidence of Commission counsel. However, this should in no way inhibit the members of the tribunal from utilising their own expertise in deciding the case.

From a reading of the Act one could conclude that the hearings before the Director would be conducted in the same manner as those before the Commission. Although the same rules as to notice, power

¹³ *Supra*, note 2, s. 5(3).

¹⁴ Cf. *St. John v. Fraser*, [1935] S.C.R. 441; *Guay v. La Fleur* (1964), 47 D.L.R. (2d) 226.

¹⁵ [1945] 2 D.L.R. 717.

to summon and compel witnesses, admissibility of evidence, records, reasons for decision and right to counsel apply to both,¹⁶ there is in fact a considerable dichotomy in the manner in which they are conducted which may be attributable to the particular conception each tribunal has of its function.

The approach taken at the initial hearing is similar to that adopted with considerable success in the United States. The hearing is treated as the final step in the investigative process in which the Director becomes an active participant confronting the person investigated with the evidence gathered by the investigator and the Commission Counsel, posing most of the questions to the witness and cross-examining the evidence he adduces. Thus, the onus is on the individual to rebut, explain or qualify the documentary evidence against him and he is subject to strong cross-examination by both Commission Counsel and the Director. On the other hand, the full Commission adopts a more detached judicial approach being astute to give each side a full opportunity to present its case and leaving the task of cross-examination to Commission Counsel.

The Americans have found that such a scheme of administration avoids the possibility of bias and expedites the crucial initial decision.¹⁷ The United States lawmakers felt that a person presiding at a hearing would not be able to bring an impartial mind to the evidence adduced by the parties where one of these was a stranger, and the other a member of the agency's investigative staff who regularly gathered evidence for the tribunal and was a fulltime employee of it. Therefore, they have improved the calibre of their investigators and completely separated them from the tribunal. The senior investigators become "hearing officers" empowered to hear evidence, prepare a record of the relevant facts revealed at the hearing and during the investigation and then to render an interim decision. If no objection is taken to this decision by either of the parties within a specified time, it becomes final. If it is not accepted, the adjudicative tribunal of the agency will conduct a hearing with full opportunity for parties to lead new evidence. This method has been quite successful with ninety-five per cent of the initial decisions by the investigative staff being accepted. Because of the relatively small number of cases which come before the tribunal, the problem of prejudice toward one party's evidence due to familiarity is removed, and the members have more time to devote to other facets of administration—one of which is the preparation of a body of rules.

Although this is a commendable procedure, under the present Ontario legislation the Director is not intended to become a part of the investigative branch of the Commission. Rules as to the conduct of hearings are identical for the Director and the full Commission, and indicate an expectation by the legislators that the hearings before both tribunals be carried on in a similar impartial manner. Although in practice the present approach has its advantages in expediting deci-

¹⁶ *Supra*, note 2, s. 5.

¹⁷ Administration Procedure Act, 5 U.S.C. ss. 1004-1007.

sions, it must be remembered that in such hearings justice must not only be done, but appear to be done.

Another difficulty at the initial decision-making stage arises from the fact that there is presently no record taken of the evidence adduced by any of the parties. This places the individual involved at a disadvantage on review since, in most cases, all the evidence against him is contained in the documents introduced at the hearing, while most of his evidence is oral. Thus, the appellant must re-introduce his oral testimony and bring his witnesses back a second time if he appeals the Director's decision. Also, in considering the basis of the Director's decision, the Commission will only have access to the evidence of the investigator and the important testimony of the individual himself is unavailable unless re-introduced. In contrast, the Commission makes a complete record of all evidence adduced at its hearings. These inequities should be removed, however, when section 5(4) of the new Act requiring all oral evidence adduced at the Director's hearing be transcribed, comes into force.

The traditional freedom an administrative agency has to prescribe its own procedures is tempered with certain non-statutory standards of natural justice which must be observed in all decisions affecting the rights of parties. The Ontario courts have adopted the requirements laid down by the House of Lords in *Board of Education v. Rice*:

The tribunal must act in good faith and fairly listen to both sides . . . and must grant a fair opportunity to the parties for correcting or contradicting any relevant statement prejudicial to their view.¹⁸

Williamson suggests that this requires the evidence gathered by the investigator be freshly adduced at the hearing and that the individual be given an adequate opportunity to confront those who denounce him. However, the Ontario Court of Appeal in *Re Securities Act and Gardiner* held that because the Act provided that the Commission was not bound by technical rules of evidence, it was free to obtain information in any way it felt was best.¹⁹ Consequently this case vitiates any requirement that evidence be freshly adduced and subject to cross-examination, although the Supreme Court of Ontario insists that in the absence of cross-examination the individual be given a reasonable opportunity to disprove evidence against his case.²⁰

It is submitted that the present hearing given the individual is inadequate to enable him to disprove the evidence against him, and thus falls short of the requirements of natural justice. The extremely active participation by the Director and the limited opportunity given the individual before the hearing to examine the allegations made against him are not conducive to a full and fair hearing of both sides of the case. Though there is presently no statutory requirement that the investigator's report be disclosed to the individual Gale J., (s he then was) in *Re Knapman and the Board of Health of the Township of*

¹⁸ [1911] A.C. 179 at 182.

¹⁹ [1948] O.R. 71.

²⁰ *Re Fairfield Modern Dairy Limited and the Milk Control Board of Ontario*, [1942] O.W.N. 579; *Re Jackson and Ontario Labour Relations Board*, [1955] O.R. 83.

Saltfleet denounced the procedure of calling on a person to give evidence at a hearing where the propriety of his conduct was in issue without informing him of the allegations against him.²¹ Presently, the individual is confronted at the initial hearing with evidence he has never seen before and which is usually the basis of a decision which seriously affects his rights. Without the benefit of cross-examination such evidence, no matter how experienced and impartial the person who gathers it may be, is subject to the usual problems of faulty memories, misinterpretation of facts and statements, exaggerations, and, in the area of registration and cancellation, is often the product of deep prejudices. Because these deficiencies cannot be brought to the Director's attention by way of cross-examination, it is most important that the individual investigated be given a better opportunity to rebut the evidence than he now receives. This could be accomplished if the recommendation above, that he be given a copy of the investigator's report and the allegations against him one to two weeks in advance of the hearing, were implemented. In this way he would be able to prepare his rebuttal, assemble relevant material, marshal his defences and participate more meaningfully in the hearing than in the present circumstances where he is suddenly faced with damaging accusations and evidence and is forced to make an extemporaneous rebuttal.

IV. *The Alternative of Rule-making*

Having examined the way in which the Commission administers by adjudication, the question arises whether this is the best vehicle to formulate policy and establish standards for regulating the industry. Professor Shapiro, in a recent article, submits that agencies could improve their administration by resorting to rule-making rather than adjudication.²² In light of the above criticisms, there may be a possibility of improving the administration of the Securities Act by utilising this process.

First let us examine the advantages of adjudication before considering its replacement. It is wrong to say that adjudication fails to lay down any clear standards to guide the industry. Not all cases are specific applications of a general statutory provision to a single factual situation. Rules declared in recent Commission decisions include declarations pertaining to presumptions based on experience acquired in similar cases, the shifting of the onus of proof in application for registration as securities salesmen,²³ and in issues whether the promoter has received an unconscionable consideration for his claims.²⁴ In some instances it may not be wise for the Commission to lay down inflexible rules to govern all cases. Even after considerable experience it may be best to do no more than announce factors to be considered if the situation arises, for it is a fact of life that deceitful

²¹ [1954] O.R. 360.

²² Shapiro, David L., *The Choice of Rulemaking or Adjudication in the Development of Administrative Policy*, 78 Harv. L. Rev. 921.

²³ Percy Brand, O.S.C. July 1966 Bulletin.

²⁴ Prima Mines Ltd., O.S.C. Oct. 1966 Bulletin.

men will search for loopholes to avoid the spirit of the law. In other areas it may be necessary to gain experience through the adjudication of many cases before regulations can be formulated to elaborate on the general discretion given the Commission by the Act. Finally, administrators who have experienced the reaction of the public to a policy enunciated in a case as compared to one promulgated by a rule feel that adjudication is more advantageous. When the policy appears in the form of a regulation there is a tendency to evaluate it in terms of the maximum possible scope of its language. Highly unusual factual situations which might fall within the literal meaning of the rule are envisioned and viewed with alarm even though no sensible administrator would give the rule such an extreme interpretation. Thus, there is a distortion of the policy laid down in a rule while the policy established in an adjudication is evaluated in its factual context.

In certain areas, however, the advantages offered by rule-making recommend it as a superior means of developing and promulgating policy.

(1) The opportunity for submissions from parties interested but not involved in the present litigation is negligible in adjudications but a dominant characteristic of rule-making. In the latter process, notice is given to the industry that rules are being drafted in a particular area and representations are entertained. The increased participation that results will inevitably produce a sounder policy than one resulting from consideration of submissions by one or two litigants in an adjudication.

(2) Where administrative courts depend on the accident of litigation to initiate policy formulation, rule-making affords the administrator the opportunity for advance planning and an organized approach.

(3) Judge Henry J. Friendly of the United States Court of Appeals submits that formal rules have an advantage over adjudications for defining standards because they make possible the avoidance of trivia and personalities involved in individual cases and permit administrators to concentrate on the principles involved.²⁵

(4) There is a greater flexibility in procedures available in rule-making than in adjudications where the tribunal is bound to observe the dictates of natural justice. In rule-making the agency can consult its staff, hear wide-ranging submissions from third parties affected by the proposed policy and limit or forbid oral testimony and cross-examination which could slow the process.

(5) Rules laid down by adjudication are often hidden because of the many cases which have previously been decided and been combined to establish the rule. A person not familiar with the agency's previous decisions will have to review all previous cases on the point when researching a policy set out in an adjudication. The difficulty of the search is aggravated by the fact that there is no complete report of earlier Commission decisions. On the other hand, the issuance of regulations would give a clear and accessible source of Com-

²⁵ Henry J. Friendly, *The Federal Administrative Agencies*, 75 Harv. L.Rev. 863.

mission policy to all who seek it, providing, of course, that the Commission has the power to enact them.

V. *The Power to Make Rules*

One of the explanations for the failure to make rules lies in the uncertainty that the Ontario Securities Act confers this power on the agency. The Kimber Committee alluded to this problem when it recommended that section 72 of the old Act and other pertinent sections be analysed to determine whether they would permit the formulation of necessary policies by regulations.²⁶

Under the new Act no specific power is given to the Commission itself. Sections relating to registration of salesmen, filing of prospectuses and others give the Commission broad discretionary powers. Because the Commission has not attempted to formulate policy through rule-making until very recently, it is necessary to look to the attitude of the courts with respect to similar action by other administrative bodies to determine whether or not the Commission has the power.

In the case of *Peterkin v. Hydro Electric Power Commission*, the court was confronted with an appeal by a landowner from an expropriation award of the Ontario Municipal Board.²⁷ In fixing the amount of compensation the Board referred to their experience that estimates of construction cost exceed the actual cost by as much as 20 per cent. The Court of Appeal held that the Board's function is not to proceed on a basis which has no support in the evidence and cannot rest its judgment on a rule of thumb of its own invention. Under the statute the Board was given a discretion in fixing the compensation but no specific power to enact regulations. This view was reiterated by the same court in the recent case of *Re Hopedale Developments Ltd. and Oakville*.²⁸ There the Municipal Board refused the applicant's petition on the grounds that he failed to bring his case within the principles enunciated by the Board in earlier cases. McGillivray J.A. recognized and encouraged the exercise of the right of an administrative agency to formulate general principles by which it is to be guided. However, he stated that the agency in deciding must not limit its consideration to the application of these principles. These cases indicate that it is permissible for an agency in the absence of statutory rule-making power to enunciate principles which may be used as guidelines, but it is prohibited from establishing standards which have the binding effect of legislation. Therefore, it is unlikely that the Court of Appeal would approve the formulation of rules by the Commission under the Securities Act as it now stands. Any future government action which would make the O.S.C. an independent body must necessarily confer rule-making power and would eliminate this problem.

There is another means by which the Commission could legally enact policy rules under the present scheme. Section 144 of the new

²⁶ Report of the Atty. General's Committee on Securities Legislation in Ontario, s. 8.06.

²⁷ [1958] O.W.N. 225.

²⁸ [1965] O.R. 659.

Act provides that the Lieutenant Governor in Council may make regulations with respect to some eighteen separate matters. These cover all sections of the Act where the Commission is given discretionary power, including the form and content of prospectuses, the preparation of financial statements of the affairs of securities issuers, and requirements respecting applications for registration and renewal and expiration of registrations. The final clause of this section confers a broad power to make regulations respecting any matter necessary to carry out the intent and purpose of the Act. However, such regulations must be presented on completion to the Minister of Financial Affairs and approved by the Cabinet. In view of the present public concern over the operations of the Commission and the securities industry generally, it is unlikely that these regulations will get a rubber stamp approval. No doubt interested parties will pressure the government to alter those rules which are unfavourable to their interests, amendments will be made and some regulations dropped before approval is given by the Cabinet. Although the power in section 144 is not absolute (the regulations being subject to approval by a politically sensitive body), this is the only means available for the formulation of policy by rule-making. Presently, a committee is drafting regulations under section 144 in many of the above-mentioned areas which will clarify considerably Commission policy. This is an encouraging development in the current attempts by the Commission to implement the recommendations of the Kimber Committee concerning the use of regulations in revealing policy to the industry.

VI. *The American Approach*

Although the legislation²⁹ which created the Securities and Exchange Commission (S.E.C.) in the United States differs in many areas from the Ontario Act, the basic intent of the two and the means to achieve the end are similar. General principles are established in these statutes to govern the operations of the securities industry and administrative agencies are created to carry out the legislative purposes. The experience of the S.E.C. has been that neither adjudication nor rule-making alone is sufficient to implement the statute. While some sections lend themselves to the adjudicative process, others are enforced best by the codification of policy into a body of rules applicable in the area governed by the section.

The American statutes have vested in the S.E.C. power to adopt rules necessary for the enforcement of the Acts.³⁰ They have similar provisions to the Ontario Act concerning prospectus filings, standards of conduct for securities salesmen and licensing and revocation of traders. This latter power is exercised in the discretion of the S.E.C. which applies the same criteria as our statute (i.e., whether registration or revocation is in the public interest).

In the area of broker dealer selling practices the Commission has adopted twenty-two rules over the years to implement the general

²⁹ Securities Act, 48 Stat. 85 (1933), Securities Exchange Act, 48 Stat. 903 (1934).

³⁰ *Id.*, s. 19(a); s. 23(a).

statutory mandate to prohibit the use of manipulative, deceptive, or other fraudulent device or contrivance.³¹ These rules include: prohibitions against representations that registration with the S.E.C. indicates Commission approval of the transaction,³² disclosure requirements which every broker must include in the written confirmation of each securities transaction sent to the customer,³³ requirements that every financial statement set forth the assumptions on which a pro forma financial statement purporting to give effect to the receipts of a public offering is based.³⁴

Manuel Cohen and Joel Rabin (member of the S.E.C., and legal assistant to the S.E.C. respectively), related the experience of the Commission in choosing between rule-making and adjudication for administering specific areas of the American securities legislation.³⁵ Because specific rules may permit unethical (or ethical, depending on the way you file income tax returns) persons to devise schemes to avoid them, and in view of the unlimited variety of opportunities for unethical practices presented in sales transactions the S.E.C. has relied mainly on adjudication in the development of standards for selling practices. Consequently, since 1934, only twenty-two rules have been enacted in this area. Most of these rules already have been set out in Part VIII of the new Ontario Act dealing with trading practices. In the balance of this field the Americans have relied on adjudication with the advantages resulting from its emphasis on the factual context in the proceeding rather than on rigid principles. Problems such as the fiduciary nature of the securities dealer's relationship with his customer, boiler room operations with their high pressure telephone solicitations, and such fraudulent manipulative practices as wash sales, matched orders and transactions creating trading in a security to induce transactions by others, have been best dealt with on a case by case basis. Cohen feels it affords flexibility by giving the Commission discretion in applying principles of earlier cases and the opportunity for further modification of the principles in later cases. Since the problems confronting the O.S.C. in this area are not unlike those of the S.E.C. and, in view of the fact that Part VIII of the Ontario Act covers the same area which the S.E.C. rules cover, it would seem that the present reliance on a case-by-case adjudication in this area is the most effective method of administration.

On the other hand, the S.E.C. has relied on detailed formal rules, and informal procedures preliminary to drafting them, in regulating proxy solicitations and disclosure requirements for new offerings of securities under the Act. The Securities Exchange Act of 1934 left the problem of the nature, extent and form of federal proxy regulations to the discretion of the S.E.C.. Section 14 required proxy solicitations to conform with "such rules and regulations as the Commission may

³¹ S.E.C. Rules 10(b), 15(c) (1), 15(c) (2).

³² *Id.*, 15(c)1-3.

³³ *Id.*, 15(c)1-4.

³⁴ *Id.*, 15(c)1-9.

³⁵ 29 *Law and Contemporary Problems* 691 (1964).

prescribe as necessary in the public interest or for the protection of investors".³⁶ Over the years the Commission has evolved proxy rules pursuant to this power which deal with requirements of a brief description of the issues to be considered at the meeting together with action proposed to be taken by the proxy, the mailing of other pertinent material by management, a general prohibition against materially false or misleading statements, and filing of preliminary proxy material ten days before distribution so that the staff of the Commission can examine and compel amendments to it.

The new Ontario Securities legislation is more specific than the American Act in the proxy sections. Rather than delegating a broad rule-making power to the O.S.C., it has enunciated the specific requirements in Part X. Nevertheless, some uncertainty remains in regard to the requisite contents of the information circular.³⁷ No pre-filing of the circular is called for as in the S.E.C. rules. Consequently, an onus is placed on management to decide what to disclose which may leave them vulnerable to prosecution for breach of the Securities Act, or to a civil action for damages. The Americans have removed some of the uncertainty by enacting a rule which stipulates the contents of the circulars sent out in the case of a proxy battle,³⁸ although regulations governing the normal unopposed situation have yet to be drafted.

The S.E.C. has removed much of the uncertainty which shrouded the prospectus filing requirements in a similar manner. Rules were formulated which include requirements concerning: financial statements, auditor's reports, the independence of auditors, newspaper prospectuses, size of type to be used in a prospectus, a statement on the first page of every prospectus that the security has neither been approved nor disapproved by the S.E.C. There are encouraging signs that the O.S.C. intends to follow the lead of the S.E.C. in resorting to rule-making in this area. The new draft regulations (Part II) should clarify the Commission policy towards disclosure in primary distributions.

Although further examination of the American approach to the administration of their securities legislation is not possible at this time, the above illustrations indicate that the O.S.C. could profit from their experience in choosing between rule-making or adjudication in those areas where the American and Ontario Acts are parallel. Through the process of trial and error the S.E.C. has discovered which approach is best in implementing particular sections of the legislation and it is submitted that this experience should be utilised and applied by the O.S.C.

One area where the Commission could benefit from the American experience is in relation to unreported decisions. Because many questions of prospectus disclosure policy either never reach the stage of a hearing before the Director (being settled informally through advisory opinions of the Commission staff) or never are reported, the disclosure requirements for primary distributions are very vague. While recog-

³⁶ *Supra*, note 29, s. 14.

³⁷ *Supra*, note 2, s. 102(1).

³⁸ Interim Draft Regulations, s. 36.

nizing a limited need for the Director to retain the broad discretionary power given under section 61 and without losing the advantages of adjudication to resolve certain questions in this area, the Commission could codify those policy standards with respect to disclosure which have previously been established in unreported hearings and informal rulings. This would resolve many minor inconsistencies and provide a single readily available source for those seeking to ascertain Commission policy.

VII CONCLUSION

In his 1962 Holmes Lecture at Harvard Law School, Judge Henry J. Friendly submitted that

wherever the legislature grants power to an agency in broad terms, it is imperative that steps be taken over the years to define and clarify it—to canalize the broad stream into narrower ones.³⁹

Having administered certain sections of the Act for many years now, the experience acquired and the cases adjudicated by the O.S.C. should be reviewed and policies extracted and codified into a body of regulations to govern the financial industry.

These regulations should not be too extensive (as too many rules in this area can impede the smooth functioning of an economy), though they should lay down general guidelines and principles which define the policy followed by the Commission in exercising its discretionary powers. One example of the adverse result of intervention by government in the market place is found in the effect on small investors of the information required from a company before a public distribution is permitted. One broker estimated that 70 per cent of the good issues are distributed by private placement to large institutional investors as a means of avoiding the disclosure requirements. As a result, the public gets only a small percentage of the good issues and the majority of the uncertain ones. Nor should the regulations be too inflexible, lest they become outdated and unsuited for the frequent and unforeseen changes in the securities field. Therefore, an essential quality in a draftsman is the ability to anticipate the course of future events, and to incorporate this in every regulation.

In the following areas where presently there is uncertainty as to Commission policy, regulations formulated with the active participation of the financial community may dispel the doubt while improving the administration of the Securities Act. As already mentioned, the S.E.C. has taken steps to enunciate in regulations the disclosure and accountancy requirements for prospectuses. Similar action is recommended in Ontario. The discretion which the Commission would lose by such action would not be as great a detriment to the public as anticipated and would be outweighed by the advantages to the industry of full knowledge of Commission policy. Although certain fraudulent men may find ways of concealing information, the Report of the Special Study of the Securities Markets of the Securities and Exchange Commission indicates that the effect of these individuals on the public

³⁹ Friendly, *The Federal Administration Agencies*, 75 Harv. L.Rev. 863.

will be minor. It discovered that individual investors did not use the prospectus as a guide in investments and that the key to the purchase was usually the salesman and the pitch he makes. Thus, the main focus of efforts to protect the public should be on the salesman, and the Commission must retain its broad discretion in determining whether a salesman's conduct reaches the required standards of fair dealing in each particular set of circumstances. Regulations which could be circumvented would be harmful to the public in this area, but this would not be the result of regulations in the prospectus field.

Recently the Commission has used adjudication to articulate its policy with respect to releases of shares from escrow,⁴⁰ prerequisites for registration,⁴¹ and the amount of consideration to be paid to a promoter for his claims.⁴² Although this is a step in the right direction, the adjudicative process, for the reasons set out above, is not the best vehicle for articulating policy. The quality of these policies would have been enhanced had they been formulated by the rule-making process which provides an opportunity for interested parties not involved in the litigation to participate, and for greater advanced planning.

Another area where the Commission might consider the enactment of regulations to implement and clarify the policy of the Act is section 139 which gives the Commission power to make decisions or orders concerning trading of any security on or through the facilities of a stock exchange. The former Attorney General, Kelso Roberts, advocates the enactment of regulations or guidelines which enunciate when and under what circumstances the O.S.C. must intervene in areas which normally are under the jurisdiction of the Toronto Stock Exchange. Though at a later date such regulations would be desirable, it is submitted that the Commission has not had enough experience in the area covered by this new section to enable it to lay down any strict rules. The flexibility of discretion is needed at first to enable the agency to develop expertise in dealing with a statutory power, which can later be used as a basis for enacting regulations, and as a guide in anticipating future developments.

Under the proxy solicitation section of the Act there is a need for regulations which prescribe the degree of disclosure required in the information circular. Since there is no requirement that the circular be approved by the Commission, the onus is on management to decide what points to disclose in the proxy. If there is insufficient disclosure, presumably the corporation could be subject to criminal charges or the Directors held liable in a civil action. Presently, regulations are being drafted with the co-operation and participation of lawyers involved in corporation work to clarify this section of the Act.

In considering the alternative of rule-making it must be remembered that initially this process requires much time and effort; submissions from the industry must be heard, previous adjudications

⁴⁰ North Lodge, O.S.C. Sept. 1966 Bulletin.

⁴¹ Liberty Securities Ltd., O.S.C. Sept. 1966 Bulletin.

⁴² Prima Mines, O.S.C. Oct. 1966 Bulletin.

reviewed and future trends anticipated. In discussing this problem, William L. Carey, the present Chairman of the S.E.C. remarked:

Hand in hand with any effort of re-examination is the effort of getting and keeping good people . . . the personnel problem is in part a function of the budget, as reflected in salaries, promotions, and the opportunity to bring in new and able young people—particularly lawyers.⁴³

The question of the merits of rule-making as a means of administering the Securities Act will remain academic so long as the Commission remains understaffed and under-financed. An illustration of the need for a larger budget and more staff is the fact that as of this date the position of Chief Commission Counsel is vacant. No lawyer has been found who satisfies the prerequisites for the position, and who is satisfied with the salary it offers. This is not the first time that recommendations for the separation of the Commission from the Legislature or for new approaches to financing and staffing have been made.⁴⁴ Nevertheless, the implementation of such recommendations are actually conditions precedent to the adoption of any of the above suggestions.

If rule-making is not possible immediately, promulgation of Commission policy could be achieved by publication of all relevant cases in monthly bulletins. At present, only a small percentage of the decisions rendered are contained in the bulletins, and an "information gap" has been created between the Commission and the community it governs. The S.E.C. prevents this by publishing decisions in each of its areas of authority. However, there is a feeling at the Commission that publication of decisions favourable to registrants or to individuals investigated would be unfair to the parties. A similar dilemma was solved by the Revenue Department in Income Tax disputes by changing the names of parties to the litigation to numbers and altering the facts to conceal their identity before publication of the decision. The adoption of this method, or a procedure of publishing examples of administrative rulings on accountancy and disclosure problems in drafting prospectuses would avoid this problem of unfairness and would assist the members of the industry dealing with the Commission.

In conclusion, the process of adjudication should not be thought of as a mutually exclusive alternative to rule-making. Although it would be an equally acceptable solution to the problem of informing the industry of Commission policy, once formulated, it is submitted that rule-making with its opportunity for advanced planning, informal proceedings and submissions from members of the industry, is a superior process for the development of that policy. Therefore, the two should be complimentary. If standards and requirements were enunciated in the statute or in a body of regulations which the Commission could apply to the day-to-day problems of administration, by resorting to adjudication to resolve cases falling between, or not governed by, the rules, the agency could fulfill the great aspirations the legislators and the Commissioners presumably have for it.

⁴³ 29 *Law and Contemporary Problems* 651 (1964),

⁴⁴ See—*Report of the Royal Commission to Investigate Trading in Windfall Mines Ltd.* 99-103; Baillie, 8 *Can. Pub. Admin.*, 172 at 252; *Report of Attorney General's Commission on Securities Legislation in Ontario*, 66-68.