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OF PROSPECTUSES AND CLOSED SYSTEMS: AN ANALYSIS OF SOME PRESENT AND PROPOSED LEGISLATION IN CANADA AND THE UNITED STATES

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I. INTRODUCTION

Since the early 1960's there has been a wave of securities reform proposals in Canada and the United States.[1] The wave in Canada has reached a significant new point with the coming into force in September, 1979 of Ontario's *The Securities Act, 1978*[2] and with the publication in December, 1979 of the federal government's *Proposals for a Securities Market Law for Canada (Proposals),*[3] the culmination of almost six years work.[4] The wave in the United States has reached a significant new point with the membership of the American Law Institute in May, 1978 approving with amendments the Proposed Official Draft of the Federal Securities Code (ALI Code).[5] This is the product of over eight years' work dedicated[6] to the comprehensive restatement, with some major revisions, of the present scheme of American federal securities regulation, composed principally of the *Securities Act of 1933* and the *Securities Exchange Act of 1934.*[7] The ALI Code

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[1] A convenient listing of the major ones in the two jurisdictions appears in Can., 3 *Proposals for a Securities Market Law for Canada, Background Papers* (Ottawa: Minister of Supply & Services, 1979) [hereinafter 3 *Proposals*] at xiii-xv. Because the various background papers in that volume were finished at different times before 1979, and not updated for publication in it, their dates of completion are given where they are cited.

[2] *The Securities Act, 1978*, S.O. 1978, c. 47, in force 15 September 1979, as am. by S.O. 1979, c. 86, in force 1 January 1980.

[3] Can., 1 *Proposals for a Securities Market Law for Canada, Draft Act* (Ottawa: Minister of Supply & Services, 1979) [hereinafter 1 *Proposals*]; Can., 2 *Proposals for a Securities Market Law for Canada, Commentary* (Ottawa: Minister of Supply & Services, 1979) [hereinafter 2 *Proposals*]; and 3 *Proposals, supra* note 1. 1 *Proposals*, s. 16.16, discussed in 2 *Proposals* at 396-97, directs that 2 *Proposals* and 3 *Proposals*, together with any other report laid before Parliament in connection with the *Proposals* and the proceedings of Parliament on the consideration of the Draft Act should be considered in construing the latter. Hence, frequent reference will be made to the appropriate parts of 2 *Proposals* and, where apparently germane, 3 *Proposals* in connection with individual Draft Act provisions.

[4] A history of the project is in 1 *Proposals, supra* note 3, at vi-viii.

[5] American Law Institute, *Federal Securities Code, Proposed Official Draft* Lewis Loss, Reporter (Philadelphia: The American Law Institute, 1978) [hereinafter *ALI Code, POD*], as am. by *Supplement to Proposed Official Draft* (Philadelphia: The American Law Institute, 1978) [hereinafter *ALI Code, Supp. to POD*].

[6] An account of the reasons for and history of the ALI Code project is in volume 1 of the two volume work which consolidates, with further minor amendments approved or authorized in 1979, *ALI Code, POD, id.* and *ALI Code, Supp. to POD, id.*; this work also includes all the Reporter's Comments, as amended from prior tentative drafts of the Code: American Law Institute, 1 *Federal Securities Code* Lewis Loss, Reporter (Philadelphia: The American Law Institute, 1980) [hereinafter 1 *ALI Fed. Sec. Code*] at xix-xxiv. The second volume is American Law Institute, 2 *Federal Securities Code* (Philadelphia: The American Law Institute, 1980) [hereinafter 2 *ALI Fed. Sec. Code*].

[7] The *Securities Act of 1933*, 15 U.S.C. §§77a-77aa (1976); and the *Securities Exchange Act of 1934*, 15 U.S.C. §§78a-77jj (1976). A listing of the other statutory components of that scheme and a compact account of its structure are to be found in Securities and Exchange Commission, *The Work of the Securities and Exchange Commission April 1974* [hereinafter *SEC* (1974)], published by the Commission and reprinted with some deletions in Jennings and Marsh, *Securities Regulation Cases and Materials* (4th ed. Mineola: The Foundation Press, 1977) [hereinafter Jennings and Marsh] at 29-45. All page references to the Commission publication are to the appropriate pages in the latter work.

could go before the House of Representatives in the present session of the Congress.[8]

An important topic in the reform process has been the requirement on a new issue of securities to file a disclosure document with the relevant administrative agency for examination and eventual delivery to investors in the new issue.[9] This requirement, along with one for the licensing of securities market professionals by that agency,[10] has long been a staple of securities regulation in the two countries.[11] Licensing is designed to ensure that such persons are honest, competent and financially responsible.[12] New issue disclosure through the mechanism of a prospectus[13] provides the investor with

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[8] 1 *ALI Fed. Sec. Code, supra* note 6, at xxiii-xxiv, which notes that the version to be so considered could differ to some extent from the present version. And see Schorr, *Plan to Rewrite Federal Securities Law Appears Close to Being Endorsed by SEC*, Wall St. J., July 31, 1980 at 3, col. 3 (some revisions proposed by SEC, numbering about six major ones).

[9] *The Securities Act, 1978*, S.O. 1978, c. 47, Parts XIV-XVI, read with ss. 1(1)42 ("trade"), 40 ("security"), 14 ("distribution to the public"), 11 ("distribution") and 43 ("underwriter") as am. by S.O. 1979, c. 86, ss. 4-10; 1 *Proposals, supra* note 3, Parts 5, 6 and 3 read with ss. 2.17 ("distribution"), 2.40 ("sale"), 2.45 ("security") and 2.49 ("underwriter"); the *Securities Act of 1933*, §§ 5-8, 10, 3 and 4 read with §§ 2(1) ("security"), (3) ("sale" or "sell"), (10) ("prospectus") and (11) ("underwriter"), 15 U.S.C. §§ 77e-77h, 77j, 77c (and 15 U.S.C.A. § 77c (1979)) and 77d read with § 77b(1), (3), (10) and (11) (1976); and 1 *ALI Fed. Sec. Code, supra* note 6, Part V and §302 read with the definitional cross reference in §501. The Ontario Act in its present form is largely the result of proposals made in Ontario Securities Commission, *Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements* (Toronto: Department of Financial & Commercial Affairs, 1970) [hereinafter *OSC Disclosure Report*], cc. III-VI and VIII. The Ontario Act in its turn was one of the major influences on the drafting of 1 *Proposals*, Part 5, the central part of the *Prosopals'* new issue regulatory scheme: 2 *Proposals, supra* note 3, Part 5. A discussion of the major proposals for reform in the new issue disclosure area contained in the 1 *ALI Fed. Sec. Code* is in Painter, *The Federal Securities Code and Corporate Disclosure* (Charlottesville: Mitchie, 1979) [hereinafter Painter], c. 1 (on *ALI Code, POD, supra* note 5, as am. by *ALI Code, Supp. to POD, supra* note 6: there have been only minor changes since he wrote). The new issue disclosure area has not been the main focus of reformers' attentions in the two jurisdictions, however: see note 15 and text accompanying that note, *infra*.

[10] *The Securities Act, 1978*, S.O. 1978, c. 47, Parts X and XI read with ss. 1(1)42 ("trade"), 40 ("security"), 43 ("underwriter") and 1 ("adviser"), as am. by S.O. 1979, c. 86, s. 3; 1 *Proposals, supra* note 3, Part 8, read with ss. 2.07 ("broker"), 2.14 ("dealer"), 2.02 ("adviser") and 2.49 ("underwriter"); the *Securities Exchange Act of* 1934, § 15 read with §§ 3(a)(4) ("broker"), (5) ("dealer") and (12) ("exempted security"), 15 U.S.C. §78o (and 15 U.S.C.A. §77o (1979)) read with §78c(4), (5) and (12) (1976); and 1 *ALI Fed. Sec. Code, supra* note 6, Part VII and §302(5) read with the definitional cross references in §701.

[11] For a history covering new issue disclosure regulation in Canada and the United States, see Grover and Baillie, "Disclosure Requirements" (1976), in 3 *Proposals, supra* note 1, at 368-78; for a brief history of licensing requirements in the two countries, see Connelly, "The Licensing of Securities Market Actors" (1978), in 3 *Proposals, op. cit.*, [hereinafter Connelly (1978)] at 1269-70.

[12] Connelly (1978), *id.*, at 1273-74.

[13] "Prospectus" is here used in the sense of the required new issue disclosure document that is subject to the detailed contents requirements of the relevant regulatory scheme and vetting by the relevant administrative agency before that document's delivery to investors: see *The Securities Act, 1978*, S.O. 1978, c. 47, ss. 55, 60 and 70(1) and

investment information in lengthy narrative and financial form. In some detail, it outlines the method of offering, the security being offered, the issuer and its business, its management and control and other matters.[14] Undoubtedly the main effect of the securities reform waves in Canada and the United States has been to shift the disclosure regulation emphasis away from new issue or primary market "special occasion" disclosure to "continuous disclosure" for traders in previously issued securities in the "secondary markets."[15] However, that has not meant that significant changes in the new issue disclosure scheme have not been forthcoming, striving to define better the circumstances in which new issue disclosure is required[16] and to integrate better the new issue with the continuous disclosure[17] schemes.

The purposes of this article are to examine for Canada,[18] in the light of the legislation borne up by the securities reform waves, these shifts and changes and, with the appearance of the *Proposals*, to comment on the handling of the two levels of disclosure regulation in Canada, federal and provincial. The article will draw, as seems appropriate, on the present and the proposed American federal legislation, which has exercised,[19] and seems likely to

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S.O. 1979, c. 86, s. 7 (adding new s. 62 to principal Act); 1 *Proposals, supra* note 3, ss. 5.05, 5.09 and 5.15(1); the *Securities Act of 1933*, §§10(a), 7, 8 and 5(b), 15 U.S.C. §§77j(a), 77g, 77h and 77e(b) (1976) and 1 *ALI Fed. Sec. Code, supra* note 6, §§505(a), 502(c) and (d) and 504(a). Compare the wider usage in the *Securities Act of 1933*, §2(10), 15 U.S.C. §77b(10) which usage is dropped in 1 *ALI Fed. Sec. Code. op. cit.*, (see §202(127)) as §503(a), Comment (3) explains. In the 1933 Act, the "prospectus" (narrower sense) is part of a larger document, called a "registration statement," which must be filed in new issue situations: Ratner, *Securities Regulation in a Nutshell* (St. Paul: West Publishing, 1978) [hereinafter Ratner] at 33. In 1 *ALI Fed. Sec. Code, op. cit.*, this scheme is carried forward, the "prospectus" being part of a document called an "offering statement": 1 *ALI Fed. Sec. Code*, § 502(c), *op. cit.* The *ALI Fed. Sec. Code, op. cit.*, retains the term "registration statement," but rather confusingly puts it to another use: to denote the document filed when the continuous disclosure scheme in the Code is entered; see Part VC of the text, *infra*.

[14] Ratner, *supra* note 13, at 32, 34; Alboini, *Ontario Securities Law* (Toronto: De Boo, 1980) [hereinafter Alboini] at 360-70.

[15] Grover and Baillie, *supra* note 11, at 406-409 and Baillie, "Remarks to National Investor Relations Institute—Canada Friday, February 22, 1980," O.S.C.W.S. 22 February, 1980, Supp. "X" [hereinafter Baillie (1980)] at 2 (on Ontario and U.S. federal law); 2 *Proposals, supra* note 3, at 61-62; and 1 *ALI Fed. Sec. Code, supra* note 6, at xxvii-xxviii. "Special occasion" disclosure and "continuous disclosure" are from the seminal article, Cohen, *"Truth in Securities" Revisited* (1966), 79 Harv. L. Rev. 1340 [hereinafter Cohen] at 1340-41. For a description of the primary and secondary capital markets in Canada, see Williamson, "Canadian Capital Markets" (1978), in 3 *Proposals, supra* note 1, [hereinafter Williamson (1978)] at 5-25.

[16] See Part IV B3 of the text, *infra*.

[17] See Part VI of the text, *infra*.

[18] Ontario's legislation is used without any attempt to indicate the (often considerable) divergencies in other provinces and the federal territories. This is because, at the time of writing, Ontario's is the most recently revised and likely to be the major influence on securities reform across the country: Buckley, *Small Issuers under The Ontario Securities Act, 1978: A Plea for Exemptions* (1979), 29 U. Toronto L.J. 309 [hereinafter Buckley] at 310n. 6 and text of that note. None of the reform proposals has been enacted as of the time of writing.

[19] For the influence of the present U.S. federal scheme of securities regulation on Ontario, see Simmonds, *Directors' Negligent Mis-statement Liability in a Scheme of*

continue to exercise, an important influence on this country. The particular focus will, however, be on the *Proposals* with their Draft Act,[20] Commentary on the Draft Act[21] and lengthy Background Papers.[22] While the Draft Act's passage into law must be a matter of some doubt,[23] the Act and its superb Commentary and Background Papers provide a new standard by which to judge Canadian securities regulation. A theme important to this article that emerges particularly from a reading of the *Proposals* is the complexity of securities regulation and its dependence on administrative action for adjustment to changes in perceptions of the needs of the capital markets—in particular the primary markets. A related emergent theme is the uncertainty surrounding those needs, which has important implications for the spirit in which the administrative authorities go about their tasks.

II. PROSPECTUS DISCLOSURE POLICY

Prospectus regulation of the modern sort took some time to become a legal staple after legislation in the United Kingdom first mandated disclosure by large business entities.[24] However, the legal system had earlier required disclosure in other ways for both existing and prospective security-holders in a new issue. Historical research done for the *Proposals* revealed the earliest disclosure requirements in the constating documents of the forerunners of the twentieth century business corporation.[25] The use of voluntary documentary sales aids in flotations, the forerunners of today's formal prospectus document,[26] attracted a judicial concern with defective disclosure that bid fair to become a full disclosure requirement.[27] However, the courts soon resiled from

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Securities Regulation (1979), 11 Ottawa L. Rev. 633 [hereinafter Simmonds] at 645, 649 and references in 645nn. 87-89 and 649n. 128. For the influence of the *ALI Code, POD, supra* note 5 and *ALI Code, Supp. to POD, supra* note 5, on 1 *Proposals, supra* note 3, see the "Sources" notes to the sections in the latter.

[20] 1 *Proposals, supra* note 3.

[21] 2 *Proposals, supra* note 3.

[22] 3 *Proposals, supra* note 1.

[23] 1 *Proposals, supra* note 3, at viii says: "The *Proposals* are intended as a discussion document to facilitate the formulation by the Government of Canada of its policy on the regulation of the Canadian securities market."

Initial reaction to the *Proposals* from Ontario, the single most significant province in the regulatory area, has been very cool: statement of [Ontario's] Minister of Consumer and Commercial Relations, November 28, 1979 in O.S.C.W.S. 30th November, 1979 at 5A. The present state of federal-provincial relations, absent a major catastrophe in the financial markets, would seem likely to remain unpropitious to any major unilateral federal initiative along the lines of the *Proposals* for the foreseeable future. But see Catherwood, *Business Speaks out on the Constitution*, Financial Post, September 6, 1980 (survey of 107 companies: 73% of respondents favoured federal participation in securities regulation).

[24] The British legislation was the *Joint Stock Companies Registration and Regulation Act, 1844*, 7 & 8 Vict., c. 110 (U.K.), which is discussed in Grover and Baillie, *supra* note 11, at 364-65, and which lacked a "prospectus" requirement of the sort here discussed. Although any written solicitation material given to investors had to be filed at a central registry, specification of the contents of any such document was lacking.

[25] *Id.* at 359-61.

[26] *Id.* at 362.

[27] *Id.* at 362, 365.

that position to one allowing that the new issue purchase contract was not one *uberrimae fidei*. The voluntary prospectus was not even to be measured against too exacting a standard of literal truthfulness.[28]

Against this background, and following a stock exchange boom and bust, the first statutory provisions setting minimum contents standards for new issue documents appeared in 1867 in the United Kingdom.[29] Similar legislation in the United States and Canada came much later.[30] In fact, in both jurisdictions the earliest disclosure requirements were oriented to the secondary markets. It was not until the early twentieth century that legislatively mandated new issue disclosure surfaced.[31] However, the dominant approaches to regulation of the securities markets in the two countries were the consideration by administrators of non-exempt new issues to determine if the issue merited public sale and the control of the more egregious types of promoters' misrepresentation.[32] It was not until the American *Securities Act of 1933*[33] first brought investor protection legislation to the federal level that the British disclosure philosophy was moved to prominence in North America.[34] The American scheme was closely followed by a call,[35] not for the last time,[36] for a federal initiative in securities regulation in Canada. But no such initiative was made. Instead, the disclosure philosophy made its influence felt in the provincial securities laws enacted after 1933.[37] The philosophy's influence has grown since then. In particular, although merit and misrepresentation—or "anti-fraud"—regulation continue to play a role in provincial securities laws, the major thrust of modern securities reform, provincial and now in the federal *Proposals*, has moved disclosure to centre stage while making it more cost effective.[38] In light of historical development, it may be quaeried at this point if there is anything necessary or desirable in this central role.

In fact there is now a significant body of literature, largely American, on this question,[39] which emanates principally from economists and lawyers,

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[28] *Id.* at 365; and see, *e.g.*, *Bellairs* v. *Tucker* (1884), 13 Q.B.D. 562 (Div. Ct.) esp. at 90 *per* Denman J.; *Central Ry. Co. of Venezuela* v. *Kisch* (1867), L.R. 2 H.L. 99 at 113, 36 L.J. Ch. 849 at 852, 16 L.T. 500 at 501 *per* Lord Chelmesford L.C.

[29] *The Companies Act, 1867*, 30 & 31 Vict., c. 131, s. 38 (U.K.).

[30] Grover and Baillie, *supra* note 11, at 365, 367.

[31] *Id.* at 367 (Canada); Loss, 1 *Securities Regulation* (2d ed. Boston: Little, Brown, 1961) [hereinafter 1 Loss] at 25-27.

[32] Grover and Baillie, *supra* note 11, at 369.

[33] Pub. L. No. 73-22, 48 Stat. 74 (1933).

[34] Grover and Baillie, *supra* note 11, at 369-71.

[35] *Id.* at 371-72 (combining both "blue sky" and disclosure elements).

[36] *Id.* at 373.

[37] *Id.* at 372.

[38] See *OSC Disclosure Report*, *supra* note 9, at paras. 1.19-1.27; *cf.* 2 *Proposals*, *supra*, note 3, at 59-60.

[39] The major references can be gathered from Saari, *The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry* (1977), 29 Stan. L. Rev. 1031 [hereinafter Saari]; Benston, *Required Periodic Disclosure Under the Securities Acts and the Proposed Federal Securities Code* (1979), 33 U. Miami L. Rev. 1471 [hereinafter Benston]; Kripke, *Securities Law Reform and the ALI Federal Securities Code* (1979), 33 U. Miami L. Rev. 1453 [hereinafter Kripke (1979)] at 1465n. 63.

some of it even sponsored by the securities regulators themselves.[40] The literature does not argue with the basic premise of disclosure philosophy: that securities require for their accurate valuation information on the affairs of the issuer, information which will thereby protect investors. This notion can be traced back at least as far as the English Board of Trade Report by William Gladstone which preceded the 1844 *Joint Stock Companies Registration and Regulation Act*.[41] The literature also does not quarrel with the later development of that notion which affirms the utility of adequate information in seeing that capital is directed to its most efficient uses.[42] What the critical literature does is quarrel with the way securities legislation has responded to this premise.

The most fundamental criticism is directed at legislatively mandating *any* disclosure from issuers, whether primary or secondary market disclosure.[43] The criticism is founded largely on the strongest form of an hypothesis about securities price formation developed in the United States and extensively tested there: that securities prices fully reflect all the information to be had about an issuer, including information not yet disclosed in mandated disclosure filings.[44] This can be explained by citing an issuer's incentive to disclose voluntarily to avoid investors demanding uncertainty premiums in their desired rates of return, the trading activity flowing from the competitive efforts of analysts to ferret out information for their clients and also perhaps trading activity by the issuer's insiders.[45] Tests in the United States in both the primary and secondary markets have so far produced results mostly, but not entirely, consistent with the hypothesis.[46] A review of research done for the *Proposals* shows that less work has been done in this country.[47] What Canadian data there are seem more equivocal. Because there may be proportionately fewer financial analysts in this country, and generally thinner capital markets,[48] there is reason

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[40] The most significant example in recent years is the *Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission*, Committee Print 95-29, 95th Cong., 1st Sess. (1977) [hereinafter Advisory Committee Report], discussed in Kripke, *Where Are We on Securities Disclosure After the Advisory Committee Report?* (1978), 6 Sec. Reg. L. J. 99 [hereinafter Kripke (1978)]. See also Williamson (1978), *supra* note 15.

[41] 1844, 7 & 8 Vict., c. 110 (U.K.). The report [hereinafter the *Gladstone Report*] is digested in Hunt, *The Development of the Business Corporation in England 1800-1867* (New York: Russell & Russell, 1969) at 92-94, to which all subsequent page references refer.

[42] See H. R. Rep. No. 85, 73d Cong., 1st Sess. at 2-3 (1933) [hereinafter H. R. Rep. No. 85], quoted in Saari, *supra* note 39, at 1032n. 7 and Ont., *Report of the Attorney-General's Committee on Securities Regulation in Ontario* (Kimber Report) (Toronto: Queen's Printer, 1965) [hereinafter Kimber Report] at paras. 1.06, 1.07.

[43] For a collection of the arguments and citations to supporting data, see Saari, *supra* note 39; Benston, *supra* note 39; and Lothian, *The Role of Government in the Securities Market* (1979), 33 U. Miami L. Rev. 1587.

[44] Saari, *supra* note 39, at 1039, 1041-54.

[45] *Id.* at 1065, 1054-56.

[46] *Id.* at 1041-54. There is serious debate over the strength of the support the hypothesis draws from those data, however, especially in the area of mandated disclosure for the primary capital markets: compare Saari, *id.* at 1058nn. 135, 136 with Williamson (1978), *supra* note 15, at 61-62.

[47] Williamson (1978), *id.* at 31.

[48] See the references collected in Simmonds, *supra* note 19, at 677n. 316.

to think that at least some segments of our primary and secondary markets are less informationally efficient than the American—in particular the mining and oil markets.[49] In those segments at least a convincing case against legislatively mandated disclosure has yet to be made.

But the evidence on mining and oil issuers' securities can be read to make a case for merit regulation. The case would go as follows: capital is a scarce commodity. At least a significant body of investors in mining and oil securities seem to be investing despite evidence that returns *decrease* as risks rise, because they see investment in those stocks as a gambling opportunity.[50] More information may have no significant effect on their preferences. It might therefore be argued that securities regulators should intercede, not to demand more information, but to deny those investors access to such investments.

However, while some evidence exists that merit regulation might have a valuable role to play in the administration of the securities laws,[51] at the least such regulation would seem to demand the sort of case-by-case exercise of administrative discretion which is extremely expensive in manpower terms.[52] In fact, the pattern of regulation in the United States and Canada has been to have merit regulation supplement, rather than substitute for, disclosure.[53] Until a better case for merit regulation, and against disclosure, is made, this seems likely to continue.

A different response to the efficient market evidence, or lack of it, is contained in a background paper on disclosure done for the *Proposals*.[54] Grover and Baillie argue that even if it is accepted that the capital markets do not always need mandated disclosure for securities valuation purposes, such disclosure has *other* valuable purposes to serve. Those purposes derive from the fact that only the larger businesses feel the full weight of securities laws' disclosure requirements.[55] In light of that fact, disclosure serves to signal early the advent (to both law enforcers and to the business concerned) of major financial "scandal," and thus reduce its incidence or effect. Disclosure also serves to address popular concerns about secretiveness in our society.[56] Investors, by divesting, may avoid impending scandals. However, they may not have a share in the general social concern about secretiveness, especially in

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[49] Williamson (1978), *supra* note 15, at 31-32.

But see Connelly, *Fixed Versus Negotiated Commission Rates on the Toronto Stock Exchange* (1977), 2 Can. Bus. L. J. 244 [hereinafter Connelly (1977)] at 247 (suggesting there may be too much research activity in Canada at present).

[50] Williamson (1978), *supra* note 15, at 32.

[51] Goodkind, *Blue Sky Law: Is There Merit in the Merit Requirement?*, [1976] Wis. L. Rev. 79, criticized in Buckley, *supra* note 18, at 318-19n. 48.

[52] *Cf.* Johnston, *Canadian Securities Regulation* (Toronto: Butterworths, 1977) [hereinafter Johnston] at 160.

[53] *Id.*; Grover and Baillie, *supra* note 11, at 393-94.

[54] Grover and Baillie, *supra* note 11.

[55] See Part VI (continuous disclosure scheme's impact).

[56] Grover and Baillie, *supra* note 11, at 384-85. See also *Report of the Royal Commission on Corporate Concentration* (R.B. Bryce, Chairman) (Ottawa: Minister of Supply and Services, 1978) at 321-23.

light of the possibility, recognized explicitly in Ontario's securities laws,[57] that certain kinds of disclosure can produce political or other responses which will reduce the return on their investments.

There is, in the work of the Securities Exchange Commission (SEC) in the United States, recognition of this view of the purposes of disclosure. The classic example in recent times is the controversial SEC response in the foreign corrupt payments area.[58] However, it is significant to note that the suggestion of Grover and Baillie on a broader view of the purposes of disclosure does not seem to have been acted upon in the *Proposals*.[59] Apart from the question whether mandated disclosure for investors in fact has the broader value those authors ascribed to it, it is difficult to see why securities regulators, traditionally concerned with investor protection and efficient capital markets, are well suited to developing disclosure to effect that broader value.[60]

Although no convincing case has yet been made in Canada against legislatively mandated disclosure, there is another related line of criticism that is not as easily dealt with. This criticism does not quarrel with the value of mandated disclosure in general, or prospectus disclosure in particular. Rather, it concerns itself with the form of required disclosure and the notion in the securities laws that a prospectus document must be delivered to investors in a form intelligible to them.[61] This criticism calls for clearer recognition that investors do not and should not[62] decide to invest without expert financial advice. The purveyors of such advice have access to greater information about the merits of the investment—especially its comparative merit—than a prospectus could provide. Prospectuses should be designed for those experts with that constraint in mind. This in turn would result in less conservativism, especially significant for a disclosure document traditionally designed to counteract selling pressures.[63] It would also mean less simplification of complex information, fewer omissions of more speculative or uncertain matters (so called

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[57] See *The Securities Act, 1978*, S.O. 1978, c. 46, s. 74(2); Grover and Baillie, *supra* note 11, at 388.

[58] See *Advisory Committee Report, supra* note 40, at 695-99, 733-34; Note, *Disclosure of Payments to Foreign Government Officials under the Securities Acts* (1976), 89 Harv. L. Rev. 1848.

[59] Compare Grover and Baillie, *supra* note 11, at 384-85 with 1 *Proposals, supra* note 3, s. 1.02 (purposes of Draft Act).

[60] This does not deny the virtue of a willingness by the regulators to allow for the concerns of other government policy-makers to the extent the regulators can do so consistently with their main mission: see Garrett and Weaver, *The Securities and Exchange Commission and the Code* (1977), 30 Vand. L. Rev. 441 [hereinafter Garrett and Weaver] at 448-49.

[61] The single most significant author in this field has been Professor Kripke of the Faculty of Law, New York University: see references collected in Kripke (1979), *supra* note 39, at 1465n. 63.

[62] Kripke (1978), *supra* note 40, at 111, 116-20; but see Saari, *supra* note 39, at 1071.

[63] Kripke, *The SEC, the Accountants, Some Myths and Some Realities* (1970), 45 N.Y.U. L. Rev. 1151 [hereinafter Kripke (1970)] at 1188-1201 and Kripke, *A Search for a More Meaningful Securities Disclosure Policy* (1975), 31 Bus. Law 293 at 314-16.

"soft" information), such as earnings projections, and consequential loosening of the rigidity in format and content of required disclosure documents.[64]

The major response to this line of criticism appears to be phrased in terms of a conception of investor equality, based on equal direct access to information about an issuer.[65] This in turn is commonly linked to preserving investor confidence in "fair" securities markets.[66] However, the evidence suggests that investors' confidence in the fairness of securities markets may not significantly derive from *their* access to mandated disclosure.[67] It indicates that investors are most interested in "fair prices"; that is, prices that reflect fully all that there is to be known relevant to valuation, with what that implies about access to information for those whose judgments determine that valuation. If there is recognition in the securities laws of Canada that at least some forms of required disclosure are inappropriate for the goal of equally informed investors, such recognition appears in those laws' evolving continuous disclosure systems.[68]

III. CONTINUOUS DISCLOSURE AND PROSPECTUS DISCLOSURE

While the single most significant required disclosure document is undoubtedly the prospectus, continuous disclosure has received much greater attention from securities reformers since the mid-1960's.[69] Historically, statutorily required periodic disclosure preceded the prospectus and served to inform shareholders in the exercise of their corporate franchise as well as those making or advising others in the making of investment decisions.[70] However, subsequent greater regulatory attention to the prospectus is quite understandable. A direct benefit to the issuer is discernible in the new issue to warrant a special disclosure effort, where no such benefit is discernible for secondary market trades.[71] (The exception concerns trades by control persons where prospectus requirements have in fact also traditionally been applied.[72]) Related to the matter of direct benefit is the fact that the primary markets rather than the secondary ones perform the function of allocating resources among competing business uses.[73] An often articulated goal of securities regulation is the enhancement of the capital market's ability to perform that function, through more and better information, and the improvement in public partici-

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[64] Saari, *supra* note 39, at 1061-62.

[65] *Id.* at 1032-34; Kimber Report, *supra* note 42, at paras. 1.11, 1.12.

[66] H. R. Rep. No. 1383, 73d. Cong., 2d Sess. (1934) at 2, quoted in Securities and Exchange Commission, *Disclosure to Investors: a Re-Appraisal of Federal Administrative Policies under the '33 and '34 Acts* (Wheat Report) (Washington: CCH, 1969) at 50; Kimber Report, *supra* note 42, paras. 1.11, 1.12.

[67] Saari, *supra* note 39, at 1071; Williamson (1978), *supra* note 15, at 28, 30-32.

[68] See also note 552, *infra*.

[69] See the references in note 15, *supra*.

[70] See Gladstone Report, *supra* note 41, at 92-94.

[71] Grover and Baillie, *supra* note 11, at 391.

[72] *Id.*, and see text accompanying notes 128 *et seq.*, *infra*.

[73] Grover and Baillie, *supra* note 11, at 390.

pation that would flow from better information, *inter alia,* raising the level of public confidence in the market.[74]

However, securities regulators have also come to perceive clearly that efficient primary markets presuppose efficient secondary ones.[75] Secondary market trading helps establish for an issuer the rate of return it should offer on future new issues.[76] Also, secondary markets provide investors with liquidity which helps to maximize the number of potential investors in new issues and hence keep down an issuer's cost of capital.[77] A much simpler reason also exists: the number of investors who participate in the secondary markets vastly exceeds the number of those in the primary ones.[78] The outgrowth of this appreciation is a desire to reduce the disparity between required new issue disclosure and required continuous disclosure.[79]

While this effort engages the criticisms of the disclosure philosophy canvassed above, one finds no attempt by the regulators to ensure required disclosure documents reach the hands of secondary market investors other than those already equity holders of the issuer.[80] Rather, the emphasis is on filing disclosure documents for digestion and dissemination by, predominantly, securities market professionals.[81]

The existence of improved continuous disclosure raises the question whether there should be a reciprocal effect on new issue disclosure. For those issuers providing continuous disclosure, should there be the same prospectus requirements as for those not providing such disclosure? The answer given here and in the United States, where the question was first raised,[82] is *no,* subject to having an adequate continuous disclosure system in place. That is, some degree of "integration"[83] of the two disclosure systems may be appropriate, either by doing away with the prospectus requirement altogether or making prospec-

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[74] See, *e.g.,* H. R. Rep. No. 85, *supra* note 42, at 2-3; Kimber Report, *supra* note 42, paras. 1.06, 1.11, 1.12.

[75] See, *e.g., Advisory Committee Report, supra* note 40, at 573, 616; Kimber Report, *supra* note 42, paras. 1.11, 1.12.

[76] Williamson (1978), *supra* note 15, at 29.

[77] *Id.* at 30.

[78] *Id.* at 29.

[79] *Advisory Committee Report, supra* note 40, at 601-16; *OSC Disclosure Report, supra* note 9, paras. 2.05-2.08.

[80] *SEC* (1974), *supra* note 7, at 34-35 and 17 C.F.R. s. 240.14c-3 (1979); Alboini, *supra* note 14, at 528-29. But see 1 *Proposals, supra* note 3, s. 7.01, discussed in 2 *Proposals, supra* note 3, at 110-11 and 1 *ALI Fed. Sec. Code, supra* note 6, §602(a)(2) (other security holders).

[81] *SEC* (1974), *supra* note 7, at 34-35; *OSC Disclosure Report, supra* note 9, paras. 2.08, 2.09, 2.46, 2.47. But see 1 *ALI Fed. Sec. Code, supra* note 6, §602(a)-(d) Comment (2) (annual report delivered to stockholders coming to be "central device for continuous disclosure"). See also note 552, *infra.*

[82] The seminal publication was Cohen, *supra* note 15; for Ontario, see, *e.g.,* Baillie (1980), *supra* note 15, at 2.

[83] For its usage in this context see, *e.g.,* Cohen, *supra* note 15, throughout the article; *OSC Disclosure Report, supra* note 9, paras. 2.06, 2.18.

tus disclosure less onerous. The "integration" notion itself, however, is only acceptable if continuous disclosure, mediated by securities professionals, is at all a substitute for the prospectus document delivered into an investor's hands. The "integration" one notices in the prospectus requirements thus represents a surprisingly unacknowledged[84] shift in emphasis in the regulators' perception of the role of the prospectuses of at least continuously reporting issuers.

IV. THE PROSPECTUS REQUIREMENT: THE BASIC PROHIBITION

A. *Introduction*

The Securities Act, 1978, like its predecessor, operates through a broad prohibition that has its ambit reduced by a network of exemptions.[85] The prohibition is backed up by a "draconic" set of sanctions designed to ensure that a prospectus is filed if one is required and no exemption is available, and that the filed prospectus makes its way into the hands of investors in the new issue.[86] The purpose of this section is to examine the basic contours of the prohibition in the Act, the *Proposals* and the ALI Code. The examination of the last will make necessary a brief review of the present American federal scheme of securities regulation, the exeprience upon which the ALI Code, the *Proposals* and the Ontario Act have built.

B. *Present Legislation in Ontario*

1. Introduction

The prohibition under the 1978 Act triggers special occasion prospectus disclosure in one way for the first eighteen months after its coming into force and in another way thereafter. Until 15 March 1981, the end of the transitional period, no one may "trade in a security . . . where such trade would be a distribution to the public of such security . . . unless a preliminary prospectus and a prospectus have been filed and receipts therefore obtained from the Director [of the Ontario Securities Commission (OSC)]."[87] On and after 15 March 1981, the prohibition is engaged "where such trade would be a distribution of such security" *simpliciter*.[88] For both periods, the terms "trade" and "security" have the same broad statutory definitions.[89] However, the central term "distribution" is more narrowly defined in the first than the

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[84] The *Advisory Committee Report*, *supra* note 40, comes close, but cannot bring itself to admit the point, at XXXVII-XXXIX; *cf.* Kripke (1978), *supra* note 40, at 110-12 and Kripke (1970), *supra* note 63, at 1165.

[85] *The Securities Act, 1978*, S.O. 1978, c. 47, ss. 52, 71-73, as am. by S.O. 1979, c. 86, s. 10; *The Securities Act*, R.S.O. 1970, c. 426, ss. 35, 58 and 59, as am. by S.O. 1971, c. 31, ss. 13 and 14, rep. by S.O. 1978, c. 47, s. 142, in force 15 September 1979.

[86] Buckley, *supra* note 18, at 311-16: the quoted adjective is from 311.

[87] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 52(1)(a), in force 15 September 1979. The terms "trade," "security," "distribution to the public," "distribution" and "Director" are defined in ss. 1(1)42, 40, 14, 11 and 9, respectively. The office of the Director is dealt with in s. 6; the OSC is principally dealt with in Part I.

[88] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 52(1)(b).

[89] See Alboini, *supra* note 14, at 74-77 ("trade") and 27-72 ("security").

second period[90] and the phrase "distribution to the public" appears only for the transitional period. In that state of affairs resides the 1978 Act's major prospectus regulation changes from its predecessor legislation, *The Securities Act*, introduced in 1966.[91] Here one finds the basic architecture for the "closed system" which is a mark of the reform movement that began in the United States and has its expression in the federal securities regulation scheme and in the proposed *Federal Securities Code* to replace it.[92] The Ontario provisions represent its first statutory expression in Canada while the federal *Proposals* represent a further development.[93] To understand the reform one must understand the statutory background on both sides of the border that gave birth to it.[94]

2. The Background to the Closed System: the 1966 Act and the Transitional Period.

As it is mirrored in the 1978 Act's transitional provisions, the prohibition in Ontario's 1966 Act is a good starting point. Under the 1966 Act no one could "trade in a security . . . where such trade would be in the course of distribution to the public until there ha[s] been filed with the Commission both a preliminary prospectus and a prospectus . . . and receipts therefor obtained from the director."[95] This was subject to a scheme of exemptions on which the 1978 Act extensively draws.[96] "Distribution to the public," the

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[90] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)11, concluding clause.

[91] *The Securities Act*, R.S.O. 1970, c. 426, as am. by S.O. 1971, c. 31, S.O. 1972, c. 1, and S.O. 1973, c. 11, rep. by S.O. 1978, c. 47, s. 142, effective 15 September 1979.

[92] See Emerson, *Vendor Beware: The Issue and Sale of Securities Without a Prospectus under The Securities Act, 1978 (Ontario)* (1979), 57 Can. B. Rev. 195 [hereinafter Emerson (1979)] at 195-97, esp. at 195-96 (the "closed system"). "Closed system" is a term not often used to describe the American legislation present or proposed. But see 2 *Proposals, supra* note 3, at 92.

[93] The Ontario system was not without a series of tentative expressions beginning with *The Securities Act, 1972*, Bill 154 (2nd Sess., 29th Legis. Ont.), which is discussed in Emerson, "An Integrated Disclosure System for Ontario Securities Legislation," in Ziegel, ed., 2 *Studies in Canadian Company Law* (Toronto: Butterworths, 1973) [hereinafter Emerson (1973)]. Bill 154 was succeeded by *The Securities Act, 1974*, Bill 75 (4th Sess., 29th Legis. Ont.); *The Securities Act, 1975*, Bill 98 (5th Sess., 29th Legis. Ont.), discussed in Bray, *Ontario's Proposed Securities Act: an Overview—Its Purposes and Policy Premises*, [1975] O.S.C.B. 235 and Dey, *Securities Reform in Ontario: The Securities Act, 1975* (1975), 1 Can. Bus. L.J. 20 [hereinafter Dey (1975)]; *The Securities Act, 1977*, Bill 20 (4th Sess., 30th Legis. Ont.), taken account of throughout Johnston, *supra* note 52; and Bill 20's identical replacement, *The Securities Act, 1977*, Bill 30 (1st Sess., 31st Legis. Ont.).

The federal *Proposals* do not create a "closed system" in the same way as the Ontario Act; but they represent a variation on the theme. See the text following note 228, *infra; cf.* 2 *Proposals, supra* note 3, at 93.

[94] For recent general studies of that background legislation, see, *e.g.*, Johnston, *supra* note 52 (Ontario); Ratner, *supra* note 13 (the American scheme).

[95] *The Securities Act*, R.S.O. 1970, c. 426, s. 35(1). The terms "trade," "security," "Commission" and "Director" are defined in ss. 1(1)24, 22, 3 and 6, respectively, and "distribution to the public" in s. 1(1)6a, added by S.O. 1971, c. 31, s. 1(2). The Commission is principally dealt with in ss. 2 and 3; the office of Director is dealt with in s. 4.

[96] See Parts V B1 and 2, *infra*.

term the 1978 Act uses but not with the same meaning for the transitional period, was defined in a complex way. That definition can be divided into two parts.

The first part dealt with trades "for the purpose of distributing *to the public* securities issued by a company *and not previously distributed to the public.*" An extension stipulated that this was "whether such trades are made directly . . . or indirectly . . . *through an underwriter or otherwise*, and includes any . . . series of transactions involving a purchase and sale or a repurchase and resale in the course of or incidental to such distribution."[97] On the face of it, this was directed at new issue situations, including within these extensions to underwritings where the underwriter purchased the issue as principal and resold.[98] What that reading misses, however, is the second set of words emphasized: "not previously distributed to the public."[99] What this seemed to contemplate was the possibility of a "distribution" to persons who were *non*-"public," who later resold to "public" purchasers in what would then be a "distribution to the public."[100] This fairly obvious result of a lawyer's close reading of statutory text was not entirely undisputed, however.[101] The basis for the dispute was the definition of "public"; the term's elimination from the 1978 Act's basic prohibition after the transitional period must be counted one of that Act's major accomplishments.

The qualification of the prospectus requirement by reference to the involvement of "public" purchasers goes back to early English companies legislation[102] and is also found in the American federal securities scheme. There it appears in an exemption from the prohibition in the *Securities Act of 1933* on any one using the mails for the purpose of, or to use any means or instruments of interstate commerce for the purpose of, or for delivery after, the sale of any "security," "unless a registration statement is in effect as to [that] security."[103] The relevant exemption to this prohibition is for "transactions by an issuer not involving any public offering."[104]

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[97] In s. 1(1)6a, added by S.O. 1971, c. 31, s. 1(2). [Emphasis added.]

[98] This extension is discussed later, together with the "or otherwise" and "any series of transactions" wording: see notes 135, 145 and text accompanying those notes, *infra*.

[99] The original wording, "not previously distributed," was changed to that quoted by S.O. 1971, c. 31, s. 1(2), the background to which is in Grover and Baillie, *supra* note 11, at 417.

[100] Grover and Baillie, *supra* note 11, at 417 and references in 417n. 288.

[101] *Id.*

[102] *Companies Act 1900*, 63 & 64 Vict., c. 48 (U.K.), s. 9 read with s. 30 ("prospectus"). The first Ontario legislation to use the "public" *desideratum* in this context appears to have been *The Ontario Companies Act, 1912*, 2 Geo. V, c. 31, s. 99(1).

[103] *Securities Act of 1933*, §5(a), 15 U.S.C. §77e(a) (1976). This is the part most readily comparable to Ontario's of a complex prohibition. A short summary is in Ratner, *supra* note 13, at 39-48. "Security" is defined in *Securities Act of 1933*, §2(1), 15 U.S.C. s. 77b(1) (1976); "sale" in §2(3), 15 U.S.C. §776b(3) (1976). For the relationship between the Act's "registration statement" and its "prospectus," see note 13, *supra*.

[104] *Securities Act of 1933*, §4(2), 15 U.S.C. §77d(2) (1976).

At one time the OSC took the position that the term "public" in the 1966 legislation was meant to include "everyone" or, at least, everyone without an exemption.[105] The widest such reading, made before the words "to the public" were added to the "not previously distributed" phrase, would drain those words of virtually all meaning.[106] For that reason, and in the face of what limited jurisprudence there is on point,[107] both readings seem wrong for the later form of the definition.[108] What was not clear is what "public" *did* mean.

It is fair to say that the quest for a definition of "public" was the source of the major operational uncertainty in the 1966 Act.[109] Lawyers could draw, as some courts did, on the rich store of American judicial and administrative learning on the subject in the 1933 Act. The American material sees the term focusing on the purchaser's need for the informational and other protections of the Act.[110] This in turn is seen to make relevant the number of offerees; their access to information equivalent to mandated new issue disclosure, in the sense of their power to demand such information or in the sense of their actually having received it; their sophistication in the sense of their ability to use the information; and their "economic status."[111] Each of these has its interpretive difficulty[112] and their weighting is not altogether clear.[113] In Ontario, difficulties were compounded by the fact that, even if this material is the source of the "leading"[114] test of "public," its precise Ontario application might have needed to be different. In particular, tests of access to information, sophistication and economic status might have

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[105] The widest view is in *OSC Disclosure Report, supra* note 9, para. 8.01; the narrower view is referred to in Grover and Baillie, *supra* note 11, at 417, and *OSC Disclosure Report, op. cit.*, para. 3.18. For an earlier OSC view, also extremely broad, see Williamson, *Securities Regulation in Canada* (Toronto: University of Toronto Press, 1960) [hereinafter Williamson (1960)] at 121.

[106] But not of all meaning: see the word "distributed," discussed in Dey, "Exemptions under the Securities Act of Ontario," [1972] *Law Society of Upper Canada Special Lectures Corporate and Securities Law* (Toronto: De Boo, 1972) 127 [hereinafter Dey (1972)] at 141.

[107] See *id.* at 134.

[108] *Accord* Grover and Baillie, *supra* note 11, at 417 and authorities cited in 417n. 288. See also S.O. 1971, c. 31, s. 13(2).

[109] See Dey (1975), *supra* note 93, at 22. *Cf.* Johnston, *supra* note 52, at 148. But see also Chapman, "The Securities Act, 1978 and the Occasional Practitioner: the Private Company Exemption is not for the Meek," in [1980] *Recent Securities and Corporate Law Developments* (Toronto: Canadian Bar Association, Ontario, 1980) [hereinafter Chapman] at II 3.

[110] See Buckley, *supra* note 18, at 331-38.

[111] *Id.* at 332-38 (the quotation is at 338).

[112] *Id.*

[113] See *id.* at 363; Dey (1972), *supra* note 106, at 139-40.

[114] Buckley, *supra* note 18, at 331 (although the authorities he cites in 331n. 120 are equivocal on the point); contrast Alboini, *supra* note 14, at 288; Grover and Baillie, *supra* note 11, at 410; Chapman, *supra* note 109 at II 15; and *R.* v. *Kiefer* (1976), 6 W.W.R. 541 at 546 (B.C. Co. Ct.), *per* Ferry J., *aff'd* 70 D.L.R. (3d) 352, [1976] 4 W.W.R. 395 (Prov. Ct.). Only the first instance decision in *Kiefer* is referred by Buckley at 331n. 120.

needed to be applied more rigorously in Ontario than in the United States.[115] There those tests had been used in effect to provide exemptions for "private placements"; that is, offerings of securities in large values to institutional investors.[116] Such transactions in both countries are very significant sources of new issue financing.[117] Such excogitation is and has long been unnecessary in Ontario with its specific exemptions for such issues,[118] carrying with them, it may be argued, a narrowing of the scope of the non-"public."

To the uncertainties to which the "need to know" test gave rise in Ontario could be added those arising from the other major test used in the area: the "close friends or business associates" test.[119] This test was first articulated in the context of an exemption from the licensing and prospectus requirements similar to the one in the 1966 Act carried forward into the 1978 Act for trades in "securities of a private company issued by the private company if the securities are not offered for sale to the public."[120] One might assert that the test should be restricted to the "private company"[121] issuer, to which its linguistic affiliation is clear.[122] In any event, the criteria of relationship that this test makes relevant are not obviously any easier to apply than those under the "need to know" test.[123] Also, if this test did apply to the general prohibition as well as the "private company" exemption, the question arose of how to deal with a conflict between the two tests.[124]

All of this interpretive difficulty remains under the 1978 Act, during

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[115] *Cf.* Dey (1972), *supra* note 106, at 138-39; Grover and Baillie, *supra* note 11, at 410.

[116] For a working definition of "private placement" transactions in the Ontario context, see Grover and Baillie, *supra* note 11, at 415-16; for a narrower definition, see Dey (1972), *supra* note 106, at 147. On "private placements" in the American context, see Ratner, *supra* note 13, at 49-50.

[117] See Ratner, *id.* at 50; 1980 O.S.C.B. at 31.

[118] Notes 316-18 and accompanying text, *infra.*

[119] See Buckley, *supra* note 18, at 328-31; Alboini, *supra* note 14, at 288-96.

[120] *The Securities Act,* R.S.O. 1970, c. 426, s. 58(2) (a), incorporating by reference, *inter alia,* s. 19(2)9, as am. by S.O. 1971, c. 31, s. 13(2); *The Securities Act, 1978,* S.O. 1978, c. 47, s. 72(1)(a), incorporating by reference, *inter alia,* s. 34(2)10. The language of the latter exemption slightly differs from that of the former; see Alboini, *supra* note 14, at 287-88. "Private Company" is defined in the former Act, in s. 1(1)14, in the latter Act, in s. 1(1)31. The relevant case is *R.* v. *Piepgrass* (1959), 23 D.L.R. (2d) 220, 29 W.W.R. 218 (Alta. C.A.); and see also *R.* v. *Empire Dock Ltd.* (1940), 55 B.C.R. 34 at 38-39 (Co. Ct.). *Piepgrass* was referred to as the "leading case" in *R.* v. *Kiefer, supra* note 114, at 546.

Caselaw not involving the application of such an exemption but referring with approval to the test in the text or to *Piepgrass* is *R.* v. *McKillop,* [1972] 1 O.R. 164, 4 C.C.C. (2d) 290 (Prov. Ct.), and *R.* v. *Cottrelle* (1972), 3 Can. Sec. L. Rep., para. 70-024, 7 C.C.C. (2d) 30 (Ont. Prov. Ct.). See also *Re Shelter Corp. of Canada,* [1977] O.S.C.B. 6 at 13, and *Les Mines Chandor Ltée,* Q.S.C.W.B. 5 June 1974, 1.

[121] *The Securities Act,* R.S.O. 1970, c. 426, s. 1(1) 141; *The Securities Act, 1978,* S.O. 1978, c. 47, s. 1(1)31.

[122] But see the caselaw not involving application of the exemption cited, *supra* note 119.

[123] See Buckley, *supra* note 18, at 328-31.

[124] *Id.* at 363; Dey (1972), *supra* note 106, at 138.

the transitional period only, with its "distribution to the public" prohibition. During both the transitional and the post-transitional period it remains in the context of the private company exemption examined below.[125] The major difference between the first limb of the 1966 Act's application and the corresponding part of the transitional provisions in the 1978 Act[126] is the deletion of "not previously distributed to the public" in the former. That phrase seemed to require multiple applications of the "public" concept to determine where, along the chain of transactions starting with the issue of the securities, the first "public" purchasers appeared.[127] This exercise was likely to be fraught with evidentiary uncertainties, in proportion to the number of removes from the issuer at which a purchaser who proposed to resell found himself. On that exercise's outcome depended the answer to the question whether a prospectus was needed for a *secondary* market transaction.

A respectable precedent for the application of prospectus requirements to secondary, in addition to primary, market transactions has long existed in Ontario and the United States. This is represented by the second part of the 1966 Act's definition of "distribution to the public," requiring a prospectus for non-exempt

> trades in previously issued securities for the purpose of distributing such securities to the public where the securities form all or a part of or are derived from the holdings of any person, company or combination of persons or companies holding a sufficient number of any of the securities of a company *to materially affect* the control of such company.[128] [Emphasis added.]

The interpretive difficulty caused by the use of the control concept[129] is relieved by the inclusion in that second limb of a presumption of material effect on control for a twenty percent of outstanding "equity shares"[130] holding or combination of holdings. The rationales for applying the prospectus requirement to control person trades to the "public" are:

(1) the control person's presumptive access to information not available to others coupled with
(2) his ability to "manage" the issuer's news;
(3) the likelihood of his sale being large and hence accompanied by significant selling efforts which a mandatory disclosure document delivered to investors might counter; and

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[125] Text accompanying notes 365-71, *infra.*

[126] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)14, read with s. 1(1)11i also s. 1(1)11ii (trades by issuer in previously issued securities redeemed by or donated to it), discussed by Alboini, *supra* note 14, at 6. For discussion of the other parts, see notes 154, 155 and 180 and text accompanying those notes, *infra.*

[127] See Dey (1972), *supra* note 106, at 140-43.

[128] *The Securities Act*, R.S.O. 1970, c. 426, s. 1(1)6a ii, added by S.O. 1970, c. 31, s. 1(2). This extension first appeared in Ontario in *The Securities Act, 1945*, S.O. 1945, c. 22, s. 1(1)(j)(ii). The corresponding provision in the U.S. is the *Securities Act of 1933*, §2(11), 15 U.S.C. s. 77b(11), discussed in this respect in the text accompanying notes 138 and 139, *infra.*

[129] See Johnston, *supra* note 52, at 144-47.

[130] Defined in *The Securities Act*, R.S.O. 1970, c. 426, s. 1(1)7.

(4) the fact that any departure of his from a control position is a significant piece of investment information in itself.[131]

The force of the second and fourth policies was substantially reduced if not eliminated by the introduction into Ontario's securities laws of insider trading controls and an administrative policy calling for timely disclosure of all material development in the issuer's affairs as those developments occur, subject to an opportunity to keep the development confidential where appropriate.[132] The first policy is not clearly restricted to control persons, as the American learning on the "need to know" test would indicate.[133] And the third element is clearly not restricted to them.

Hence, one could reason from the control person scheme to rationalize the application of prospectus regulation to resales to the public by the last in a chain of non-public purchasers. A more significant policy justification, however, seems to have been the avoidance of two-stage distributions whereby securities are moved out to the public through the "conduit" of non-public purchasers.[134] At this point in the discussion, one may ask why the "underwriter" extension of "distribution to the public" did not catch this, for the statutory definition of the term in 1966 did not require either that the "underwriter" be registered as such or be in the business of underwriting. An "underwriter" was simply defined in material part as a "person or company who, as principal, purchases securities from a person or company with a view to, or who as agent for a person or company offers for sale or sells securities in connection with, a distribution to the public of such securities. . . ."[135]

In fact, in the United States the equivalent provisions of the *Securities Act of 1933* were used for just this purpose. The "registration statement" requirement is examined above in connection with the exemption for "trans-

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[131] *OSC Disclosure Report, supra* note 9, para. 4.04. But the Act recognised that a person may be a control person and yet not have sufficient access to information to have a prospectus made up: see *The Securities Act*, R.S.O. 1970, c. 426, s. 60, as am. by S.O. 1971, c. 31, s. 15.

[132] *The Securities Act*, R.S.O. 1970, c. 426, Part XI, as am. by S.O. 1971, c. 31, ss. 31-36, originally added by S.O. 1966, c. 142, Part XI; and De Boo, *Ontario Securities 1978 with Regulation and Policy Statements* (9th ed. Toronto: De Boo, 1979) at 336-37 (Uniform Act Policy 2-12), an amended version of an OSC policy statement first appearing in O.S.C.W.S. 27 September 1968 at 1A-2A.

[133] See its application to private places: text accompanying notes 110 and 117, *supra.*

[134] *Cf. OSC Disclosure Report, supra* note 9, paras. 5.02, 5.19, although on the Commission's reading of the Act as it then stood the taking of securities under an exemption impressed "public" status on the purchaser: *op. cit.*, para. 5.18. Despite the amendments to the Act made by S.O. 1971, c. 31, s. 13(2) this view apparently continued to command some adherents: Dey (1972), *supra* note 106, at 143-44; Grover and Baillie, *supra* note 11, at 417.

[135] *The Securities Act*, R.S.O. 1970, c. 426, s. 1(1)25, as am. by S.O. 1971, c. 31, s. 1(4). But *cf.* Alboini, *supra* note 14, at 79-80. The registration requirement for underwriters made its first appearance in Ontario in *The Securities Act, 1966*, S.O. 1966, c. 142, s. 6(1)(d). It can be argued that only substantial purchasers should be covered, particularly in light of this registration requirement: *cf.* 1 Loss, *supra* note 31, at 642-43; but see also the definition of "distribution to the public" in s. 1(1)6a, and compare text accompanying note 138, *infra.*

actions . . . not involving any public offering."[136] On the face of it, that requirement sweeps in all secondary as well as primary market transactions that had the necessary federal jurisdictional element. What cuts that requirement back most significantly for present purposes is the further exemption for "transactions by any person other than an issuer, underwriter, or dealer."[137] The term "underwriter" is defined very similarly to the Ontario one except for an express extension of the term "issuer" in the definition to include control persons or persons under common control with the issuer and the use of "distribution" for "distribution to the public."[138] The effect of the control extension is to make the registration statement requirement applicable to control person transactions through intermediaries.[139] The decisional materials on the exemption are in large part concerned with persons who claimed to take under the non-public offering exemption; ascribing "underwriter" status to them would not only constrain their resale but also dissolve "retroactively" the original exemption.[140] Those materials saw as the litmus test for "underwriter" status an intention on the part of the reseller at the time of the original acquisition to hold the securities for investment and not for resale in a "public offering."[141] The "investment intent" requirement rated on a purchaser's motives rivalled "public" in the U.S. scheme for uncertainty in application.[142]

There appear to be no judicial considerations of "underwriter" in the Ontario scheme. As a matter of construction of the 1966 Act, it is arguable that lack of "investment intent" in a purchaser from the issuer was a necessary but, at least in a "public" purchaser,[143] not a sufficient condition for application of the prospectus requirement solely through the underwriter limb. This is because of the purposive language in the 1966 definition of "distribution to the public," which is not found in the American Act's requirement or the exemption to it, coupled with the words of section 1(1)6a: "whether such trades are made directly . . . or indirectly through an underwriter or otherwise, and includes any . . . series of transactions involving a

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[136] Text accompanying note 103, *supra.*

[137] *Securities Act of 1933*, §4(1), 15 U.S.C. §77d(1) (1976). "Issuer" is defined in Act, §2(4), 15 U.S.C. §77b(4) (1976); "dealer" in Act, §2(12), 15 U.S.C. §77b(12) (1976). See generally 1 Loss (1961), *supra* note 31, at 641-53, Loss, IV *Securities Regulation* (Supp. to 2d ed. Boston: Little, Brown, 1969) [hereinafter IV Loss] at 2621ff.

[138] For the meaning ascribed to "distribution," which is not statutorily defined, see Buckley, *supra* note 18, at 339 ("synonymous with public offering"); and 1 Loss, *supra* note 31, at 642-43 (probably restricted to purchasers of substantial blocks of securities). See further note 135, *supra.*

[139] The question whether the controlling person could be liable under this extension *as well as* his intermediary apparently was not settled until 1969: Jennings and Marsh, *supra* note 7, at 306.

[140] Buckley, *supra* note 18, at 339-40: the quotation is at 339.

[141] *Id.*; IV Loss, *supra* note 137, at 2580.

[142] Buckley, *supra* note 18, at 340.

[143] The distinction is drawn because a *non*-"public" purchaser who purchased with a view to resales among members of the public could be said without further inquiry to be looking to a "distribution to the public" (under the "not previously distributed to the public" limb).

purchase and sale . . . incidental to such distribution."[144] It could be argued that this required some element of collusion between "underwriter" and issuer.[145] Furthermore, if catching a two step distribution through a "conduit" is the major objective, the collusion requirement makes sense.[146]

However, the collusion requirement makes less sense if, as American materials stress, the concern is not so much the two-stage distribution, with its implicit focus on a transfer of funds from the public to an issuer, but preventing "the creation of public markets in securities of issuers concerning which adequate current information concerning the issuer is not available to the public."[147] Interestingly, this rationale makes more sense in Ontario than it does in the United States since, in the latter, "registration statement" qualification does *not* entail subjection to the continuous disclosure scheme of the *Securities Exchange Act, 1934*.[148] Prospectus qualification of an equity issue did entail subjection to the 1966 Act's continuous disclosure scheme.[149]

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[144] *The Securities Act*, R.S.O. 1970, c. 426, s. 1(1)6a added by S.O. 1971, c. 31, s. 1(2).

[145] At least an intention *by the issuer* that the purchaser from it resell among members of the public would suffice. The "or otherwise" language may even have made the participation of an "underwriter" unnecessary. The resultant position would then have been very similar to that under the British companies legislation: Gower *et al.*, *Gower's Principles of Modern Company Law* (4th ed. London: Stevens, 1979) at 352 (on then existing and proposed legislation). It is unlikely that any change in this respect was made by The Companies Act, 1980 (Imp.); however, this author did not have access to the statutory text to verify this. The difference from the American position flows from the definition of "distribution to the public" in the Ontario legislation. It is unclear if the "series of transactions" language adds anything; its primary application is to stabilization trades in the course of formal underwritings; Baillie, *The Protection of the Investor in Ontario* (1965), 8 Can. Pub. Admin. 172 at 186, and Johnston, *supra* note 52, at 147; although it is not clearly so restricted.

[146] It must be admitted that the reading has only faint support: see Johnston, *supra* note 52, at 147, 197n. 217; *OSC Disclosure Report, supra* note 9, para. 5.15. The contrary view simply requires an intention to resell among the public, apparently whether the purchaser is "public" or not (contrast the author's view, *supra* note 143): Williamson (1960), *supra* note 105, at 122; *OSC Disclosure Report, supra* note 9, paras. 5.17, 5.26; Johnston, *op. cit.*, at 80, 201. See also 2 *Proposals, supra* note 3, at 42. It might be argued that the extension only applied to *registered* underwriters (see *The Securities Act*, R.S.O. 1970, c. 426, s. 6(1)(d), the history of which is discussed by Meech, "Prospectus and Registration Requirements," in [1968] *Special Lectures of the Law Society of Upper Canada* (Toronto: De Boo, 1968) 211, at 213-15): *cf.* Alboini, *supra* note 14, at 79-80, 487; Beattie *et al.*, "Panel Discussion: The Closed System and How it Works: Prospectuses; Reporting Issuers and Exemptions" in Law Society of Upper Canada, *New Securities Legislation* (Toronto: L.S.U.C., 1978) [hereinafter Beattie *et al.*] at 134 (Dey). But this is not beyond argument in light of the wording of the statute and the fact that the 1966 Act's underwriter extension derived from *The Securities Act, 1945*, 1945, S.O. 9 Geo. VI, c. 22, s. 49(1) read with s. 1(1)(y), and before that *The Ontario Companies Act, 1912*, 1912, S.O. 2 Geo. V, c. 31, s. 97(3), in both of which cases there was no "underwriter" registration requirement.

[147] See, *e.g.*, Rule 144, promulgated under the *Securities Act of 1933*, §19(a), 15 U.S.C. §77s (1976), in 17 C.F.R. §230.144 (1979), "Preliminary Note."

[148] See the *Securities Exchange Act of 1934*, §12, 15 U.S.C. §§ 78 1, 78 o (1976).

[149] See The *Securities Act*, R.S.O. 1970, c. 426, s. 118(1)(b)(i) as am. by S.O. 1971, c. 31, s. 37(2). The restriction to "equity securities" (defined in Act, s. 1(1)(7) is discussed in *OSC Disclosure Report, supra* note 9, paras. 2.35, 2.36.

Whether in Ontario the element of collusion was necessary or not, the use of "not previously distributed to the public" in the definition served to extend the prospectus requirement without involving the troublesome question of "investment intent." The problem of who were the "public" remained. The question was particularly troublesome for the private placee. Unless it was the case that simply because it fitted within a private placement exemption it was a "public" purchaser for the purpose of "distribution to the public,"[150] the placee had to ensure that it was not reselling to, or that on the original acquisition it had been, a "public" purchaser.

Even if a private placee did fit within an exemption, the policy rationales discussed above for having prospectus-type controls on resales could still apply to them, a state of affairs that the position in the United States recognized.[151] Under the 1966 Ontario Act, this was recognized by attaching an "investment intent" requirement to the other qualifications for the private placement exemptions.[152] This requirement is continued under the 1978 Act for the transitional period[153] as the sole prospectus requirement resale control in secondary market trading apart from the underwriter[154] and control person[155] extensions of "distribution" (the term also applicable to the post-transitional period).

3. The Post-Transitional Period: The Closed System Arrives.

It is noted above that in the post-transitional period the words "to the public" disappear from the prospectus triggering condition. Under the 1978 Ontario Act the issuer proposing to issue securities is remitted solely to the exemptions. Two of these in large part were designed to compensate for the loss of the 'exemption' implicit in the "public" concept and are new to Ontario's legislation.[156] However, neither is free of serious interpretive difficulty.

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[150] This is a view the OSC has held: see references in note 105, *supra*.

[151] See Rule 144, promulgated under the *Securities Act* of 1933, §19(a), 15 U.S.C. §77s(a) (1976).

[152] See *The Securities Act*, R.S.O. 1970, c. 426, s. 58(1)(a) and s. 58(1)(b), as substituted by S.O. 1971, c. 31, s. 13(1) and read with s. 19(1)3 and 19(3), discussed by Dey (1972), *supra* note 106, at 147-51.

[153] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 143(2).

[154] The "underwriter" extension is in *The Securities Act, 1978*, S.O. 1978, c. 47, ss. 1(1)14 and 1(1)(11)iv,v and last phrase, read with s. 1(1)43 ("underwriter": includes purchaser "with a view to distribution"). Except for s. 1(1)(11)iv and v, the deletion of "not previously distributed to the public" and the change in the definition of "underwriter" ("with a view to distribution" replacing "with a view to distribution to the public"), the extension is identical to that in the earlier legislation, with its purposive, "whether directly or indirectly ... through an underwriter or otherwise and also includes any ... series of transactions involving a purchase and sale ... incidental to a distribution" language. On that language see *supra* note 145. The purpose of s. 1(1)(11) iv and v is discussed in Alboini, *supra* note 14, at 488-89 (although the author disagrees with the view Alboini appears to entertain that those sub-subparagraphs only apply to registered underwriters: see *supra* note 146). If the author's argument derived from the earlier legislation is correct, then s. 1(1)(11)v is probably unnecessary.

[155] The "control person" extension is in *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)(11) iii, discussed and contrasted with the earlier legislation in Alboini, *supra* note 14, at 505-507.

[156] At least one is new as a distribution exemption: see Johnston, *supra* note 52, at 221.

Furthermore, the more important of the two is so hedged about with restrictions as to be of very little value.

The first of the two is the isolated trade transaction exemption. It is modelled on an exemption in the 1966 Act that is on its face restricted to transactions in previously issued securities, and applicable not to the prospectus requiring prohibition but to the licence requiring one.[157] The 1978 Act contains a prospectus exemption available to issuers, but not to holders of previously issued securities, that will come into force only after the expiry of the transitional period.[158] The relevant trade must be "isolated," and "not made in the course of continued and successive transactions of a like nature, and . . . not made by a person or company whose usual business is trading in securities."[159]

There is no corresponding provision to this one in present American federal securities legislation. However, state securities laws in the United States do contain similarly worded new issue disclosure exemptions, on which there is a comparatively large body of jurisprudence to contrast with the small body of Canadian material.[160] As a recent Canadian review of the jurisprudence on both sides of the border concluded, the better reading of the exemption does not require the impossible of an issuer: a solitary issue. Rather, the "continued and successive transactions" passage is taken as an explication of "isolated," requiring that qualifying issues be single transactions each, with single purchasers and of sufficiently different characters as not to form successive parts of a single plan.[161] As that analysis pointed out, the utility of this exemption based on the American experience is likely to be very low since issuers will seldom feel confident about the exemptions applicability.[162]

Prima facie of more significance is the second of the two new exemptions: that for "limited offerings." Unlike the isolated transaction one, it applies during the transitional period also.[163] During that period it will function as a "safe harbour" from the prospectus prohibition in much the same manner as the provision from which it derives in the U.S. federal securities laws.[164]

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157 *The Securities Act*, R.S.O. 1970, c. 426, s. (19(1)2, discussed in Johnston, *supra* note 52, at 122-26.

158 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(b) rep. and re-enacted by S.O. 1979, c. 86, s. 9(1), and read with s. 143(2).

159 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(b).

160 See Buckley, *supra* note 18, at 323-24. For the reason for the non-adoption of the exemption under the present federal scheme, see Landis, *The Legislative History of the Securities Act of 1933* (1959), 28 Geo. Wash. L. Rev. 29 at 37.

161 Buckley, *supra* note 18, at 323-24; and see 2 *Proposals, supra* note 3, at 96-97.

162 *Id.* at 324, 325.

163 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(p), to be read with O. Reg. 478/79, ss. 19 and 20 as am. by O. Reg. 190/80, s. 7, promulgated under the power contained in the Act, s. 139.21, which is discussed in the text accompanying and following note 399, *infra*. However, during the transitional period, the exemption carries an "investment intent" requirement: see s. 143(2).

164 *I.e.* it will enable the issuer to avoid the difficult task of determining if its purchaser(s) are members of the "public." The American provision is in Rule 146, made pursuant to the *Securities Act of 1933*, §19(a), 15 U.S.C. §77s (1976), in 17

That provision is Rule 146 made pursuant to the SEC's power under the *Securities Act of 1933* to make "such rules and regulations as may be necessary to carry out the provisions of this [*Act*], including rules and regulations . . . *defining accounting, technical and trade terms in this* [*Act*]."[165] Rule 146 is the SEC's response to the interpretive uncertainties created by the exemption to the registration statement requirement for "transactions . . . not involving any public offerings."[166] Satisfaction of its requirements ensures that the exemption is available. Failure to satisfy one or more of the requirements is not fatal, however, if the person claiming the benefit of the exemption can successfully invoke ordinary standards of statutory construction;[167] hence the "safe harbour" on which the 1978 Act extensively draws.

Again, a recent Canadian analysis of the limited offering exemption in conjunction with its Rule 146 forbear[168] makes unnecessary a detailed analysis here. As that analysis points out, the Ontario exemption is a "once-and-for-all" one,[169] unlike Rule 146 and the "public" jurisprudence. The gravamen of the exemption is a limitation both on the number of offerees that can be approached in the offering (to 50), and the number of purchasers that can result (25).[170] Only the latter type of limit (with 35 instead of 25) applies under Rule 146.[171] Numbers of offerees and purchasers were, of course, only a factor, albeit a significant one, under the "public" jurisprudence.[172] Allied with the numbers limitation is a prohibition in the 1978 Ontario Act on the use of general advertising which has its analogue under Rule 146.[173]

Coupled with the numbers limitation, however, is the major inhibiting factor on the use of the limited offering exemption that both the 1978 Act and Rule 146 share, derived directly from the "public" caselaw. This is the eligibility rules for purchasers (offerees in Rule 146). They must all have

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C.F.R. §230.146 (1979): see Buckley, *supra* note 18, at 343-44n. 202. See also the SEC's then proposed Rule 242, referred to in Lang and Backman, *The Federal Securities Code in Flux: Limited Offerings and Tender Offers* (1979), 33 U. Miami L. Rev. 1551 [hereinafter Lang and Backman] at 1557n. 32, and now in force (see Chapman, *supra* note 109, at II 7n. 38 and accompanying text).

[165] See preceding note. For a Canadian reaction to this sort of provision, see 2 *Proposals, supra* note 3, at 347. The *vires* of this rule is apparently far from beyond question: see Loss *et al., Panel Discussion* (1979), 33 U. Miami L. Rev. 1519 at 1535-36 (Loss.).

[166] Painter, *supra* note 9, at 14-15.

[167] Rule 146, 17 C.F.R. §230.146 (1979), "Preliminary Note" 1.

[168] Buckley, *supra* note 18, at 343-49. See also Alboini, *supra* note 14, at 299-301, 476-85.

[169] This is probably the most severely criticized feature of the exemption: see Buckley, *supra* note 18, at 349; Alboini, *supra* note 14, at 477.

[170] This raises the problem of integration of what would otherwise be a limited offering with other transactions, a long familiar problem to American lawyers: Buckley, *supra* note 18, at 348.

[171] 17 C.F.R. §230.146(g)(l) (1979). But there are qualifications which *all* offerees must possess: see 17 C.F.R. §230.146(d) and (e) (1979).

[172] Buckley, *supra* note 18, at 332-34.

[173] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(p)(iii); 17 C.F.R. §230.146(c) (1979).

access to (substantially) prospectus quality information[174] and the ability to evaluate the information presented[175] unless (under the Ontario Act only) they are senior officers or directors (or immediate family) of the issuer.[176] Unless the investors are made senior officers or directors of the issuer[177] this does not represent very much of an advance on the "public" learning.[178] When this state of affairs is coupled with the "once-and-for-all" character of this exemption, it appears likely that the exemption will be seldom used.[179]

It is the other major achievement of the 1978 Act that the "investment intent" requirement disappears after the transitional period. In its place, the definition of "distribution" is widened to include, *inter alia*, "the first trade in securities previously acquired pursuant to [any of, *inter alia*, the isolated trade, limited offering and private placement exemptions] other than a further trade exempted by [subsection 71(1)]."[180] This is unless the issuer is subject to the continuous disclosure scheme and not in default under its requirements, and has been subject to those requirements for a stipulated period. Also, the securities must have been held for a stipulated period, ranging from six to eighteen months, since acquisition, or the date of subjection to the continuous disclosure scheme, whichever is the later. Finally, no unusual effort can be made to prepare the market and no extraordinary commission can be made in respect of the trade; and reports of the original acquisition and of the resale must be duly filed with the OSC.[181]

It is this extension which will, with a number of others for securities acquired pursuant to other exemptions which for the most part resemble it,[182] institute the "closed system" in Ontario. Securities issued to private placement-type purchasers can be traded among them but not outside their circle

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[174] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(p)(ii), and see O. Reg. 190/80 s. 7, substituting new s. 20 for O. Reg. 478/79 s. 20; 17 C.F.R. §230.146(e) (1979). Both are discussed and contrasted in Buckley, *supra* note 18, at 344-46.

[175] *The Securities Act, 1978*, S.O. 1978, s. 71(1)(p)(ii)(a); 17 C.F.R. §230.146(d) (1979). Both are discussed and contrasted in Buckley, *supra* note 18, at 346-47.

[176] *The Securities Act, 1978*, S.O. 1978, s. 71(1)(p)(ii)(b).

[177] Recommended by Buckley, *supra* note 18, at 346; but *quaere* if the OSC might not, if this manoeuvre became popular enough, intervene under *The Securities Act, 1978*, S.O. 1978, c. 47, s. 124(1): *cf.* Alboini, *supra* note 18, at 844-45.

[178] See Buckley, *supra* note 18, at 349 and Alboini, *supra* note 14, at 484-85. Compare the conclusion come to in relation to Rule 146 in Painter, *supra* note 9, at 14-16.

[179] *Accord* Buckley, *supra* note 18, at 349; Alboini, *supra* note 14, at 485.

[180] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)11 concluding words, read with s. 71(4). But see also text following note 195, *infra*. Securities acquired under other exemptions are covered by other extensions of "distribution": see ss. 71(5)-(7); and see also O. Reg. 478/79 s. 17 as am. by O. Reg. 190/80, s. 5 (applying selected resale controls from the Act to exemptions created by the Regulation). The s. 71(6) extension is discussed in the text following note 195, *infra*. The s. 71(5) and (7) extensions are discussed in the text following note 537, *infra*. Not all of the exemptions in s. 71(1) discussed in the next section of the text by their terms can apply to resales: see Alboini, *supra* note 14, at 493. There are a number of exemptions in the regulations created for resale situations: see O. Reg. 478/79, s. 16.

[181] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(4)(a)-(c) and concluding clause.

[182] *Supra* note 180, and references there.

unless the permitted resale rules are followed. The first, "reporting issuer" rule, is the first taste of "integration" by the 1978 Act of the prospectus and continuous disclosure schemes.[183] The second, is the establishment of a roadblock to two-stage distributions that is not dependent on the uncertainties of "investment intent" or "collusion."[184] It should be noted, however, that one of the other extensions of distribution does not present such a feature.[185] The third is directed at large-scale resales with attendant special selling pressures for which prospectus delivery to an investor is seen as a counter.[186] The fourth, the reporting rules, keeps the regulators and the marketplace informed of the change in the "float" of the reporting issuer's securities.[187]

These requirements derive from the American response to the uncertainties of "investment intent" in the 1933 Act, coupled with the drive to upgrade the quality of the continuous disclosure scheme and to harmonize the new issue one with it.[188] This response took the form of the SEC's Rule 144,[189] which provided pursuant to the SEC's power by rule to provide definitions,[190] an interpretation of "distribution" in the statutory definition of "underwriter."[191] Each one of the requirements for permitted resales under the Ontario Act has its analogue in Rule 144, which, unlike Rule 146 (defining "transactions . . . not involving a public offering"), is not a "safe harbour."[192] Rule 144 differs from the Ontario provision in having a uniform holding period of two years from the date of acquisition.[193] It also differs in having an additional requirement: compliance with resale quantity limits that are based on a percentage of the outstanding securities of the relevant class and average weekly trading volumes in such securities.[194]

The Ontario Act's post-transitional period resale rules represent a major change from the 1966 Act's and the transitional period's controls. The degree

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183 Returned to in the Part VIB of the text *infra*.

184 *OSC Disclosure Report, supra* note 9, para. 5.20; Alboini, *supra* note 14, at 499-500. But see Johnston, *supra* note 52, at 232.

185 See *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(5), returned to in note 542, *infra*.

186 *Cf.* Johnston, *supra* note 52, at 178 (two day "cooling off" period after mandated delivery of prospectus); and Grover and Baillie, *supra* note 11, at 438, 448, 458.

187 See Grover and Baillie, *id.* at 451; Johnston, *id.* at 232.

188 Emerson (1973), *supra* note 93, at 430-37.

189 17 C.F.R. §230.144 (1979); and see also 17 C.F.R. §230.237 (1979).

190 Text accompanying note 165, *supra*.

191 17 C.F.R. §230.144 (1979), "Preliminary Note to Rule 144." Its *vires* is apparently not beyond doubt: see Loss *et al.*, *supra* note 165, at 1535-36 (Loss).

192 Cheek, *Exemptions under the Proposed Federal Securities Code* (1977), 30 Vand. L. Rev. 355 [hereinafter Cheek] at 372.

193 17 C.F.R. §230.144(d)(1) (1979). The reason for the different Ontario position appears to be the justifiability of making a series of concessions to "safer investments": Alboini, *supra* note 14, at 497. And see also 17 C.F.R. §230.237 (1979) (five years).

194 17 C.F.R. §230.144(e) (1979). It is arguable that this additional requirement is unnecessary against a background of continuous disclosure and a prohibition on market grooming (in which some quantity limitations are instinct in any event: *cf.* Grover and Baillie, *supra* note 11, at 438): see Sowards, *Private Placements and Secondary Transactions: The Wheat Report Proposals for Reform*, [1970] Duke L.J. 515, at 521. Rule 144 was recently amended to remove the quantity limitations for

of liquidity of securities acquired pursuant to exemptions covered by those rules will in most cases be less, drastically so in the case of securities of non-reporting issuers. This of course was quite intentional; issuers are being supplied with strong incentives to enter the Act's continuous disclosure system.[195]

However, there is a problem with the neatness of the closed system so set up, with its deletion of "investment intent." This problem derives from the underwriter extension of the definition of "distribution," which is in the form that "the first trade in securities previously acquired under [*inter alia*, the exemption covering a trade with an underwriter] other than a further trade exempted by [subsection 71(1)] is a distribution."[196] When the definition of "underwriter" is read with its "view to a distribution,"[197] it is arguable that a person who purchases under another exemption, to which a resale extension of "distribution" applies, with a view to a resale *outside* any exemption and the applicable resale rules is an "underwriter." Any resale by such a person outside the exemptions, even an otherwise permitted resale, would then be a "distribution."[198] While there is no purposive language to found an argument for a collusion with the issuer requirement,[199] a form of investment intent requirement is plain.

It is at least arguable that the underwriter extension of the distribution limb is unnecessary in a closed system to prevent the formation of public

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sales by non-"affiliates" in certain circumstances: Wolfson, *Comments on the Proposed Federal Securities Code: Transformation of the Securities Act of 1933* (1979), 33 U. Miami L. Rev. 1495 [hereinafter Wolfson (1979)] at 1509n. 55; and see 17 C.F.R. §230.144(e)(2), 2nd sentence (1979). One advantage to quantity limitations over "market grooming" controls alone is their greater ease of application by the regulators: *cf.* Grover and Baillie, *op. cit.*, 449-50. It should also be noted that the Ontario provisions, unlike the Rule 144 ones, do not require the use of a broker: see Grover and Baillie, *op. cit.*, 450-51; but see note 467 and accompanying text, *infra*. See further text following note 568, *infra*.

[195] Baillie (1980), *supra* note 15, at 3.

[196] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)11, concluding clause, when read with s. 71(6) (from which the quotation comes) and s. 71(1)(r).

[197] *Id.*, s. 1(1)43. In light of other provisions of the Act, particularly s. 24(1)(b) (registration requirement), it is arguable that only purchasers of a substantial block of securities are covered: *cf.* 1 Loss, *supra* note 31, at 642-43; but see the definition of "distribution" in *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)11, and compare note 138 and accompanying text, *supra*.

[198] But see Beattie *et al.*, *supra* note 146, at 131-32 (Boast) and Alboini, *supra* note 14, at 487, who suggests that it is "likely" that the s. 71(1)(r) exemption is restricted to *registered* underwriters, a view entertained about s. 71(1)(r)'s predecessor under the former legislation: Dey (1972), *supra* note 106, at 152; but see also Emerson (1979), *supra* note 92, at 236n. 106. Most purchases by an "underwriter" on the view in the text would be qualifiable under *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(d) ($98,000 purchases), to which the s. 71(4) permitted resale rules apply. But compliance with those rules would not appear to meet s. 71(6)'s exclusionary conditions. *Quaere* if a resale after a purchase by an "underwriter" qualifiable under an exemption covered by s. 71(5) which complied with the latter's permitted resale rules would not be free of s. 71(6), by virtue of the form of s. 71(5)'s permission: *cf.* Alboini, *supra* note 14, at 511-12.

[199] Except for the "series of transactions" language in the concluding words of *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)11, which are derived from the former legislation, which is discussed in this aspect in note 195, *supra*.

secondary markets for which there is inadequate disclosure. The extension may be important to prevent the two-stage distribution through a conduit that can proceed under a resale control without a holding period requirement. If so, it would at least make sense to require an element of collusion between issuer and "underwriter," or at least a holding period "safe harbour." The 1978 Act does not require either of these.[200]

C. *Proposed Legislation in the United States and Canada*

The federal *Proposals'* Draft Act draws extensively on the existing American federal scheme, the 1978 Ontario Act and the present American scheme's proposed replacement, the ALI Code. In both what it does and does not draw upon, the Draft Act contains some valuable lessons for provincial legislators.

Like the ALI Code and the 1978 Ontario Act in the post-transitional period, the Draft Act has as its prospectus requirement trigger a "distribution," defined without reference to any provision for the purchaser to be a member of the "public."[201] As in the ALI Code and the 1978 Act the Draft Act's "distribution" focuses on new issues and a limited category of secondary market transactions. However, it differs significantly from its two major sources.

The "new issue limb" of the Draft Act's definition requires "a sale by or on behalf of the issuer of the security."[202] Like the 1978 Act, but unlike the ALI Code, there is an "underwriter" extension.[203]

The Draft Act covers secondary market transactions in three separate parts of the definition of "distribution." There is a part to cover

> a sale of a previously issued security from the holdings of a person or prescribed group of persons, if the aggregate holdings of securities of that class *enable the person or group to exercise a determinative influence over the management and policies of the issuer in any manner.*[204] [Emphasis added.]

This derives from the 1978 Act's control person limb, with an attempt made to sharpen the control language.[205] The body to be charged with the adminis-

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[200] Two-stage distributions through a conduit without a holding period roadblock are possible under *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(5): see Alboini, *supra* note 14, at 497. However, on the argument in the text the "underwriter" extension would not apply unless a resale with market grooming were in view (see s. 71 (5)(c)). Compare the ALI Code position in the text accompanying note 203, *infra*. See also 1 *Proposals, supra* note 3, ss. 2.49 ("underwriter") and 2.17(b) ("distributions' " underwriter extension) discussed in the text accompanying notes 231-33, *infra*.

[201] 1 *Proposals, supra* note 3, s. 2.17, discussed in 2 *Proposals, supra* note 3, at 16-19. Compare 1 *ALI Fed. Sec. Code, supra* note 6, s. 202(41) read with §202(110).

[202] 1 *Proposals, supra* note 3, s. 2.17(a). The concluding words of paragraph (a) are omitted; these make it clear that the ground covered by *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)11ii is also covered here. See 2 *Proposals, supra* note 3, at 17.

[203] 1 *Proposals, supra* note 3, s. 2.17(b); compare 1 *ALI Fed. Sec. Code, supra* note 6, §202(172)(A), Comment (1).

[204] 1 *Proposals, supra* note 3, s. 2.17(c). This represents a rejection of a proposal made in one of the Proposals' Background Papers to remove such an extension from the prospectus triggering provision, a rejection which is not, however, explained in 2 *Proposals, supra* note 3: see note 225, *infra*.

[205] 2 *Proposals, supra* note 3, at 18-19.

tration of the Draft Act, the Canadian Securities Commission (CSC), with the approval of the Governor-in-Council is to make "regulations" to set out the criteria for a control "group," allowing this concept to be sharpened as well.[206] Despite these two desirable changes, it seems that difficulties of interpretation remain.[207] In that regard it is interesting to note that the ALI Code has abandoned the 1933 Act's control person concept.

The ALI Code follows the *Securities Act of 1933* in providing a new issue disclosure trigger that, unlike the 1978 Ontario Act and the Draft Act, does not separately deal with primary and secondary market transactions. The ALI Code requires that before a person "in connection with a distribution" can sell, or confirm a sale, or deliver a security after sale or accept payment for a security, an "offering statement" must be filed with respect to that "distribution."[208] "Distribution" is defined as, "an offering other than (i) a limited offering or (ii) an offering by means of one or more trading transactions."[209] The first exclusion[210] corresponds roughly with the "transactions . . . not involving a public offering" exemption in the 1933 Act.[211] The second, unlike the first, is at present confined to secondary market transactions not involving a security that is the subject of a "limited offering." It must be put through a broker or dealer performing the usual function and receiving no unusual compensation. The total of all trading transactions for the seller during a "specified" period can not exceed whatever amount in dollars, percentage of trading volume or percentage of outstanding securities of the class that the SEC specifies by "rule."[212] If a secondary transaction is not within either of these exclusions, it is caught, unless an exemption applies. Control status, or the lack of it, is irrelevant. Three important provisions relieve against the hardship of this broad coverage, however.[213]

The first, applicable only to an issuer which has been subject to the Code's continuous disclosure system for at least a year (a "one year registrant"),[214] permits a holder of not more than fifteen percent of the voting securities of such an issuer freely to resell.[215] In effect this erects a fifteen percent

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[206] See 1 *Proposals, supra* note 3, s. 2.17(c) read with s. 15.14(1)(a). On the CSC generally, see *id.*, Part 15.

[207] "Determinative influence," while much sharper than *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)11 iii's "affect materially the control," is still not a bright line concept. Compare 1 *Proposals, supra* note 3, s. 2.12.

[208] 1 *ALI Fed. Sec. Code, supra* note 6, §504(a). See also §§502 and 503. "Offering statement" is defined in §202(111) and is the equivalent under the Code of the "registration statement" under present legislation (see *supra* note 13): see 1 *ALI Fed. Sec. Code*, §202(111), Comment. The definition of "distribution" is in the immediately following text.

[209] 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(A). "Offering" is defined in §202(110).

[210] Elaborated upon in 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(B).

[211] See text following note 258, *infra.*

[212] 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(C). See text following note 575, *infra.*

[213] 1 *ALI Fed. Sec. Code, supra* note 6, §502(b), Comment (1) lists all the forms of relief available.

[214] Defined in 1 *ALI Fed. Sec. Code, supra* note 6, §202(113).

[215] *Id.*, §512(4). Note, however, the exclusion in the subsection's concluding words.

"conclusive presumption"[216] of lack of control, without the possibility of rebuttal that exists in the 1978 Ontario Act's twenty percent control person concept, but with the complication of a "control group" gloss.[217] However, this conclusive presumption only applies to the "one-year registrant," a further step towards integration that the 1978 Ontario Act and the Draft Act may be reluctant to take[218] until further Canadian experience with continuous disclosure warrants an appropriate exemption being created.

The second provision that relieves against the width of the "distribution" exemption for secondary transactions permits the holder of securities (including a fifteen percent plus one) of a "one-year registrant" to elect to file a "distribution statement"[219] in place of an offering statement.[220] The "distribution statement" is a type of scaled down offering statement with its required level of disclosure more appropriate to the holder's station.[221] A similar concept in the Draft Act is examined below.[222]

The third relieving provision is designed for the secondary distributors of the non-"one-year registrant," for whom neither of the preceding provisions will have any value. It confers on such persons the right, unless waived, to demand that the issuer file an "offering statement."[223] The issuer must then either file the statement or offer to buy the securities involved at fair value.[224]

This complex scheme appears to achieve the desirable result of eliminating the uncertainties endemic to the control person trigger while avoiding the "overkill" of having all substantial secondary distributors subjected to a prospectus disclosure requirement.[225] It might be responded that the ALI

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[216] *Id.*, §512(4), Comment (4)(a).

[217] *Id.*, §202(121)(B).

[218] There are also some considerable reservations felt about it in the United States; see *id.*, §512(4), Comment (5).

[219] Defined in *id.*, §202(42).

[220] *Id.*, §510.

[221] See Loss, *Keynote Address: The Federal Securities Code* (1979), 33 U. Miami L. Rev. 1431 [hereinafter Loss (1979)] at 1442.

[222] Text accompanying notes 246 *et seq., infra.*

[223] 1 *ALI Fed. Sec. Code, supra* note 6, §512(b), a short discussion of which is in Loss (1979), *supra* note 221, at 1443.

[224] 1 *ALI Fed. Sec. Code, supra* note 6, §502(b)(5)(C). The filing on demand provision is well analyzed in Wolfson (1979), *supra* note 194, at 1511-12.

[225] See text accompanying notes 252 *et seq., infra.* For an alternative approach which achieves the same result somewhat more simply, see Grover and Baillie, *supra* note 11, at 416-17, 438-39, 462 (require prospectus only on primary distributions, and in case of "large secondary distributions," to be defined by rule; but have second requirement only if no serious adverse impact; eliminate requirement for prospectus for control person trades; and leave CSC with discretion to require prospectus in cases of heavy secondary market trading).

Regrettably, while 1 *Proposals, supra* note 3, s. 2.17(c) extension of "distribution" witnesses the rejection of this proposal, no explanation of the rejection is proffered. The same is also true of the apparent partial rejection (see note 581, *infra*) of the part to do with heavy secondary market trading.

Code scheme places a faith, not yet warranted in Canada, in the efficacy of continuous disclosure. This is especially so in relation to resales of large blocks of securities (with their accompanying selling pressures), which non-fifteen percent voting security holders appear to be free to resell without restriction. In conjunction with elimination of an "underwriter" extension of "distribution," this would appear to free formal underwritings from distribution disclosure, which, in the light of the special selling efforts to be expected, might give the regulators some concern.[226] The matter of what relaxations in the distribution régime may be justified by continuous disclosure is returned to below.[227]

From the control person limb of the Draft Act's definition of "distribution" we move to its equivalent to the 1978 Ontario Act's controls on resales by purchasers who took under an exemption. The Draft Act provision extends "distribution" to cover

> a sale of a previously issued security purchased from an 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 [Canadian Securities] Commission prescribes, before the sale.[228]

In form this looks quite dissimilar to the 1978 Ontario Act's extensions of distribution. In operation it is likely to be less restrictive, with the exception of prospectus qualified distributions of larger issuers.

Clearly, the immediate aftermarket in newly issued securities, whether prospectus qualified or not, is to be restricted to the exemptions.[229] This is accomplished because the "pursuant to an exemption," or like locutions, in the 1978 Act's closed system "distribution" extensions[230] is missing. Whether purchasers after the first are caught in their resales will depend on whether their seller was an "underwriter." "Underwriter" is defined (in material part) as one who purchased "in furtherance of" a distribution.[231] The language is derived from the ALI Code's "in aid of a distribution" in its definition of an "underwriter."[232] It is unclear what improvement on the "with a view to" locution this represents; the language in the Draft Act, at least, still focuses on the buyer's state of mind at purchase, although it may be argued

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[226] *Quaere*, if something like this underlies the reservations in 1 *ALI Fed. Sec. Code, supra* note 6, §512(4), Comment (5).

[227] See Part VI of the text, *infra*.

[228] 1 *Proposals, supra* note 3, s. 2.17(b).

[229] For holders of securities of "reporting issuers," the holding periods in s. 2.17(b) are likely to be shorter than the provincial ones: see 2 *Proposals, supra* note 3, at 17. A "reporting issuer" is one subject to the Act's continuous disclosure scheme: see 1 *Proposals, supra* note 3, s. 2.38. Not all the exemptions in the Draft Act discussed in the next section of the text can on their terms apply to resales: see 1 *Proposals, op. cit.*, s. 6.01(c), (d), (e), (g).

[230] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(4),(5),(6), and (7), as am. by S.O. 1979, c. 86, s. 9(2).

[231] 1 *Proposals, supra* note 3, s. 2.49, discussed in 2 *Proposals, supra* note 3, at 40-43.

[232] 1 *ALI Fed. Sec. Code, supra* note 6, §202(172)(A).

that it requires a more dominant motive concerning a more immediate resale.[233] If this reading is correct, the Draft Act's "closed system" is much less "closed" than the Ontario Act's,[234] except where an underwriter is involved. When viewed in conjunction with the Draft Act's limited offering exemption,[235] and with its trading transaction one,[236] the Act's exemption system offers some significant outlets not available under the Ontario scheme.

The goal of preventing the formation of public markets for which inadequate disclosure is provided[237] might be seen to be compromised by the ambit of the Draft Act's exemptions. However, subjection to its continuous disclosure scheme, and hence "reporting issuer" status, is to follow after listing on a "registered securities exchange" or attainment of at least 300 "public security holders."[238] The latter condition derives from the provision in the ALI Code that stipulates the conditions in which an issuer must file the document that makes it a "registrant," and therefore subject to the Code's continuous disclosure scheme.[239] The condition dealing with the number of security holders is not found in the Ontario legislation.[240] However, distribution qualification under the Draft Act does not, of itself, entail subjection to the legislation's continuous disclosure scheme, unlike the Ontario Act and the ALI Code.[241] The Draft Act takes the position, which the discussion in this article of the material critical to the utility of mandated disclosure might be read to support, that, in the absence of a significant spread of security holders there will not be a sufficient "following" for an issuer to ensure that the continuous disclosure file is used properly.[242] Hence, in its closed system's coverage of a prospectus qualified distribution by a non-reporting issuer, the

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[233] Compare 2 *Proposals, supra* note 3, at 42-43 with 93, 99-100 and 131. See also *SEC* v. *Guild Films Co.*, 279 F. 2d 485 (2d Cir. 1960), *cert. denied* 364 U.S. 819, 81 S. Ct. 52 (1960) referred to in 2 *Proposals, op. cit.*, at 42n. 207; and Oxford, IV *The Oxford English Dictionary* (Oxford: Oxford Univ. Press, 1961) at 619 ("furtherance"). It is arguable that a substantial purchase is required to qualify as an underwriter, in the light of, *inter alia*, the registration requirement, *infra*: *cf.* 1 Loss, *supra* note 31, at 642-43; but compare 1 *Proposals, supra* note 3, s. 2.17 with text accompanying note 138, *supra*. It is not clear that the reading in the text was the intention of the drafters of the Draft Act: see 2 *Proposals, op. cit.*, at 42-43 read with *ALI Code, POD, supra* note 5, §299.74, Revised Comment (2) to which 2 Proposals refers.

[234] See 2 *Proposals, supra* note 3, at 93.

[235] Text accompanying notes 258 *et seq., infra.*

[236] Text accompanying notes 575 *et seq., infra.*

[237] See text accompanying note 147, *supra.*

[238] 1 *Proposals, supra* note 3, s. 402(1); and see s. 402(2) (issuer not meeting criteria may apply for reporting issuer status). See further the discussion of this section in Part VIC of the text, *infra.*

[239] The Draft Act provision makes some changes, however: see 2 *Proposals, supra* note 3, at 66, and 1 *ALI Fed. Sec. Code, supra* note 6, §402(a).

[240] Compare *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)38.

[241] See 2 *Proposals, supra* note 3, at 67 and 1 *Proposals, supra* note 3, s. 4.02(1); and see s. 4.02(2) (issuer not meeting criteria may apply for reporting issuer status).

[242] 2 *Proposals, supra* note 3, at 67; and see 2 *Proposals, op. cit.*, at 61-62, 64 (concern is with issuers of securities in which there are "active trading markets"); for the material critical of the utility of mandated disclosure, see notes 39 and 40, *supra*; and on the substance of the criticisms, see text accompanying notes 44-49, *supra*. Of course, that text would strongly suggest that precisely where there is a following,

Draft Act, with its exemption for resales by non-fifteen percent voting security holders restricted to "one-year registrants," is close to the Ontario and ALI Code position.[243]

But in its closed system's coverage of prospectus qualified distributions of a "reporting issuer" it is on its face some distance from them. It may be appropriate to confine immediate aftermarket trading to the widened exemptions until at least a sufficient following for the issuer has developed for the issuer to merit becoming a reporting issuer, and perhaps not until the issuer has had some experience as in the case of the ALI Code's "one year registrant."[244] But, once the latter condition has been met, there seems to be no reason for controlling resales through the distribution prohibition, even one relieved by a trading transaction exemption, in the absence at least of a control relationship with the issuer, or a large volume resale.[245]

The matter of a large volume resale is encompassed by the final limb of the Draft Act's definition of "distribution," which is likely to be the most controversial. It makes a "distribution": "a sale of previously issued securities from the holdings of a sophisticated purchaser or prescribed group of persons, if the aggregate number of securities exceeds an amount prescribed by the [Canadian Securities] Commission."[246] This extension was included "to invite discussion" of the application of special disclosure requirements to "large sales by substantial investors."[247] The rationale for such application is closely related to that for control persons, but shorn of those related to the preoccupation with control: the likelihood that special market grooming efforts will be entailed in such resales.[248] The special disclosure to be required will be significantly less onerous (as seems appropriate) than a prospectus, but, like a prospectus, will have to be delivered to investors.[249] The CSC's ability to vary the application of the extension by regulations specify-

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"mandated disclosure" of any sort is unnecessary. But if there *is* to be such disclosure, that text would suggest that reliance for investor protection on the *filed* disclosure chacteristic of continued disclosure schemes over the *delivered-to-investors* form characteristics of new issue disclosure would be misplaced outside the cases where there is a following.

[243] 1 *ALI Fed. Sec. Code, supra* note 6, §512(4), discussed in the text accompanying notes 215-18, *supra.*

[244] See the discussion in the text following note 225, read with the text accompanying note 242, *supra.*

[245] *Cf.* Grover and Baillie, *supra* note 11, at 438-39, 448, (who would add "heavy secondary trading"). The trading transaction exemption in s. 6.04, discussed in the text following note 573, *infra,* could and probably would be tailored to avoid the problem in the text. But it is submitted that it should not be *necessary* in the situation in the text to qualify under an *exemption*: rather, the onus should be squarely placed on the regulators to show that distribution regulation is appropriate for the reasons the text suggests.

[246] 1 *Proposals, supra* note 3, s. 2.17(d).

[247] 2 *Proposals, supra* note 3, at 19.

[248] *Id.* Compare the given rationales for including resales by controlling persons as events justifying prospectus regulation in the text accompanying note 131, *supra.*

[249] 1 *Proposals, supra* note 3, ss. 5.05(1) and 5.04(1); 2 *Proposals, supra* note 3, at 19. The relevant disclosure document will be called a "block distribution circular," thus differentiating it clearly from the prospectus: see 2 *Proposals, op. cit.,* at 73.

ing the triggering aggregate number of securities and "prescribed groups" will further permit adjustments in the impact of the extension.[250] But, even reduced to this degree, it goes beyond any corresponding provision in the ALI Code, after account is taken of the Code's exemptions; at least this is so in the Code's application to "one year registrants."[251]

The cause for controversy is undoubtedly the concern expressed in the *Proposals* about a negative impact upon institutional purchasers' willingness to purchase securities.[252] Their significance as a source of private placement financing in Canada gives point to this concern.[253] The problem seems to have influenced the drafting of the ALI Code, which has dealt with the matter by the widely drafted exemption for secondary distributions by non-fifteen percent voting security holders, but only of one-year registrants.[254] The Draft Act did not adopt this provision, and the probable reason therefor would seem to obtain here.[255] However, one should also note that it seems the SEC will be able, by rule, to cut back the scope of this exemption in response to the type of investment protection concern expressed in the *Proposals*.[256]

The breadth of the definition of "distribution" in the Draft Act, as under the 1978 Ontario Act, makes the exemptions even more important than they were under the old "distribution to the public" rubrics. In the next section, the matter of the exemptions under the new closed systems is reviewed. Here, the concern is with the replacements in the Draft Act for the possibility of distribution, free of required disclosure, for non-"public" distributions.

The Draft Act in this area borrows at least as extensively from the ALI Code as it does from the 1978 Ontario Act. Like the latter, but unlike the former, there is an isolated trade exemption that is worded similarly to the Ontario provision and appears to share its interpretive difficulties. Like the Ontario Act there is a limited offering exemption but it is structured after the radically different ALI Code exception to the definition of a "distribution." There is also a separate "sophisticated purchaser" exemption that somewhat confusingly draws more on the 1978 Act's limited offering exception than it does the Code. These last two exemptions deserve some scrutiny.[257]

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[250] *Cf.* Grover and Baillie, *supra* note 11, at 462.

[251] See 1 *ALI Fed. Sec. Code, supra* note 6, §202(41) and 512(4). But see also, *op. cit.*, s. 512(4), Comment (5).

[252] 2 *Proposals, supra* note 3, at 19.

[253] Text accompanying note 117, *supra.*

[254] 1 *ALI Fed. Sec. Code, supra* note 6, §512(4); but see also §512(4), Comment (5).

[255] See the text accompanying notes 225-27, *supra.*

[256] 2 *ALI Fed. Sec. Code, supra* note 6, §1804(a) read with 1 *ALI Fed. Sec. Code*, §512(4), Comment (2) (s. 512(4) directed at "block trading" problem); but see also, *op. cit.*, s. 512(4), Comment (5) (reformulation of s. 512 would be desirable to avoid its possibly excessive breadth).

[257] See also the discussion of the trading transaction exemption in 1 *Proposals, supra* note 3, s. 6.04 in the text accompanying notes 574 *et seq., infra.*

The Draft Act's limited offering exemption is confined to a distribution within a period prescribed by the CSC to not more than thirty-five "purchasers."[258] Like the ALI Code limited offering exception and unlike that of the 1978 Ontario Act, there is no requirement for access to information, or sophistication, or both, on the part of those "purchasers." As in the ALI Code provision, the major limitation is on the number of "purchasers" that can result from the original distribution and any resales by an original purchaser over a stipulated period from the end of the original distribution.[259] By contrast, there is no special limitation on expansion of the original number of security holders under the 1978 Ontario Act. Like the ALI Code and the 1978 Ontario Act, there is a further limitation on promotional activities in connection with the offering.[260] Like the 1978 Ontario Act, but unlike the ALI Code, there is a limitation on the number of offerees, because of the definitions of "sale" and "purchase" in the Draft Act.[261] As in the 1978 Ontario Act, but not the ALI Code, there is no express provision dealing with the problem of whether other distributions made under other exemptions at about the same time as a limited offering are to be integrated with the limited offering so as to limit its availability.[262] Like the ALI Code, but unlike the 1978 Ontario Act, there is included in the exemption provision a CSC regulation-making power to vary, in effect, the terms of the exemption—although the power so conferred is broader than the SEC's under the ALI Code.[263] Finally, like the ALI Code, but unlike the 1978 Ontario Act, the limited offering is available to secondary distributors as well as to issuers.[264]

Dealing with the last matter first, it seems likely that unless the CSC makes relieving rules, compliance with the limitation on a spreading out beyond thirty-five purchasers will be particularly hard for secondary distributors to ensure.[265] Secondary distributors will, in any event, have at least

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[258] 1 *Proposals, supra* note 3, s. 6.03, discussed in 2 *Proposals, supra* note 3, at 100-102. Note that "purchasers" and "sale" in the word "distribution" are defined to include unconsummated offerings: see ss. 2.32 and 2.40, discussed in 2 *Proposals, supra* note 3, at 27-28.The significance of this is returned to in the text accompanying notes 261, 270-71, *infra.*

[259] This is discussed in the text accompanying notes 265-66, 273, *infra.*

[260] See 1 *Proposals, supra* note 3, s. 6.03(2)(b); 1 *ALI Fed. Sec. Code, supra* note 3; §503(b); and *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(p)(iii). The Code prohibition is not a condition of the exemption, however, which seems in a sound position in light of the sanctions for engaging in unqualified unexempt distributions (see 1 *Proposals*, s. 13.02; Buckley, *supra* note 18, at 312-13); see 1 *ALI Fed. Sec. Code*, §202(41), Comment (2)(a); but see Lang and Backman, *supra* note 164, at 1563n. 66.

[261] *Supra* note 258.

[262] See 1 *ALI Fed. Sec. Code, supra* note 6, §202(110); and see §202(110), Comment (1)(b). See Buckley, *supra* note 18, at 348, on the importance of the integration concept in this area.

[263] Compare 1 *Proposals, supra* note 3, s. 6.03(4) with 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(B)(iii) (restricted to non-"one-year registrants"). See the discussion of this power in the text accompanying notes 281-84, *infra.*

[264] See, however, immediately following text.

[265] See 2 *Proposals, supra* note 3, at 101.

the isolated trade and sophisticated purchaser exemptions to use up to the limit.[266]

The Draft Act's condition requiring the initial distribution to be completed within a period prescribed by the CSC can be compared with that of the 1978 Ontario Act's requiring six months[267] and the lack of any such condition in the ALI Code. The limitation may have been designed to reduce the incidence of integration problems.[268] It also appears to have the beneficial effect of making it easier for the purchaser in a limited offering to determine when the restrictive period must have expired.[269] The Draft Act's departure from a fixed period for all issuers, as under the 1978 Ontario Act, seems desirable in light of the different trading patterns between securities of seasoned and unseasoned issuers.

The Draft Act's abandonment of the access/sophistication criterion in favour of a numbers test with spreading out controls and a prohibition on promotional activities is the most distinctive feature of the exemption. They will serve to confine most uses of the limited offering to transactions involving "a small number of associates who are not likely to require the protection of part 5 even though they lack professional investment advice."[270] However, it may be asked why, with controls on promotional activities, it was felt necessary to control the number of offerees as opposed to final purchasers.[271] The logic of the ALI Draft Code is persuasive: in such circumstances "it is hard to see how an offeree is hurt."[272] The spreading out restriction borrowed from the ALI Code will create, in effect, a holding period without even the possibility of resales pursuant to other exemptions, thereby reflecting the need to curb the peculiar potential for such a limited offering exemption to become a "broad public offering."[273] The exemption will be of par-

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[266] Discussed in the text accompanying notes 434-36 and 289 *et seq.*, respectively, *infra.*

[267] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(p)(i).

[268] The Commentary to the Draft Act does not discuss the point: 2 *Proposals, supra* note 3, at 101.

[269] This is a problem that was mentioned in connection with an earlier version of the ALI Code provision and which the provision now appears to have largely overcome: compare American Law Institute, *Federal Securities Code, Tentative Draft No. 1* (Philadelphia: The American Law Institute, 1972), §227(b)(7) with 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(B)(vii), and Lang and Backman, *supra* note 164, at 1568.

[270] 2 *Proposals, supra* note 3, at 100.

[271] The explanation in 2 *Proposals, supra* note 3, at 99 (solicitees rather than purchasers "determines the nature of the distribution") is not very satisfying, unless it is expanded (and see 2 *Proposals, supra* note 3 at 28) following Cheek, *supra* note 192, at 363. It may be possible to condition the market and mislead later purchasers without falling foul of the special market grooming rules referred to. But it seems that the better way to proceed would be via the power by regulation to vary the terms of the exemption: see text accompanying notes 281-84, *infra.*

[272] 1 *ALI Fed. Sec. Code, supra* note 6, §202(41), Comment (2)(a); *accord* Grover and Baillie, *supra* note 11, at 446.

[273] *Cf.* Cheek, *supra* note 192, at 365 (source of quotation), which notes at 365n. 35, 366n. 37 and 375 that, while the ALI Code provision does permit resales past the 35 person limit, this is provided that an exemption is available, and by virtue of the Code's provisions in only the limited offering one and any created by SEC rule (see 1 *ALI Fed. Sec. Code, supra* note 6, §30) are candidates.

ticular value to small issuers unable or unwilling to tap sophisticated or institutional sources of funds, for which other exemptions exist.[274] In this respect, the exemption can be taken not so much as an indication of where investor protection is unnecessary because of "self-fending"[275] considerations, shorn of the interpretive difficulties of the access/sophistication concept, but rather as an acknowledgement that the cost of regulation is not justified by the potential for harm to investors and may unnecessarily chill small enterprise.[276] The circumscriptions of the Draft Act's exemption are thus essential to its acceptability in a scheme of regulation that emphasizes investor protection.[277]

A number of application difficulties arise with an exemption like this which are probably best left to solution by regulation. Restrictive legends on securities certificates and special procedures for securities transfer agents are fairly obvious examples which occurred to the drafters of the ALI Code and the Draft Act.[278] The regulation-making power in the Draft Act provision is not restricted to such topics, however.[279] It extends to vary the period within which the "spreading out" restriction applies; it is to be expected that the ALI Code example of having a shorter period for "one-year registrants" will

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[274] *Cf.* Buckley, *supra* note 18, at 364 (who prefers the broader Code provision). For those other exemptions, see text accompanying notes 404-12, *infra*. For a criticism of the choice of 35 instead of a larger number of investors, based on the experience of financing under the present American federal scheme, see Loss *et al.*, *supra* note 165, at 1528 (Kripke).

[275] This is a term employed by Cheek, *supra* note 192, *e.g.*, at 364.

[276] See Grover and Baillie, *supra* note 11, at 437-38; Buckley, *supra* note 18, at 316-22. This is not to deny the possibly greater potential for fraud in the case of small enterprise: compare Cheek, *supra* note 192, at 364 with Buckley, *op. cit.*, at 321; and see notes 277, 281 and accompanying text, *infra*. But consider the importance of small businesses in the Canadian economy: Buckley, *op. cit.*, at 311; *The Financial Post*, April 5, 1980, s. 1-s.10; and see recent initiatives by the SEC that would lighten the regulatory burden on small issuers: Lang and Backman, *supra* note 164, at 1557n. 32; Williamson (1978), *supra* note 15, at 63. It must be conceded that, from an investor protection perspective, this position is easier for federal than provincial regulators to take: *cf.* Cheek, *op. cit.*, at 362n. 26. It is also easier to take if there are effective anti-fraud controls in the statute: Cheek, *op. cit.*, at 362n. 26; Lang and Backman, *op. cit.*, at 1564-66; and compare 1 *ALI Fed. Sec. Code, supra* note 6, Parts XVI and XVII (esp. §§1602(a)(1) read with 202(61) and (96) and 1703(a)) and 1 *Proposals, supra* note 3, Parts 12 and 13 (especially ss. 12.01 and 13.16(1) with *The Securities Act, 1978*, S.O. 1978, c. 47, s. 118 and Part XXII and Part 5d of the text, *infra* (generally more expansive controls in the two federal schemes than in the provincial one). Overall, it is hard to resist the force of the analysis of the Code provision of Wolfson, *supra* note 194, at 1504-506, concluding at 1506 that the reform was "without benefit of scientific empirical studies" and it may be "unwise" to "freeze the new Code provisions in this area based upon lawyers' hunches." For a response to this concern, see text following note 637, *infra*.

[277] *Id.*

[278] Compare 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(B)(iv)(II) and (III) with 1 *Proposals, supra* note 3 s. 6.03(4)(a) and (b) read with 2 *Proposals, supra* note 3, at 102.

[279] 1 *Proposals, supra* note 3, s. 6.03(4)(a); compare 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(B)(iii) (non-"one-year registrants" only), which is returned to in note 281 and accompanying text, *infra*.

be followed.[280] More controversially, the general regulation-making power for "establishing further conditions for a limited offering" could, for example, enable the CSC to reintroduce self-fending criteria for limited offerings, as it has been suggested the SEC acting under the corresponding provision in the ALI Code could do.[281] The matter of delegated legislation is returned to below. For now, it suffices to say that the operation of this novel provision may suggest a need for further changes consistent with the broad policy of the Act[282] and that the CSC should have the ability to make such changes through the relatively prompt law-making mechanism of regulation.[283] There appear to be sufficient constraints on abuse while preserving the desired degree of flexibility built into the Draft Act.[284]

A related exemption to that for limited offerings excludes from the application of the Draft Act (except its enforcement part and the CSC's power to deny exemptions) securities of an issuer other than a reporting issuer "where the total number of security holders of the issuer, excluding employees, is less than fifty."[285] This is the Draft Act's equivalent to the "private company" exemption in the 1978 Ontario Act.[286] Its scope, wider than that of the limited offering exemption, should be noted: there is no back-up, subject to the CSC's power to deny exemptions, of the anti-fraud controls in the Act.[287] Given the much broader application of the limited offering exemption, with its potential for greater investor harm, this seems appropriate.[288]

In turning to the Draft Act's access-sophisticated purchaser exemption,[289] one notes that there is no equivalent in the Code.[290] The Draft Act

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[280] See 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(B)(ii).

[281] For concern expressed on this score in the United States, see Lang and Backman, *supra* note 164, at 1562 and references in 1562n. 61.

[282] 1 *Proposals, supra* note 3, s. 1.02 (especially efficient functioning of capital markets and protection of investors), returned to in the text accompanying note 641, *infra*.

[283] See note 277, *supra*; but *cf.* Bialkin, *The Issuer Registration and Distribution Provisions of the Federal Securities Code* (1977), 30 Vand. L. Rev. 327 [hereinafter Bialkin] at 338.

[284] See text following note 637, *infra*.

[285] 1 *Proposals, supra* note 3, s. 3.01(e); and see the text following note 469, *infra* on the selective operation on the rest of the Act of the distribution exemptions.

[286] See text accompanying notes 446-47, *infra*.

[287] For the justifiability of such an application, *cf.* Lang and Backman, *supra* note 164, at 1564-66. See generally on the anti-fraud protections the text following note 494, *infra*.

[288] See note 278, *supra*.

[289] 1 *Proposals, supra* note 3, s. 6.02(2).

[290] The closest is the extension of the Code's limited offering exemption to include "institutional investors," who are not to be counted as part of the 35 limit: see 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(B)(i)(I); and §202(74) ("institutional investor"). See also under the present American federal scheme the SEC's Rule 242, referred to in Lang and Backman, *supra* note 164, at 1557n. 32, and Chapman, *supra* note 109, at II fn. 38 and text of that note.

provision is patterned on two distinct provisions in the 1978 Ontario Act: its "private placement" exemption for 97,000 dollar purchasers and its "limited offering" exemption.[291] The 97,000 dollar purchaser exemption is discussed under the private placement exemptions described below. The part patterned on the Ontario provision follows the parent provision sufficiently closely so that separate comment is not necessary, except to note two points. First, the Draft Act provision is not, unlike the 1978 Ontario Act one, a "once-and-for-all" provision; this is probably a desirable change.[292] Second, there is the special treatment accorded resales by sophisticated purchasers under the Draft Act provision: if the resale is pursuant to the isolated trade exemption, the purchaser is placed in the resale shoes of his vendor.[293] This prevents creation of a public aftermarket through the isolated trade exemption—but not through any other—without reliance on the "underwriter"[294] definition. The reason for this special treatment of a combination of two exemptions is not explained adequately in the Commentary to the Draft Act.[295] The reason appears to be similar to that warranting the "spreading out" control on the limited offering exemption: the peculiar possibility for the involvement of persons not sensitive to the nuances of "underwriter" status.[296]

While the 1978 Ontario Act's "limited offering" exemption was strongly criticized for its retention of the interpretive uncertainties of the access-sophistication concept,[297] such a criticism would be inappropriate for the Draft Act provision. That provision does not, as under the Ontario Act, stand only in company with another exemption, the isolated trade one, of perhaps equally forbidding difficulty.[298] The Draft Act's limited offering exemption relieves a great deal of the pressure that would otherwise bear on those two difficult exemptions, particularly in view of the fact that the exemption is not a "once-and-for-all" provision. In that context, the access-sophisticated purchaser exemption is likely to be relied upon in a much smaller category of residual cases than its "public" forbear. The CSC could always, as the OSC can, move to carve out sharper exemptions by regulation.[299]

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[291] The latter is discussed in the text following note 162, *supra*, the former in the text accompanying notes 318 *et seq., infra.*

[292] Alboini, *supra* note 14, at 477; Buckley, *supra* note 18, at 349.

[293] 1 *Proposals, supra* note 3, s. 6.02(6).

[294] See text accompanying notes 231-34 and note 233, *supra.*

[295] 2 *Proposals, supra* note 3, at 100 indicates that it is to eliminate "the difficulties of an 'investment intent'." This raises the questions of why here especially?

[296] On that status see text accompanying notes 231-34, *supra.* In fact, the provision in the text here may in one respect *ease* the position of a reseller of securities of a reporting issuer, by giving him the benefit of his vendor's elapsed holding period. See the wording of 1 *Proposals, supra* note 3, s. 6.03(6), last 3 lines, read with s. 2.17(b); see also 2 *Proposals, supra* note 3 at 100.

[297] Text following note 174, *supra.*

[298] See text accompanying notes 161, 162, *supra.*

[299] In Parts VB3 and C3 of the text, *infra,* where the power to create *ad hoc* exemptions (see 1 *Proposals, supra* note 3, s. 6.01(1); *The Securities Act, 1978,* S.O. 1978, c. 47, s. 73 as am. by S.O. 1979, c. 86, s. 10) is also referred to.

V. EXEMPTIONS

A. *Introduction*

Enough has been said of the main contours of the distribution regulation triggering provisions in the modern closed system to make plain the importance of the network of exemptions those systems provide. The 1978 Ontario Act, the Draft Act and the ALI Code have a large number of exemptions in their respective networks.[300] The details of those most basic to their respective schemes are given above.[301] Some of the other exemptions—particularly those commonly placed in the "private placement" category[302]—are in practical terms perhaps even more significant. However, there now exists quite a substantial body of literature on the various exemption network[303] and therefore this analysis will simply highlight what seems to be important to the successful operation of a closed system.

Successful operation of a closed system requires a network of exemptions that is neither too restrictive nor too broad in terms of the regulatory objectives.[304] The most obviously appropriate class of exemption is one that sees adequate investor protection provided by other means; typically, the investor can fend for himself, the risk of loss on the security is very low, or there is adequate statutory protection elsewhere.[305] A less obvious and much more amorphous class covers those cases where any investor protection good to be achieved is outweighed by the cost of regulation.[306] The exemptions here could run the gamut from those where the number or type of investors involved does not warrant application of scarce administrative resources to those where there is a serious question of chilling beneficial activity.[307]

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[300] Respectively, *The Securities Act, 1978*, S.O. 1978, c. 47, ss. 71(1), 72(1) and 73; and s. 139.20 (power to add to exemptions by regulation), as am. by S.O. 1979, c. 86, ss. 9, 10; O. Reg. 478/79, s. 14, as am. by O. Reg. 667/79, s. 1 and O. Reg. 190/80, ss. 3 and 4; 1 *Proposals, supra* note 3, ss. 3.01, 3.02(1), 3.03, 6.01, 6.02, 6.03, 6.04 and 6.05; and 1 *ALI Fed. Sec. Code, supra* note 6, §§512 (read with s. 302), 514, 515, 303 and 304, and see also the "exceptions" to the Code's definition of "distribution" in §202(41)(B) ("limited offerings") and (c) ("trading transactions") for exemptions from the present American federal scheme, see the *Securities Act of 1933*, §§3 and 4, 15 U.S.C. §§77c and 77d (1976) and 15 U.S.C.A. §77c (1979). As virtually all of these are carried forward into the Code, in one form or another, they will not be separately discussed, except as seems appropriate.

[301] Text accompanying notes 156-79, 258-99 and 209-24 respectively, *supra.*

[302] As to which see note 116 and accompanying text, *supra.*

[303] The most useful for the present Ontario legislation are in Dey (1972), *supra* note 106; Johnston, *supra* note 52; Emerson (1979), *supra* note 92; Iacobucci, "The Definition of Security for Purposes [sic] of a Securities Act," in 3 *Proposals, supra* note 3, 221 [hereinafter Iacobucci]; Grover and Baillie, *supra* note 11; and Alboini, *supra* note 14. For the Draft Act provisions, see 2 *Proposals, supra* note 3; Grover and Baillie, *op. cit.*, and Connelly (1978), *supra* note 11. For the Code and the present American federal scheme, see Bialkin, *supra* note 283; Cheek, *supra* note 192; Loss (1979), *supra* note 221; Wolfson, *supra* note 194; Lang and Backman, *supra* note 164; Painter, *supra* note 9; and 1 *ALI Fed. Sec. Code, supra* note 6, "Introduction" and "Comments" (as applicable to relevant code sections).

[304] See Grover and Baillie, *id.* at 409, 411.

[305] See Iacobucci, *supra* note 303, at 261; *cf. Johnston, supra* note 52, at 223.

[306] See Iacobucci, *id.* at 261, who also proffers a further reason returned to in notes 326, 339, *infra.*

[307] *See* Part V B2 of the text, *infra.*

Especially in relation to the second main class of exemption, but also in relation to the first, the rate of change in the capital markets, and the imperfections in our knowledge of it, make residual provision for adaptation appropriate, through the creation of new exemptions by the comparatively expeditious regulation-making process.[308] Those factors also make appropriate *ad hoc* exemptions, created by administrative decision on application for particular situations. These *ad hoc* exemptions provide a more particularized form of justice[309] and serve as a valuable source of information for the future exercise of the regulation-making power.[310]

Finally, attention should be paid to the question whether any protection other than the distribution regulation scheme should apply to the area covered by an exemption. Simply because an investor does not need prospectus-type protection does not necessarily mean that he does not need other protection—for example, that to be derived from having any securities professional involved in the transaction meet minimum standards of probity, competence and financial stability.[311] What follows is a review of the basic architecture of the exemption networks in the 1978 Ontario Act and the Draft Act, with comparisons where appropriate with the ALI Code and existing American federal law.

B. *Present Legislation: the 1978 Ontario Act*

1. Exemptions Where Investor Protection is Seen to be Provided Elsewhere.

The pattern in the 1978 Ontario Act subdivides the specific exemptions[312] into transactional and security types, the former relates to the characteristics of the transaction concerned, focusing on the disponee, the latter relates to the characteristics of the security concerned.[313] The classification scheme adopted in this article instead focuses on the rationales of the exemptions. Accordingly, both security-type and transaction-type exemptions are discussed together where appropriate.

There are in fact twenty-eight exemptions, eight of the security type and

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[308] On the rate of change in the capital markets, see Williamson (1978), *supra* note 15, at 75; on the imperfections in our knowledge of them see *id.* at 31-32, 56-63; and on the justifiability of exemption by regulation-making see 2 *Proposals, supra* note 3, at 56 and Loss (1979), *supra* note 221, at 1435-36. However, the American approach to granting this sort of power has heretofor been much more cautious than the Canadian: see 1 Loss, *supra* note 31, at 605-39, IV Loss, *supra* note 137, at 2605-20; and Garrett and Weaver, *supra* note 60, at 449-58. On the general issue of delegated legislative power, see Howard, "Securities Regulation: Structure and Process" (1978), in 3 *Proposals, supra* note 1, [hereinafter Howard] at 1662-65.

[309] *Cf.* 2 *Proposals, supra* note 3, at 56, 57.

[310] See Alboini, *supra* note 14, at 525.

[311] See Connelly (1978), *supra* note 11, at 1273; *cf.* 2 *Proposals, supra* note 3, at 50.

[312] The terminology used for the ones fixed in the Act or the regulations: see, *e.g.*, Iacobucci, *supra* note 303, at 261.

[313] *The Securities Act, 1978*, S.O. 1978, c. 47, ss. 71(1) (as am. by S.O. 1979, c. 86, s. 9(1)) and 72(1)(a), (b), (c) and (d).

twenty of the transaction type, that can be placed in the present category.[314] Here we find in dollar terms probably the most important exemptions, the three "private placement" ones.[315] The first exempts distributions to banks, the Crown, municipalities, public boards, and insurance, loan and trust companies.[316] The second exempts distributions to institutions specifically recognized as exempt purchasers by the OSC.[317] The third exempts distributions to institutions or individuals where the purchaser takes securities having an aggregate acquisition cost of 97,000 dollars or more.[318] A closely related exemption covers distributions to vendors of assets of 100,000 dollars or more.[319] Also related is a security-type exemption for " 'short-term' paper in denominations of $50,000 or more."[320] None of the first four is an exemption *eo nomine* from the present American federal scheme's registration statement requirement, although they have a fairly long history in Ontario's regulatory scheme.[321] However, under the American scheme much of their work is done by the exemption for "transactions by an issuer not involving a public offering."[322] In the ALI Code there is an extension of the "limited offering" exception to the definition of a "distribution" for the benefit of transactions with "institutional investors," sales to whom will not count for the purposes of the initial count or the spreading-out limitation.[323] "Institutional investors" are defined as banks, insurance companies and registered investment companies, to which list the SEC may add other institutions by rule.[324]

The Ontario Act makes comparatively minor changes to previous legislation in the definition of the private placement exemptions.[325] One of them

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[314] Classification by rationale is not (as will become apparent) an altogether "clean" exercise: see Iacobucci, *supra* note 303, at 261. The count is based on the number of discrete subparagraphs of the statutory and regulation provisions. It does not include the two exemptions referred to in note 180, *supra*.

[315] On usage here, see note 116, *supra*. On the exemptions' importance, see the reference in note 117, *supra*.

[316] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(a).

[317] *Id.*, s. 71(1)(c).

[318] *Id.*, s. 71(1)(d).

[319] *Id.*, s. 71(1)(l).

[320] This is the characterization in Grover and Baillie, *supra* note 11, at 414, of what is now the exemption in *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)4.

[321] They have all been in the Act since *The Securities Amendment Act, 1971*, S.O. 1971, c. 31, while that in *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(a) has been a prospectus exemption in one form or another since *The Securities Act, 1945*, 1945, S.O. 9 Geo. VI, c. 22, s. 49(7)(a) read with s. 19(c), with one interruption (see S.O. 1947, c. 98, ss. 80 and 46 and S.O. 1948, c. 82, s. 9(1)).

[322] See text accompanying note 116, *supra*.

[323] See note 290, *supra*.

[324] See 1 *ALI Fed. Sec. Code*, *supra* note 6, §202(74) and Cheek, *supra* note 192, at 364.

[325] See Alboini, *supra* note 14, at 433-35, 439-40, 440-52, 471, 516 with 276-77. The major changes appear to be the dropping of the investment intent requirement (after the transitional period) for the private placement exemptions (see text accompanying note 153, *supra*), the addition of "offering memorandum" rules for some of them (see O. Reg. 190/80, s. 7, substituting new s. 20 for O. Reg. 478/79, s. 20) and the change noted in the immediately following text.

appears to represent a bowing to practice, in the extension of the 97,000 dollars purchaser exemption to individuals. This extension however sharpens the question, which is most acute under this exemption, but which also arises under the first of the private placement troika, of the extent to which investor protection is being sacrificed to the facilitation of this type of financing.[326] The possession of 97,000 dollars or more to invest is no guarantee of investment sophistication, let alone access to prospectus quality information or an ability to absorb a loss.[327] This is a question returned to in discussion of the Draft Act.

There could be added to the list of self-fending disponee exemptions:

(1) those for limited offerings (and trades among the original group)[328] and a closely related exemption for distributions of "government incentive securities";[329]
(2) trades with an underwriter;[330]
(3) trades between registered dealers;[331]
(4) trades with and between an issuer's promoters;[332]
(5) trades with and between an issuer's control persons and where the issuer is acquiror;[333]
(6) trades reasonably necessary to facilitate the organization of the issuer;[334]
(7) trades in mortgages or other encumbrances upon realty or personalty if offered for sale by a person registered under the *Mortgage Brokers Act*;[335] and

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[326] See Johnston, *supra* note 52, at 193, which at 192 suggests that a desire to avoid constitutional confrontations may be behind some of those exemptions; see also Iacobucci, *supra* note 303, at 261.

[327] See Grover and Baillie, *supra* note 11, at 415-16, 446 and *Re Shelter Corp.*, [1977] O.S.C.B. 6 at 14. But see also *The Securities Act, 1978*, S.O. 1978, c. 47, ss. 124 and 139.21 (power to deny regulations, on an *ad hoc* or general basis) and O. Reg. 190/80, s. 7, substituting new s. 20 for O. Reg. 478/79, s. 20.

[328] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(p), discussed in the text accompanying notes 163-79, *supra* and O. Reg. 190/80, s. 3(2) substituting new s. 14(e) for O. Reg. 478/79, s. 14(e) as substituted by O. Reg. 667/79, s. 1(2).

[329] O. Reg. 190/80, s. 3(2) adding a new s. 14(g) and s. 4 adding a new s. 15(2) (definition of "government incentive security") to O. Reg. 478/79, discussed in Alboini, *supra* note 14, at 485-86.

[330] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(l)(r), discussed in notes 196-99 and accompanying text, *supra*.

[331] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(q), discussed in Alboini, *supra* note 14, at 486-87.

[332] O. Reg. 667/79, s. 1(1) substituting new s. 14(c) in O. Reg. 478/79, discussed in Buckley, *supra* note 18, at 329-30.

[333] O. Reg. 478/79, s. 14(b).

[334] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(o), discussed in Buckley, *supra* note 18, at 353-54 and Alboini, *supra* note 14, at 474-76.

[335] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)5, discussed in Alboini, *supra* note 14, at 516 and 277-79, who would put this in the 'low risk of loss because otherwise regulated' class, below; but see Grover and Baillie, *supra* note 11, at 414.

(8) trades in securities evidencing indebtedness due under conditioned sale contracts if such securities are not offered for sale to an individual.[336]

The security-type exemption for "securities of a private company where they are not offered for sale to the public" could also be included in this group.[337] But for reasons developed below[338] it is perhaps better dealt with as a member of the "Cost-Benefit" class.

In a different subclass from the above exemptions are those premised on the apparently low risk of loss associated with the security. As one would expect, the exemptions here are of the security type:

(1) debt obligations of, or guaranteed by, any government (provincial, federal or foreign or any political division thereof);
(2) debt obligations of, or guaranteed by, or secured by rates or taxes levied by municipal corporations;
(3) debt obligations of, or guaranteed by, a number of the major international development banks, subject, in the case of some of them, to the filing of any information or other material required by the OSC; and
(4) debt obligations of or guaranteed by banks, loan, trust or insurance companies.[339]

Also to be included are the exemptions for put and call options written, or guaranteed by, a member of a recognized exchange respecting listed securities and in a form prescribed under the Act;[340] certificates or receipts of trust companies for guaranteed investments;[341] variable insurance contracts;[342] and securities of a "mutual fund" administered by a registered trust company and that exists to pool tax savings plans under the *Income Tax Act*.[343]

The low risk of loss presumably stems from the high level of government involvement, whether directly or through regulation, in those issuers.[344] The difficulty with that criterion is that, in some cases, the investor may still be running a considerable risk of loss. Mere government involvement does

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[336] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)6, discussed in Alboini, *supra* note 14, at 516 and 279-80.

[337] See the discussion of the predecessor of *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a), read with s. 34(2)10, in Johnston, *supra* note 52, at 225, 226.

[338] Text accompanying notes 369-74, *infra*.

[339] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)1 and O. Reg. 478/79, s. 18, discussed in Alboini, *supra* note 14, at 515-16 and 272-5. An additional reason for including at least some of these might have been to avoid constitutional confrontations: *cf.* Johnston, *supra* note 52, at 192; Iacobucci, *supra* note 303, at 261.

[340] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(2)(c).

[341] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)2, discussed in Alboini, *supra* note 14, at 516, 275.

[342] O. Reg. 478/79, s. 14(a), discussed in Alboini, *supra* note 14, at 522-23.

[343] O. Reg. 190/80, s. 3(1) substituting new s. 14(d) for O. Reg. 478/79, s. 14(d).

[344] *Cf.* Johnston, *supra* note 52, at 223-4. *Quaere* if this applies to the last exemption, however.

not ensure that information adequate for risk evaluation reaches the investor.[345] This point is also returned to below.[346]

In a still different subclass are those exemptions where investor protection is already present rendering prospectus protection unnecessary. Here we can place most readily the exemptions:

(1) for securities offered in a securities exchange take-over bid covered by the take-over bid scheme of regulation;[347]
(2) for trades in securities exchanged in connection with other statutorily regulated forms of business combination;[348]
(3) trades in rights issues and securities of a reporting issuer held by the issuer and transferred pursuant to the exercise of a previously granted call right, which are both exempt subject to compliance with OSC requirements, which are presently largely informational;[349] and
(4) distributions through the facilities of a recognized stock exchange via a "statement of material facts."[350]

The 1978 Ontario Act also exempts all securities exchanges involved in exempt take-over bids.[351] It may be argued that this is only appropriate to the "private agreement" exemption where the offerees may be expected to have the best informational position vis-à-vis the issuer.[352] Even then this will be far from always the case.[353] A better way to handle the area covered by this class of exempt take-over bid would be through the access/sophisticated purchaser and limited offering types of exemption in the Draft Act already discussed. This is returned to below.[354]

Also includable are some "issuer internal trades";[355] that is, securities, dividends or other distributions from earnings or surplus and securities distributed as incidental to a *bona fide* reorganization of the issuer.[356] To these could be added securities issued or transferred pursuant to the exercise of a

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345 See Grover and Baillie, *supra* note 11, at 411, 412.

346 Text accompanying note 418, *infra*.

347 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(j), discussed in Alboini, *supra*, note 14, at 468-69.

348 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(i), discussed in Alboini, *supra* note 14, at 466-68; and see also Anisman, *Takeover Bid Legislation in Canada* (Don Mills: CCH Canadian, 1974) [hereinafter Anisman (1974)] at 192, 195-96.

349 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(h)(i) and (ii) read with the balance of (h) after (ii), discussed in Alboini, *supra* note 14, at 462-66.

350 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(b), discussed in Alboini, *supra* note 14, at 517-21. Also includable within the present subcategory is the exemption in s. 72(1)(a), read with s. 34(2)8: see note 388, *infra*.

351 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(r), discussed in Alboini, *supra* note 14, at 469-71.

352 See *The Securities Act, 1978*, S.O. 1978, s. 88(2)(c), as am. by S.O. 1979, c. 86, s. 12(1), and *cf.* Anisman (1974), *supra* note 348, at 194-96, 37-44.

353 *Cf.* 2 *Proposals, supra* note 3, at 95, read with 1 *Proposals, supra* note 3, s. 7.19(a)(i).

354 Text following note 429, *infra*.

355 See Johnston, *supra* note 52, at 203-207.

356 *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(f)(i) and (ii) respectively, discussed in Alboini, *supra* note 14, at 454-58.

previously granted right to purchase, convert or exchange;[357] securities of a reporting issuer held by an issuer and distributed as a dividend *in specie*;[358] and equity securities issued pursuant to a plan available to holders of a class of publicly traded securities of the issuer under which dividends or interest can be taken as such equity securities.[359]

2. Exemption Where the Cost of Investor Protection Outweighs The Benefit.

There are fourteen exemptions, seven of the transactional type and seven of the security type, that can be placed in this category.[360] The most obvious exemption is the isolated trade provision, where the amounts at stake are not likely to justify the cost of regulation.[361] However, occasional large distributions have been encountered here:[362] a "cleaner" exemption that would also avoid interpretive difficulties is the "small offering" one contained in both the present American federal scheme and the ALI Code.[363] A related exemption, and one particularly suitable for legislation like the 1978 Ontario Act which closely regulates secondary market trading, is the trading transaction exception to the definition of "distribution" in the ALI Code on which the Draft Act draws.[364]

Also a *de minimis* exemption, but of greater significance, is the security-type exemption for "securities of a private company where they are not offered for sale to the public."[365] "Private company" is defined as Canadian corporate law has defined it: in terms of a maximum number of security holders exclusive of present or former employees, a charter prohibition on offering its securities to the public, and a restriction on the right to transfer its securities.[366] Apart from the question of continuing to use a corporate law concept that is perhaps outmoded for the purpose for which it is used,[367] there is the question of why "public" is not considered to make the exemption unnecessary, at least while the prospectus requirement has the "distri-

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[357] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(f)(iii), discussed in Alboini, *supra* note 14, at 459-60.

[358] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(g), discussed in Alboini, *supra* note 14, at 460-62.

[359] O. Reg. 190/80 adding a new s. 14(f) to O. Reg. 378/79.

[360] Again, note the point made in note 314, *supra*: in particular, there is double counting here to the extent of two trade transactions (see text accompanying note 377, *infra*).

[361] See discussion in the text accompanying notes 158-62, *supra*.

[362] See Grover and Baillie, *supra* note 11, at 417. But *cf.* 2 *Proposals, supra* note 3, at 96-97.

[363] Text following note 436, *infra*, and see also the power to cut back exemptions in *The Securities Act, 1978*, S.O. 1978, c. 47, s. 139.21. See also the (trading transaction) exemption discussed in the text accompanying notes 575-84, *infra*.

[364] See 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(c) and 1 *Proposals, supra* note 3, s. 6.04.

[365] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)10; see also O. Reg. 190/80, s. 6 adding new s. 17a to O. Reg. 478/79. The *"de minimis"* classification is from Buckley, *supra* note 18, at 322-326.

[366] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)31. For a review of the other Canadian legislation, see Chapman, *supra* note 109, at II 12 to II 13.

[367] Grover and Baillie, *supra* note 11, at 413.

bution to the public" rubric.[368] Perhaps the answer lies in a desire to provide reassurance to private companies.[369] If that were the case, the exemption would be better placed in the category for exemptions where investor protection is provided elsewhere. But it is possible that "public" in the exemption does not mean the same as "public" in the old-form prospectus requirement: what caselaw there is appears to stress the "close friends or associates" test over the "need to know" test,[370] and the former seems more appropriate to the notion of a *private* company than the latter. However the caselaw is probably too sparse to provide certainty on the point.[371] In any event, given the uncertainties present, the nature of the issuer (particularly its likely inability readily to afford expensive securities advice[372]) and the apparent significance of small enterprise to a successful modified free enterprise economy,[373] this exemption appears unjustifiably ill-adapted to such companies' needs.[374] One can contrast in this connection the 1978 Ontario Act's exemption for a distribution of securities of a "private mutual fund,"[375] which has no "public" qualifier for recruitment of members, and which can be seen to anticipate the Draft Act's small issuer exemption.[376] Also much better adapted than the "private company" exemption are the ALI Code's and the Draft Act's limited offering provisions detailed above.[377]

The exempted securities described under the heading of "issuer internal trades" are also capable of being placed in this category.[378] In all these cases, one cannot be assured that prospectus quality information is available at the relevant time. This will be so even if the issuer is reporting,[379] though in such cases one would expect the discrepancy to be the smallest.[380] However, at least some of the relevant transactions could be seen to serve useful functions

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[368] Alboini, *supra* note 14, at 288, whose suggested reconciliations are discussed in the next note.

[369] But see Alboini, *id.* at 288, which explains that the exemption focuses on offers, not the completed transaction, and so sales to the public not accompanied by offers to the public would be within the prohibition but also within the exemption. In light of orthodox contract formation theory, this distinction seems impossible to maintain unless a gloss is put on "offered" to confine it to general advertising or promotion, which Alboini seems to favour.

[370] See note 120, *supra.*

[371] *Cf.* Buckley, *supra* note 18, at 331.

[372] *Id.* at 309n. 2.

[373] See the references in note 276, *supra.*

[374] *Accord* Buckley, *supra* note 18, at 342-43, 363.

[375] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)3 and s. 1(1)32 ("private mutual fund"), discussed in Alboini, *supra* note 14, at 275, 17-21, who notes that such funds are however subject to regulation elsewhere, in the "mutual fund" sections of the Act: see ss. 106-17. Note the "public" element in one branch of the definition: see s. 1(1)32i(a).

[376] But see *id.* The "small issuer" exemption in 1 *Proposals, supra* note 3, s. 3.01(e) is discussed in the text accompanying notes 446, 447, *infra.*

[377] Text accompanying notes 258-88, *supra.*

[378] See text accompanying notes 355-60, *supra.*

[379] See text accompanying notes 521 and 524-30, *infra.*

[380] Hence the inclusion of *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(g) in the previous category: see text accompanying note 358, *supra.*

that would be seriously jeopardized by required subjection to the prospectus scheme of regulation.[381]

Related to these issuer internal trades, but even farther from any question of previous acquaintance with the issuer's investment worth, is the exemption for distributions to employees.[382] American caselaw on the non-"public offering" exemptions distinguishes between employees with and employees without a "need to know."[383] The Ontario exemption opts for removing the new issue qualification impediment to employee stock ownership.[384]

There is a group of exemptions designed to facilitate the financing of prospecting activities and the acquisition of mining claims for securities.[385] All but one[386] are subject to special requirements regarding the nature of the arrangement under which the relevant activity is organized. In one case there is a restriction on offering the securities for sale to the "public" and on selling the relevant securities to more than fifty persons or companies.[387] This constitutes cogent evidence of the importance of mineral prospecting in Ontario's economy.[388]

There is also a group of exemptions covering securities of issuers organized exclusively for educational, benevolent, fraternal, charitable, religious or recreational purposes;[389] securities of corporations formed under *The Co-operative Corporations Act, 1973*;[390] and shares issued by a credit union within the meaning of *The Credit Unions and Caisses Populaires Act, 1976*.[391] There is also an exemption to allow for the fact that the 1978 Act regulates some "commodity futures contracts" or "commodity futures

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[381] See Johnston, *supra* note 52, at 204 on the stock dividend exemption referred to in the text accompanying note 356, *supra*; on the "reorganization" exemption there referred to, *cf. R.* v. *Santiago Mines*, [1946] 3 W.W.R. 129 (B.C.C.A.), discussed in Alboini, *supra* note 14, at 458; and note the change in the conversion exemption referred to in the text accompanying note 357, *supra*, discussed in Alboini, *op. cit.*, at 459.

[382] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(n), discussed in Alboini, *id.* at 473-74.

[383] Alboini, *id.* at 373-74.

[384] Johnston, *supra* note 52, at 203 (on predecessor legislation).

[385] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)11, 12 and 13 (both read with Part XIII of the Act) and s. 71(1)(m), discussed in Alboini, *supra* note 14, at 302, 339-46, 471-72.

[386] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 34(2)11.

[387] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 34(2)13.

[388] See also Kalymon *et al., Financing of the Junior Mining Company in Ontario* (Toronto: Ministry of Natural Resources, 1978), 2 vols.

[389] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)7, discussed in Alboini, *supra* note 14, at 517, 280-82.

[390] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)8, discussed in Alboini, *id.* at 516, 282-83, who would apparently treat this as an "otherwise regulated through disclosure" exemption (see text folowing note 346, *supra*); and see Grover and Baillie, *supra* note 11, at 412n. 261. But see Johnston, *supra* note 52, at 224-25.

[391] S.O. 1976 (2d Sess.), c. 62. The exemption is in *The Securities Act, 1978*, S.O. 1978, c. 47, s. 72(1)(a) read with s. 34(2)9, discussed in Alboini, *id.* at 516 and 283-84, who would appear to treat this as an "otherwise regulated so as to reduce risk of loss" exemption (see text following note 338, *supra*); Johnston, *id.* at 225.

options"; distribution of those by a "hedger" through a dealer is covered.[392]

Finally, there are two exemptions tailored to the 1978 Act's coverage of control persons and designed to avoid undue constraints on their liquidity for dealings in the ordinary course of business. One of these covers the common incident of loans to corporations with control blocks, the hypothecation or other taking of security over the control block security holding.[393] The other permits ordinary trading transactions in control block securities of reporting issuers.[394]

3. Adding to, Subtracting From the Exemptions.

Mention has already been made of the desirability in a closed system, of a regulatory power to add to the list of exemptions. This seems desirable even in a closed system with as rich a pattern of exemptions as Ontario's. Such a power in fact exists in the Ontario scheme.[395] Also desirable is a power to allow for exceptional cases through an *ad hoc* exemption, that allows the administrative agency a window on the working of the complex set of exemptions. The OSC has that power as well, in a provision that has recently been amended so as to amplify the power conferred.[396]

A power to deny exemptions seems valuable to control abuse.[397] The OSC has that power also.[398] Further, as a result of the changes brought by the 1978 legislation, regulations may be made to cut back distribution[399]

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[392] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(s) read with s. 1(1)40 xvi, discussed in Alboini, *id.* at 489 and Ont., *Report of the Interministerial Committee on Commodity Futures Trading* (Bray Report), (Toronto: Ministry of Consumer and Commercial Relations, 1975) at 21-22, 82, 84.

[393] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(1)(e), discussed in Alboini, *id.* at 452-53, 508; and see Grover and Ross, *Materials on Corporate Finance* (Toronto: De Boo, 1975) at 197-200.

[394] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(7), as am. by S.O. 1979, c. 86, s. 9(2) (which however does not come into force until the expiry of the transitional period: see s. 143(1)), discussed in Alboini, *id.* at 505-12, 512-13; and see the discussion of the predecessor legislation in Grover and Baillie, *supra* note 11, at 416-17. This exemption is returned to in the text accompanying notes 543-45, *infra*.

[395] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 139.20; see also s. 72(1)(d), the necessity for which is not apparent. This power was, under the preceding legislation comparatively little exercised; but see now O. Reg. 478/79, s. 14 as am. by O. Reg. 667/79, s. 1 and O. Reg. 190/80, ss. 3 and 4.

[396] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 73(1) as substituted by S.O. 1979, c. 86, s. 10. The change was to remedy the failure of the former s. 73 to allow the OSC to make retroactive rulings; see also, s. 139.34, discussed in Alboini, *supra* note 14, at 958-59, which has not however been implemented to give the OSC exempting power in this area.

[397] For an excellent discussion of uses of and problems with such a power, see Baillie and Alboini, *The National Sea Decision—Exploring the Parameters of Administrative Discretion* (1978), 2 Can. Bus. L.J. 454; and see Alboini, *id.* at 843-50.

[398] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 124.

[399] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 139.21, discussed in Alboini, *supra* note 14, at 957, which has been exercised in O. Reg. 478/79, ss. 18-20, as am. by O. Reg. 190/80, s. 7; *quaere* if this authority, or any other, warrants O. Reg. 478/79, s. 17 substituted by O. Reg. 667/79, s. 3. It appears to have been thought that, under the *Securities Act*, S.O. 1970, c. 426, s. 58(1), read with s. 147(o), sufficient authority existed to modify at least some prospectus exemptions: Dey (1972), *supra* note 106, at 147-48.

exemptions. It is arguable that such a general power to pass regulations is also desirable, provided that the regulation-making process affords those interested an opportunity to intervene to present their views and ensure the agency pays attention to the adverse effect of regulation.[400]

C. *Proposed Legislation: The Draft Act*

1. Exemptions Where Investor Protection May be Seen to be Provided Otherwise.

The pattern of exemptions in the Draft Act, so far as it affects the new issue regulation scheme, is very similar in structure (with its division between transactional and security-type exemptions[401]) and content to the 1978 Ontario scheme. It borrows extensively but not without modification, from that scheme; it has also drawn on the Code's contributions in the area, including the limited offering exemption.[402]

In the Draft Act there are twenty-four exemptions, six of the security type and eighteen of the transactional type, that can be placed in the present category if the limited offering one is included.[403] However, it is now plain that this is probably a miscategorization of that exemption.

The private placement exemptions, for distributions to listed types of institutional purchaser,[404] specially recognized exempt purchasers[405] and 97,000 dollar purchasers,[406] appear here as well as an exemption for "short term" paper above a minimum denomination.[407] There is no separate exemption for a sale of securities for assets worth 100,000 dollars or more; it is apparently to be covered by the 97,000 dollar purchaser exemption.[408] Comparatively minor changes are made to the Ontario precedent for institutional investors and for "short term" paper. However, a major set of changes is made for 97,000 dollar purchasers: they are subject to the numerical, offer-

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400 See on this following notes 637, 642, *infra.*

401 1 *Proposals, supra* note 3, ss. 3.01, 3.02 and 6.01-6.05.

402 Text following note 258, *supra.*

403 This illustrates the difficulty of categorization that arises here as it did under the Ontario legislation (see, *e.g.*, note 390, *supra*); and see 2 *Proposals, supra* note 3, at 92. The count here is not exactly comparable with the corresponding Ontario one, since some exemptions which are separated in the Ontario legislation are united in the *Proposals* and *vice versa.* But the count is a first approximation for the purposes of comparison.

404 1 *Proposals, supra* note 3, s. 6.02(1)(a)-(c), (e), (f), discussed in 2 *Proposals, supra* note 3, at 97-98. The inclusion of an exemption for distributions to "registered securities advisers" in s. 6.02(d), which is not in the Ontario scheme, is justified in 2 *Proposals, op. cit.*, at 98.

405 1 *Proposals, supra* note 3, s. 6.02(i)(g), discussed (by inclusion) in 2 *Proposals, supra* note 3, at 97-98.

406 1 *Proposals,* supra note 3, s. 6.02(2), read with s. 6.02(3) (a), discussed in 2 *Proposals, supra* note 3, at 98-100.

407 1 *Proposals, supra* note 3, s. 3.01(a), discussed in 2 *Proposals, supra* note 3, at 47-48.

408 See 1 *Proposals, supra* note 3, s. 6.02(3)(a) read with s. 2.32 ("purchase"); and *cf.* Alboini, *supra* note 14, at 442.

ing mode, reporting and resale regulation of the access-sophisticated purchasers exemption under the Draft Act.[409] In terms of the investor protection difficulties with the 97,000 dollar purchaser exemption in the 1978 Ontario Act, these limitations make sense if the separate exemption is not to be done away with completely.[410] Although some similar constraints were also recommended for the institutional purchaser exemptions in a Draft Act background paper,[411] a sufficient distinction between the two cases appears to exist to justify the Draft Act's position.[412]

It appears that the Draft Act's limited offering exemption[413] will do the work of the 1978 Act's exemptions for trades with and between promoters and control persons, and for trades with the issuer and organization trades exemptions, since these do not separately appear. This is similar to the apparent position under the ALI Code.[414] There are exemptions for trades to underwriters[415] and between registrants[416] similar to those in the 1978 Ontario Act. Finally there are modified versions of the Ontario legislation's exemptions for mortgages or other encumbrances[417] and for evidences of indebtedness under conditional sale contracts.[418]

Like the 1978 Ontario Act, the Draft Act has exemptions rated on the low risk character of the relevant security; but unlike the 1978 Ontario Act, greater attention is paid to the question of the adequacy of disclosure to investors. Thus, virtually all the Ontario exemptions are to be found in the Draft Act in some form.[419] Particularly noteworthy for their deletion[420]

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[409] The access-sophisticated purchaser exemption is discussed in the text accompanying notes 289-96, *supra.*

[410] See 2 *Proposals, supra* note 3, at 98.

[411] Grover and Baillie, *supra* note 11, at 439.

[412] See 2 *Proposals, supra* note 3, at 97-98.

[413] Text following note 258, *supra.* Both that exemption and the access-sophisticated purchaser one (see text accompanying notes 289-96, *supra*) could cover much of the ground represented by the "government incentive security" exemption in the text accompanying note 329, *supra.*

[414] *Cf.* Painter, *supra* note 9, at 13 *et seq.* (limited offering transaction exemption replaces non-public offering one).

[415] 1 *Proposals, supra* note 3, s. 6.01(b), discussed in 2 *Proposals, supra* note 3, at 93.

[416] 1 *Proposals, id.*, s. 6.01(a), discussed in 2 *Proposals, id.* at 93. See also the "registered adviser" exemption referred to in note 404, *supra.*

[417] 1 *Proposals, id.*, s. 3.01(d), discussed in 2 *Proposals, id.* at 48-49.

[418] 1 *Proposals, id.*, s. 3.01(b), discussed in 2 *Proposals, id.* at 48.

[419] 1 *Proposals, id.*, s. 3.02(a)-(d). See also s. 3.01(c), discussed in 2 *Proposals, id.* at 49.

[420] Also deleted is the trust company guaranteed investment certificate exemption (see text accompanying note 341, *supra*); and the variable insurance contract exemption (text accompanying note 342, *supra*); but see 1 *Proposals, id.*, s. 3.02(c) (in effect, exemption available if adequate disclosure available *aliunde*) and Grover and Baillie, *supra* note 11, at 412, which would indicate that this is a better way to handle the exemption. The other deletion is the put and call options one (see text accompanying note 338 *supra*), which is expected to be dealt with by regulation: see 2 *Proposals, id.* at 55-56; and see Grover and Baillie, *supra* note 11, at 418.

are securities of foreign governments;[421] these have traditionally been the subject of disclosure requirements in the United States, a position the ALI Code will not change.[422] Also, securities of banks and other financial institutions, including a number not included in the Ontario legislation, are exempt subject to the condition that they are regulated by a federal or provincial government agency, "that requires substantially similar disclosure by the institution in connection with a distribution and on a continuing basis to that required of an issuer under this Act."[423] There is also a useful provision that permits the CSC to relieve the interpretive uncertainty engendered by this through "[*ad hoc*] order" or "regulation" specifying an Act as requiring this level of disclosure.[424]

The Draft Act also has exemptions for situations where disclosure is already compelled for investor protection which parallel those in the 1978 Ontario Act. Thus, there are exemptions for securities exchange take-over bids[425] and other statutorily regulated forms of business combination,[426] and the information-contingent rights issue exemption.[427] There is also a Draft Act exemption that deals with distributions through the facilities of a stock exchange via a statement of material facts.[428] The exemptions grouped under "issuer internal trades" in this category for the Ontario Act are returned to below.[429]

The Draft Act does not allow an exemption for exempt take-over bids, as the 1978 Ontario Act does, for sound reasons.[430] Much of the ground covered by the exempt take-over bids will in any event be covered by the limited offering and access/sophisticated purchaser exemptions[431] and the trading transaction exemption.[432]

2. Exemptions Where the Cost of Protection May be Seen to Outweigh the Benefits.

There are nine exemptions, six of the transactional type and three of

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421 2 *Proposals, id.* at 51.

422 See Grover and Baillie, *supra* note 11, at 411.

423 1 *Proposals, supra* note 3, s. 3.02(1)(c) concluding words, discussed in 2 *Proposals, supra* note 3, at 52-53.

424 1 *Proposals, id.*, s. 3.02(3), discussed in 2 *Proposals, id.* at 52. See also 1 *Proposals*, ss. 2.27 ("order") and 2.37 ("regulation").

425 1 *Proposals, id.*, s. 6.01(f), discussed in 2 *Proposals, id.* at 94-95.

426 1 *Proposals, id.*, s. 6.01 (e), discussed in 2 *Proposals, id.* at 94-95.

427 1 *Proposals, id.*, s. 6.01(d), discussed in 2 *Proposals, id.* at 94. The exemptions for conversion into securities of a reporting issuer's own issue in the corresponding Ontario provision (see text accompanying note 349, *supra*) is apparently covered in 1 *Proposals*, s. 6.01(c)(iii), which is returned to in note 449, *infra*.

428 1 *Proposals, id.*, s. 5.14, discussed in 2 *Proposals, id.* at 88-89.

429 See note 449 and accompanying text, *infra*.

430 See text accompanying notes 351-54, *supra* and 2 *Proposals, supra* note 3, at 95.

431 See text accompanying notes 258-84 and 289-99, respectively, *supra*, a position which seems justifiable for the reasons given in the text accompanying notes 351-53, *supra*.

432 See text accompanying notes 575-84, *infra*.

the security type that under the Draft Act can be placed in this category.[433] There is an isolated trade transaction exemption[434] that parallels the 1978 Ontario Act.[435] Although no quantity limits are placed on the transaction under the exemption, the CSC has a regulation-making power similar to that of the OSC that would enable it to cut back the exemptions' scope if it seemed appropriate.[436] There is no small offering exemption here of the type in the ALI Code and the present American federal scheme, which exempts offerings up to 100,000 dollars.[437] The exemption in those instances is seen to serve a valuable function by supplementing the limited offering and the local distribution exemptions so as to facilitate the raising of equity by small business.[438] The SEC has a power to modify or withdraw the exemption in cases of offerings no smaller than 50,000 dollars.[439] The Draft Act appears to reject this exemption on the basis expressed in one of its background papers:[440] that the matter is better dealt with through an adjustment in the burden of prospectus disclosure.[441] Such is the practice under the American federal scheme for so-called Regulation A offerings up to 500,000 dollars.[442] While no special provision is made for these in the ALI Code, it is anticipated that they will be covered by SEC regulation under the Code.[443] The fact that there is a distinct exemption for offerings of less than 100,000 dollars suggests that a better reason for non-inclusion should have been forthcoming.[444] In light of the co-existence with the Draft Act of residual provincial protection and the presence in the Draft Act of substantial anti-fraud provisions the Draft Act position is even harder to understand.[445]

There is a further *de minimis* exemption in the Draft Act that corresponds to the 1978 Ontario Act's "private company" provision though it is shorn of its difficulties for small companies.[446] This is the exemption for

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[433] Again, the categorization is not altogether "clean"; see, *e.g.*, the text accompanying note 452, *infra* and the reference in notes 390, 391, *supra*. With respect to the comparability of this "count" with the same one under the 1978 Ontario Act, see note 403, *supra*.

[434] 1 *Proposals, supra* note 3, s. 6.01(h), discussed in 2 *Proposals, supra* note 3, at 96-97, where the problem raised in the text accompanying note 362, *supra*, is addressed.

[435] Text accompanying notes 159-62, *supra*.

[436] See text accompanying note 461, *infra*; but see also 2 *Proposals, supra* note 3, at 96-97 (which might suggest an interpretive escape).

[437] 1 *ALI Fed. Sec. Code, supra* note 6, §512(5), discussed in Cheek, *supra* note 192, at 398-99 (referring to 17 C.F.R. §230.240 (1979)).

[438] See Cheek, *id.*

[439] 1 *ALI Fed. Sec. Code, supra* note 6, §512(5)(ii), discussed in §512(5), Comment (1)(d).

[440] Grover and Baillie, *supra* note 11, at 453.

[441] Or through exemption by regulation: *cf.* 2 *Proposals, supra* note 3, at 97.

[442] See Cheek, *supra* note 192, at 398 and 17 C.F.R. §230.254(a)(i) (1979).

[443] *Id.* at 399; Painter, *supra* note 9, at 31.

[444] *Cf.* 1 *ALI Fed. Sec. Code, supra* note 6, §512(5), Comment (1)(d).

[445] *Cf.* Cheek, *supra* note 192, at 399. The matter of residual protections is returned to in section 5d of the text, *infra*. The existence of the provincial control factor would militate against the adoption of the exemption at the provincial level, of course.

[446] See for those difficulties text following note 366, *supra*.

trading in securities of an issuer other than a reporting issuer with less than fifty security holders, including employees.[447] Perhaps the limited offering exemption, discussed above,[448] is best suited to this category as well.

The Draft Act also exempts most of the types of issuer internal trades that the 1978 Ontario Act does, with generally little change from the Ontario model.[449]

The Draft Act, as does the 1978 Ontario Act, exempts distributions to an issuer's employees while usefully adding a limitation on sales pressures in connection with such distributions.[450]

The Draft Act also exempts, as the 1978 Ontario Act does, distributions of securities of issuers organized exclusively for educational, benevolent, fraternal, charitable, religious or recreational purposes;[451] and equity securities of co-operative corporations, and of credit unions.[452]

The Draft Act allows for ordinary course resales by control persons of reporting issuers under its trading transaction exemption.[453] It appears to allow for giving security over control block securities through its isolated trade, limited offering or institutional purchaser exemption although the omission of the 1978 Act's explicit "control block" exemption is not adequately explained.[454]

Also omitted from the Draft Act are hedgers' sales through dealers of commodities options and commodities futures contracts, and the prospecting and mineral claim exemptions in the 1978 Ontario Act. The reason for omitting the latter is the presumption that most "genuinely entitled" to the exemption will be covered by the local distribution exemption returned to below;[455] to the extent they are not, they will feel the full weight of the

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[447] 1 *Proposals, supra* note 3, s. 3.01(e), discussed in 2 *Proposals, supra* note 3, at 49-50, which justifies it on the basis that issuers here are likely "to be local in relation to the securities market" and not to require federal regulation. This appears to be the only point in relation to the exemptions where there is a suggestion of reliance on provincial securities laws; and "reliance" may put the matter too strongly: contrast Cheek, *supra* note 192, at 362n. 26; but see Buckley, *supra* note 18, at 365.

[448] Text accompanying notes 258-84, *supra*.

[449] See 1 *Proposals, supra* note 3, s. 6.01(c), discussed in 2 *Proposals, supra* note 3, at 93-94. Despite the "Sources" note to s. 6.01, there does not appear to be an equivalent to the Ontario exemption described in the text accompanying note 358, *supra*. The exemption described in the text accompanying note 359, *supra* is also not reproduced (although it probably post-dated the *Proposals*): *quaere* if 1 *Proposals*, s. 6.01(c)(iii) does its work.

[450] 1 *Proposals, id.*, s. 6.01(g), discussed in 2 *Proposals, id.* at 95-96.

[451] 1 *Proposals, id.*, s. 3.02(1)(e), discussed in 2 *Proposals, id.* at 54.

[452] 1 *Proposals, id.*, s. 3.02(1)(f), discussed in 2 *Proposals, id.* at 54-55, which explains why the exemption is confined to *equity* securities.

[453] Discussed in the text following note 573, *infra*.

[454] Grover and Baillie, *supra* note 11, at 454 do not discuss it in detail because they eliminate "control-block" distribution in their proposed scheme of regulation. But see 2 *Proposals, supra* note 3, at 97 (use of exemption-by-regulation power) and 140.

[455] 2 *Proposals, id.* at 55. The "local distribution" exemption is returned to in the text accompanying notes 622-28, *infra*.

statute, relieved perhaps by regulations specially tailoring the disclosure requirements to them.[456] This seems an appropriate position. The former omission is apparently intended not to suggest the coverage of the hedger's transaction, but rather to leave the matter to a determination whether the instrument as so traded was a "security."[457] Only if it has the necessary investment character will the transaction be caught, in which case an exemption by regulation may be appropriate.[458]

3. Adding to, Subtracting from the Exemptions.

As in the 1978 Ontario scheme there is conferred on the CSC a power by regulation to add to the exemptions and by decision to create *ad hoc* ones.[459] In regard to the latter power here is a useful reminder to the CSC to consider whether the "cost of providing a prospectus outweighs the resulting protection to investors."[460]

As in the 1978 Ontario scheme, there is a power to deny an exemption by decision or by regulation.[461] The latter power is subject to a number of controls unique to the Draft Act.[462] In addition, a number of the exemptions, including in particular the limited offering one,[463] have built into them a power to vary their terms by regulation, which is subject to the controls. These powers appear to be useful adjuncts to administrative control in this area.

D. *Residual Protection: Present and Proposed Legislation*

The 1978 Ontario Act draws heavily on its predecessor statutes in its attitude towards residual investor protection where an exemption applies. For the most part, transactions that fit within the exemptions scheme above are considered to merit no other form of protection than the Act's miscellaneous trading controls and the supervisory powers vested in the OSC.[464] It is true that some of the exemptions are conditioned on alternative disclosure and sometimes civil liability cover being provided.[465] However, most

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[456] See 1 *Proposals, supra* note 3, ss. 5.05 and 15.14(1)(a); and *cf.* Grover and Baillie, *supra* note 11, at 413-14.

[457] 2 *Proposals, supra* note 3, at 36.

[458] *Cf.* 2 *Proposals, id.* at 97 and references in note 392, *supra.*

[459] 1 *Proposals, supra* note 3, ss. 3.03 (general power: by "order" and "regulation") and 6.01(a) (distributions: by "order"), discussed in 2 *Proposals, id.* at 56-57, 97.

[460] 1 *Proposals, id.*, s. 6.01(i), discussed in 2 *Proposals, id.* at 97.

[461] 1 *Proposals, id.*, s. 3.04, discussed in 2 *Proposals, id.* at 57-58.

[462] See text following note 637, *infra.*

[463] See note 281 and accompanying text, *supra.* See also text accompanying note 577, *infra.*

[464] See *The Securities Act, 1978*, S.O. 1978, c. 47, Part XII (trading rules: most are confined to situations involving registered persons, on the involvement of which here see note 467 and accompanying text, *infra*); and ss. 122-24 (OSC supervisory powers). See also s. 139.21 (denial of exemptions by regulation) and Part VI (Investigations).

[465] See, *e.g., The Ontario Securities Act, 1978*, S.O. 1978, c. 47, ss. 71(1)(h) (alternative disclosure: see text accompanying note 349, *supra*) and 71(1)(d) read with O. Reg. 190/80, s. 7 substituting new s. 20 for O. Reg. 478/79, s. 20 (civil liability cover).

of them are also, for the most part with few changes, exemptions from the other main scheme of regulation in the 1978 Ontario Act: the trader licensing requirement.[466] The effect of this is not to compel the involvement of a registrant licensed by the OSC, which is required in the case of transactions without matching prospectus and licensing exemptions.[467] The involvement of an OSC-licensed professional, even if as agent for the seller, is seen to serve valuable investor protection purposes. Those purposes are that securities market professionals are honest, competent and financially stable, so as to reduce investor losses through market manipulation, inappropriate investments and loss of funds or securities on deposit with a professional.[468] As a practical matter, however, given the wide coverage of the securities industry by the 1978 Act, involvement of a registrant in some, but not all, trading covered by the exemptions is to be expected.[469]

The Draft Act takes a quite different and much sounder approach overall to the question of residual protection. There is what amounts to an acknowledgement in the exemptions that the reasons that activate the prospectus requirement and its scheme of exemptions will not always coincide with the reasons for requiring the licensing of securities market professionals.

The Draft Act follows the present American federal Act[470] and the ALI Code[471] in only requiring those who carry on a business of trading (instead of trading *simpliciter* as under the 1978 Ontario Act[472]), to register, with the exception of a licensing requirement for those who "act as an underwriter."[473] For this confinement in the scope of the licensing requirement there is a much reduced network of exemptions, reflecting the recommendations of the background paper on licensing prepared for the *Proposals*.[474] The federal and provincial governments, municipal corporations and public boards are exempt from the new licensing requirement.[475] So are those whose business or underwriting is confined to:

(1) "short term" minimum denomination paper;[476]

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[466] See Alboini, *supra* note 14, at 430-32.

[467] This compulsion comes about from the width of the licensing requirement in *The Securities Act, 1978*, S.O. 1978, c. 47, s. 24 read with s. 1(1)42 ("trade") (see Connelly (1978), *supra* note 11, at 1276-78) and the licensing-only exemption in s. 34(1)10 (trading through a registrant) (see Alboini, *id.* at 264-65).

[468] Connelly (1978), *id.* at 1273-74.

[469] *Cf. Re Part XV of the By-Laws of The Toronto Stock Exchange*, [1976] O.S.C.B. 289 at 307-11 (diversified character of business of TSE member firms).

[470] *The Securities Act of 1934*, §15(a), 15 U.S.C. §78o (1976) and 15 U.S.C.A. §78o (1979).

[471] 1 *ALI Fed. Sec. Code, supra* note 6, §702(a).

[472] See note 467, *supra*.

[473] The business must be interprovincial: see 1 *Proposals, supra* note 3, s. 8.07. On the "underwriter," see 1 *Proposals*, s. 8.01(1), discussed in 2 *Proposals, supra* note 3, at 131, which is partly contradicted at 41. For the meaning of "underwriter," see text accompanying notes 231-33 and of note 233, *supra*.

[474] Connelly (1978), *supra* note 11, at 1278 *et seq.* and see 2 *Proposals, id.* at 138.

[475] 1 *Proposals, id.*, s. 8.06(1)(a)-(c), discussed in 2 *Proposals, id.* at 139.

[476] 1 *Proposals, id.*, s. 8.06(2)(a) read with s. 3.01(a), discussed in 2 *Proposals, id.* at 139.

(2) mercantile or consumer transaction paper;[477]
(3) receipts or trust certificates issued by certain deposit-taking institutions;[478]
(4) certain mortgages or other encumbrances on realty or personality;[479]
(5) securities issued by a mutual fund;[480]
(6) sales to institutional purchasers;[481] and
(7) sales for a secured creditor realizing on his collateral.[482]

There are exemptions for:

(1) carrying on business as a broker[483] or dealer,[484] but not for acting as an underwriter;
(2) trading by official parties such as executors, authorized trustees in bankruptcy and receivers;[485]
(3) a bank's or trust company's execution of unsolicited orders through a "registrant";[486]
(4) a trade for its own account or an account held in trust by it by a bank, insurance, trust or loan corporation, a mutual fund or any other financial institution;[487]
(5) trading by a person for his own account solely with or through a registrant.[488]

Also there is an exemption from the requirement to register for carrying on a business as an adviser in certain circumstances which parallels the matching adviser exemptions in the 1978 Ontario Act.[489] The resulting coverage of the licensing requirement will ensure a greater likelihood than under the 1978 Ontario Act that a registrant will be involved in a transaction exempt from distribution regulation in circumstances where this seems appropriate in light of the objectives of licensing.[490]

Of greater significance than the involvement of a licensee as residual protection in disclosure exempt transactions under the present American

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[477] 1 *Proposals, id.*, s. 8.06(2)(a) read with s. 3.01(b), discussed in 2 *Proposals, id.* at 139.

[478] 1 *Proposals, id.*, s. 8.06(2)(a) read with s. 3.01(c), discussed in 2 *Proposals, id.* at 139.

[479] 1 *Proposals, id.*, s. 8.06(2)(a) read with s. 3.01(d), discussed in 2 *Proposals, id.* at 139.

[480] 1 *Proposals, id.*, s. 8.06(2)(b) read with s. 2.25 ("mutual fund"), discussed in 2 *Proposals, id.* at 140.

[481] 1 *Proposals, id.*, s. 8.06(2)(c) read with s. 6.02(1), discussed in 2 *Proposals, id.* at 140.

[482] 1 *Proposals, id.*, s. 8.06(2)(d), discussed in 2 *Proposals, id.* at 140.

[483] Defined in 1 *Proposals, id.*, s. 2.07.

[484] Defined in 1 *Proposals, id.*, s. 2.14.

[485] 1 *Proposals, id.*, s. 8.06(3)(a), discussed in 2 *Proposals, id.* at 140.

[486] 1 *Proposals, id.*, s. 8.06(3)(b), discussed in 2 *Proposals, id.* at 140. "Registrant" is defined in 1 *Proposals*, s. 2.35.

[487] 1 *Proposals, id.*, s. 8.06(2)(c), discussed in 2 *Proposals, id.* at 140-41.

[488] 1 *Proposals, id.*, s. 8.06(3)(d), discussed in 2 *Proposals, id.* at 141.

[489] 1 *Proposals, id.*, s. 8.06(4)(a)-(c), discussed in 2 *Proposals, id.* at 141-42.

[490] See 2 *Proposals, id.* at 138-42 and Connelly (1978), *supra* note 11, at 1273-74, 1279-92.

federal scheme and under the ALI Code is the scheme of anti-fraud protections in the American legislation.[491] The protections consist of a network of provisions that prohibits manipulation and deception in connection with securities trading giving rise to the possibility of criminal, administrative and civil sanctions.[492] These prohibitions are seen to go considerably beyond what common law protections exist in the area.[493] Generally speaking, they have no equivalents in the residual protection area presently relevant in the 1978 Ontario Act. What protection there is largely derives from the *Criminal Code*, OSC administrative proceedings and the common law.[494]

As with the treatment of licensing, the Draft Act on this point appears to draw more on the American example than does the 1978 Ontario Act. In particular, a broad prohibition in the Draft Act on engaging in deception or misrepresentation[495] appears to partake more of the SEC's rule 10b-5[496] prohibition to a similar effect made under the *Securities Exchange Act of 1934* and that prohibition's ALI Code derivative,[497] than of the 1978 Ontario Act or *Criminal Code* provisions which cover some of the same ground.[498] Also, there is a specific power vested in the CSC to make regulations defining and prohibiting manipulation in connection with a distribution[499] which owes much to rule 10b-5's parent provision in the *Securities Exchange Act of 1934*.[500] Backing up these provisions and others in the "Fraud and Manipulation" Part (12) of the Draft Act are investigative[501] powers and the possibility of administrative[502] as well as criminal[503] sanctions. Finally, there is a much more extensive network of express statutory

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[491] See Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?* (1967), 18 W. Res. L. Rev. 367 [hereinafter Coffey] at 371 (present scheme); Cheek, *supra* note 192, at 356-57 and Painter, *supra* note 9, at 11 (Code).

[492] See Coffey, *id.* at 371 (present law); 1 *ALI Fed. Sec. Code, supra* note 6, at xliii-lv, and 2 *ALI Fed. Sec. Code, supra* note 6, Parts XVI-XVIII (Code and present law).

[493] See Coffey, *id.*; 1 *ALI Fed. Sec. Code, id.* at xlvi-liii.

[494] See on the *Criminal Code*, Leigh, "Securities Regulation: Problems in Relation to Sanctions" (1978), in 3 *Proposals, supra* note 1, [hereinafter Leigh] at 514-31; on the OSC's major supervisory powers, Johnston, *supra* note 52, at 358-60 and Alboini, *supra* note 14, at 824-50. The major common law protections appear to be the fiduciary duties (see, *e.g.*, *Laskin* v. *Bache*, [1972] 2 O.R. 465, 23 D.L.R. (3d) 385 (C.A.); and negligent (and fraudulent) mis-statement (see, *e.g.*, *Culling* v. *Sansai Securities* (1974), 45 D.L.R. (3d) 456, [1974] 3 W.W.R. 686 (B.C.S.C.)).

[495] 1 *Proposals, supra* note 3, s. 12.01, discussed in 2 *Proposals, supra* note 3, at 216-18.

[496] 17 C.F.R. §240.10 b-5 (1979).

[497] 2 *ALI Fed. Sec. Code, supra* note 6, §1602(a).

[498] See the references in 1 *Proposals, supra* note 3, s. 12.01, "Sources."

[499] 1 *Proposals, supra* note 3, s. 12.11(a), discussed in 2 *Proposals, supra* note 3, at 233.

[500] *The Securities Exchange Act of 1934*, §10(b), 15 U.S.C. §78j(b) (1976).

[501] 1 *Proposals, supra* note 3, ss. 14.01-14.03, discussed in 2 *Proposals, supra* note 3, at 303-10.

[502] 1 *Proposals, id.*, ss. 14.04, 14.05, and 3.04, discussed in 2 *Proposals, id.* at 311-14, 314-17, 57-58, respectively.

[503] 1 *Proposals, id.*, ss. 14.10, 14.11, discussed in 2 *Proposals, id.* at 325-28.

civil liability rules,[504] including one of great interest in connection with the anti-fraud prohibitions. This is a provision in the Draft Act,[505] following one in the ALI Code,[506] that in turn draws on experience under the present American federal scheme.[507] The provision encourages courts to take a more expansive attitude toward implying civil liability for breaches of the statute, regulations or by-laws of self-regulatory organizations than they have traditionally done.[508] This is of particular interest in light of the significance that implied civil liability of that sort has come to assume in the United States.[509]

A final item of residual protection referred to in the United States[510]—but not generally speaking in the Commentary or background material to the Draft Act's exemptions[511]—is that deriving from the application of state securities laws, to fill in gaps in federal coverage. This is particularly mentioned in conjunction with the ALI Code's limited offering exemption.[512] While the purpose and operation of that exemption are commendable,[513] it may be argued that the continued application of state (or provincial) law could seriously impair its value.[514] Generally speaking, none of these Draft Act exemptions seems dependent on co-existing broader provincial regulation.[515] The matter of co-existence of the proposed federal with the provincial schemes is returned to below.[516]

VI. THE IMPACT OF CONTINUOUS DISCLOSURE ON PROSPECTUS DISCLOSURE

A. *Introduction*

The upgrading of continuous disclosure requirements in securities regulation in both the United States and Canada[517] raises the question of the

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[504] 1 *Proposals, id.*, Part 13; and see 2 *Proposals, id.* at 235-38.

[505] 1 *Proposals, id.*, s. 13.16, discussed in 2 *Proposals, id.* at 272-77.

[506] 2 *ALI Fed. Sec. Code, supra* note 6, §1722(a).

[507] See 2 *ALI Fed. Sec. Code, supra* note 6, §1722(a), Comment (1)-(3).

[508] See 2 *Proposals, supra* note 3, at 273, 274 and Leigh, *supra* 494, at 553-61.

[509] See, *e.g.*, Jennings and Marsh, *supra* note 7, c. 17. This does not suggest, and the *Proposals* do not suggest, that such civil liability will assume the same significance in Canada: our courts may be expected to be more conservative in their use of the Draft Act power than American Courts in their use of the ALI Code one.

[510] See, *e.g.*, Cheek, *supra* note 192, at 357, 362n. 26.

[511] See 2 *Proposals, supra* note 3, Parts 3 (but see also at 49, as to which see note 447, *supra*), 6; Iacobucci, *supra* note 303, at 347; Grover and Baillie, *supra* note 11, at 410-23, 444-55. The reason for the Canadian position appears to be a concern to provide a self-contained scheme of regulation: see references in note 515, *infra*. The exemption for intraprovincial transactions is a different matter: see 2 *Proposals, op. cit.*, at 92.

[512] See Cheek, *supra* note 192, at 362n. 26.

[513] See text accompanying notes 274-77, *supra*.

[514] See Bucklely, *supra* note 18, at 364; but see Cheek, *supra* note 192, at 364.

[515] The philosophy behind the *Proposals*' Draft Act seems to be to provide a self-contained scheme of regulation: see Grover and Baillie, *supra* note 11, at 422 and 2 *Proposals, supra* note 3 at 334-35.

[516] See Part VIIC of the text, *infra*.

[517] See Simmonds, *supra* note 19, at 649.

remaining utility of the new issue scheme of regulation.[518] While the regulators have concluded that scheme continues to have a role even for issuers well seasoned in the upgraded continuous disclosure scheme, at the very least a wider set of prospectus exemptions for them seems appropriate.[519] In addition there appears to be a growing acceptance of variations in the level of disclosure required in the mandated disclosure documents in new issues in recognition of any pre-existing store of continuous disclosure on file.[520] Difficult questions of degree are involved because continuous disclosure schemes can vary from simple filing of discrete periodic, timely and special event disclosure documents, with their integration to be performed by those inspecting the file, through to filing and file maintenance requirements which ensure that, at least periodically, an integrated disclosure document as close as practicable in coverage and currency to the full new issue prospectus is on file.[521] Furthermore, questions arise of the adequacy of the dissemination of the data and "following" of the issuer whose answers will affect the extent to which the continuous disclosure file is a substitute for all or any part of the new issue regulation scheme and its "delivered to investors" disclosure.[522] In view of the comparative newness of upgraded continuous disclosure one would expect much of the integration of the two disclosure schemes to be left to regulation by the administrative agency in the area.[523] The existing and proposed integration arrangements are evaluated below.

B. *Present Legislation: the 1978 Ontario Act*

Under the 1978 Ontario Act the continuous disclosure regulatory scheme consists of:

(1) requiring the making up and filing, and in some cases delivery to equity holders, of annual and quarterly financial reports as prescribed by regulation;[524]
(2) press releases providing timely disclosure of all material changes, subject to a right to keep unduly detrimental information and information consisting of certain recommendations of senior management confidential under OSC oversight;[525]
(3) any mandatory management proxy information circulars as prescribed by regulation which are otherwise required in the Act—or in their ab-

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[518] See text following note 81, *supra*.

[519] See Grover and Baillie, *supra* note 11, at 409.

[520] *Id.*; 1 *ALI Fed. Sec. Code*, *supra* note 6, §505(a) and §505(a), Comment (1).

[521] See Grover and Baillie, *supra* note 11, at 428-29.

[522] See Grover and Baillie, *id.* at 459-63.

[523] See the text accompanying note 306, *supra*. For a partially dissenting view, see Bialkin, *supra* note 283 at 333 (undesirable unless clear legislative guidelines, as to which see note 641 and accompanying text, *infra*). It is appropriate, at least if procedures like those discussed in the text following note 637, *infra* were adopted, to drop any requirement for the involvement of the Governor-in-Council; see Grover and Baillie, *id.* at 401n. 205.

[524] *The Securities Act, 1978*, S.O. 1978, c. 47, ss. 77, 76 and 78 (delivery), as am. by S.O. 1979, c. 86, s. 11.

[525] *Id.*, s. 74, illuminatingly discussed in detail in Baillie (1980), *supra* note 15, at 3-14.

sence an annual report in the prescribed form;[526] and
(4) insider trading reports as prescribed by regulation.[527]

This scheme represents an upgrading of its predecessor principally by requiring more frequent financial reporting and by elevating from policy statement to a statutory requirement the OSC's and Toronto Stock Exchange's timely disclosure policies.[528] There is, however, no provision for narrative disclosure typical of a prospectus except to the extent that this appears in the proxy information circular or in its absence in the prescribed annual report.[529] There is no provision for integration of filed documents. The OSC appears to rely, at least with respect to non-shareholders, on public access to the files for dissemination of filed data.[530]

Subjection to the continuous disclosure scheme under the 1978 Ontario Act makes an issuer a "reporting issuer" and follows from:

(1) having filed and obtained a receipt for a prospectus, or filed a securities exchange take-over bid circular, where such filing was made in respect of an issue of voting securities under a predecessor to the 1978 Act on or after 1 May 1967[531] or was made under the 1978 Act, regardless of the type of securities involved;[532]
(2) having any securities listed and posted for trading of a "recognized" stock exchange in Ontario at any time since the 1978 Act came into force;[533]
(3) being incorporated under Ontario's *Business Corporations Act* and a public offering corporation for the purposes of that Act;[534] or
(4) being a company that is the result or remnant of a statutory combination involving a company that had been a reporting issuer for at least twelve months.[535]

This may be contrasted with the attainment of the equivalent status under the *Securities Exchange Act of 1934*: a listing on a national stock exchange or at least one million dollars of assets and five hundred shareholders.[536] By

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[526] *Id., The Securities Act, 1978*, s. 80.

[527] *Id.*, ss. 102-105.

[528] Simmonds, *supra* note 19, at 636-37 and 637n. 31.

[529] See on the proxy information circular, O. Reg. 478/79, s. 157 and Form 30.

[530] *OSC Disclosure Report, supra* note 9, para. 2.09; Connelly, *Securities Regulation and Freedom of Information* (Toronto: Commission on Freedom of Information and Individual Privacy, 1979) [hereinafter Connelly, (1979)] at 10-11, 31-37.

[531] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 1(1)38i.

[532] *Id.*, s. 1(1)38ii: for the considerations underlying the "voting securities" limitation for the pre-1978 Act filings, see *OSC Disclosure Report, supra* note 9, para. 2.36. See also the elective filing procedure in s. 52(2).

[533] *Id.*, s. 1(1)38iii; the recognition procedure is in s. 22(1).

[534] *Id.*, s. 1(1)38iv: the criteria for public offering corporation status are in *The Business Corporations Act*, R.S.O. 1970, c. 53, s. 1(9) as re-enacted by S.O. 1971, Vol. 2, c. 26, s. 2 and by S.O. 1972, c. 138, s. 1 and as am. by S.O. 1978, c. 49, s. 1(6), (7).

[535] *Id.*, s. 1(1)38v.

[536] *The Securities Exchange Act of 1934*, §12, 15 U.S.C. §781 (1976).

ensuring that reporting issuers are "followed" by the financial community, the present American standard has much to commend it, a view embodied in the federal *Proposals'* Draft Act.[537]

There are only two major prospectus exceptions and one major prospectus exemption in the 1978 Act specially tailored to securities of reporting issuers.[538] They are to the extension of "distribution" which will come into effect after the transitional period ends (one also does double duty as an exemption to the control person extension of "distribution"[539]). They require that the issuer at the date of resale must have been a reporting issuer for a period ranging from six months to eighteen months and not to be in default.[540] The first, the resale rule applicable to isolated trades, private placements and limited offerings purchasers, also imposes holding periods, reporting obligations and limitations on market grooming and extraordinary commissions.[541] The second, applicable to almost all of the transactional exemptions not covered by the first rule, imposes no holding period requirement but does require reporting and has a limitation on market grooming and extraordinary commissions.[542] The third provides an exemption to the extension of "distribution" to control person trades as well as the "distribution" extension for a resale by a person to whom a control person gave his stock as security pursuant to the exemption in that behalf.[543] There are reporting requirements and a prohibition on market grooming and extraordinary commissions conditions in the exemption, but no holding period requirement.[544] The important point to note is that reporting issuers, even

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[537] Text accompanying notes 228-42 and text of note 242, *supra*.

[538] *The Securities Act, 1978*, S.O. 1978, c. 47, s. 71(4)(a)-(c) and concluding proviso; s. 71(5)(a)-(c); s. 71(7)(b) and (c) as am. by S.O. 1979, c. 86, s. 9(2). The first two subsections are the "exceptions"; they are so called because they strictly describe situations where there is no "distribution" at all; the third subsection is an exemption because it represents a "distribution," although an exempt one.

[539] *Id.*, s. 71(7)(b) and (c) as am. by S.O. 1979, c. 86, s. 9(2). For the reason for this see the reference in note 543, *infra*.

[540] *Id.*, ss. 71(4)(a), 71(5)(a), 71(7)(b) opening words; and see s. 71(8)-(11).

[541] *Id.*, ss. 71(4)(b), 71(3), 71(4)(c), 71(4) concluding proviso.

[542] *Id.*, s. 71(5)(b) and (c). For the probable reasons why no holding period requirement is imposed, see Johnston, *supra* note 52, at 232 (less likely to encounter two step distributions, as to which see text accompanying notes 134 and 146 and 147, *supra*; and more likely to encounter here "stable well established companies"), which is a more satisfying account than that in Alboini, *supra* note 14, at 497.

[543] *Id.*, s. 71(7), opening words. For reasons, see Alboini, *id.* at 453, 509.

[544] *Id.*, s. 71(7)(b) and (c), as am. by S.O. 1979, c. 86, s. 9(2). The absence of a holding period requirement for a resale by a control person is presumably because of the need to comply with the s. 71(4)(a)-(c) and concluding proviso resale rules in addition to the s. 71(7)(b) and (c) ones if the security being resold was acquired pursuant to one of the s. 71(4) exemptions: see Emerson (1979), *supra* note 92, at 247. But see Boast, "Market Dispositions by Controlling Persons and Processing Applications before the Commission," in [1980] *Recent Securities and Corporate Law Developments* (Toronto: Canadian Bar Association, 1980) at II 130 (possibility of amendment to Act to introduce holding period) and O.S.C.W.S., 27 June 1980 at 3A (same). The absence of a holding period requirement for a resale by pledges from a control person is presumably because of the *bona fide* debt requirement: see Emerson (1979), *op. cit.*, at 244n. 127; but see also 1 Loss, *supra* note 31, at 645-50.

those who have been such for only a short time, must obtain permission to "leak" those securities outside the circle of exemptions. The resulting liquidity restrictions for purchasers of securities of nonreporting issuers should supply a considerable incentive to attain reporting issuer status.[545]

That measure of integration was inspired by the American example in the rule under the *Securities Act of 1933* constraining resales of securities acquired under the non-public offering exemption.[546] Beyond that, however, there are no further integrative provisions in the Act. In particular, there are no express regulations setting the permissible forms of prospectus for a reduction of the level of disclosure for reporting issuers similar to those developed under the *Securities Act of 1933*.[547] Until recently, the statutory standard for prospectuses, that they provide full, true and plain disclosure of all material facts, denied any power to introduce differential disclosure of that type.[548] A recent set of amendments to the Act now appears to permit differential disclosure standards.[549] In light of the form of continuous disclosure and the breadth of its application being triggered simply by a prospectus filing, such tentativeness is justified.

C. *Proposed Legislation: the Draft Act*

Integration will be considerably advanced under the Draft Act, which draws heavily on the ALI Code in this area. The continuous disclosure scheme in the Draft Act, applicable to a "reporting issuer,"[550] consists primarily of filing an initial "registration statement" prescribed by the CSC on entry into the system.[551] The "registration statement" is a document inspired by, but travelling some distance from, the initial registration document under the *Securities Exchange Act of 1934* and the ALI Code.[552] This document

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[545] Text following note 194, *supra*.

[546] See text accompanying notes 189-92 and the reference in note 188, *supra*.

[547] For those rules, see Painter, *supra* note 9, at 4n. 11.

[548] See *The Securities Act, 1978*, S.O. 1978, c. 47, s. 55(1) and Grover and Baillie, *supra* note 11, at 401.

[549] See *The Securities Amendment Act, 1979*, S.O. 1979, c. 86, s. 7, in force Jan. 1, 1980, substituting a new s. 62 for *The Securities Act, 1978, id.*, s. 62. To the time of writing, there has been no implementation of the material part of this section (ss. (1)).

[550] Defined in 1 *Proposals, supra* note 3, s. 2.38, discussed in 2 *Proposals, supra* note 3, at 30.

[551] 1 *Proposals, id.*, s. 4.02, discussed in 2 *Proposals, id.* at 65-67.

[552] Compare 2 *Proposals, supra* note 3, at 68-69 (registration statement, to be periodically updated, may contain data, especially "soft" data to be omitted from "less detailed and technical" report required to be sent to investors under continuous disclosure part of Act) with 1 *ALI Fed. Sec. Code, supra* note 6, §602(b) (SEC by "rule" may require the annual report [sent to the classes of security holders prescribed by rule: § 602(a)(2)] "to integrate *and replace* the registration statement" [emphasis added]) and Bialkin, *supra* note 283, at 334-35. The Draft Act has the filed, but not delivered, periodically updated registration statement, intended for investment analysts and sophisticated investors, as its "basic" disclosure document: see 2 *Proposals, op. cit.*, at 259 (dealing with special liability rule *for this document only*) and see also 2 *Proposals, op. cit.*, at 113 (annual report and proxy circular should "together form the foundation for disclosure to investors") and at 264 (but are "not as basic to the disclosure system as the registration statement"). The ALI Code by contrast has the filed

must be amended annually[553] so that the information contained therein is brought up to the end of the issuer's most recent financial year, a provision apparently inspired by the ALI Code.[554] Interim disclosure is by means of:

(1) preparation, filing and delivery of quarterly[555] and annual reports (not necessarily confined to financial data);[556]
(2) preparation, filing and issuing of press releases containing timely disclosure of non-public material facts learnt by the issuer, subject to an ability under CSC oversight to keep the fact confidential if disclosure would be unduly prejudicial;[557]
(3) preparation, filing and delivery of proxy information circulars;[558] and
(4) preparation and filing of insider reports.[559]

There is a separate provision in the Draft Act that permits the CSC by regulation to require the initiation of dissemination of filed documents.[560] This is not quite the same mandate as the one given to the SEC under the ALI Code, however. The SEC can require a "registrant," the ALI Code equivalent to a "reporting issuer," to prepare, file and publish *whatever* reports the SEC requires "to keep reasonably current the information and documents contained in the registration statement or to keep investors reasonably informed with respect to the registrant."[561] There is a separate provision for only one other type of continuous disclosure document: proxy information circulars.[562] "Reporting issuer" status under the Draft Act, as has already been described, follows from having a class of securities listed on a "registered securities exchange" or three hundred or more "public security holders" and filing a registration statement. This follows the pattern of the *Securities Ex-*

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and delivered annual report, intended for a wider audience, rather than the once-and-for-all registration statement, as its "central device for continuous disclosure": see 1 *ALI Fed. Sec. Code, op. cit.*, §602(a)-(d), Comment (2); and see 2 *ALI Fed. Sec. Code, supra* note 6, §1704(a) (the progenitor of special liability rule in Draft Act for registration statement applies under Code to its registration statement *and its annual reports, inter alia*). With respect to some of the criticisms of mandated disclosure referred to early in this article, there is much to commend the Draft Act position: see, *e.g.*, reference in 2 *Proposals, op. cit.*, at 69n. 53.

553 1 *Proposals, supra* note 3, s. 4.04(1).

554 See 1 *ALI Fed. Sec. Code*, §602(b) referred to in note 552, *supra.*

555 1 *Proposals, supra* note 3, s. 7.02, discussed in 2 *Proposals, supra* note 3, at 109-11.

556 1 *Proposals, id.*, s. 7.01, discussed in 2 *Proposals, id.* It is noted that the CSC will move toward integrating disclosure in the "registration statement" and the disclosure documents required under Part 7, including but not limited to the annual report, to the extent feasible: 2 *Proposals, op. cit.*, at 109, 68-69.

557 1 *Proposals, id.*, s. 7.03, discussed in 2 *Proposals, id.* at 111-12.

558 1 *Proposals, id.*, s. 7.06, discussed in 2 *Proposals, id.* at 113.

559 1 *Proposals, id.*, ss. 7.12-7.18, discussed in 2 *Proposals, id.* at 116-17, 118-21.

560 1 *Proposals, id.*, s. 16.07(c), discussed in 2 *Proposals, id.* at 393; and see Grover and Baillie, *supra* note 11, at 381, 387-88, 457-58, 464.

561 1 *ALI Fed. Sec. Code, supra* note 6, §602(a).

562 *Id.*, §603(c); and see on the relative importance of the proxy circular in 1 *ALI Fed. Sec. Code, id.*, §602(a)-(d), Comment (2)(a).

change Act of 1934—but unlike the 1978 Ontario Act or the ALI Code, with their common trigger of distribution issue qualification[563]—for very sound reasons.[564]

The Draft Act contains an exception to the definition of "distribution" and a prospectus exemption that are only available to reporting issuers. In addition there is at least one prospectus exemption with terms that vary with reporting issuer status. All three are inspired by the present American scheme and the ALI Code. The exception to the definition of "distribution" is the ability to make post-holding period non-exempt trades which would otherwise be distributions for persons who acquired securities from an issuer or an underwriter.[565] The holding period, included to prevent "two step distributions," may be varied by the CSC.[566] For example, the Commentary calls for lengthening the period when the issuer has not been a reporting issuer long enough to see its continuous disclosure disseminated and to have developed a sufficient following.[567] Conspicuously absent is any condition that there be no resale market grooming or extraordinary commission.[568] The theory here appears to be that these are largely directed at disturbance of market trading patterns which, to the extent it is not prevented by the holding period requirement, will in part be handled as a distinct disclosure problem under the block distribution extension of "distribution," with its "block distribution circular."[569] It may also be that sufficient protection is seen to flow from continuous disclosure in situations outside the area covered by that extension.[570] This also appears to be the position, at least for securities of one-year registrants, under the ALI Code's only provision imposing a holding period for resale: the limited offering exemption.[571] It is not at all clear that any such faith is well placed at this point in the evolution of continuous disclosure.[572] It is arguable that at least a power by regulation to impose absence of market grooming conditions ought to be conferred on the regulatory agency, to be invoked if experience indicates it would be desirable.[573]

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563 See text accompanying notes 238-42, and of note 238, *supra*.

564 See text accompanying notes 241, 242, *supra*.

565 See 1 *Proposals, supra* note 3, s. 2.17(b), discussed in the text following note 227, *supra*.

566 1 *Proposals, id.*, s. 2.17(b) (concluding words).

567 2 *Proposals, supra* note 3, at 18.

568 Compare the positions under the Ontario and present American legislation: see text accompanying notes 181 and 192, *supra*; and see Grover and Baillie, *supra* note 11, at 450 ("tentatively recommended" market grooming prohibition; "should be the subject of continuing review").

569 On the requirement for a "block distribution circular," see 1 *Proposals, supra* note 3, s. 2.17(d), discussed in the text accompanying notes 246 *et seq.*, *supra*.

570 But see Grover and Baillie, *supra* note 11, at 450.

571 See 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(B), discussed in the text following note 258, *supra*. The power to vary the terms of the exemption as regards securities of non-one-year registrants in §202(4)(b)(iii) apparently permits imposition of an absence of market grooming condition.

572 *Cf.* Grover and Baillie, *supra* note 11, at 450.

573 Any such power should, however, be subject to the controls discussed in the text following note 637, *infra*.

The Draft Act's prospectus exemption that focuses[574] on reporting issuer status is the "trading transaction" exemption,[575] inspired by the ALI Code,[576] but in one respect broader and in another narrower than the parent provision. The Draft Act exemption covers a distribution where the issuer has been registered at least one year and is not in default; no selling or promotional expenses can be incurred except for services customarily performed by a registrant in connection with a trade in a market. Sales on behalf of the issuer or selling security holder must not exceed a prescribed dollar amount, percentage of trading volume or percentage of outstanding securities or any prescribed combination.[577] The corresponding provision in the ALI Code is very similar except that it excludes issuers, except as the SEC otherwise provides by rule,[578] and it includes securities of an issuer who is not a "one-year registrant," subject to any SEC rule modifying the conditions or imposing additional ones for such issuers.[579] The idea behind the exemption is similar to that for isolated trades:[580] to facilitate dispositions which can readily be absorbed by the market, subject to "bright-line" criteria that avoid the interpretive difficulties of isolation.[581] Viewed in that light, there seems to be no sufficient reason to withhold the benefit of the exemption from issuers.[582] That same perspective suggests that any rule absolutely excluding non-reporting issuers from the exemption may be unreasonable.[583] In fact, the CSC has the opportunity, after gaining experience with the exemption, to fashion a trading transaction exemption for non-reporting issuers under its general power to increase the number of exemptions,[584] just as the SEC under the power described could extend the exemption to such issuers.

Omitted from the Draft Act is any equivalent to the ALI Code's exemption for resales by secondary distributors of securities of one-year registrants without limit, provided that the seller does not hold fifteen percent or more of the issuer's voting securities.[585] This raises the question whether the trading transaction exemption is not too narrow for reporting issuers. In

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574 Compare the exclusionary rule for reporting issuers in 1 *Proposals, supra* note 3, s. 3.01(e), discussed in 2 *Proposals, supra* note 3, at 50.

575 1 *Proposals, id.*, s. 6.04, discussed in 2 *Proposals, id.* at 102-103.

576 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(c).

577 1 *Proposals, supra* note 3, s. 6.04 (2)(a)-(c).

578 1 *ALI Fed. Sec. Code, supra* note 6, §202(41)(c)(i)(I); and see §202(41), Comment (12).

579 *Id.*, §202(41)(c)(ii); and see §202(41), Comment (6).

580 On the isolated trade type of exemption, see text accompanying notes 158 *et seq., supra.*

581 *Cf.* Grover and Baillie, *supra* note 11, at 437 (source of quotation). And see 1 *Proposals, supra* note 3, s. 6.04(3), discussed in 2 *Proposals,* note 3, at 103 (CSC may require issuer to file and disseminate information where CSC believes that use of exemption has caused such an increase in trading activities as to warrant this).

582 See, *id.* at 437; 1 *ALI Fed. Sec. Code, supra* note 6, §202(41), Comment (12).

583 See 1 *ALI Fed. Sec. Code, id.*, §202(41)(s)(i)(I) (takes in such issuers); but see §202(41), Comment (12) and Grover and Baillie, *supra* note 11, at 437.

584 See 1 *Proposals, supra* note 3, s. 3.03; and *cf.* 2 *Proposals, supra* note 3, at 73.

585 See 1 *ALI Fed. Sec. Code, supra* note 6, §512(4), discussed in text accompanying notes 218-22, *supra*; but see also 1 *ALI Fed. Sec. Code*, §512(4), Comment (5).

particular one may ask why the importance the Draft Act attached to considering special disclosure delivered to buyers for large block resales of securities would not be neutralized where the securities are those of an issuer who has been reporting for at least one year. Moreover, reporting issuer status under the Draft Act seems better calculated[586] than "registrant" status under the ALI Code to ensure a following for the issuer. The available data from tests of the efficient capital market hypothesis adds point to this.[587]

The answer is not given in the Draft Act. One can surmise, however, that there was a concern about the efficacy even of a "following" to handle the special selling efforts entailed,[588] although one can respond that it is not clear that special disclosure delivered to investors will do better.[589] One can only hope that experience accumulated under the ALI Code exemption[590] will be monitored to see if a matching exemption should be created by regulation under the Draft Act.

Finally, the Draft Act clearly contemplates differential prospectus disclosure for reporting issuers. There is no overarching statutory "full, true and plain" disclosure requirement for Draft Act prospectuses, their content being left entirely to regulation-making by the CSC.[591] The CSC, in the exercise of that power, is directed to ensure that reporting issuers' prospectus requirements "are designed to avoid unnecessary repetition of information previously filed by the issuer."[592] The use of "unnecessary" should ensure that the CSC takes account of the actual impact of the continuous disclosure provided by the reporting issuer.[593]

VII. NATIONAL PUBLIC ISSUES.

A. *Introduction*

Against this background it is clear that the Draft Act's distribution disclosure scheme will be very similar to that of the 1978 Ontario Act. However, the former will be broader at a number of points, of which the regulation of block trades[594] and the cutting back in a number of exemptions borrowed from the Ontario Act[595] are prime examples. The Draft Act's scheme is also narrower at a number of points, as its limited offering[596] and

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[586] See text accompanying notes 241, 242, *supra.*

[587] See references in note 46, *supra.*

[588] See Grover and Baillie, *supra* note 11, at 448.

[589] See Stigler, *Public Regulation of the Securities Markets* (1964), 37 J. Bus. 117 and Saari, *supra* note 39, at 1058n. 136; but see also Williamson (1978), *supra* note 15, at 62.

[590] See, *e.g.*, the "second thoughts" on the width of 1 *ALI Fed. Sec. Code, supra* note 6, §512(4) expressed in §512(4), Comment (5).

[591] 1 *Proposals, supra* note 3, s. 5.05, discussed in 2 *Proposals, supra* note 3, at 78-79.

[592] 1 *Proposals, id.*, s. 5.05(2).

[593] See also 2 *Proposals, supra* note 3, at 79, 72.

[594] See text accompanying notes 246 *et seq., supra.*

[595] See text accompanying notes 419-24, *supra.*

[596] See text accompanying notes 258-84, *supra.*

trading transactions exemptions exemplify.[597] The Draft Act is also cut back to exclude purely local distributions. But all of this will still leave a large area of overlap in regulation between the federal Act and the legislation of the provinces following the 1978 Ontario model.[598] The cool reception so far accorded the federal initiative of the Draft Act[599] and the concerns surrounding the proposal for an additional layer of disclosure regulation[600] make appropriate background to federal regulation and the accommodation provisions in the Draft Act.

B. *The Present Legislation in Canada*

Provincial securities legislation in the distribution area typically has no express jurisdictional link with persons or transactions in the enacting province.[601] However, the "in the province" limitation on the legislature's constitutional competence[602] has not, so far, proved troublesome in the context of any distribution beyond the provincial boundaries. The few cases on record support an expansive interpretation of the permitted ambit of the provincial law.[603] Given the national character of Canada's financial markets generally,[604] and assuming the absence of any other constitutional impediment,[605] this would suggest frequent conjoint application of provincial securities laws. The continuing impulse to harmonize the relevant legislation[606] goes to ameliorate the difficulties in much of this. Perhaps more importantly, in view of the importance of administrative discretion in the new issue area,[607] there are arrangements for administrative co-ordination in national issue qualification[608] which appear to have worked well. However, it is per-

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[597] See text accompanying notes 574-84, *supra.*

[598] See 2 *Proposals, supra* note 3, at 334, which notes that only some parts of the Draft Act would likely be found to displace provincial legislation on paramountcy principles. Part 5—the distribution part—is probably not one of them, as 1 *Proposals, supra* note 3, s. 5.10, discussed in 2 *Proposals, op. cit.*, at 85-86 (but note the case of block distribution circulars: 86) acknowledges. For a recent case on pre-emption of provincial securities legislation by federal corporations law, see *Multiple Access* v. *McCutcheon* (1977), 16 O.R. (2d) 593, 78 D.L.R. (3d) 701 (Div. Ct.), *aff'd* (1978), 19 O.R. (2d) 516 (C.A.), appeal to the Supreme Court of Canada pending.

[599] See note 23, *supra.*

[600] Grover and Baillie, *supra* note 11, at 420.

[601] See Johnston, *supra* note 52, at 324 (former legislation). See now *The Securities Act, 1978*, S.O. 1978, c. 47, s. 52 read with s. 1(1)11 ("distribution") and s. 1(1)42 ("trade") and Alboini, *supra* note 14, at 213-16.

[602] See *The British North America Act, 1867*, 30 & 31 Vict., c. 3, s. 92(13); and see Anisman and Hogg, "Constitutional Aspects of Federal Securities Regulation" (1978), in 3 *Proposals, supra* note 1, [hereinafter Anisman and Hogg] at 147.

[603] See Anisman and Hogg, *id.* at 144-47.

[604] See Anisman and Hogg, *id.* at 139-40, who go on to note the international character of that market, *op. cit.*, 140-41. See also Hebenton and Gibson, "International Aspects of Securities Regulation" (1978), in 3 *Proposals, supra* note 1, at 1139 *et seq., passim.*

[605] A matter returned to in the text accompanying notes 612, 613, *infra.*

[606] See Buckley, *supra* note 18, at 310n. 6 and accompanying text.

[607] See Grover and Baillie, *supra* note 11, at 395-96.

[608] See National Policy No. 1, set out and discussed in Alboini, *supra* note 14, at 358-60.

haps less clear that administrative co-operation in Canada is adequate to the task of providing uniform official encouragement and guidance for the development of a nation-wide securities trading mechanism that will liberate the market from the tyranny of paper.[609] The same may also be true of fostering automated methods of disseminating disclosure documents' contents.[610] Also, administrative co-operation is not always likely to be forthcoming where the efficient functioning of a national market might seem to put a premium upon it.[611]

However, there may also be constitutional impediments to the apparently broad application of provincial securities law which would create a Canadian legislative vacuum. Caselaw discussed in a background paper to the *Proposals* suggests this, in relation to transactions with interprovincial and international elements[612] and those involving federal corporations.[613] The *Proposals* concede that the constitutional basis is not altogether firm for a complete scheme of federal regulation that would fill any gap, as well as more unabashedly deal with the national character of securities trading.[614] But there are strong arguments that can be adduced in support of the new issue and continuous disclosure schemes of regulation, at least in the Draft Act, that draw much of their strength from the national character of the Canadian primary and secondary securities markets.[615]

C. *Proposed Federal Regulation in Canada*

The Draft Act will follow the example of the *Securities Act of 1933*[616] in providing a second layer of securities regulation for all primary market transactions other than purely local ones. For constitutional reasons, the Draft Act[617] does not attempt the pre-emption in the non-local "distribution" area which is to be found in the ALI Code,[618] the result of an agreement with the state securities regulators in the United States.[619] The degree of duplication in the Draft Act is, if anything, greater than in the present American arrangements. Under them, disclosure is the federal regulatory technique while state schemes feature both disclosure and "blue sky" or merit

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[609] *Cf.* Williamson (1978), *supra* note 15, at 126-30 (noting that non-goverment initiations have so far been very successful, however).

[610] *Cf.* Anisman and Hogg, *supra* note 602, at 140, 142.

[611] See, *id.* at 142.

[612] *Id.* at 147-50.

[613] *Id.* at 150-52.

[614] *Id.* at 190-97 (civil remedies); and see now *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 (S.C.C.).

[615] See Anisman and Hogg, *supra* note 602, at 156-76 (based on trade and commerce power and works or undertakings power).

[616] See 1 Loss, *supra* note 31, at 157-58.

[617] See 2 *Proposals, supra* note 3, at 384.

[618] See 1 *ALI Fed. Sec. Code, supra* note 6, §1904(a), (b) and (d).

[619] See, *id.*, §1904, Comment (2), described as "almost a minor miracle" by the Reporter for the Code project in Loss (1979), *supra* note 221, at 1448.

control.[620] The Draft Act, by contrast, will follow the 1978 Ontario Act and the other provincial legislation in expressly reposing "blue sky" discretion in the CSC.[621]

However, given the rationale of the Canadian federal scheme as well as its constitutional underpinnings, it is clear that the focus of that scheme will be on national issues. This is acknowledged in the distribution regulation area by the local distribution exemption. That exemption covers a distribution, "where all of the sales are made in the same province."[622] The exemption is wider than the corresponding provision in the *Securities Act of 1933*, which requires that the issue be confined in offer and sale to persons "resident within a single state or territory" and that the issuer of a corporation be "incorporated and doing business within . . . such state or territory."[623] The Draft Act exemption is both wider and narrower than the corresponding ALI Code provision, which requires that the distribution be one that,

> results in sales substantially restricted to persons who are residents of or have their primary employment in a single State, or an area in contiguous States (or a State and a contiguous foreign country) as that area is defined by rule or orders [and] involves securities of an issuer that has or proposes to have its principal place of business in that State or area, regardless of where it is organized.[624]

One may question the excision of the "doing business" criterion from the Draft Act exemption, which will leave it to the provinces to extract and test the quality of disclosure of material facts having their locus outside the province.[625] The restriction of the Draft Act exemption to single provinces will do less harm in a country of large provinces than the corresponding provision in the American Act which led to the trans-state extension in the Code.[626] Should a corresponding problem arise in Canada,[627] it is contemplated that the Draft Act's power to create exemptions by regulation will be used.[628]

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[620] 1 *ALI Fed. Sec. Code, supra* note 6, §1904, Comment (6). This is not to deny that disclosure control by the SEC has been administered with some "blue sky" objectives: *cf.* Anderson, *The Disclosure Process in Securities Regulation: A Brief Review* (1974), 25 Hastings L.J. 311 at 333.

[621] 1 *Proposals, supra* note 3, s. 5.09(2)-(4), discussed in 2 *Proposals, supra* note 3, at 82-85.

[622] 1 *Proposals, id.*, s. 6.05, discussed in 2 *Proposals*, id. at 104-106.

[623] *Securities Act of 1933*, §3(a)(11), 15 U.S.C. §77c(11) (1976); and see 1 Loss, *supra* note 31, at 591-605, esp. at 598-600, 601; and IV Loss, *supra* note 137, at 2600-606, esp. at 2603-604.

[624] 1 *ALI Fed. Sec. Code, supra* note 6, §514(c) read with §514(a)(1) and (2); and see §1904, Comment (3). For a critical review of the exemption see Wolfson (1979), *supra* note 194, at 1506-508.

[625] However, it is not clear that this is the rationale of the condition in the present American exemption: *cf.* 1 Loss, *supra* note 31, at 601n. 158 and text accompanying that note; IV Loss, *supra* note 137, at 2604. But note the change in wording in 1 *ALI Fed. Sec. Code, supra* note 6, §514(a)(2).

[626] See Cheek, *supra* note 192, at 380.

[627] The prime examples seem to be Ottawa-Hull and Windsor (Ontario)-Detroit. The latter example, from a different geographical perspective, occurred to the drafters of the Code: 1 *ALI Fed. Sec. Code, supra* note 6, §1904, Comment (3)(g)(ii).

[628] 2 *Proposals, supra* note 3, at 105.

Where overlap between the federal and the provincial schemes does exist, and in view of the substantial correspondence between them in regulatory approach which is missing in the United States, there are a number of useful accommodation provisions in the Draft Act not to be found in the present American federal scheme or (with one exception) the ALI Code.[629] The CSC must issue a receipt for a prospectus for which a receipt has been issued by a provincial securities commission.[630] However, under the same provision the CSC may by order confine the distribution to that province, a qualifier which seems likely to encourage co-operation between federal and provincial administrative authorities. For its part, the CSC in another provision somewhat similar to one in the ALI Code[631] is directed to be co-operative with the provincial authorities "in order to minimize duplication of effort and maximize the protection afforded investors in Canada."[632] Finally, institutionalized co-operation is provided for in a pair of sections in the Draft Act that permit: delegation of any or all CSC powers, duties, functions or responsibilities to existing provincial bodies or a new body;[633] the CSC to exercise of all or any powers or to perform all or any duties, functions or responsibilities of a provincial authority;[634] and a provincial securities commissioner to join the CSC.[635]

VIII. SUMMARY AND CONCLUSION

This article has sought to provide the origins and elaboration of the distinctive feature of recent securities reform in Canada in the distribution area, present and proposed. That feature is the introduction of a distribution disclosure document requirement that omits the element of "public" participation, with all its uncertainties, while addressing itself to the problem of resale of securities acquired without such documentation through an exemption. The Canadian reformers have also addressed themselves to the questions of whether and how to regulate other resales which also appear to merit a distribution disclosure document requirement. The resultant closed systems, under Ontario's *Securities Act, 1978* and the Draft Act put forward by the federal *Proposals for a Securities Market Law for Canada*, as well as their American inspirations, are dauntingly complex. However, the Canadian systems are far more amenable to certainty of application than the schemes typified by the 1966 Ontario Act.

The 1978 Ontario Act and the Draft Act's systems, however, are not beyond criticism. It was found that the more recent Draft Act and its excel-

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[629] See for the latter the provisions of 1 *ALI Fed. Sec. Code, supra* note 6, §1904 (a), (b) and (i).

[630] 1 *Proposals, supra* note 3, s. 5.10, discussed in 2 *Proposals, supra* note 3, at 85-86. Block distribution circulars are excluded for the reasons given in 2 *Proposals, op. cit.*, at 86.

[631] 1 *ALI Fed. Sec. Code, supra* note 6, §1904(i).

[632] 1 *Proposals, supra* note 3, s. 15.12(1), discussed in 2 *Proposals, supra* note 3, at 344.

[633] 1 *Proposals, id.*, s. 15.06(1)(a), discussed in 2 *Proposals, id.* at 334-35.

[634] 1 *Proposals, id.*, s. 15.06(1)(b), discussed in 2 *Proposals, id.*

[635] 1 *Proposals, id.*, s. 15.07, discussed in 2 *Proposals, id.*

lent published Commentary and Background Papers as well as the ALI Code provisions on which the Draft Act so extensively draws, were fertile sources of criticism of the 1978 Ontario Act. At a number of points it is not at all clear that the Draft Act has produced better solutions.

Perhaps the Draft Act has the most to offer in the area of the exemptions. A much better job than the 1978 Ontario Act appears to have been done in elaborating the occasions when the distribution document should not be required and what residual protections are left in place. Nowhere was this better illustrated than in the exemptions of value to smaller issuers. In addition, the Draft Act has some very useful proposals to offer, elaborating the degree of integration between its distribution disclosure and its continuous disclosure schemes.

Throughout this discussion, the theme of administrative power to make adjustments in the distribution disclosure trigger, in the exemptions and the contents of required disclosure, was sounded. Such power seems desirable in a field as specialized and subject to rapid change in context as securities regulation. Further evidence of the utility of such power is given by the circumstances of its use in the Draft Act.

However, as the discussion of the disclosure philosophy in securities regulation at the beginning of this article made clear, there is much more to be learned about the costs and the benefits of the distribution disclosure schemes. In the exercise of its powers, there is a need for the securities regulatory agency to be kept informed of the work being done in that area and its implications for the law.[636] The Draft Act has some particularly important contributions to make in this area too. Not only are there to be found among its background papers a particularly thought-provoking pair on the role of disclosure,[637] but the Draft Act itself appears to give statutory encouragement to the kind of receptiveness here commended. The Act can be seen doing this in the procedure it mandates for regulations. That procedure, drawing heavily on American experience, entails publication of all *proposed* regulations, provision of an opportunity to "interested persons" to make representations, power in the OSC to convene a hearing and a requirement to publish with the final regulation a statement of its purpose.[638] As well, there is provision for any person to petition the CSC to make, amend

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[636] *Accord*, Williamson (1978), *supra* note 15, at 83; Wolfson (1979), *supra* note 194, at 1501-502. For somewhat more prosaic matters that could usefully be put on the research agenda, see Wolfson (1979), *op. cit.*, at 1502-506 (on the ground covered by the ALI Code's limited offering exemption), 1506-508 (on that covered by the Code's local distribution exemption) and 1508-15 (on that covered by the Code's handling of secondary distributions).

[637] Williamson (1978), *id.*; Grover and Baillie, *supra* note 11.

[638] 1 *Proposals, supra* note 3, s. 15.15(1)-(4); but see the dispensing power in s. 15.15(5). The section is discussed in 2 *Proposals, supra* note 3, at 352-58, which relates it to American and Canadian experience. However, without positive encouragement to intervene—including financial support—it is not clear that as comprehensive a sampling of opinion as is desirable will be achieved: see Taylor, *Comments on The Mandate and Operation of the Ontario Securities Commission* (1978), 36 Fac. L. Rev. U. of T. 1 at 34-39.

or repeal a regulation.[639] All of this is against the background of (limited) judicial review of regulations[640] and a lengthy statement of the purposes of the Draft Act, headed by "the efficient functioning of the capital market" and "the securities market should provide an effective means for the allocation of capital to the most efficient users."[641] This goes significantly beyond what is now provided in the Ontario scheme of regulation.[642]

None of these institutional arrangements in the Draft Act will ensure that the regulators ask the "right" questions about their regulatory scheme.[643] But in a welter of change in an economically significant area of law, it helps set a good statutory forum.

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[639] 1 *Proposals, id.*, s. 15.15(6), discussed in 2 *Proposals, id.* at 358.

[640] 1 *Proposals, id.*, s. 15.20, discussed in 2 *Proposals, id.* at 372-77.

[641] 1 *Proposals, id.*, s. 1.02(a), (b). The section is discussed in 2 *Proposals, id.* at 1-5. This listing here is rather more elaborate than that in the preamble to the *Securities Act of 1933*, Pub. L. No. 73-22, 48 Stat. 74 (1933) or the provisions of 1 *ALI Fed. Sec. Code, supra* note 6, §§101 and 102, as to which 1 *ALI Fed. Sec. Code*, Part I, Introductory Comment. For the importance of elaboration of legislative policy in the context of broad delegated legislative power, see Garrett and Weaver, *supra* note 60, at 461-62. The reservation expressed in Taylor, *supra* note 638, at 40 (may prematurely freeze debate over proper goals) seems to this author to be adequately addressed in 2 *Proposals, op. cit.*, at 372-77, and its supporting material. Less easy to counter, however, is the concern in Taylor, *op. cit.*, at 28 that an administrative agency subject to these types of controls might be driven to prefer policy statement over regulation. However, recent OSC activity (see following note and note 395, *supra*) is somewhat heartening in this regard. For a suggested counter to this concern, see Taylor, *op. cit.*, at 28-29.

[642] On regulation-making procedure in Ontario, see *The Regulations Act*, R.S.O. 1970, c. 410. There are no statutory provisions in Ontario confirming a person's ability to petition to make a regulation. Judicial review of regulations is a common law matter: 2 *Proposals, id.* at 375-76; Reid and David, *Administrative Law and Practice* (2d ed. Toronto: Butterworths, 1978) at 274 *et seq.* Also, there is no recital of the purposes or background to regulation in *The Securities Act, 1978*, S.O. 1978, c. 47. It is readily admitted, however, that in regulation-making procedure the OSC (the body with which virtually all of them originate: see Connelly (1979), *supra* note 530, at 28) as a matter of practice does take care to invite the opinion of interested parties with respect to proposed regulations: see, *e.g.*, O.S.C.W.S., week ending 14 December 1979, Supp. "X-2" (on what later became, as amended, O. Reg. 190/80, in force 7 April 1980).

[643] *Cf.* Wolfson, *The Need for Empirical Research in Securities Law* (1976), 49 S. Cal. L. Rev. 286 at 286-90; Taylor, *supra* note 638, at 8, 37 (importance of who are chosen to be the regulators).