

2006

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Source Publication:

Queen's Law Journal Vol 32 (1) pp. 1-44, 2006

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Rethinking Enforcement and Litigation in Ontario Securities Regulation

*Mary Condon**

The Ontario government has recently made changes to provincial securities law that are aimed at more effective enforcement. For example, statutory civil remedies are now available to investors in actions involving misrepresentation or inadequate disclosure in the secondary market. A broader range of sanctioning options has also been made available to the Ontario Securities Commission. The author explores the factors contributing to these developments, identifies recent controversies surrounding the Commission's enforcement activities, and evaluates the effectiveness of different approaches to enforcement.

The author reviews policy issues surrounding enforcement through public, criminal and quasi-criminal sanctions, as well as civil remedies, and places these issues in the context of academic legal debate. She considers administrative law principles in the context of issues in securities enforcement, such as apprehension of bias, "judicialization" of Commission hearings, and the diversity of enforcement efforts across Canada. She then considers whether regulations should be oriented to deterring violations or creating incentives for compliance. She notes that current incentives to comply with securities regulations may have little influence on employee and firm behaviour in a competitive business environment. Enforcement mechanisms aimed at deterrence may therefore be less effective than those seeking to encourage compliance with regulations.

Since the provisions recently added to the Ontario Securities Act are aimed at deterrence rather than compensation, she then discusses whether private enforcement mechanisms, such as the statutory civil remedies available under that Act, are preferable to public enforcement mechanisms. The author concludes that public and private mechanisms may be interdependent and could together achieve effective securities regulation.

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Introduction

It has become commonplace to say that enforcement of securities regulation is currently a subject of intense interest among investors, the financial press, issuers, market intermediaries and the general public. Many commentators suggest this is because of various scandals involving alleged manipulation of accounting and financial information, though I argue in this paper that the heightened attention to enforcement needs to be placed in a larger context. Apart from the downstream effects of various North American corporate scandals, there are other obvious reasons why this is an opportune time to consider the appropriate role of enforcement in an overall scheme of securities regulation.¹ A new Chair of the Ontario Securities Commission (OSC) began his tenure in 2005. Not long after, the Ontario government proclaimed Part XXIII.1

1. The focus of this paper is the role of enforcement in Ontario securities regulation, but comparative material on enforcement in other Canadian or international contexts will be discussed where illuminating.

of the *Securities Act*² which provides for the first time statutory civil remedies for investors alleging deficiencies in continuous disclosure material of reporting issuers.³

Even more interesting than the media attention to enforcement of securities regulation is the fact that it has become a contested site of policy and intellectual debate. This contestation has a number of dimensions that are explored in this paper. One is a reassessment of principles of administrative law in the context of OSC enforcement practices. Second is a debate, taking place at the highest regulatory levels,⁴ in the appellate courts and in the academic literature about the normative goals of sanctioning by securities regulators. Here the orienting frameworks of two intellectual perspectives on regulatory enforcement generally, and securities regulatory enforcement specifically, collide.⁵ The neo-classical law and economics approach is deeply committed to the rational actor model of behaviour and the role of deterrence in influencing those actors.⁶ In contrast, a socio-legal

2. *Securities Act*, R.S.O. 1990, c. S-5 [OSA].

3. As discussed later in this paper, the possibility has existed for some time for investors to sue issuers under securities legislation for deficiencies in the documents used to validate the initial issuing of securities. See *ibid.*, s. 130. However the practical significance of this so-called “primary market” for securities pales in comparison to the volume of transactions taking place in the secondary market, where securities trade among investors after they have been issued by the entity.

4. See comments by David Wilson, the Chair of the OSC and Christopher Cox, also appointed Chair of the Securities and Exchange Commission (SEC) in the U.S. in 2005, vowing to aggressively enforce securities law and to use criminal sanctions to do so; Jacquie McNish, “Veteran banking executive appointed OSC head” *The Globe and Mail* (23 June 2005) B1; Kevin Drawbaugh, “New SEC chairman to face major policy debate on crime” *The Globe and Mail* (2 August 2005) B3.

5. See Lauren B. Edelman & Robin Stryker, “A Sociological Approach to Law and the Economy” in Neil J. Smelser & Richard Swedberg, eds., *The Handbook of Economic Sociology* (2d ed.) (Princeton N.J.: Princeton University Press, 2005) 527.

6. Raymond Paternoster & Sally Simpson, “Sanction Threats and Appeals to Morality” (1996) 30 *Law & Soc’y Rev.* 549. See also the exchange between Daniel Kessler & Steven D. Levitt, “Using Sentence Enhancements to Distinguish between Deterrence and Incapacitation” (1999) 42 *J.L. & Econ.* 343; and Cheryl Marie Webster, Anthony N. Doob & Franklin E. Zimring, “Proposition 8 and Crime Rates in California: The Case of the Disappearing Deterrent” (2006) 5 *Criminology and Public Policy* 417, concerning the effectiveness of harsh sanctions as a deterrent to criminal activity.

approach to regulatory enforcement attempts to test empirically the respective roles of a deterrence model of behaviour and a compliance model, which focuses on a variety of ways of inducing law-abiding behaviour.

A third and final arena of debate is the broader question of the appropriate balance between public and private enforcement of securities regulatory norms.⁷ Is it necessary to have a public enforcer of securities law in the form of an administrative agency, or should we instead rely more robustly on private parties to enforce their claims against market participants in court? An important point of departure here is that public enforcement of securities regulatory norms may have different normative goals than those of private enforcement. Specifically, public enforcement is considered to be about punishing market actors or producing markets that operate with integrity, while private enforcement is about compensation for investors. Should one of these goals be privileged over another? Here again there is a clear schism between law and economics approaches and others, such as a socio-legal orientation, which favour an ongoing role for public enforcement in maintaining market integrity.

Writing from a law and economics perspective, La Porta *et al.* recently asserted in a study of regulatory arrangements in 49 countries that there is “little evidence that public enforcement benefits stock markets, but strong evidence that laws mandating disclosure and facilitating private enforcement through liability rules benefit stock markets.”⁸ In concluding their paper, these authors reinforce this strong message with the comment that “securities laws matter because they facilitate private contracting rather than provide for public regulatory

7. I use “public enforcement” as a shorthand expression to capture the various enforcement resources at the disposal of the OSC as adjudicator or prosecutor, including criminal and administrative sanctions and civil remedies. I will not deal with the enforcement activities of a variety of other significant institutions, such as self-regulatory organizations (SROs), like the Market Regulation Services (RS), the Investment Dealers Association (IDA) or the Mutual Fund Dealers Association (MFDA). Meanwhile by private enforcement, I mean the remedies available to investors acting on their own behalf to seek compensation for various breaches of securities law.

8. Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, “What Works in Securities Law?” (2006) 61 *Journal of Finance* 1 at 1.

enforcement. Specifically, we find that several aspects of public enforcement, such as having an independent and/or focused regulator or criminal sanctions, do not matter. . . .”⁹ From this perspective, robust regulatory application of administrative and criminal sanctions is a mistake at a policy level.

This paper canvasses these issues by first mapping recent regulatory and judicial developments in securities law enforcement in Ontario. This stock-taking exercise places recent developments in the enforcement area in the context of a number of background conditions, as well as the commitment to enforcement demonstrated by the former Chair of the OSC, David Brown, between 1998 and 2005. It identifies a number of the current policy-related controversies in which the enforcement activity of the OSC is embroiled, and examines them against the backdrop of the academic literature on techniques of regulatory enforcement. Part II of the paper examines the secondary market civil liability provisions in the *OSA* Part XXIII.1 and to the argument of La Porta *et al.* that private enforcement of securities law is preferable to public enforcement on grounds of the former’s greater contribution to the development of stock markets. The conclusion will try to weave the two strands of the paper into a coherent assessment of what might work best in enforcing securities law. Ultimately, the argument of this paper is that the new civil liability provisions will not significantly diminish the need for public enforcement efforts in the securities regulatory arena in Ontario. However, in order to be more effective, deterrence-based enforcement efforts, such as after-the-fact sanctioning, should be re-oriented towards strategies for developing “compliance cultures” within market participants.

9. *Ibid.* at 28-29.

I. Administrative and Criminal Enforcement of Ontario Securities Law

A. Surveying the Terrain: The Enforcement Contribution of the “Brown Years”

As noted above, many commentators date the current heightened media and public concern about the effectiveness of securities regulation enforcement from the notorious Enron,¹⁰ WorldCom and other securities market scandals, with BreX¹¹ and Nortel providing Canadian flavour. It should not be forgotten, though, that a number of significant background factors have shaped the multilevel political and regulatory response to such scandals.

One of these background factors is the changing nature of retirement provision in North America, which has contributed to the rise of powerful pension funds as “repeat players” in securities trading, but has also turned employees into investors by way of the shift to defined contribution (DC) pensions in the employer-sponsored pension sector. DC pensions can require employees to make pension-related decisions to invest in a variety of investment vehicles.¹² The concern of Canadian employees contributing to DC plans about the well-being of their pension-related investments and the adequacy of securities market regulation more generally is not likely to diminish, even after Enron fades into the past.

Another background factor is the trend toward firm-based consolidation on the part of various professional gatekeepers, such as lawyers, accountants and investment bankers. Such consolidation has led to concern about conflicts of interest among the gatekeepers who

10. Timothy F. Malloy, “Regulation, Compliance and the Firm” (2003) 76 Temp. L. Rev. 451.

11. But see Jeffrey MacIntosh, “Lessons of Bre-X(?): Some Comments” (1999) 32 Can. Bus. L.J. 223.

12. Mary Condon, “The Feminization of Pensions? Gender, Political Economy and Defined Contribution Pensions” in Libby Assasi, Duncan Wigan & Anastasia Nesvetailova, eds., *Global Finance in the New Century: Beyond Deregulation* (New York: Palgrave Macmillan) [forthcoming in 2007].

advise, audit or offer reputation capital to issuers.¹³ Yet another factor, at an even more general level, is the increased significance of the financial services industry to the productive economy of many countries.¹⁴

Systemic changes like these provide the context in which the fraud and incompetence revealed in several large-scale corporate scandals were interpreted by regulators, media, policy advisors¹⁵ and the general public.¹⁶ The starting point in examining how the Brown-led OSC responded to these events and trends in securities market operation is through the legal resources available to accomplish securities regulatory enforcement in Ontario. These include deployment of the public interest-based sanctioning power in section 127 of the *OSA*, *Criminal Code* and quasi-criminal action, and the possibility of civil remedies under section 128.¹⁷ These various items in the enforcement lexicon will be considered in turn below.

B. Prometheus Unbound? The Use of Section 127 Powers by the OSC

A theme of securities regulatory enforcement in the last several years in Ontario has been the OSC's proactive efforts to obtain a broader arsenal of potential sanctions upon a finding that the public interest warrants the application of such a sanction. Recent successes here include the power to levy administrative penalties, disgorgement and

13. John C. Coffee, "Understanding Enron: It's About the Gatekeepers, Stupid" (2002) 57 *Bus. Law.* 1403 [Coffee, "Understanding Enron"].

14. Richard Minns, *The Cold War in Welfare: Stock Markets versus Pensions* (London: Verso, 2001).

15. Wise Persons' Committee to Review the Structure of Securities Regulation in Canada, *It's Time* (Ottawa: Department of Finance, 2003).

16. One might add to this the enduring fact of dispersed ownership systems of governance in North America which put the issuer's managers in the driver's seat. See John C. Coffee Jr., "A Theory of Corporate Scandals: Why the U.S. and Europe Differ" (2005) CLE Working Paper No. 274, online: Social Science Research Network <<http://ssrn.com/abstract=694581>>.

17. Mary G. Condon, Anita I. Anand & Janis P. Sarra, *Securities Law in Canada: Cases and Commentary* (Toronto: Emond Montgomery Publications Ltd., 2005) c. 11.

costs.¹⁸ It should be noted, though, that the OSC was not the first provincial securities regulator to obtain such powers under the rubric of the public interest sanctioning power, and that an argument for obtaining them in Ontario was to harmonize sanctioning powers across Canada.

Internally, the OSC has significantly expanded the role of enforcement within the regulatory enterprise and has hired many more enforcement personnel. The agency has considerably more matters under active investigation than it had at the beginning of David Brown's tenure. In a May 2004 speech, David Brown made the claim that:

We have made significant strides in improving our enforcement efforts over the past few years. In fact, the OSC has obtained jail sentences in four of the last five cases in which we have sought a jail term. In the past four years, we've successfully initiated proceedings or settled more than 100 separate actions.¹⁹

The OSC has launched a number of complicated enforcement proceedings involving insider trading (*Donnini*²⁰ and *ATI Technologies*²¹), mutual fund trading practices (market timing settlements²²), and inadequate prospectus and secondary market disclosure (*YBM*²³). The new administrative penalty option was first exercised against an individual, Andrew Cheung, in early 2005.²⁴

In 2003, I conducted comparative research for the Wise Persons Committee (WPC) into the use of public interest sanctioning powers by

18. Philip Anisman, "Proposed Amendments to the Ontario Securities Act: An Open Letter to the Ontario Securities Commission" (1999) 31 Can. Bus. L.J. 272.

19. David A. Brown, Q.C., "A Cooperative Approach to Fighting Economic Crime" (Remarks delivered at PricewaterhouseCoopers, Toronto, 27 May 2004), online: Ontario Securities Commission <http://www.osc.gov.on.ca/About/Speeches/sp_20040527_db-economic-crime.pdf> at 6.

20. *Re Donnini* (2002), 25 O.S.C.B. 6225.

21. *Re ATI Technologies Inc.* (2005), 28 O.S.C.B. 8558; (2004), 27 O.S.C.B. 1194; (2004), 27 O.S.C.B. 6859 [*ATI Technologies*].

22. See Ontario Securities Commission, "Mutual Fund Market Timing Settlements," online: Ontario Securities Commission <http://www.osc.gov.on.ca/HotTopics/FundSettle/fs_index.jsp>.

23. *Re YBM Magnex International Inc.* (2003), 26 O.S.C.B. 5285 [*YBM*].

24. *Re Cheung* (2005), 28 O.S.C.B. 4685.

securities commissions across Canada. The conclusion of that research was that over the three-year period investigated (2000–2003), comparatively speaking, the OSC conducted fewer hearings than other large commissions, such as the British Columbia Securities Commission (BCSC), but it did pursue more novel and complicated matters than the other agencies.²⁵ Meanwhile the Canadian Securities Administrators (CSA) has recently taken the initiative to provide semi-annual reports on the enforcement activities of its member commissions, making comparative data easier to access.²⁶ This transparency might well have an impact on the enforcement efforts of individual provinces by allowing the media and the public to access more readily information about the numbers and types of enforcement matters being pursued by individual commissions, as well as how they are being resolved. Commentators could also make informed assessments about this information, in particular by putting them into the context of the enforcement resources available to individual provincial enforcement divisions.²⁷

In Ontario in the last several years there has been some increase in enforcement actions targeting gatekeepers, such as accountants (Miller Bernstein²⁸ and William Andrew Campbell²⁹), investment bankers (YBM³⁰), and to a lesser extent, lawyers.³¹ It has been noted above that consolidation in the organization of professional service delivery in capital markets is an important component of systemic change in those

25. Mary Condon, “The Use of Public Interest Enforcement Powers by Securities Commissions in Canada” in A. Douglas Harris, ed., *WPC – Committee to Review the Structure of Securities Regulation in Canada: Research Studies* (Ottawa: Department of Finance, 2003) online: Wise Persons’ Committee <http://www.wise-averties.ca/reports/WPC_10.pdf> [Condon, “Enforcement Powers”].

26. Canadian Securities Administrators, *Report on Enforcement Activities from April 1 to September 30, 2004* (Montreal: Canadian Securities Administrators, 2004); Canadian Securities Administrators, *Report on Enforcement Activities from October 1, 2004 to March 31, 2005* (Montreal: Canadian Securities Administrators, 2005).

27. See Charles River Associates, “Securities Enforcement in Canada: The Effect of Multiple Regulators” in A. Douglas Harris, ed., *supra* note 25.

28. *Re Miller Bernstein & Partners LLP* (2005), 28 O.S.C.B. 7093.

29. *Re Campbell* (2005), 28 O.S.C.B. 1072.

30. *Supra* note 23.

31. *Wilder v. Ontario Securities Commission* (2000), 47 O.R. (3d) 361 (Div. Ct.); (2001), 53 O.R. (3d) 519 (C.A.).

markets. It is likely that issues pertaining to the nature and quality of internal supervision of market actors, or internal information flow within firms, will likely continue to be a significant source of enforcement activity, with the scope of this attention broadening to encompass not just professional gatekeepers or registrants in securities firms, but also management personnel in reporting issuers.³² In other words, it is an open question as to whether the OSC will move to enforce some of the norms with respect to information generation and certification that have been implemented in the last several years to provide a Canadian equivalent to the *Sarbanes-Oxley* legislation in the U.S.³³ The adequacy of supervisory controls within market participants

32. See MI 52-109. The Canadian Securities Administrators have proposed initiatives, known as “national instruments” (NI) and “multilateral instruments” (MI), that have either been passed by provincial securities regulators or are under consideration. Information about each of these initiatives can be found at Ontario Securities Commission, Commission Document, “Ongoing Requirements for Issuers and Insiders” online: Ontario Securities Commission <http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/rrn_part5_index.jsp#rrn55101>.

33. *Sarbanes-Oxley Act of 2002*, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended at 15 U.S.C. § 7201 (2002)) [*Sarbanes-Oxley*]. These initiatives are colloquially known as CanSox, and include rules addressed to those providing accounting and auditing services to public companies, and to those in managerial roles in issuers. The former group of initiatives includes: NI 52-107 which deals with identifying or restating the requirement that financial statements be prepared in accordance with Canadian GAAP and that audits be conducted in accordance with Canadian GAAS; NI 52-108 which establishes the Canadian Public Accountability Board — the Canadian equivalent of Public Company Accounting Oversight Board (PCAOB) that is required to oversee the activities of “public accounting firms” and auditors of public companies; MI 52-110 which establishes requirements for the activities and composition of audit committees. The second group of innovations is addressed rather to management of public companies. These include; MI 52-109, proposed MI 52-111 and NI 58-101 (and NP 58-201). MI 52-109 requires CEOs and CFOs to certify, on an annual and interim basis, that (i) annual and interim filings do not contain a misrepresentation, (ii) that disclosure controls and procedures have been designed to provide reasonable assurance that material information has been made known to these parties, and (iii) that the CEO and CFO have evaluated the effectiveness of these controls on an annual basis. See Mary Condon, “Corporate Governance and Securities Regulation: What’s Next?” (Paper presented to the CLPE Conference, Osgoode Hall Law School, York University, 20 October 2005) [unpublished]; Julia Dublin, “The David Brown Years at the Ontario Securities Commission (1998–2005)” in Paul D. Paton, ed., *Taking Stock: Challenge and Change in Securities Regulation: Papers Presented at the 12th Queen’s*

was an aspect of Justice Khawly's decision in *Rankin*, though of course in the criminal context. The issue was also a feature of the recommendations of the CSA's Task Force report on insider trading,³⁴ the settlement agreements reached between the OSC and ATI Technologies,³⁵ and more recently, Zoran Popovic.³⁶ It may also yet become relevant in the Portus matter, which as David Brown has indicated, "[goes] to the adequacy of the investment advice given by intermediaries to individual investors."³⁷

The OSC has made efforts to systematize and rationalize initial regulatory consideration of which enforcement matters to pursue. OSC enforcement staff sort potential offences into the following categories:

[A]busive trading (including market manipulation and insider trading); abusive sales practices; deficient disclosure (including prospectuses, financial results and material change reports); failure to file reports; takeover bid issues; registrant misconduct (such as misappropriation and improper supervision); and sale of unregistered securities.³⁸

Annual Business Law Symposium (Kingston, Ont.: Queen's Annual Business Law Symposium, 2005) 2; David Wilson, "Dialogue with the OSC 2005: Setting the Standard" (Remarks presented at Dialogue with the OSC 2005, 17 November 2005), online: Ontario Securities Commission <http://www.osc.gov.on.ca/About/Speeches/sp_20051117_dw_dialogue-opening-remarks.pdf>.

34. Insider Trading Task Force, *Illegal Insider Trading in Canada: Recommendations on Prevention, Detection and Deterrence* (Calgary: Canadian Securities Administrators, November 2003).

35. An aspect of the settlement with *ATI Technologies*, *supra* note 21, was that it was required to provide the OSC with a letter of comfort to confirm that it has instituted new practices and procedures related to trading and corporate governance matters consistent with the practices and procedures of other TSX listed companies.

36. In the settlement agreement with Zoran Popovic and DXStorm.Com Inc., the OSC required the company to implement a Code of Conduct including an insider trading and reporting policy. See *OSC Settlement with Zoran Popovic and Dxstorm.Com Inc. Approved Over Failure to File Insider Trading Reports* (2005), 28 O.S.C.B. 4346.

37. David A. Brown, Q.C., Address (Remarks delivered to the Toronto CFA Society 10 May 2005) [unpublished], online: Ontario Securities Commission <http://www.osc.gov.on.ca/About/Speeches/sp_200500510_db_torontocfasociety.jsp>.

38. *Re OSC Staff Notice 11-719 A Risk-Based Approach for More Effective Regulation* (2002), 25 O.S.C.B. 8410 at 8416 [*OSC Staff Notice*].

No specific priorities among these categories of offences are identified. The articulation of case selection criteria³⁹ is a welcome initiative as a way of structuring the enforcement discretion of the OSC. Although the approach to enforcement resource allocation seems sensible, the criteria are couched in relatively general terms and would benefit from further elaboration. For example, with respect to the nature of the activities involved, it is indicated that “Staff consider the categories of market participants involved, such as registrants and non-registrants, reporting issuers and their officers and directors, as well as non-reporting issuers and their officers and directors.”⁴⁰ The relevance of the category of market participant for a case selection decision is unclear. Will staff be more likely to pursue a case involving a registrant, a reporting issuer, or a non-reporting issuer? Again, with respect to the issue of “investigative value,” one relevant criterion is described as whether the “case involves an issue that the Commission has determined is a high priority issue.”⁴¹ This lack of clarity is particularly intriguing with respect to the apprehension of bias issues discussed below, as it is not made clear how and when the Commission makes such a determination.

An important similarity across the large securities agencies in Canada is the frequency with which matters end in settlement rather than going to a hearing.⁴² This phenomenon, of course, is not unique to administrative tribunals, but is true of criminal and civil justice more generally. While it is necessary to conserve enforcement resources, it does raise the issue of whether settlements contribute to, or derogate from, the policy goals that the enforcement process is supposed to serve. For example, if deterrence is indeed one of those goals, it is questionable whether it is furthered by settlements, which obviously imply that

39. These include: the nature of the activities; impact; urgency; investigative value; other factors; and diminishing factors.

40. *OSC Staff Notice*, *supra* note 38 at 8417.

41. *Ibid.*

42. Condon, “Enforcement Powers”, *supra* note 25; Philip Anisman, “The Ontario Securities Commission as Regulator: Adjudication, Fairness and Accountability” in Anita I. Anand & William F. Flanagan, eds., *Conflicts of Interest in Capital Market Structures: Papers Presented at the 10th Queen’s Annual Business Law Symposium* (Kingston Ont.: Queen’s University, 2003) 101.

enforcement staff will seek lesser sanctions than might otherwise be applicable in order to dispose of the matter expeditiously.

C. Administrative Law Norms and Securities Regulatory Enforcement

The visibly enhanced activity in Ontario securities enforcement has spawned renewed attention to the application of administrative law norms to enforcement practices. Several specific areas of controversy are enumerated below.

(i) Apprehension of Bias

The OSC's overlapping functions of investigation, adjudication and general policy and rule-making, which had long been taken for granted as aspects of its operation, became an overt source of controversy several years ago. The controversy likely has a number of sources.⁴³ Chief among them were the OSC's successful lobbying for increased administrative sanctioning powers as noted earlier, along with an alleged "aggressive enforcement policy,"⁴⁴ especially with respect to the handling of settlements and the use of the media by enforcement staff.⁴⁵

The controversy was further fuelled by a letter to David Brown from three former OSC chairs in November 2002, on the topic of separating the OSC's investigative and adjudicative functions,⁴⁶ and by a recommendation from the Five Year Review Committee that the question of the Commission's structure be addressed "on a priority basis."⁴⁷ A "Fairness Committee"⁴⁸ established by the OSC to examine

43. See Anisman, *ibid.* for a full account of these issues.

44. Coulter A. Osborne, David J. Mullan & Bryan Finlay, "Report of the Fairness Committee to David A. Brown, Q.C. Chair of the Ontario Securities Commission" (2004), online: The Ontario Securities Commission <http://www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_20040818_fairness-committee.pdf> at 13.

45. Jeffrey Leon, "Administrative Justice and the Ontario Securities Commission: Balancing Fairness with the Fifth Estate" (2000) 12 *The Advocate's E-Brief* 1 (September).

46. Osborne *et al.*, *supra* note 44 at 10.

47. Five Year Review Committee, *Reviewing the Securities Act (Ontario): Final Report* (Toronto: Minister of Finance, 2003) at 65.

its structure discovered “overwhelming” evidence in favour of separating the OSC’s adjudicative function from its other responsibilities.⁴⁹ It further recommended in March 2004 that the adjudicative function of the OSC should be separated from its other tasks, and that an Ontario Securities Tribunal (OST) should be established to make sanction decisions under the *OSA* and to hear reviews from SROs.⁵⁰ In a strongly worded conclusion, the Committee said:

We are satisfied that the nature of the apprehension of bias has become sufficiently acute as to not only undermine the Commission’s adjudicative process, but also the integrity of the Commission as a whole among the many constituencies that we interviewed. Matters of institutional loyalty, the involvement of the Chair in the major cases, the increased penalties, the sense that “the cards are stacked against them,” the home-court advantage, the lengthy criminal law-like trials, and the Commission’s aggressive enforcement stance, which likely will only increase over time, all combine to make a compelling case for a separate adjudicative body.⁵¹

A similar recommendation was made by the Ontario Legislature’s Standing Committee on Finance and Economic Affairs in late 2004, if “substantial progress” towards establishing a single regulator was not made within a year.⁵² The responsible Minister stated that he had “not seen a strong argument against” separation.⁵³ In the meantime the Ontario government appointed a senior legal practitioner, Purdy Crawford, as head of a panel to further study the design of a “common regulator” for securities markets across Canada.⁵⁴ In a speech to the Ontario Legislature on November 14, 2005, Minister Phillips addressed the topic of a separate OSC tribunal:

48. The Committee was established in February 2003, and its members were Coulter Osborne, Q.C., David Mullan, and Bryan Finlay.

49. Osborne *et al.*, *supra* note 44 at 32.

50. *Ibid.*

51. *Ibid.*

52. Anisman, *supra* note 42 at nn. 243-46.

53. *Ibid.*

54. See Crawford Panel, “Blueprint For A Canadian Securities Commission: Final Paper” (7 June 2006), online: Crawford Panel on a Single Canadian Securities Regulator <http://www.crawfordpanel.ca/Crawford_Panel_final_paper.pdf>.

[W]e believe this issue is especially relevant to the structure of a common regulator. Steady progress has been made over the last 12 months toward establishing a single regulator. In the context of a goal that has been proposed since the 1960's, that progress is significant. We have asked the Crawford panel to look at the structure of the adjudicative function in the model they develop, and I look forward to their recommendations. In the meantime, it is important to remember that the independent Fairness Committee . . . found no evidence that OSC hearings have been biased or unfair.⁵⁵

Thus, the ultimate outcome of this policy debate about structural change at the OSC is still unknown. As indicated by the above quote from the Fairness Committee, the proposal for introducing an OST is based on the idea that it would be valuable to take a “sober second look” at regulatory decision-making about the investigations and enforcement matters chosen for formal action. It is perhaps foolhardy to attempt to mount an argument against apparently enhanced accountability and due process, especially when the recommendation for a new tribunal comes from such an august body of experts. It does seem perverse, however, that intense discussion of the need for a new tribunal arises when the OSC, by many accounts, is taking its enforcement role more seriously than it may have in the past. This leads to speculation that complaints about bias are another weapon in the legal arsenal of respondents and their lawyers.⁵⁶

Leaving aside the political context of these proposals, some of the justifications proffered by the Fairness Committee for its

55. “Ontario Government Makes Progress on Securities Reform” *CNW Group* (14 November 2005), online: Ministry of Finance News <http://ogov.newswire.ca/ontario/GPOE/2005/11/14/c4918.html?lmatch=&lang=_e.html>.

56. Some commentators also note an unfortunate coincidence of timing between the government's acceptance of the recommendations of the Fairness Committee and the OSC's investigations into the role played by government officials in issuer companies. Thus, in her paper for the Queen's Business Law Symposium, Dublin, *supra* note 33 at 15 argues that the government's desire to proceed with bifurcation was a surprising defeat for David Brown, and one can only speculate that it may have been a manifestation of the strained relationship with the government that had developed as a result of the fallout that the OSC's automatic notification process had inadvertently created for Finance Minister Sorbara in connection with the Royal Group Technologies investigation. In other words, perceived concerns about OSC's integrity with respect to its exercise of investigative functions came about in part because of its investigations of government officials.

recommendations seem stronger than others. How exactly do we judge when an enforcement stance is too “aggressive?” Why would we assume that the members of a new OST would not exhibit their own form of “institutional loyalty?” If “lengthy criminal law-like trials” are a problem, how will this situation be improved by a new tribunal? Indeed one might just as cogently argue that this tendency will increase when hearings take place before a body that is detached from the day-to-day business of regulating. In this respect, a salutary reminder is provided by Kagan’s critique of “adversarial legalism” in the U.S. context. He argues that:

In its prescriptiveness, punitiveness, and formalization of business-government relationships, American adversarial legalism induces mutual resentment, defensiveness, and mistrust. It thereby discourages the kind of cooperation that is essential to the full achievement of regulatory goals, and it gives regulation a bad name, making it more difficult to adopt justifiable new regulatory programs and rules. That is its most serious consequence.⁵⁷

In other words, as I argue further below, we need to pay close attention to the full range of possible consequences of removing the adjudicative function from the Commission itself. One possible result might be that any consequences will be muted by the fact that the volume of settlements entered into so as to resolve enforcement matters dwarfs the number of actual hearings under section 127. Indeed, those concerned about the accountability of the regulator might argue that “arms-length review” of settlement decisions is even more important than further independence for hearing decision-makers. But a possible consequence of creating an arms-length decision-maker is that the hyper-proceduralization of regulatory decisions I discuss below will persist and be enhanced, turning administrative hearings even more into criminal-type trials. As Kagan notes, the higher costs and greater uncertainty that may result “are borne by the society at large, not merely by regulated firms.”⁵⁸ Thus, before moving to bifurcate the Commission’s enforcement functions, we should be clear about what “comparative

57. Robert A. Kagan, *Adversarial Legalism: The American Way of Law* (Cambridge: Harvard University Press, 2001) at 206 [Kagan, *Adversarial Legalism*].

58. *Ibid.* at 198.

advantages” regulatory enforcement can bring to the task of achieving the statutory mandates enumerated in section 1 of the *OSA*. One of these advantages, presumably, is the ability to align emerging norms of rule and policy making with reactive enforcement decisions. Another is the capacity of regulatory enforcement to find creative ways to accomplish “cultures of compliance” within regulated firms — a capacity which is obviously greater than that of the criminal courts making episodic sanctioning decisions.

(ii) “Judicialization” of Commission Hearings

As noted by the Fairness Committee, the growing frequency of lengthy criminal-type trials is a discernible trend in Ontario securities enforcement. Issues of process in regulatory decision-making have generated increasing attention from litigators and regulatory subjects.⁵⁹ The OSC’s enthusiasm for proceeding under section 127 of the *OSA* has made respondents more skittish about the breadth of the decision-making powers under that provision. It is now beyond question that to sanction under section 127, the OSC does not have to find a breach of a substantive provision of the *Act*, as long as its considered opinion is that it would be in the public interest to make the order.⁶⁰ This has led respondents to increasingly seek greater clarity about the OSC staff’s intentions, with respect to the allegations being made, at an earlier stage in the proceedings.

The *ATI Technologies* matter, which involved allegations of insider trading against a number of individuals associated with the firm, illustrates the increasing adversarialness on procedural issues.⁶¹ A motions hearing was requested by respondents’ counsel to clarify whether the evidence on which an order under section 127 can be made

59. James A. Riley & Cathy Singer, “Process and Accountability for the OSC Enforcement Branch” in Anita I. Anand, Justin A. Connidis & William F. Flanagan, eds., *Crime in the Corporation: Papers Presented at the 11th Queen’s Annual Business Law Symposium* (Kingston Ont.: Queen’s Annual Business Law Symposium, 2004) 226; Anisman, *supra* note 42.

60. *Re Canadian Tire Corporation Limited* (1987), 10 O.S.C.B. 857.

61. *Supra* note 21.

(in the absence of a finding that there was a substantive breach of the Act) must be presented to the hearing panel in a way that allows the respondents to prepare their case properly.⁶² Interestingly, however, at that point Staff conceded that they would not request an order under section 127 if they could not prove a breach of the section 76 insider trading prohibition. This could be read as a practical example of an effort being made by OSC enforcement staff, under pressure from respondents' counsel, to distance themselves from the decision-makers that ultimately make discretionary public interest determinations under the OSA.

In the same matter, a further motions hearing was conducted at the close of the evidence presented by enforcement staff, in which counsel for one of the respondents requested a nonsuit motion on the basis that staff had not established a *prima facie* case against another respondent, Betty Ho. This was a novel issue for the OSC hearing panel, which ruled that such a motion could in fact be brought.⁶³ Following consideration of the matter, the panel concluded that the respondent had not discharged the onus to demonstrate that staff had not alleged a *prima facie* case, but rather that inferences could reasonably be drawn from the evidence presented by staff that an offence had been committed by the respondent.⁶⁴ My point here is to illustrate that I

62. *In the Matter of the Securities Act, R.S.O. 1990, chapters s.5, As Amended. — and — In the Matter of ATI Technologies Inc., Kwok Yuen Ho, Betty Ho, Jo-Anne Chang, David Stone, Mary de la Torre, Alan Rae and Sally Daub* (2004), 27 O.S.C.B. 6859. One of the respondents, K.Y. Ho, requested a reconsideration of this issue when the hearing panel itself was constituted, but this request for reconsideration was refused.

63. It further ruled that, given its discretion to control its own procedure and the circumstances of the case, it would not require the respondent to be put to an election as to whether to call evidence prior to considering the nonsuit motion.

64. The OSC Panel's final decision in this matter was released on October 14, 2005. See *In the Matter of the Securities Act, R.S.O. 1990, chapters s.5, As Amended. — and — In the Matter of ATI Technologies Inc., Kwok Yuen Ho, Betty Ho, Jo-Anne Chang, David Stone, Mary de la Torre, Alan Rae and Sally Daub* (2005), 28 O.S.C.B. 8558. In it the panel addressed further procedural issues with respect to (i) the burden of proof to be met in a matter involving a "serious complaint" ("While the standard of proof in administrative proceedings is the civil standard of the balance of probabilities, Staff conceded that, this being an alleged violation of subsection 76(1) of the Act, it could only discharge its burden by clear and convincing proof based on cogent evidence"), and (ii) reliance on

expect this close attention to procedural issues in the context of section 127 hearings to continue, as respondents increasingly use experienced litigators to represent them.⁶⁵

But this enhanced “proceduralization” again raises the policy issue identified earlier, which is whether we want the regulatory process to become dominated by Kagan’s notion of “adversarial legalism,”⁶⁶ thereby increasing costs both for respondents and the regulator, as well as producing uncertainty and further divisiveness in relations between regulators and the regulated.⁶⁷ Indeed, we may even be in danger of forgetting that enforcement is meant to be only one prong of an integrated regulatory approach. As John Scholz puts it, “public [regulatory] institutions provide an arena to debate, reinterpret, and legitimize changes in the standards of corporate conduct required in a dynamic economy.”⁶⁸

To return to administrative law basics, what are the purported advantages of giving enforcement powers to a regulatory agency? Ideally, we give them such powers because they can be more nimble, more targeted and more specialized than the courts in their approach to economic or social regulation. Indeed, the exercise of regulatory discretion (such as the determination of what is in the “public interest”)

hearsay evidence in the context of an OSC hearing (“There are numerous rationales for permitting tribunals to accept hearsay evidence. . . . The more serious and contentious a complaint, the more a tribunal in exercising its discretion under subsection 15(1) of the *SPPA*, must have regard to the rights of the person who is the subject of the complaint,” *ibid.* at para. 13, 21).

65. For another example, see the SCC’s decision in *Deloitte & Touche LLP v. OSC*, 2003 SCC 61, [2003] 2 S.C.R. 713.

66. Kagan, *Adversarial Legalism*, *supra* note 57.

67. It is, however, important to remember, as Michael Code points out, that there remain significant differences between criminal and regulatory proceedings with respect to, for example, the rules of evidence that apply, the requirement to prove individual elements of an offence in a criminal context, and the fact that those found guilty in a regulatory context cannot be jailed. See Michael Code, “Comments on ‘Your Money or Your Life’” (Paper presented at the Queen’s Business Law Symposium, 14 October 2005) [unpublished].

68. John T. Scholz, “Enforcement Policy and Corporate Misconduct: The Changing Perspective of Deterrence Theory” (1997) 60 *Law and Contemporary Problems* 253 at 263.

can only be justifiable if it is engaged in by individuals with a deep understanding of the overall regulatory framework to be maximized. Thus, if the Fairness Committee is correct that “the role of policy in sanctioning proceedings is limited”⁶⁹ then this could be a problem since the main purpose of sanctioning is to further the policy goals of the statute.

(iii) Is Diversity of Enforcement Efforts Across Canada a Problem?

Reference was made earlier to the types of enforcement actions the OSC has been recently engaged in under section 127, as well as its attempt to structure its discretion by way of adopting risk-based criteria as guides for priority setting. On a national level, there is a larger issue with respect to the structuring of enforcement discretion. One of the issues that surfaced during my research for the WPC was the existence of some fragmentation of enforcement effort among different provinces, particularly with respect to matters that became the subject of enforcement hearings under section 127 or its equivalent in other provinces. For example, B.C. concentrated on illegal distributions, and to a lesser extent, insider trading, whereas Ontario tended to focus more on registrant-specific issues. As was acknowledged in the research study, these contrasts became more subtle when bigger numbers of settlement agreements in both provinces were factored in, but the issue remains as to how we should think about the fact that different regulators in Canada may pursue different enforcement priorities. The easy answer is that this is to be expected, since regulators respond to features of their local market environment, but we must consider whether it is desirable that there could be a perception of differential possibilities to successfully conduct an illegal distribution in one province rather than another. The WPC study ultimately recommended that greater attention be paid to rationalizing enforcement priorities across the country, so as to develop a concerted multi-provincial approach to the task of enforcing where appropriate, and to use scarce enforcement resources more effectively. The CSA is likely to be the most appropriate venue for sharing information, debating priorities and pursuing multi-

69. Osborne *et al.*, *supra* note 44.

provincial enforcement initiatives. This is particularly important given that the so-called passport system retains a great deal of provincial autonomy in enforcement matters.⁷⁰

D. Sanctioning Philosophies: The Punishment Versus Protection Conundrum

Another controversy related to applying administrative law norms to enforcement adjudication is the robustness, in practice, of the distinction between penal and protective objectives in regulatory sanctioning. The well-known justification for giving sanctioning powers to a regulatory agency like the OSC is that such powers are necessary for it to fulfill its overall statutory mandate. In the case of securities commissions, this has been held to mean that the exercise of sanctioning powers is legitimate insofar as they contribute to the goal of protecting investors and capital markets from the harm caused by a variety of “unfair, improper or fraudulent practices.”⁷¹ Thus the appropriate analysis must be *future-oriented*, focusing on the need to protect the integrity of the capital markets on a going forward basis rather than being focused on designing an appropriate punishment for the nefarious activities being impugned. Conceptually, this is a very hard line to draw, given that it is occurring in the context of determining sanctions for particular respondents, following the finding that they engaged in such behaviour.⁷²

70. See Proposed MI 11-101 *Principal Regulator System*, Ontario Securities Commission, *supra* note 32. A quite different mechanism for structuring enforcement discretion is the possibility that over time standard setting by the International Organization of Securities Commissions (IOSCO) will have a trickle-down effect on the enforcement activities of domestic regulators. This is particularly likely because of the ongoing involvement of David Brown in IOSCO activities, but will also be because IOSCO is a natural vehicle for addressing cross-border issues in enforcement, as well as features of the global economy (such as money laundering) that affect a large number of countries.

71. *OSA*, *supra* note 2, s. 1.1. See *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132 at para. 41 and *Re Cartaway Resources Corp.*, [2004] 1 S.C.R. 672 [*Cartaway*].

72. Mary Condon, “Hope Deferred? Comments on Groia and Seaman ‘Enron: Fear and Loathing on Bay Street’” in Anita I. Anand & William F. Flanagan, eds., *The Corporation*

In practice too, the nature of the sanctions available to the OSC under section 127 makes it difficult to distinguish penalty from protection. Does it matter that when the OSC levies an administrative penalty of \$100,000 on an individual found to have engaged in insider trading, so as to deter that individual (or others) from doing it again and thereby protect the securities market from such behaviour, the respondent experiences this outcome as punitive? In addition, such scenarios raise a constitutional issue, as was flagged by the Fairness Committee, in the sense that sanctioning powers which carry “truly penal consequences” may engage the protections of section 11(d) of the *Canadian Charter of Rights and Freedoms*, which provides for a presumption of innocence until a hearing before an independent and impartial tribunal.⁷³ One possibility is, therefore, that the severity of the sanctions available to regulators may force a collapse of the analytical distinction between protection and punishment in a future Supreme Court of Canada decision on the issue.

The analytical confusion is heightened by the fact that securities regulators in Ontario have begun to rely heavily on deterrence as the guiding principle for making public interest-based orders, and we have noted that the severity of punishment that this is thought to cause is a significant source of the concern about bias in enforcement decision-making. The deterrence-based approach to section 127 decision-making was sanctioned by the Supreme Court in *Cartaway* when it accepted the idea that deterrence can be both the basis for severe punishment by courts and a way to further the enterprise of policing capital markets by regulators.⁷⁴ Thus, Justice LeBel said in *Cartaway* that “it is reasonable to view general deterrence as an appropriate, and perhaps necessary,

in the 21st Century: Queen's Annual Business Law Symposium (Kingston, Ont.: Queen's University, 2002) 258.

73. Osborne *et al.*, *supra* note 44 at 70; Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11. The Committee ultimately concluded that recent changes in the way cases are allocated to individual Commissioners of the OSC would probably be sufficient to withstand a s. 11 challenge, such as a prohibition in the *Act* on Commissioners acting in both investigatory and adjudicative capacities in connection with the same proceedings.

74. *Supra* note 71.

consideration in making orders that are both protective and preventative.”⁷⁵ Furthermore, he asserted:

It may well be that the regulation of market behaviour only works effectively when securities commissions impose ex post sanctions that deter forward-looking market participants from engaging in similar wrongdoing. That is a matter that falls squarely within the expertise of securities commissions, which have a special responsibility in protecting the public from being defrauded and preserving confidence in our capital markets.⁷⁶

While this law and economics-inspired perspective on the triggers of market actor behaviour certainly gives the regulators a green light to continue to use deterrence as a guiding philosophy of public interest administrative orders, it may serve to further muddy the waters about whether there can be a principled distinction between the role of courts and regulators in sanctioning market participants. It is also likely to fuel continued complaints about the OSC’s multiple roles.

One way out of the conceptual quagmire is to rethink the commitment to deterrence as the orienting basis for administrative orders under section 127. Instead, one might propose that enforcement efforts should be redirected to improving compliance cultures and outcomes among the variety of market participants regulated by the Commission.⁷⁷ This argument will be further elaborated later in the paper, but it leads now to the suggestion that there has in fact been an *underuse* of some forms of administrative order by the OSC. Much attention has been paid to the arrival of the administrative penalty and the order for disgorgement, and the older registration suspension and cease trading powers are well established in the Commission’s jurisprudence. What have been less readily employed are the powers to require market participants to submit to a review of practices or

75. *Ibid.* at para. 60.

76. *Ibid.* at para. 62.

77. Donald C. Langevoort, “Monitoring: The Behavioural Economics of Corporate Compliance with Law” (2002) *Colum. Bus. L. Rev.* 71 [Langevoort, “Monitoring”].

procedures and to institute change therein,⁷⁸ or to impose terms and conditions on existing registrations or recognitions.⁷⁹

E. "Monopoly for Grown-Ups?":⁸⁰ The Use of Criminal Sanctions in Ontario Securities Regulation

A variety of *Criminal Code* provisions address inappropriate activity in securities markets, such as fraud, fraudulent manipulation of stock exchange transactions, publishing a false prospectus and the recent enactment of an insider trading offence.⁸¹ Other amendments to the *Criminal Code* have increased the maximum penalties for conviction of some of these indictable offences. Adding a new prohibition against insider trading to the arsenal of insider trading sanctions already provided in provincial statutes is frequently cited as an example of "get tough" politics at the federal legislative level. Several academic commentators have persuasively argued that there are significant problems with the formulation of this provision, making it unlikely that it will be extensively used to ground criminal convictions.⁸² The provision uses a definition of the information whose use is proscribed that is different from that contained in the *OSA*, it applies to a broader class of issuer than the typical *Securities Act* class, and in particular it

78. *ATI Technologies*, *supra* note 21.

79. *Re Paradigm Capital Inc.* (2004), 27 O.S.C.B. 5790.

80. See comment by Justice Khawly on mergers and acquisitions in *R. v. Rankin*, [2005] O.J. No. 3202 at para. 36 (Ct. J.) (QL), [*Rankin*]. As this paper went to press, Rankin's conviction was overturned by Justice Nordheimer of the Ontario Superior Court and a new trial ordered. Ontario Securities Commission News Release, "Andrew Rankin Convictions Set Aside on Appeal" (9 November 2006), online: Ontario Securities Commission <http://www.osc.gov.on.ca/Media/NewsReleases/2006/nr_20061109_osc-rankina.jsp>.

81. See *Criminal Code*, R.S.C. 1985, c. C-46, ss. 380-84, 400. See s. 382.1 for the new offence of insider trading.

82. Mark Gillen, "Recent Developments in Insider Trading Regulation in Canada" in Anita I. Anand, Justin A. Connidis & William F. Flanagan, eds., *Crime in the Corporation: Papers Presented at the 11th Annual Queen's Business Law Symposium 2004* (Kingston, Ont.: Queen's University, 2004) 142; Anita Anand, "A political bill" *National Post* (16 September 2005) FP19 [Anand, "A political bill"]; Coffee, "Understanding Enron", *supra* note 13 at 597.

requires proof of a higher degree of knowledge. Anand also points to potential constitutional law problems with the *Criminal Code* provision, such as a paramountcy problem and the possibility of double jeopardy.⁸³

In Ontario, section 122 of the *OSA* establishes a number of quasi-criminal offences: making materially misleading or untrue statements in evidence or information submitted to the Commission; making such statements in documents required to be filed under Ontario securities law, such as prospectuses or takeover bid circulars; and the offence of “contravening Ontario securities law.”⁸⁴ Section 122 is thus a relatively broadly-cast provision. In contrast, the proposed British Columbia *Securities Act*⁸⁵ enumerates a large number of specific infractions for breaches of specific provisions of the *Act*. These differences in legislative approach have been reduced by the introduction in 2005 of sections 126.1 and 126.2 of the *OSA*. These provisions create new offences relating to fraud, market manipulation and making misleading or untrue statements that would reasonably be expected to have a significant effect on the market price or value of a security. One possible result is that matters involving fraud, market manipulation or making misleading statements, which would have been the subject of a section 127 administrative hearing will now be dealt with criminally. However, there are some problems with proceeding in this way.

There has been some increase in Ontario in the use of quasi-criminal remedies in cases like *Harper*,⁸⁶ *Atlas Cold Storage*,⁸⁷ and most recently *Rankin*,⁸⁸ *Discovery Biotech*⁸⁹ and the *von Anhalt* matter.⁹⁰ This increase

83. Anand, “A political bill”, *ibid*.

84. Section 122(4) provides for enhanced penalties for contraventions of s. 76, the insider trading prohibition (*supra* note 2).

85. Bill 38, amending the current British Columbia *Securities Act* (*BCSA*), was passed by the B.C. government in May 2004, but its proclamation has been deferred until December 31, 2007. *Securities Act*, R.S.B.C. 1996, c. 418.

86. *Re Harper* (2004), 27 O.S.C.B. 3937; *R. v. Harper*, [2000] O.J. No. 2791 (Ct. J.) (QL) aff'd [2003] 232 D.L.R. (4th) 738, [2003] O.J. No. 4196 (C.A.) (QL).

87. *Re BMO Nesbitt Burns Inc.* (2001), 24 O.S.C.B. 6969 [*Atlas Cold Storage*]. *Atlas Cold Storage* was a party to the case.

88. *Supra* note 80.

89. *Re Discovery Biotech Inc.* (2003), 26 O.S.C.B. 4322.

is contrary to the alleged “disappearance” of corporate crime in other contexts,⁹¹ although it must be admitted that the frequency of criminal disposition in Ontario securities matters has historically been very low. As noted earlier, the current Chairs of the OSC and SEC have indicated a pre-commitment to the strategy of exacting criminal penalties for securities-market related infractions.

In practice, there are a number of difficulties associated with using criminal or quasi-criminal provisions to ground sanctions. One is the ongoing problem of the time it takes to resolve a criminal matter. It is a staple of deterrence-based thinking that punishment has to come swiftly and sharply for maximum effect. Yet this is often precluded by difficulties of investigation, such as accessing and interpreting large quantities of documents and obtaining court dates for a variety of pre-trial matters. A notorious example is the *Livent* matter, where several charges were recently dropped and the trial is expected in spring 2007, some nine years after allegations of fraud and inaccurate financial reporting first surfaced.⁹² Similarly, Khawly J. noted in his decision in *Rankin* that “justice for the public or Mr. Rankin has not been swift as this matter has taken four years to come to trial.”⁹³

Another pervasive strategic issue for enforcement staff, of course, is the limitation in the *OSA* on the use of compelled testimony. Section 13 of the *OSA* allows enforcement staff to compel testimony in the course of an investigation, but section 18 goes on to provide that this testimony may not be admitted in evidence in a prosecution under section 122. These provisions offer a lot more scope to gather evidence pursuant to a

90. *Ontario (Securities Commission) v. von Anhalt*, [2005] O.J. No. 247 (Sup. Ct.) (QL) [von Anhalt]. Outstanding matters include: *Re Landen and Diamond* (2006), 29 O.S.C.B. 264 (insider trading/tipping); *R. v. Felderhof* (2003), 68 O.R. (3d) 481 (C.A.) (misleading statements, insider trading); *Re Maitland Capital Ltd. et al.* (2006), 29 O.S.C.B. 7872 (distribution of securities without a prospectus, misleading statements); *Re Portus Alternative Asset Management Inc. et al.* (2006), 29 O.S.C.B. 5213 (misleading statements, distribution of securities without a prospectus).

91. Laureen Snider, “The Sociology of Corporate Crime: An Obituary (Or: Whose Knowledge Claims have Legs?)” (2000) 4 *Theoretical Criminology* 169.

92. Paul Waldie & Richard Blackwell, “Several Charges Against Drabinsky Dropped; Impresario’s Trial Should Start in 2007” *The Globe and Mail* (23 September 2005) B5.

93. *Supra* note 80 at para. 7.

section 127 hearing than for a quasi-criminal action.⁹⁴ Relatedly, the *Rankin* case illustrates how prosecutors may expose themselves to criticism in an effort to obtain the cooperation of trial witnesses so as to sustain a criminal burden of proof.⁹⁵

Interestingly, cases like *Harper* return us to the question of the blurring of the distinction between the sanctioning function of courts and regulators. Following appeals from his original sentence for insider trading, Harper ended up serving six months imprisonment as well as paying a fine of two million dollars. On his release from jail, the OSC made a section 127 order prohibiting him from acting as officer or director of a reporting issuer for 15 years, and it also issued a cease trading order against him for the same period. The panel was quite cognizant of the fact that “since Harper is 60 years of age, 15-year bans would keep Harper out of the market, in effect, for the rest of his remaining business life.”⁹⁶ In its reasons, the OSC panel was clear that it viewed its jurisdiction under section 127 as entirely independent of action taken under other legal provisions, and that “protective and prophylactic orders should be made, which would also send the message that any like-minded individuals in circumstances similar to Harper’s . . . may be subject to similar prophylactic consequences regarding their access to the capital markets.”⁹⁷

Meanwhile, Puri has addressed some of the difficulties involved in the criminalization strategy. She proposes that judges should receive “greater education and social context training on the real harms caused by capital markets misconduct and [on] appropriate sanctions in the

94. Query whether this proposition has been softened by the SCC’s decision in *R. v Jarvis*, [2002] 3 S.C.R. 757, in the sense that *Jarvis* allows evidence gathered in the course of an administrative audit to be used pursuant to a criminal matter, as long as the primary purpose of gathering the evidence was not to impose criminal liability.

95. *Supra* note 80. See the comments of Khawly J. at paras. 238-243 concerning the views of the “hardworking, person-on-the-street, investor” about the “deal with Duic.”

96. *Re Harper*, *supra* note 86 at para. 53.

97. *Ibid.* at para. 52.

criminal law context,” and that specialized criminal courts for corporate and white collar crime should be created.⁹⁸

While these proposals undoubtedly have merit, in the end the criminalization strategy is likely, for both conceptual and practical reasons, to have limited effect in bringing about the state of affairs desired by investors, the public, regulators and law-abiding market participants. Rather, we need to seriously confront the issue of whether the blunt instrument of criminal law can succeed in deterring inappropriate behaviour where the internal organizational incentives (such as the pressures of competitiveness or forms of compensation) to behave in such ways are at odds with the strictures of the law.⁹⁹ This is not to say that criminal law is not legitimately used to express a collective sense of outrage and disapproval at the socially irresponsible and damaging behaviour of some capital market actors but such denunciatory impulses may be temporally limited and ultimately insufficient to produce much behaviour modification.

F. Follow the Money?: Section 128 of the OSA

Section 128 of the OSA allows the OSC to apply to the courts for a declaration that a person or company has not complied with or is not complying with Ontario securities law.¹⁰⁰ It remains a puzzle why this provision has been used so rarely in Ontario, given the popularity of similar provisions available in the U.S. to the SEC.¹⁰¹ One reason is that

98. Poonam Puri, “Enforcement Effectiveness in the Canadian Capital Markets: A Policy Analysis” (Toronto: Capital Markets Institute, University of Toronto, June 14, 2005) [Puri, “Enforcement Effectiveness”].

99. Rankin, *supra* note 80. Note here Justice Khawly’s account of the “caliber and character” of individuals who work in the mergers and acquisitions field. Thus (at para. 192), “That type is no wallflower, he or she is competitive, driven, ambitious, hungry to learn and earn.”

100. If a court makes such a declaration, s. 128(3) enumerates a wide range of orders it may make, though other unspecified orders may also be made, whether or not a penalty has been imposed under s. 122 or an order made under s. 127.

101. A recent example of its use has been the *von Anhalt*, *supra* note 90, matter where the OSC brought an application for a declaration of non-compliance under s. 128 based on a failure to comply with a previous OSC order.

some of the enumerated orders which can be made by a court can be made by the OSC itself under section 127. These include prohibiting someone from being an officer or director of an issuer, requiring submission to a review of business practices, and disgorgement for noncompliance with Ontario securities law. Another reason for the non-use of the provision may have to do with the regulators' assessment of the specialized expertise of the judges from whom an order would be sought.

However, one remedial order available to a court under section 128 is the power to "require the person or company to compensate or make restitution to an aggrieved person or company."¹⁰² A number of commentators argue for increased use of this provision in order to facilitate civil remedies for investors.¹⁰³ In a presentation to the Standing Senate Committee on Banking, Trade and Commerce on June 16, 2005, David Brown observed that "it's increasingly apparent that there's a need to place more emphasis on providing protection to the investor as a consumer of financial services."¹⁰⁴ Similarly, speakers at the OSC's Investor Town Hall, held in May 2005, expressed "a strong desire for restitution mechanisms for consumers who have suffered a loss as a result of wrongful actions of market participants."¹⁰⁵ Brown indicated that the OSC was examining several ways of pursuing the goal of allowing investors to "pursue restitution in a timely and affordable manner."¹⁰⁶ The proposal that the OSC reimagine itself as a facilitator of investor restitution should, in my view, be evaluated in the context of two issues. One is the implementation of sections 138.1-14 of the *OSA*, which provide enhanced civil remedies to investors with respect to issuers in the secondary market, to be discussed later in this paper. The other is the question of the appropriate purposes to be served by regulatory enforcement. It is to this issue that I now turn.

102. *OSA*, *supra* note 2.

103. Puri, "Enforcement Effectiveness", *supra* note 98; Wojtek Dabrowski, "OSC Struggles Under Load" *National Post* (Aug 28, 2004) FP1.

104. David A. Brown, "Remarks to Standing Senate Committee on Banking, Trade and Commerce" (16 June 2005), online: The Ontario Securities Commission <www.osc.gov.on.ca/About/Speeches/sp_20050616_db_standing-senate-comm.pdf>.

105. *Ibid.* at 2.

106. *Ibid.*

G. What Should Enforcement Do?

The academic literature on regulatory enforcement strategies poses a tension between two general approaches, a deterrence-based and a compliance-based strategy. Each of these proceeds from a particular vision of how targeted individuals or firms operate. Those who propose deterrence as an optimal strategy argue that it will work because individuals or firms are rational profit-maximizers, and “violations [will] occur when the perceived benefits of noncompliance exceed the anticipated cost of sanctions.”¹⁰⁷ In the competing vision, individuals or firms are generally law-abiding and prepared to follow the “compliance norm,” which is that “legitimate regulation . . . ought to be followed.”¹⁰⁸ These alternatives can fuel a variety of empirical studies, designed to test which vision of individual or firm behaviour seems the most plausible in specific locations of economic or social regulation.¹⁰⁹ A body of recent socio-legal research suggests that deterrence-based enforcement strategies are impoverished as a motivator of individuals and firms. For example, there is evidence in non-securities regulatory contexts that the dissemination of information among industry participants about so-called “signal cases,” in which deterrence-based sanctions are applied, is not sufficiently widespread to be the source of compliance with law.¹¹⁰ In a research study that surveyed 233 firms to assess respondents’ knowledge of and attitude to U.S. *Environmental Protection Act* enforcement actions, Thornton, Gunningham and Kagan made a number of relevant findings. They discovered that of far greater importance than either specific or general deterrence is what they term “‘implicit general deterrence’ where the outcome of sustained inspection and enforcement activity is to inculcate a ‘culture of compliance’ in which it was the *regulations themselves* rather than enforcement action

107. Malloy, *supra* note 10 at 453.

108. *Ibid.* at 455.

109. See e.g. Jon Sutinen & K. Kuperan, “A Socio-Economic Theory of Regulatory Compliance” (1999) 26 *International Journal of Social Economics* 174.

110. See Dorothy Thornton, Neil A. Gunningham & Robert A. Kagan, “General Deterrence and Corporate Environmental Behavior” (2005) 27 *Law & Pol’y* 262.

that had a direct impact on compliance behavior.”¹¹¹ If this is correct, it suggests that the establishment of proactive standards, rather than reactive enforcement, is important in influencing regulatory compliance. Thus, “company managers were not closely attentive to or knowledgeable about the penalties assessed against violators, generally underestimating them.”¹¹² Gunningham and Kagan conclude that the relationship of business behaviour to regulatory law and enforcement is complex, and

not adequately captured by traditional economic models which assume that firms respond only to short-term economic incentives, including predicted costs of detection and punishment. In economically advanced democracies, firms are concerned about their reputations and legitimacy as well, and often are responsive to the norms underlying regulatory requirements . . . a key contribution of regulation is to trigger and direct managerial commitments — educating them about regulatory concerns and problems, stimulating proactive measures to review and improve previously established compliance programs, or the search for more cost-effective modes of achieving regulatory goals.¹¹³

In other words, this empirical research suggests that deterrence as a philosophy of either criminal or administrative sanctioning has limited success as a motivator of “good” behaviour among members of an industry or business sector.

A principal reason for this, according to Malloy, is that insufficient attention is paid in conventional research to the ways in which a “firm’s internal environment can affect managers’ decisions about compliance.”¹¹⁴ He elaborates:

Deficient routines can undercut the power of deterrence and hobble the compliance norm’s capacity to secure compliance in areas that traditional enforcement cannot reach. If deficient firm routines are a significant cause of violations, it appears that regulators could increase compliance by ensuring that the routines are improved. In other words,

111. Neil A. Gunningham & Robert A. Kagan, “Regulation and Business Behavior” (2005) 27 *Law and Pol’y* 213 at 215.

112. *Ibid.* at 282.

113. *Ibid.* at 217.

114. *Supra* note 10 at 457.

routine noncompliance is essentially a “management problem,” and as such it is an obvious case for considering direct regulation of the firm’s management function.¹¹⁵

Thus Malloy argues that the immediate firm environment in which employees operate is more consequential for the issue of compliance or noncompliance than external regulatory influences. If the organizational incentives framing employee behaviour emphasize individual competitiveness or the suppression of negative information, it will be difficult for legal sanctions to be an effective counterweight. As Langevoort puts it with respect to the lessons to be drawn from Enron:

[S]uccess in highly competitive business organizations is skewed in the direction of rewarding those who are highly focused at the business of competing, which of necessity means the cognitive ability to block out concerns — like difficult ethical problems — that are likely to be distracting.¹¹⁶

Langevoort elaborates on this argument with an example drawn from the financial services sector. He states:

Imagine . . . an integrity-based system in a financial services firm that emphasizes the need to be candid and responsive to customer needs. That sounds very appealing as a way of building long-term customer loyalty, and one might predict that salespeople would react positively to the legitimacy of the message. Now, however, introduce a highly competitive tournament and quota system for salespeople in which pecuniary rewards are heavily skewed to the top performers and laggards are dealt with harshly . . . one can see how the incentives skew against the values message, simply because of the timing mismatch between the temporally distant return to the firm from customer loyalty and the immediate carrots and sticks built into the incentive structure.¹¹⁷

One could easily replicate this example in the context of a reporting issuer environment where managerial compensation is tied to the price of the issuer’s shares or where a high share price is necessary to leverage the firm’s future business activities. Significantly, Langevoort argues that

115. *Ibid.* at 497.

116. Donald C. Langevoort, “The Organizational Psychology of Hyper-Competition: *Corporate Irresponsibility* and the Lessons of Enron” (2002) 70 *Geo. Wash. L. Rev.* 968 at 971.

117. Langevoort, “Monitoring”, *supra* note 77 at 107.

legal rules or standards establishing vague or indeterminate requirements on corporate actors, such as “reasonableness” or “good faith,” will be insufficient to offset the biases created by the firm’s ongoing operating environment. The implication is that a more specific set of regulatory requirements and/or more pervasive monitoring by regulatory agents is required to reorient the “culture” of such firms. This all leads to an argument that the role of regulation should be to foster a compliance culture that is clear-sighted about the tendencies of internal incentives to undermine legal rules, and to design enforcement programmes that are much more fine-grained in their attempts to educate and shape organizational behaviour.¹¹⁸ As indicated above, there are some signs that the OSC is aware of this task, such as its recent settlement agreements, and more generally its proactive efforts to streamline and enhance corporate governance and internal reporting practices among issuers.¹¹⁹ Much more needs to be done to assess the current incentive structures within reporting issuers and securities firms and the extent to which those incentive structures undermine statutory goals, though the difficulties involved in changing course should not be underestimated. A further implication of this argument is that the task at hand — finding ways to change organizational cultures — is more suited to regulators than it is to courts. It may be objected that if the enforcement task is as

118. At a proactive level, it is clear that this is the impulse behind the introduction of the various *Sarbanes-Oxley* requirements in the U.S. (*supra* note 33) and their equivalents in Canada, such as MI 52-109 and MI 52-110, *supra* note 32.

119. Particularly noteworthy is the resolution of the CP Ships matter, which involved the issuing of a warning letter instead of formal enforcement proceedings where disclosure of the restatement of financial statements was delayed and insider trading may have occurred. In cooperating with the OSC, CP Ships established a special committee to investigate the issues and, among other things, undertook a review and revision of the company’s insider trading and corporate disclosure policies. See Ontario Securities Commission, News Release/Communiqué, “Credit for Cooperation by a Reporting Issuer Results in a Caution to CP Ships Rather than the Commencement of Formal Proceedings” (7 July 2005), online: Ontario Securities Commission <http://www.osc.gov.on.ca/About/NewsReleases/2005/nr_20050707_osc-cp-ships.jsp>. Note also David Wilson’s comment in his November 17, 2005 speech that with respect to the regulation of the mutual fund industry, the CSA is considering “a number of policy initiatives, such as mandated compliance programs.” See Wilson, *supra* note 33 at 5.

suggested here,¹²⁰ self-regulatory organizations (SROs) are better suited to it because they are “closer” to the regulatory subjects. Self-regulation exists, of course, only for certain sectors of the financial services industry rather than reporting issuers more generally. Nor does its existence in those sectors undercut the need for policy-level guidance and oversight by the OSC as the arms-length agency with responsibility to further the statutory mandate, though it may be that a rational division of labour between the regulator and SROs, with respect to this task, could be possible.

II. Civil Remedies in the Secondary Market

A. The Winter of Our Discontent?: Proclaiming Sections 138.1–14 of the OSA

Part XXIII.1 (sections 138.1-138.14) of the OSA was finally proclaimed at the end of 2005, three years after it first appeared as a set of legislative amendments. The provisions of this part are heralded as a major change in securities law in Ontario¹²¹ by allowing investors to sue issuers and others for inadequate disclosure provided to the secondary marketplace. Since the secondary market is where the vast majority of securities trading actually takes place, this provision theoretically opens the door to the robust involvement of so-called “private attorneys general” in enforcing the norms of securities law. Thus, it seems that a reasonable way to proceed would be to identify the policy goals that are sought by these provisions, and to assess the likelihood of success in

120. I pursue in more detail the issue of what a compliance orientation might look like in specific securities regulatory enforcement contexts in a research study conducted with Poonam Puri for the Task Force to Modernize Securities Legislation in Canada. See Mary Condon & Poonam Puri, “The Role of Compliance in Securities Regulatory Enforcement” (28 June 2006), online: Task Force to Modernize Securities Legislation in Canada <[http://www.tfmsl.ca/docs/V6\(1\)%20CondonPuri.pdf](http://www.tfmsl.ca/docs/V6(1)%20CondonPuri.pdf)>.

121. The BCSA, *supra* note 85, which has been passed by the B.C. legislature but not proclaimed, also contained provisions with respect to civil remedies for issuer disclosure inadequacies in the secondary trading markets.

achieving them, so as to determine whether a policy preference for either public or private enforcement of securities law is warranted.

B. Policy Goals of Enhanced Civil Remedies

Statutory civil remedies are generally justified as providing an avenue for compensation for victims of fraud or negligence, typically on terms more favourable to plaintiffs than common law actions can provide. They thus represent a legislative commitment to facilitate redress. In the case of the OSA, a related motivation is to realign the remedies available in the secondary trading market with those in the primary market, where OSA section 130 has for several decades allowed investors to sue issuers and others for misrepresentations in prospectus offering documents.¹²² A further goal is to move the availability of secondary market remedies in Ontario closer to those available in the U.S., an issue of particular relevance where issuers' securities are interlisted in Canada and the U.S.¹²³ A second policy objective is deterrence, based on the assumption that the rational cost-avoider firm will make increased efforts to improve the quality of its disclosure in order to avoid being sued by investors.¹²⁴ Again this is in part an empirical question, both as to whether business organizations are in fact motivated by deterrence strategies, and whether the expanded availability of civil suits to investors will motivate better disclosure. Even more ambitiously, as noted above, La Porta *et al.* claim that private enforcement of securities law norms can result in the enhanced development of stock markets.¹²⁵

122. See *Kerr v. Danier Leather Inc.* (2004), B.L.R. (3d) 167 (Ont. Sup. Ct.) [*Danier Leather*].

123. However once ss. 138.1-14 are proclaimed, there will remain significant differences from the position in the U.S. See R. Yalden, "Legislative Deference and Canadian Securities Regulators: Lessons from the Debate on Civil Liability for Continuous Disclosure" (Paper presented at 2004 Consumer and Commercial Law Conference, Vancouver, October 2004) [unpublished].

124. *Ibid.* See also James D. Cox, "Private Litigation and the Deterrence of Corporate Misconduct" (1997) 60:4 *Law & Contmp. Probs.* 1. See also *Dura Pharmaceuticals, Inc v. Broudo*, 125 U.S. 1627 (2005) [*Dura Pharm.*].

125. *Supra* note 8.

C. *What Do the New Provisions Involve?*

The main contours of these provisions are relatively well known, at least among securities lawyers. Several causes of action are being created. These include actions in relation to: (i) documents released by a responsible issuer that contain a misrepresentation;¹²⁶ (ii) public oral statements containing misrepresentations, if they are made by a person “with actual, implied or apparent authority to speak on behalf of a responsible issuer”;¹²⁷ and (iii) failure to make timely disclosure.¹²⁸ Those obtaining a cause of action include “a person or company who acquires or disposes” of the issuer’s securities between the time the document was released or public oral statement was made which contained the misrepresentation and the time the misrepresentation was publicly corrected.¹²⁹ In the case of failure to make timely disclosure, a person or company who acquired or disposed of the securities between the time the material change was required to be disclosed and its subsequent disclosure can bring an action. Notably there is no requirement for the plaintiff(s) to demonstrate reliance on the misrepresentation, or on the issuer having complied with timely disclosure requirements, in making the decision to trade the securities. This is obviously a more plaintiff-friendly state of affairs than under the various common law remedies which plaintiffs were required to mobilize with respect to misrepresentations, in documents released by an issuer, in the secondary market.

Similarly, the class of defendants to these new causes of action is broader than the equivalent liability provisions for misrepresentations in offering documents (in provisions such as section 130 of the *OSA*). The class includes not only the responsible issuer, its directors and officers, but also “influential persons” and, in the case of written or oral statements, experts. The definition of “influential person” includes, with respect to responsible issuers, control persons, promoters and insiders

126. *OSA*, *supra* note 2, s. 138.3(1).

127. *Ibid.*, s. 138.3(2).

128. *Ibid.*, s. 138.3(4).

129. *Ibid.*, s. 138.3(1).

who are not directors or senior officers.¹³⁰ The expansion of possible defendants to a section 138.1 action is potentially revolutionary, though it has attracted little published commentary to date. It derogates from long held assumptions about the relationship of shareholders *qua* shareholders to a corporation, and may impose additional monitoring duties on key corporate shareholders. However, unless the influential person released the impugned document or made the public oral statement, “knowing influence” on the responsible issuer will be required to ground an action.¹³¹ Finally, if the person who made the public oral statement is not already captured in the above list, he or she may also be liable. Furthermore, the new provisions make a distinction between core and non-core documents,¹³² and require a higher burden of proof to be discharged by plaintiffs where non-officer directors and influential persons are being sued with respect to such non-core documents. A similarly elevated burden of proof is also required where directors and influential persons are being sued for failure to make timely disclosure.

A number of defences are made available by the provisions. These include a defence that the plaintiff knew of the misrepresentation, as well as a “reliance on experts” or the making of confidential disclosure to the regulator. The most significant in practice is likely to be the “due diligence” defence. With respect to both the due diligence and “plaintiff knowledge” defences, the burden of proof shifts to the defendants. The legislative provisions enumerate a variety of factors that should be considered by a court in determining whether the defendant(s) undertook a reasonable investigation (or alternatively were guilty of gross misconduct). One factor that is likely to be most significant in future litigation is “the existence, if any, and the nature of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations.”¹³³ Thus, issuers wishing to position themselves favourably with respect to possible litigation under Part XXIII.1 are

130. That is, those who own or exercise control or direction of over more than 10% of the voting securities of the issuer.

131. *OSA*, *supra* note 2, ss. 138.3(1)-(2).

132. The latter category basically comprises material change reports.

133. *OSA*, *supra* note 2, s. 138.4(7)(e).

likely to establish written disclosure policies featuring the establishment and implementation of procedures for reviewing disclosure documents, for identifying those responsible for reviewing them and for determining whether material changes have occurred.¹³⁴

If the foregoing could fairly be described as plaintiff-friendly, a number of other features of the provisions tend in the opposite direction. Chief among these is the so-called “gatekeeper provision,”¹³⁵ which requires plaintiffs to obtain leave of the court to proceed with the action.¹³⁶ Leave is to be granted only where the court is satisfied that the action is being brought “in good faith” and that there is a “reasonable possibility” that the action will be resolved in favour of the plaintiff at trial. A key issue is how robust this merit-based leave assessment will be in practice.¹³⁷ Leon and Armstrong argue that courts should take this “gatekeeper” function seriously so as to avoid “litigation abuse” while giving investors an effective remedy. They argue that courts should strive to avoid situations where companies feel compelled to settle early, regardless of the merits of the claim. Insofar as private litigation is meant to deter issuers from providing misleading or inappropriate information, achieving deterrence will revolve significantly around whether the phenomenon of meritless settlement is present. In other words, if a practice of early routine settlement develops, the deterrent effects of large court-determined awards will be minimized.

Of further significance is the “liability limit” established in the new provisions,¹³⁸ which limits damages payable by a defendant issuer or a non-individual influential person to the greater of \$1 million or 5% of the issuer’s market capitalization. Those payable by an individual influential person, officer or director, are limited to the greater of

134. Such a development is also being promoted by securities regulators in other ways. See MI 52-109, *supra* note 33.

135. Jeffrey S. Leon & Sarah J. Armstrong, “Preparing for the Road Ahead: Bill 198 and Secondary Market Disclosure,” (Paper given at the Insight Information Securities Litigation Forum, Toronto, 13-14 June 2005) [unpublished].

136. *OSA*, *supra* note 2, s. 138.8.

137. Garry Watson, “Class actions and the dilemma of ‘Entrepreneurial Lawyering’: The good and the not so good aspects of Class Actions” (2005) [unpublished, archived with author].

138. *OSA*, *supra* note 2, s. 138.7.

\$25,000 or 50% of aggregate compensation received during the 12-month period immediately preceding the day on which the misrepresentation was made or the failure to make timely disclosure occurred. Liability is also to be proportionate with respect to each defendant's responsibility for the damages assessed.¹³⁹ These liability limits make it clear that the compensation goal usually associated with private litigation is being kept within bounds, since it is conceivable that plaintiffs may not be able to recover the full extent of their losses. On the other hand, the fact that liability can be assessed against individual defendants is presumably designed to contribute to the deterrence objective of private remedies.¹⁴⁰

It is also significant that the liability limits are inapplicable (except for the responsible issuer) where the plaintiff can prove the defendant's knowledge of the misrepresentation or failure to make timely disclosure. As Leon and Armstrong argue,

[t]his provision may well have the effect of encouraging plaintiffs to allege fraud so as to put pressure on defendants to settle in order to avoid unlimited exposure to damages. This pressure becomes even more formidable given the potential negative effect on the ability of directors and officers to depend on insurance to respond to a successful claim.¹⁴¹

Strategically, then, it will become important whether a court will determine the likelihood of success on the issue of the defendant's knowledge at the leave stage.¹⁴² My own view is that this is probably unlikely, since evidentiary issues will be paramount. In general, though, early cases specifying the required elements of proof of the defendant's knowledge will be significant to the usefulness of these provisions to disgruntled investors.

With respect to the calculation of losses in order to compute damages, the provisions do not require plaintiffs to crystallize those losses by selling the security.¹⁴³ A 2005 U.S. Supreme Court decision has

139. *OSA*, *supra* note 2, s. 138.6.

140. See Keith Johnson, "Deterrence of Corporate Fraud Through Securities Litigation: The Role of Institutional Investors" (1997) 60 *Law and Contemp. Probs.* 155.

141. *Supra*, note 135 at 6.

142. Sandra Rubin, "Pairing Up for a Payday" *National Post* (7 September 2005) FP9.

143. *OSA*, *supra* note 2, s. 138.5(1).

generated a lot of attention because of its stricter approach to the requirement for U.S. plaintiffs to prove a causal connection between the alleged misrepresentation and the economic loss suffered.¹⁴⁴ The U.S. Supreme Court made it clear that it was seeking to achieve the policy goal of avoiding “abusive” litigation. However, in Canada the defendant bears the onus of proving that losses were unrelated to the misrepresentation.¹⁴⁵ This is likely to involve a “battle of experts” on the issue of what caused the issuer’s stock price to decline.¹⁴⁶

D. Reactions to the New Provisions

Media reports suggest that the Canadian plaintiffs’ bar does not expect that Part XXIII.1 will open the floodgates of securities litigation.¹⁴⁷ But one intriguing possibility that has been mooted is that institutional investors may perceive it necessary to fulfill their fiduciary duties to their beneficiaries to take full advantage of the new litigation opportunities.¹⁴⁸ In response to this one might argue that we have not seen a flood of litigation from institutional investors based on existing statutory remedies like section 130, even since class actions have become a possibility. It is, however, true that the documents that could form the basis of such claims are much more sporadic in the life of a reporting issuer. It is also the case that public and regulatory scrutiny of the corporate monitoring and internal governance activities of pension funds and mutual funds, as institutional investors, has been recently heightened. A scenario of increased involvement by institutional investors in pursuing litigation for secondary market misrepresentations

144. *Dura Pharmaceuticals*, *supra* note 124.

145. *OSA*, *supra* note 2, s. 138.5(3).

146. Douglas Worndl, “Opening the Door to Shareholder Class Actions” (Paper given at the Border Ladner Gervais National Client Seminar Series, Directors’ and Officers’ Liability: A New World Order, October 19, 2005) [unpublished].

147. The first suit under the new provisions was filed in September 2006, by a class of shareholders of IMAX, alleging that there were misrepresentations in financial statements filed by the company in 2005. See Ron Stang, “IMAX sued under revised securities law” *Law Times* (18 September 2006) online: *Law Times* <http://www.lawtimesnews.com/index.php?option=com_content&task=view&id=751&Itemid=82>.

148. Rubin, *supra* note 142 at FP10.

or inadequate disclosure might raise its own dilemmas with respect to the ongoing problem of whether securities regulatory norms can meet the needs of both institutional and individual investors. Will the enhanced financial and legal resources of institutions to pursue litigation and settlements against issuers at some point squeeze out individual investors? A related concern is whether the U.S. plaintiffs' bar will begin to search for business in Ontario, even as legislative and jurisprudential attempts have been made in the U.S. to close off a perceived flood of securities litigation.¹⁴⁹

E. Will Part XXIII.1 of the OSA Achieve Its Policy Goals?

Are there features of these provisions that militate against the achievement of compensatory or deterrence goals? I have noted that the provisions are designed to place limits on the funds available for compensating plaintiffs, absent a finding of fraud on the part of individual defendants. This suggests that the legislators are more interested in achieving goals of management or key shareholder deterrence rather than compensation. As to whether the goal of deterrence will be achieved such that the possibility of being sued will concentrate the minds of management or individual influential shareholders engaged in disseminating corporate information, one issue will be whether the liability caps are pitched at a rigorous enough level to produce this effect. More generally, it has been argued above that deterrence appears to be empirically an elusive goal for organizations or the individuals within them. In the context of litigation, specifically, there might well be a further concern that deterrence objectives could be undercut by the availability of directors and officers insurance. Another key issue will be whether the gatekeeper provisions are successful in preventing distortion of the underlying policy goals by systemic features of the class action process. Such features are argued to encourage "meritless settlement" and a ceding of litigation control from clients to "entrepreneurial lawyers." Thus Garry Watson points out that "modern

149. Rubin, *supra* note 142 at FP9; *Class Action Fairness Act*, 28 U.S.C. §§ 1332(d), 1453 and 1711-15 (2005); *Dura Pharm*, *supra* note 124.

opt-out class action regimes, combined with entrepreneurial lawyering” produce a situation where

litigation is run and controlled by class counsel (because it is effectively ‘clientless litigation’), producing the risk that it may be conducted primarily with a view to maximizing class counsel’s financial return, e.g. the desire to maximize financial returns may lead counsel to refuse to accept what may, objectively, be reasonable offers of settlement, which therefore never come before the court for a fairness hearing. Also the desire to maximize financial returns may lead class counsel to seek a settlement agreement by which the defendant agrees to pay directly class counsels fees or to support an application to the court that class counsel receive a sizeable fee from the common fund.¹⁵⁰

This rather pessimistic account of “noise” in the class action process suggests that it is a blunt instrument for achieving overarching social or economic policy goals.

Conclusion

With respect to public enforcement of securities law by the OSC, I argue that there is insufficient evidence that deterrence is an effective regulatory strategy to justify the weight that is currently placed on it in sanctioning, at both the administrative and criminal levels. If in fact it does not work well enough, regulatory enforcement strategies must be refocused on preventing or reshaping internal organizational incentives within securities firms or reporting issuers that run counter to the public interest and that produce securities law infractions. There likely remains a residual role for criminal sanctions in terms of their denunciatory aspect, but this should not consume significant amounts of enforcement resources.

What about the proposition that private enforcement of securities norms works better than public enforcement to develop robust securities markets? Of course the goals of these alternative ways of pursuing enforcement are different: private enforcement is primarily about compensating classes of wronged investors, while public enforcement is about creating and maintaining orderly markets. With

150. *Supra* note 137 at 6.

respect to the new civil liability provisions in the OSA, the limits on compensation and the gatekeeper provisions of sections 138.1–14 appear, on balance, likely to limit the frequency with which private remedies will be employed. Conceptually, the results of the research conducted by La Porta *et al.* purport to show that common law countries, which have more comprehensive and investor-friendly rules for private recovery of damages from courts, also have more “developed” stock markets.¹⁵¹ An empirical question for Ontario will be whether the rules embedded in Part XXIII.1 will be robust enough to make a significant contribution to further development of stock markets in the province. More seriously, a weakness of this research that purports to find a persuasive relationship between private enforcement rules and the development of stock markets is that the contours of “development” are relatively bluntly drawn.¹⁵² The indicators of development relied upon by La Porta *et al.* do not purport to capture more subtle information about the nature and extent of public or investor confidence in the integrity of those markets, or, for example, the characteristics of the investor population in them.¹⁵³

Yet La Porta *et al.*'s paper may, on close investigation, contain the seeds of an answer to the question of how to assess the relative importance of public and private enforcement of securities norms in the current Ontario context. The paper ranks various countries on the basis of their rules about public or private enforcement of securities law. Canada¹⁵⁴ scores second highest to the U.S. in terms of having rules

151. The level of development of a securities market was measured by a number of variables, including: ratio of stock market capitalization to GDP; the number of domestic publicly-traded firms relative to population; and the value of IPOs in each country relative to GDP. It should be noted that the rules for private recovery they considered in their research were those relating to misrepresentations in offering documents.

152. Watson, *supra* note 137.

153. See Mathias M. Siems, “What does not work in comparing securities laws: a critique on La Porta *et al.*'s methodology” (2005) *International Company and Commercial Law Review* 300, for a critique of their methodology for comparing the characteristics of a variety of regulatory systems.

154. It is not clear from the paper to what “Canada” refers exactly. The methodology used to gather information was to ask one attorney from each country surveyed to complete a questionnaire describing the securities laws applicable to an offering of shares listed on the country's largest stock exchange in December 2000.

facilitating private enforcement, in the case of misrepresentations in offering documents. However, the existence of rules facilitating private enforcement does not correlate well in Canada with the actual frequency of litigation. One of the most significant aspects of the *Danier Leather* case, where a class of investors sued Danier Leather for alleged misrepresentations contained in a forecast embedded in a prospectus document, is that it is the first case based on OSA section 130 to go to trial in Ontario.¹⁵⁵ With respect to rules facilitating public enforcement, La Porta *et al.*'s research ranks Canada third, after Australia, with Hong Kong, Singapore and the U.S. all in second place. What this suggests with respect to the U.S. and to some extent Canada, is that both countries facilitate private *and* public enforcement of securities law.¹⁵⁶ Could it be that public and private enforcement are to some extent interdependent? In the Ontario context it was the regulatory authorities who were at the forefront of agitating for statutory civil remedies in the secondary market, suggesting that they might favour some form of public/private division of labour in the task of enforcing regulatory norms against issuers.¹⁵⁷ On balance, it seems premature to assert that public regulatory enforcement should be dismissed as making an unimportant contribution to the maintenance of market integrity in Ontario. However, it might benefit from recalibration in order to concentrate on the more systemic organizational features of capital market actors that contribute to infractions, than either private or criminal-type enforcement can plausibly address.

155. *Danier Leather*, *supra* note 122.

156. Kagan, *Adversarial Legalism*, *supra* note 57 at 193.

157. One intriguing possibility is that Part XXIII.1 may become "an enforcement investigatory tool" in that it requires copies of applications for leave to proceed and any affidavits to be sent to the OSC when filed. See OSA, *supra* note 2, s. 138.8(4) and Frank Newbold & James Douglas, "Selected Issues/Litigation Strategies" (Paper given at the Border Ladner Gervais National Client Seminar Series, Directors' and Officers' Liability: A New World Order, October 19, 2005) [unpublished].