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# Canada: Governing the Future for Investor Confidence

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## I. Introduction

From late 2001 through 2002, corporate fraud and scandal dominated business headlines in the United States, resulting in a serious decline in investor confidence.[1] Enron Corporation's failure, in particular, proved to be a monumental business event because the company was so large and esteemed.[2] Unfortunately, this event was the first of several corporate humiliations. In addition to Enron, companies such as WorldCom, Adelphia, Arthur Andersen, Martha Stewart Living Omnimedia, and Tyco captured similar negative publicity during the parade of scandals.[3] Consequently, many questions surfaced regarding the integrity of capital markets and related participants, including company executives, directors, and external auditors.[4]

Because of the United States' central economic role, these collapses also impacted the rest of the world. In North America alone, trillions of dollars disappeared from the marketplace, both in company worth and in investors fleeing the equity and mutual fund markets.[5] As a result of these losses, many legislators, lawyers, and jurists voiced various opinions with regards to the future of corporate and securities law.

Many countries have radically restructured their regulatory systems or are in the process of doing so. In particular, Canada, the United States' northern neighbor, received increased scrutiny regarding the country's regulatory structure for capital markets. As a result, Canada took several initiatives, not all of which are collaborative, that attempt to restore confidence and give the country's capital markets a national and international competitive advantage.

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1. Department of Finance Canada, *Fostering Investor Confidence in Canadian Capital Markets*, *available at* http://www.fin.gc.ca/toce/2003/fostering_e.html (Sept. 10, 2003) [hereinafter *Fostering Investor Confidence*].

2. Charles M. Elson & Christopher J. Gyves, *The Enron Failure and Corporate Governance Reform*, 38 WAKE FOREST L. REV. 855 (2003) [hereinafter Elson & Gyves].

3. Paul Caulfield, *Sarbanes-Oxley & Canadian Cross-Border Issuers*, *available at* http://www.prcanada.ca/IR/SARBOXT.HTM (Nov. 25, 2002) [hereinafter Caulfield].

4. *Fostering Investor Confidence*, *supra* note 1.

5. Caulfield, *supra* note 3.

Part II of this comment introduces occurrences within the United States that became a catalyst for change in Canada. Part III describes the unique characteristics of Canada's regulatory structure and capital market. The bulk of this comment is contained in part IV, which discusses multiple initiatives that are emerging from Canada's major authorities. Finally, part V concludes with a brief recap and analysis of the possible changes to come.

## II. The American Catalyst for Change

Although the purpose of this comment is to focus on the changes taking place in Canada, many of them seem to have been expedited, thanks, in part, to the overtures which took place in the United States. Because of the immediate effects of corporate failures, U.S. lawmakers had strong incentives to act quickly in order to restore confidence in the "system." A discussion of the U.S. response to corporate failures is helpful, as it provides insight into the legislation enacted to achieve this objective, as well as insight into what lawmakers sought to avoid in the process.

### A. Enron in a Nutshell

While it might be limiting to direct attention to any one entity or individual, practicality suggests that we consider the failure of Enron Corporation to see where the system broke down. In hindsight, Enron operated under a bad business model and employed a management team that was unable to remedy resulting complications.[6] The company was once a high-tech global corporation that traded energy contracts as marketable commodities.[7] It acted as the intermediary in large natural gas and electricity deals by providing commodity markets, which allowed delivery of physical commodities to its customers at a predictable price. At its best, the company had over $100 billion in gross revenues, and, at the time of its failure in 2001, it was the seventh-largest company in the United States.[8] At some point, however, the company's business model began to falter. In an effort to disguise the downturn, key executives designed transactions, approved by the accounting firm Arthur Andersen, that kept debt off of the company's balance sheet allowing it to maintain its credit rating and the façade of a stable stock price.[9] In 2001, however, Enron was required to correct the financial statements for its 1997 to 2000 fiscal years, which revealed a considerable increase in total debt.[10]

Because of the significance of Enron's collapse, much attention has been devoted to preventing similar disasters in the future. Confronting this issue raises several "hot topics" in corporate circles everywhere. Specifically, many believe that Enron's destruction was a result of structural weaknesses in the governance system as revealed by substantial misstatements in the financial statements, the inadequacy of boards of directors and public accountants to detect and correct these errors on a timely basis, and the evident failures of stock analysts to detect weaknesses in financial information.

6. Elson & Gyves, *supra* note 2.

7. Janis Sarra, *Rose-Colored Glasses, Opaque Financial Reporting, and Investor Blues: Enron as Con and the Vulnerability of Canadian Corporate Law*, 76 St. John's L. Rev. 715, 716 (2002) [hereinafter Sarra].

8. Elson & Gyves, *supra* note 2.

9. *Id.*

10. *Id.*

### B. The Law Makers' Response

Special reports, investor sob stories, and executives in handcuffs highlighted the aftermath of Enron's bankruptcy. However, a longer lasting impression of Enron was left by lawmakers. Designed to provide additional investor protection by improving the accuracy and reliability of corporate disclosures, the Sarbanes-Oxley Act of 2002 (SOX) was signed into law by President George W. Bush on July 30, 2002.[11] Similar to the initiatives taken following the market crash of 1929, Congress once again drafted legislation to reassure the public that it will take an aggressive stance in regulating securities. SOX takes broad steps to reform corporate governance, disclosures, and the conduct of accounting firms, in order to increase investor confidence.

Specifically, SOX contains provisions requiring the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) to certify the annual and quarterly reports filed by their company.[12] Certification means that the officer reviewed the report, the report does not make or omit any untrue statements of material fact, and the financial statements and other information fairly present the financial condition of the corporation.[13] This also provides assurances that the officer established and maintained internal controls to ensure that material information is conveyed to decision makers and that the officer evaluated the effectiveness of the internal controls and presented the conclusions in the report.[14]

In addition to certification requirements, SOX also authorized the establishment of the Public Company Accounting Oversight Board (PCAOB).[15] The PCAOB was created to increase investor confidence in the preparation of informative, accurate, and independent audit reports.[16] Its duties consist of registering public accounting firms that prepare audit reports for issuers, regularly inspecting registered firms, and, when necessary, disciplining firms that do not comply with PCAOB standards.[17]

## III. Canadian Context

### A. Regulatory Framework

Although Canada's legal system governing corporations is often considered to be tailored after that of the United States, there are important differences. Despite what seems to be a separation between corporate and securities law in Canada, there is much debate on this matter. Essentially because of statutory amendments and aggressive use of statutory discretion by securities regulators, corporate law and securities law in Canada have become "inexorably intertwined."[18] Canada has a federalist constitution and is divided into ten provinces and three territories. The ten provinces each have their own legislature, and there is

11. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).
12. *Id.* § 302(a) (codified at 15 U.S.C. § 7241).
13. *Id.* § 302(a)(1)-(3) (codified at 15 U.S.C. § 7241).
14. *Id.* § 302(a)(4)(A)-(D) (codified at 15 U.S.C. § 7241).
15. *Id.* § 101(a) (codified at 15 U.S.C. § 7211).
16. *Id.*
17. *Id.* § 101(c)(1)-(4) (codified at 15 U.S.C. § 7211).
18. Patrick Moyer, *The Regulation of Corporate Law by Securities Regulators: A Comparison of Ontario and the United States*, 55 U.T. Fac. L. Rev. 43, 44 (1997).

one federal jurisdiction, which houses the federal parliament. Each province and the federal jurisdiction have legislative power in the area of corporate law.[19]

Contrary to the United States, "Canada's corporate law structure features a federal business corporations statute, the *Canada Business Corporations Act* (CBCA), in addition to provincial corporate statutes."[20] These statutes administer the conduct of the incorporated companies. Even though the provinces only have constitutional authority to incorporate corporations with "provincial objects," it has been held that corporations incorporated under provincial statutes can operate outside the province, subject to the laws of the other jurisdiction.[21] Thus, all eleven jurisdictions have the power to bring corporations into existence and to regulate their activities, regardless of the site of incorporation.[22]

For the most part, however, securities regulation in Canada envelops corporate law, and it is geared towards investor protection and efficient capital markets.[23] Unlike the United States, where the Securities and Exchange Commission (SEC) regulates the industry on a nationwide basis, the regulatory framework in Canada is fragmented, and securities commissions and regulatory administrators operate on a province-by-province basis.[24] Each provincial authority administers the appropriate provincial securities act by licensing investment dealers, ensuring prospectuses meet disclosure requirements, and investigating deficient industry conduct.[25] Of particular importance is the Ontario Securities Commission (OSC), since most domestic and foreign securities transactions occur in that province.[26] Some of the authority of the securities regulators in Canada is delegated to self-regulatory organizations (SRO), which play a significant role in Canadian markets, including the exchanges.[27] The Toronto Stock Exchange (TSX), Montreal Exchange (ME), and the Investment Dealers Association of Canada (IDA) are among the most recognized SROs.

The thirteen provincial and territorial regulators are each members of the Canadian Securities Administrators (CSA). As a whole, the CSA provides a forum for the regulators to coordinate and harmonize regulation of the capital markets, while promoting market integrity and investor protection.[28] Although this forum does increase harmonization, there has been a strong push for a single, national regulator in Canada. The current system, as described, contains thirteen different sets of securities laws administered by thirteen dif-

19. There are both federal and provincial statutes of incorporation since section 92(11) of the *Constitution Act* gives the provinces power to incorporate companies having "provincial objects," while the federal Parliament has general power to enact legislation with respect to all matters not specifically assigned to the provinces. *See* CAN. CONST. (Constitution Act, 1867) pt. VI (Distribution of Legislative Power), § 92; Bruce Welling, CORPORATE LAW IN CANADA: THE GOVERNING PRINCIPLES 1 (1984) [hereinafter Welling].

20. Ruth O. Kuras, *Corporate Social Responsibility: A Canada—U.S. Comparative Analysis*, 28 MAN. L.J. 303, 312 (2002).

21. Mark Gillen, et al., CORPORATIONS AND PARTNERSHIPS: CANADA 19 (1994); citing Bonanza Creek Gold Mining v. The King, [1916] 1 A.C. 566.

22. Welling, *supra* note 19.

23. David Johnston & Kathleen Doyle Rockwell, CANADIAN SECURITIES REGULATION 2 (2d ed. 1998) [hereinafter Johnston & Rockwell].

24. Professional Referrals Canada, *Regulation of Securities Markets*, *available at* http://www.professionalreferrals.ca/article-429.html (last visited Jan. 9, 2004) [hereinafter *Regulation of Securities Markets*].

25. *Id.*

26. Johnston & Rockwell, *supra* note 23.

27. Department of Finance Canada, *Canada's Securities Industry*, *available at* http://www.fin.gc.ca/toce/2002/cansec_e.html (July 2002) [hereinafter *Canada's Securities*].

28. *Regulation of Securities Markets*, *supra* note 24.

ferent regulatory authorities.[29] Despite the benefits that local regimes create, proponents suggest that they come with high costs and that a standardized set of rules will increase efficiency without sacrificing investor protection.[30]

### B. Canadian Market Composition

In addition to its distinctive regulatory structures, Canada's capital markets are similarly unique. First, Canada has a small number of large, inter-listed companies. Out of approximately 4,000 public companies, only 177 of the largest have securities trading in U.S. markets.[31] A second distinctive characteristic of Canadian capital markets is the large number of small public companies. Unlike U.S. companies, Canadian companies go public at an earlier stage in their development and therefore, by U.S. standards, are much smaller.[32] Finally, Canada has a higher proportion of companies with controlling shareholders. Governance theory suggests that closely-held companies, as opposed to large public companies, are at a lower risk of being involved in controversial business practices.[33]

## IV. Canada's Numerous Responses

Although changes were considered prior to the corporate failures in the United States, the initial reaction of Canadian securities regulators and stock exchanges was that Enron-type abuses could not happen in Canada. Repercussions in the markets conveyed, however, that investors were not as convinced.[34] In response, authorities across Canada stepped up the initiative to restore investor confidence, which in essence means reforming its corporate laws.

While agreeing that reforms are necessary, legislators throughout Canada are in disagreement regarding the substance of such changes. Many provinces and territories, led by Ontario, favor a rules-based approach that is notably similar to steps taken by the United States. In Western Canada, however, British Columbia (B.C.) is against mimicking U.S. changes and instead proposes reforms that focus on principles rather than prescriptive sets of rules. Other initiatives are also taking place in an effort to bring uniformity to the fragmented structure of Canadian securities laws.

Part A discusses the rules-based approach as set forth by authorities in Ontario. Part B considers several new rules promoted by the CSA and outlines the concepts within the CSA's Uniform Securities Legislation Project. Part C describes the federal government's input on the discussion. Finally, part D describes B.C.'s alternative principles-based approach.

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29. Ontario Ministry of Finance, *Five Year Review Committee: Final Report Reviewing the Securities Act (Ontario)*, *available at* http://www.gov.on.ca/FIN/english/publications/2003/5yrsecuritiesreview4.htm (last modified Sep. 19, 2003).

30. *See id.*

31. Christopher C. Nicholls, *The Canadian Response to Sarbanes-Oxley*, *available at* http://www.rotman.utoronto.ca/cmi/news/Canadian%20Response%20to%20SOX.pdf (Jan. 2003).

32. *Id.*

33. *Id.*

34. Sarra, *supra* note 7.

### A. Ontario's Rules-Based Approach

Representing the rules-based approach, Ontario leads the charge and is supported by most provinces and territories in Canada.[35] By October 2002, the Ontario government and OSC had initiated reforms that closely mirrored those in the United States. They posit that, due to its proximity and reliance on U.S. capital markets, Canadian securities law and enforcement cannot afford to venture too far off the American line.[36] The most significant development by the Ontario legislature was passage of *Bill 198, Keeping the Promise for a Strong Economy Act (Budget Measures)* (Budget Measures Act).[37] These amendments, part of Ontario's response to the passage of SOX in the United States, are intended to increase the protection of investors and improve investor confidence in the integrity of Ontario's capital markets.

Much like SOX, the Budget Measures Act made changes to the securities laws in Ontario. This discussion focuses on the amendments to the *Securities Act* (Ontario). Of primary importance are the amendments that create new offenses, add stricter penalties, and enhance the rule-making authority of the OSC.[38]

#### 1. *New Offense—Civil Liability for Secondary Market Disclosure*

A significant provision in the Budget Measures Act provides for civil liability for secondary market disclosure violations. Although this provision has not been proclaimed into force, the Ontario Ministry of Finance stated in the 2003 Ontario Budget that "[t]he government intends to propose minor technical changes, following which it will implement the rest of the Fall 2002 investor confidence initiatives, including broader rights for secondary market investors to sue, which would provide a strong deterrent to poor disclosure practices."[39] The provision is important because the *Securities Act* (Ontario) would then provide civil remedies for nearly all misrepresentations made by a reporting company.[40] This means that, for the first time, potential liability would attach not only to public issuers of securities, but also to a broader category of persons including directors, officers, influential persons, and experts.

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35. George C. Glover, Jr., *Family Feud: Competing Proposals for Radical Change in Canadian Securities Regulation*, Securities and Mergers & Acquisitions Bulletin, *available at* http://www.fasken.com/web/fmdwebsite.nsf (Jan. 6, 2004) [hereinafter Glover].

36. Jim Middlemiss, *The Sarbanes of Their Existence*, *available at* http://www.cba.org/cba/national/augsep03/feature2.asp (last visited Jan. 9, 2004).

37. An Act to Implement Budget Measures and Other Initiatives of the Government, S.O., ch. 22 (2002) (Ont.) (Can.), *available at* http://www.ontla.on.ca/documents/Bills/37_Parliament/Session3/b198_e.htm.

38. Several of the amendments to the *Securities Act* (Ontario) found in the Budget Measures Act were proclaimed into force on April 7, 2003. However, the amendment creating offenses for secondary market disclosure, fraud and market manipulation, and misleading or untrue statements has not been proclaimed into force. *See* Walter Douglas Stuber, et al., *International Legal Developments in Review: 2002 Business Regulation*, 37 Int'l Law. 359, 379 (2003); *see also* H. Garfield Emerson, Q.C. & Geoff A. Clarke, *Bill 198 and Ontario's Securities Act: Giving Investors and the OSC Added Muscle*, *available at* http://www.fasken.com (Nov. 17, 2003) [hereinafter Emerson & Clarke].

39. Ontario Ministry of Finance, *Budget Paper A: Strong Economic Growth Continues: Ontario's Economic and Revenue Outlook*, *available at* http://www.gov.on.ca/FIN/bud03e/papera.htm (last modified March 28, 2003); *see* Emerson & Clarke, *supra* note 38.

40. Emerson & Clarke, *supra* note 38; *see* Securities Act, R.S.O. ch. S.5, §§ 130, 130.1 & 131 (1990) (Ont.) (Can.).

Section 138.3 of the *Securities Act* (Ontario) will expand the rights of investors to sue for written or oral misrepresentations.[41] The amendment is inclusive when considering parties that are potentially liable for misrepresentations. Shareholders can sue: (1) the issuer; (2) each director of the issuer at the time the document was released or the person who made the public statement; (3) each officer who authorized, permitted, or acquiesced in the release of the document or statement; (4) "influential persons"[42]; and (5) "experts"[43] (e.g., a person whose profession gives authority to a statement made in a professional capacity) who made misrepresentations in a report that was later used and released with the expert's consent.[44] However, as will be discussed later, plaintiffs may be limited to suing the party making the misrepresentation if they are only acting with apparent authority.

Despite the fact that the common law provides a cause of action for misrepresentation, plaintiffs have the difficult burden of proving that they relied on the misrepresented statement.[45] The proposed amendment, however, imposes liability ". . . without regard to whether the person or company relied on the misrepresentation."[46] This statutory language indicates that the investor will be relieved of proving reliance when bringing an action under this section. Further, as one commentator notes, this language might also enable securities class-action lawsuits.[47]

Specifically, section 138.3 states:

> Where a responsible issuer or a person or company with actual implied or apparent authority to act [or speak] on behalf of a responsible issuer releases a document that contains a misrepresentation [or makes a public oral statement that relates to the business or affairs of the responsible issuer and that contains a misrepresentation], a person or company who acquires or disposes of an issuer's security during the period between the time when the document was released [or public oral statement was made] and the time when the misrepresentation contained in the document [or public oral statement] was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages . . .[48]

Therefore, investors can bring an action for uncorrected misrepresentations in documents or statements. Furthermore, this amendment will also provide a right of action for failing to make a timely disclosure "when a material change was required to be disclosed . . ."[49]

a. Documents and Public Oral Statements

By defining the terms broadly, this change imposes liability upon people for every written or electronic communication that is filed with the OSC, a government or an agency of a government, or a stock exchange, as well as "any other communication the content of which would reasonably be expected to affect the market price or value of a security of the responsible issuer."[50] Additionally, liability attaches to public oral statements that are made

41. Securities Act, R.S.O. ch. S.5, § 138.3(1) & (2).
42. Influential Person is a defined term. *Id.* § 138.1.
43. *Id.*
44. *Id.* §§ 138.1, 138.3(1) & (2).
45. Emerson & Clarke, *supra* note 38.
46. Securities Act, R.S.O. ch. S.5, § 138.3(1) & (2).
47. Emerson & Clarke, *supra* note 38.
48. Securities Act, R.S.O. ch. S.5, § 138.3(1) & (2).
49. *Id.* § 138.3(4).
50. *Id.* § 138.1.

under circumstances where a reasonable person would believe that the information contained in the statement would become generally disclosed.[51] However, in situations where a person only has apparent authority to release a document or speak on behalf of an issuer, plaintiffs are limited as to who they can sue. In cases where a public oral statement is made by a person having only apparent authority or where a document or public oral statement is released or made by an "influential person" merely possessing apparent authority, liability is limited to the person making the misrepresentation.[52]

b. Burden of Proof and Defenses

To prevent unmeritorious litigation, plaintiffs are required to get leave of the court before commencing an action for liability for secondary market disclosure.[53] For a person or company to be found liable "under section 138.3 in relation to a misrepresentation in a document that is not a core document,[54] or a misrepresentation in a public oral statement," a plaintiff must prove that the defendant: (1) knew that the document or statement contained the misrepresentation at the time it was released or made; (2) deliberately avoided acquiring knowledge that the document or statement contained the misrepresentation at or before the time it was made; or (3) was guilty of gross misconduct in connection with releasing the document or making the statement containing the misrepresentation.[55] If the action is against an "expert," however, the plaintiff does not have to meet this burden.[56]

"In a proceeding under section 138.3 in relation to a failure to make timely disclosure," the plaintiff must prove that the defendant: (1) knew of a change and that the change was material; (2) "deliberately avoided acquiring knowledge of the change or that the change was a material change"; *or* (3) was guilty of gross misconduct in connection with the failure to make timely disclosure.[57] Nevertheless, the plaintiff does not have to prove any of these circumstances if the proceeding is against the issuer, an officer of the issuer, an investment fund manager, or an officer of an investment fund manager.[58]

While liability is expanded under the amendments to the *Securities Act* (Ontario), potential defendants to a claim for misrepresentation or failure to make timely disclosure are provided with several defenses. While defenses are found in section 138.4, additional defenses are located in other sections. For example, as noted previously, no defendant is liable for public oral statements made by another person who only has apparent authority.[59] Additionally, a plaintiff cannot recover for any loss suffered that the defendant is able to prove is attributable to a change in the market price of the issuer's security that is unrelated to the misrepresentation or failure to make timely disclosure.[60] However, the first labeled "defense" in section 138.4 allows a person or company to avoid liability if it proves that the plaintiff acquired or disposed of the security and knew that the document or public oral statement contained a misrepresentation or knew of the material change.[61]

51. *Id.*
52. *Id.* §§ 138.3(2), (3) & (7).
53. *Id.* § 138.8.
54. "Core document" is defined in the Securities Act. Securities Act, R.S.O. ch. S.5, § 138.1.
55. *Id.* § 138.4(1).
56. *Id.* § 138.4(2).
57. *Id.* § 138.4(3).
58. *Id.* § 138.4(4).
59. *Id.* § 138.3(7).
60. Securities Act, R.S.O. ch. S.5, § 138.5(3); *see also* Emerson & Clarke, *supra* note 38.
61. Securities Act, R.S.O. ch. S.5 § 138.4(5).

The Budget Measures Act also provides for a "reasonable investigation" defense.[62] A party is not liable for misrepresentation or failure to make timely disclosure if it proves that a reasonable investigation was conducted before the release of the document or statement or before the failure to make timely disclosure first occurred, *and* the party had no reasonable grounds to believe that there was a misrepresentation or that a failure to make timely disclosure would occur.[63] In determining whether an investigation was reasonable or whether a party is guilty of gross misconduct, the Budget Measures Act provides a list of factors to be considered by the court.[64] This list includes, but is not limited to, factors such as the nature of the issuer; the knowledge, experience, and function of the defendant involved; the nature of any system in place to ensure continuous disclosure obligations are met; and the reasonableness of reliance on the defendant's systems, officers, or employees.[65]

Another liability defense is available where there is a confidential disclosure. If a defendant failed to make timely disclosure, it has a defense if it satisfies several elements. First, the issuer disclosed the material change in a report filed confidentially with the OSC under section 75(3) of the *Securities Act* (Ontario).[66] Second, the issuer had a reasonable basis for making the disclosure confidentially.[67] Third, the issuer promptly and publicly disclosed a material change if the information contained in the report remained material and a basis for confidentiality ceased to exist.[68] Fourth, the person, company, or issuer did not release a document or make a public statement that resulted in a misrepresentation because of the undisclosed material change.[69] Finally, if the material change became publicly known by some other manner, the issuer must have promptly disclosed the material change.[70]

Another defense for a potentially liable party is provided where a misrepresentation is made in "forward-looking information."[71] The statute defines forward-looking information as disclosures regarding possible events, conditions or results presented either as a forecast or a projection.[72] The defense is valid if the forward-looking information contains cautionary language, identifies material factors that could cause actual results to differ materially from the forecast or projection, and states the material factors or assumptions applied in making the forecast or projection in the forward-looking information.[73] This defense is not available to a person or company using forward-looking information in the issuer's prospectus filed in connection with the initial public distribution of securities or contained in financial statements prepared by the issuer.[74]

The statute provides an additional defense for persons who rely on experts. Defendants are not liable for any part of a document or public oral statement that quotes or summarizes a statement or opinion made by an expert if the defendant obtained written consent from

62. *Id.* § 138.4(6).
63. *Id.*
64. *Id.* § 138.4(7).
65. *Id.* § 138.4(7).
66. *Id.* § 138.4(8).
67. Securities Act, R.S.O. ch. S.5, § 138.4(8).
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.* § 138.4(9).
72. *Id.* § 138.1.
73. Securities Act, R.S.O. ch. S.5, § 138.4(9).
74. *Id.* § 138.3(10).

the expert to use the statement or opinion and the expert did not withdraw consent prior to the release of the document or public statement.[75] In addition, the defendant must prove that they did not know and did not have reasonable grounds to believe there had been a misrepresentation.[76] Furthermore, the portion of the document or public statement must fairly represent the expert's statement or opinion.[77] Experts are not liable if they prove that they withdrew their previously provided written consent prior to the release of the document or public statement.[78]

Furthermore, a person or company is not liable under section 138.3 for the unintentional release of a document, unless the statute requires the person or company to file the document with the OSC.[79] The defending party must prove that it unintentionally released the document by illustrating that it did not know and had no reasonable grounds to believe that the document would be released at the time it was actually released.[80]

Additionally, the defendant can assert a defense based on derivative information. The defendant must prove that the misrepresentation in a document or public oral statement was also included in a document filed with a securities commission, authority, or stock exchange by, or on behalf of, another person or company, other than the responsible issuer. The defendant must prove that no one corrected the misrepresentation in the document filed by or on behalf of that other person before the release of the document or public statement made by or on behalf of the responsible issuer.[81] Further, the proponent must show that the document or public oral statement contains a reference identifying the document that was the source of the misrepresentation, along with the date that the document was released. Lastly, the defendant must show it did not know and had no reasonable grounds to believe that the document or statement contained a misrepresentation.[82]

Finally, the statute provides an individual defendant, other than the responsible issuer, with a defense when that individual takes corrective action. The defendant is not liable for misrepresentation or a failure to make timely disclosure if: (1) they made the misrepresentation without knowledge or consent; (2) after becoming aware of the misrepresentation or failure to disclose, they promptly notified the issuer's board of directors before the misrepresentation or disclosure was corrected; and (3) no subsequent correction was made by the issuer within two business days after notification. The defendant must also promptly provide written notice to the OSC when the board of directors fails to subsequently act or disclose the misrepresentation.[83]

c. Assessment of Damages

Section 138.5 of the new legislation sets forth the methods of damage assessment. As previously discussed, damages are to be granted to investors who acquired or disposed of an issuer's securities after the release of a document or public statement that contained a misrepresentation or after a failure to make a timely disclosure.[84]

75. *Id.* § 138.4(11).
76. *Id.*
77. Securities Act, R.S.O. ch. S.5.
78. *Id.* § 138.4(12).
79. *Id.* § 138.4(13).
80. *Id.*
81. *Id.* § 138.4(14).
82. *Id.*
83. Securities Act, R.S.O. ch. S.5, § 138.4(15).
84. *Id.* § 138.5(1) & (2).

Damages are assessed under three possible scenarios. The first scenario occurs when a person or company subsequently disposed of or acquired the securities on or before the tenth trading day after the violation is publicly corrected. Depending on whether the securities were disposed of or acquired, the assessed damages will equal the difference between the average price paid and the price received upon disposition.[85]

The second scenario involves securities that are subsequently disposed of or acquired after the tenth trading day after the public correction or disclosure. In this situation, recoverable damages are equal to the lesser of (1) the difference between the average price paid and the price received upon disposition (or if subsequently acquired, the difference between the average price received upon disposition and the price paid upon acquisition); or (2) an amount equal to the number of securities disposed of, multiplied by the difference between the average price per security paid for (or received upon the disposition of) those securities and the trading price for the security during the ten trading days following correction.[86] If there is no published market for the security to determine the trading price for the ten trading days following correction, the court determines that amount.[87] Also, in the first two scenarios, commissions are included in making price determinations.

The third assessment scenario is where a person or company has not disposed of or acquired the securities. Here, damages equal the number of securities acquired or disposed of, multiplied by the difference between the average price paid or received per security and the trading price of the issuer's securities during the ten trading days following correction.[88] Again, if there is no published market for the security to determine the trading price for the ten day trading period, the court determines that amount.[89] In each of these scenarios, damages must include any amount that the defendant proves is attributable to a change in the market price "that is unrelated to the misrepresentation or the failure to make timely disclosure."[90]

Section 138.6 addresses proportionate liability. Where more than one defendant is found liable for secondary market disclosure, the court determines each defendant's share of the plaintiff's assessed damages.[91] If, however, the court determines that a particular defendant, other than the issuer, *knowingly* "authorized, permitted or acquiesced" in making the misrepresentation or failing to make timely disclosure, that defendant may be held responsible for the full amount of the damages.[92] If the court finds multiple defendants *knowingly* "authorized, permitted or acquiesced" in making the misrepresentation or failing to make timely disclosure, each of these defendants is jointly and severally liable.[93]

Although the penalties appear harsh, there are limits to liability, which vary depending on the defendant involved.[94] By providing limitations for liability, this liability scheme effectively adopts a deterrence-modeled policy rather than one modeled on compensation.[95]

85. *Id.* § 138.5(1)1 & (2)1.
86. *Id.* § 138.5(1)2 & (2)2.
87. *Id.*
88. *Id.* § 138.5(1)3 & (2)3.
89. Securities Act, R.S.O. ch. S.5., § 138.5(1)3 & (2)3.
90. *Id.* § 138.5(3).
91. *Id.* § 138.6(1).
92. *Id.* § 138.6(2).
93. *Id.* § 138.6(3).
94. *Id.* § 138.1.
95. Emerson & Clarke, *supra* note 38, at 13.

Under most circumstances, these limits are only relevant when actual assessed damages exceed them.[96] The limitations provision takes into account damages paid by a person or company under similar "legislation in other provinces or territories in Canada."[97] They are inapplicable, however, if the plaintiff proves that the defendant *knowingly* "authorized, permitted or acquiesced" or "influenced the making of the misrepresentation or failure to make timely disclosure while knowing that it was a misrepresentation or a failure to make timely disclosure."[98]

Section 138.1 provides specific liability limits. The limit for an issuer or non-individual (for example, corporate) "influential person" is limited to the greater of one million dollars and 5 percent of the market capitalization. An individual director, officer, or "influential person" is limited to the greater of $25,000 and 50 percent of the aggregate compensation from the responsible issuer and its affiliates.[99] Expert liability is equal to the greater of one million dollars or the revenue earned by the expert and their affiliates from the responsible issuer and its affiliates during the twelve months prior to the misrepresentation.[100]

In addition to the liability limits, the Budget Measures Act also contains a provision that allows courts to use their discretion in determining whether multiple misrepresentations or failures to make timely disclosure concerning a common subject matter will be treated as a single misrepresentation or failure to disclose.[101] Without this provision, plaintiffs would likely be able to circumvent liability limitations by claiming multiple misrepresentations or failures to make timely disclosures.[102] With the provision, however, the courts are left with making a determination that has a significant impact on the amount that an investor can recover.[103]

d. Procedural Matters

As with the commencement of a suit, a court must approve a discontinuance, settlement, or dismissal of a section 138.3 claim.[104] A court, in deciding whether to grant approval, must consider terms such as it sees fit, including terms as to costs and whether other outstanding proceedings exist in other Canadian provinces or territories relating to the same misrepresentation or failure to make timely disclosure.[105]

In addition to damages, a successful party is entitled to costs.[106] Some believe that the OSC added this provision to avoid the "strike suits" which apparently have flooded American courts due to the lack of a loser-pay cost system.[107] This provision of the Budget Measures Act does, however, allow the courts to determine the amount of costs awarded.[108]

Finally, all claimants must file suit within the limitation period. In the case of misrepresentation in a document or public oral statement, a plaintiff must bring an action no later

96. Securities Act, R.S.O. ch. S.5, § 138.7(1).
97. *Id.*
98. *Id.* § 138.7(2) (emphasis added).
99. *Id.* § 138.1.
100. *Id.*
101. *Id.* § 138.3(6).
102. *See* Emerson & Clarke, *supra* note 38, at 12.
103. *Id.*
104. Securities Act, R.S.O. ch. S.5, § 138.10.
105. *Id.*
106. *Id.* § 138.11.
107. Emerson & Clarke, *supra* note 38, at 20.
108. *Id.*; Securities Act, R.S.O. ch. S.5, § 138.4(11).

than: (1) three years after the date on which the document (or statement) containing the misrepresentation was first released; and (2) six months after the issuing of a news release disclosing that leave has been granted to commence a similar proceeding relating to the same misrepresentation in Ontario or another province or territory, whichever occurs first.[109] Similarly, in the case of a failure to make timely disclosure, the government cannot commence a lawsuit: (1) after more than three years from the required disclosure date; or (2) six months after the issuance of a news release announcing that leave has been granted to commence a similar proceeding relating to the same failure to make timely disclosure in Ontario or another province or territory, whichever happens first.[110]

2. *New Offenses—Fraud and Market Manipulation & Misleading or Untrue Statements*

Another remedial provision, already implemented, relates to fraud, market manipulation and the making of misleading or untrue statements. Before these amendments were implemented, the *Securities Act* (Ontario) did not prohibit securities fraud, market manipulation, or making a misleading or untrue statement.[111] Although Canada's criminal code contains laws against fraud and stock market manipulation, the complexity of such schemes and the limited resources of the Crown resulted in few prosecutions.[112] Section 126.1 was proclaimed into force on October 1, 2003,[113] and it provides a new offense entitled "fraud and marketplace manipulation," by which the OSC can pursue fraudulent activities.[114] It forbids persons from directly or indirectly participating in any act, practice, or course of conduct relating to securities or derivatives, that they know, or reasonably ought to know: (1) results in or contributes to a misleading appearance of trading in, or an artificial price for, a security or derivative of a security; and (2) perpetrates a fraud on any person or company.[115]

Section 126.2 creates another new offense to protect investors from "misleading or untrue statements."[116] A violation occurs under this section if a person or company makes a statement that it knows, or reasonably ought to know: (1) at the time and in the light of the circumstances, is misleading or untrue in a material respect or does not include a fact that is required to be stated or that is necessary to make the statement not misleading; and (2) significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of a security.[117]

3. *Stricter Penalties*

Along with creating these new offenses, the Budget Measures Act increases the maximum penalty for violation of offenses under the *Securities Act* (Ontario) and provides the OSC with new power to order payment of penalties and order disgorgement. As of April 7, 2003, the maximum penalty for general offenses under the *Securities Act* (Ontario) is a fine of five

109. Securities Act, R.S.O. ch. S.5, § 138.14.

110. *Id.*

111. David A. Brown, *Program on Bill 198, available at* http://www.osc.gov.on.ca/en/About/News/Speeches/spch_20030319_bill-198_txt.htm (March 19, 2003); *see* Emerson & Clarke, *supra* note 38, at 27.

112. Emerson & Clarke, *supra* note 38, at 28.

113. Legislative Assembly of Ontario, *Table of Proclamations, available at* http://www.e-laws.gov.on.ca/dblaws/Tables/Public%20Statutes/Table_of_Procs.htm (last updated Dec. 10, 2004).

114. Securities Act, R.S.O. ch. S.5, § 126.1.

115. *Id.*

116. *Id.* § 126.2.

117. *Id.*

million dollars and imprisonment for five years less a day, or both.[118] This increases the prior maximum penalty of one million dollars or two years less a day, or both.[119] Penalties for directors or officers who "authorize, permit or acquiesce" to the commission by their company of the general offenses under section 122(1), are identically increased.[120] Further, the Budget Measures Act raises penalties for insider trading from one million to five million dollars.[121]

As of April 7, 2003, the OSC has the power to order a person or company not in compliance with Ontario securities law to pay an administrative penalty of no more than one million dollars for each failure to comply.[122] Moreover, the OSC has the authority to order the person or company failing to comply to disgorge any amounts received as a result of non-compliance.[123] Section 129.2 provides that where a person or company other than an individual has not complied with Ontario securities law, a director or officer of the company or person who "authorized, permitted or acquiesced" in the non-compliance shall also be deemed non-compliant.[124]

4. *Enhanced Rule Making Authority*

Although section 143(1) of the *Securities Act* (Ontario) already grants the OSC power to make rules, the Budget Measures Act provides power in a number of new areas.[125] First, the new amendments supply the OSC power to review disclosures that a reporting issuer or mutual fund made or ought to have made.[126] These disclosure reviews, previously conducted on a voluntary basis only, can now be performed at the discretion of the OSC or the director.[127] An issuer or mutual fund subject to this review may be required to deliver any information and documents relevant to such disclosures that have been made or ought to have been made to the OSC or director.[128] Furthermore, issuers and mutual funds, or those acting on their behalf, are prohibited from representing to the public that the OSC has reviewed and approved a particular disclosure.[129]

Additional amendments grant authority to the OSC to make rules: (1) "defining auditing standards for attesting to and reporting on a reporting issuer's internal controls;" (2) concerning appointment, functioning, and responsibilities of auditing committees; (3) "[r]equiring reporting issuers to devise and maintain a system of internal control systems;" (4) requiring reporting issuers to establish disclosure controls and procedures; (5) requiring chief executive officers and chief financial officers of reporting issuers to certify the company's internal controls; and (6) requiring chief executive officers and chief financial officers of reporting issuers to certify the company's disclosure controls and procedures.[130]

118. *Id.* § 122(1).
119. *Id.*
120. Securities Act, R.S.O. ch. S.5, § 122(3).
121. *Id.* § 122(4).
122. *Id.* § 127(1)9.
123. *Id.* § 127(1)10.
124. *Id.* § 129(2).
125. Emerson & Clarke, *supra* note 38, at 28.
126. Securities Act, R.S.O. ch. S.5, § 20.1(1).
127. *Id.*; Emerson & Clarke, *supra* note 38, at 24.
128. Securities Act, R.S.O. ch. S.5, § 20.1(2).
129. *Id.* § 20.1(4).
130. Emerson & Clarke, *supra* note 38, at 28, *citing* Securities Act, R.S.O. ch. S.5, § 143(1)25.vi, 143(1)57-61.

### B. The CSA Response

As previously mentioned, the thirteen provincial and territorial regulators are each members of the CSA, which provides a forum for these regulators to coordinate and harmonize regulation of the capital markets.[131] In light of the changes taking place in the United States and Canada, this group has been particularly active. Specifically, it made national and multilateral instrument proposals to implement new investor confidence measures and initiated the Uniform Securities Legislation Project.

#### 1. *Corporate Governance Standards*

On June 27, 2003, the Canadian securities regulatory authorities in each jurisdiction, other than British Columbia, released three proposed investor confidence rules for comment.[132] After allowing market participants the opportunity to comment, they released these rules on January 16, 2004.[133] Pending provincial ministerial approval, National Instrument 52-108—*Auditor Oversight*, Multilateral Instrument 52-109—*Certification of Disclosure in Issuers' Annual and Interim Filings* and Multilateral Instrument 52-110—*Audit Committees* will take effect March 30, 2004.[134]

##### a. National Instrument 52-108—Auditor Oversight

All Canadian jurisdictions have adopted National Instrument 52-108—*Auditor Oversight*. The purpose of this rule is to increase "public confidence in the integrity of financial reporting of reporting issuers by promoting high quality, independent auditing."[135] This instrument requires that reporting issuers have auditor reports signed by a public accounting firm that is: (1) a participant in the Canadian Public Accountability Board (CPAB) oversight program for public accounting firms that audit reporting issuers; and (2) "in compliance with any restrictions or sanctions imposed by the CPAB."[136] Public accounting firms in Alberta, British Columbia, and Manitoba, however, are not required to participate in the CPAB program.[137]

Canadian federal and provincial financial and securities regulators, as well as Canada's chartered accountants, created the CPAB in July 2002.[138] The expressed purpose of this independent public oversight system for accountants and accounting firms is to "promote high quality external audits of reporting issuers."[139] Primarily, this is achieved through a registration system for public accounting firms, and many firms in the country have indicated that they intend to participate in the program.[140] In addition to applying to join the program, a firm must sign a participation agreement that sets out compliance requirements,

131. *Regulation of Securities Markets*, *supra* note 24.

132. CSA/ACVM, *Securities Regulators Implement New Investor Confidence Measures*, *available at* http://www.csa-acvm.ca/html_CSA/news/04_02confidence_measure.htm (Jan. 16, 2004).

133. *Id.*

134. *Id.*

135. CSA/ACVM, *Notice of National Instrument 52-108 Auditor Oversight*, *available at* http://www.albertasecurities.com/index.php?currentPage=222 (Jan. 16, 2004) [hereinafter *Notice of National Instrument 52-108*].

136. National Instrument 52-108 Auditor Oversight, 27 O.S.C.B. 874, § 2.2 (2004).

137. *Id.* § 1.2.

138. Emerson & Clarke, *supra* note 38, at 29.

139. *Notice of National Instrument 52-108*, *supra* note 135, at 2.

140. *Id.*

such as adhering to quality control standards established by the CPAB and submitting to regular inspections.[141]

b. Multilateral Instrument 52-109—Certification of Disclosure in Issuers' Annual and Interim Filings

Every Canadian jurisdiction, except British Columbia, has adopted Multilateral Instrument 52-109. The purpose of implementation was to "improve the quality and reliability of reporting issuers' annual and interim disclosure."[142] Similar to the SEC's certification requirements, this rule requires Chief Executive Officers (CEO) and Chief Financial Officers (CFO) of all reporting issuers in Canada, other than investment funds, to certify their issuers' annual and interim filings.[143]

Pursuant to this instrument, reporting issuers must file annual and interim certificates in which their CEOs and CFOs personally certify that, based on their knowledge and review of the filings, there are no misrepresentations and the annual and interim financial statements fairly present the financial condition of the issuer.[144] Because these representations are knowledge-based, CEOs and CFOs are also required to personally certify that they are responsible for establishing and maintaining disclosure controls, procedures, and internal control over financial reporting that effectively eliminate the defense of ignorance.[145] Forms 52-109F1 and 52-109F2 specifically require CEO and CFO to certify that: (1) they have designed, or caused to be designed, disclosure controls and procedures to provide reasonable assurances that material information relating to the issuer and its consolidated subsidiaries is made known to them by others within those entities; (2) they have designed, or caused to be designed, internal control over financial reporting to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements in accordance with the issuer's generally accepted accounting principles; (3) they have evaluated the effectiveness of such disclosure controls and procedures and have caused the issuer to disclose in the annual management discussion and analysis (MD&A) the conclusions they made; and (4) they have required the issuer's annual MD&A to disclose any change in the issuer's internal control over financial reporting that occurred during the issuer's most interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.[146] These requirements are intended to ensure that an issuer's senior management is aware of material information that is filed with securities regulators and released to investors and is held accountable for the fairness and accuracy of this information.[147]

141. *Id.* at 2-3.

142. CSA/ACVM, *Notice of Multilateral National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings*, *available at* http://www.albertasecurities.com/index.php?currentPage=222 (Jan. 16, 2004) [hereinafter *Notice of National Instrument 52-109*].

143. *Id.* §§ 1.2, 2.1, 3.1.

144. *Id.* parts 2 & 3; Forms 52-109F1 & 52-109F2, *available at* http://www.gov.ns.ca/nssc/ContDiscl/cd.html (last visited Dec. 13, 2004).

145. *Notice of National Instrument 52-109*; *supra* note 142; Forms 52-109F1 & 52-109F2, *available at* http://www.gov.ns.ca/nssc/ContDiscl/cd.html (last visited Dec. 13, 2004).

146. *Notice of National Instrument 52-109*; *supra* note 142; Forms 52-109F1 & 52-109F2, *available at* http://www.gov.ns.ca/nssc/ContDiscl/cd.html (last visited Dec. 13, 2004).

147. *Notice of National Instrument 52-109*, *supra* note 142, at 2.

Unlike sections 404(a) and (b) of SOX, this rule does "not require a report of management on an issuer's internal control over financial reporting or auditor attestation on management's assessment of an issuer's internal control over financial reporting."[148] As a separate initiative, however, a proposed instrument is being developed "which will require a report on management's assessment of an issuer's internal control over financial reporting," and an evaluation has commenced in order to determine whether auditor attestation should also be required.[149] As of October 16, 2004, this instrument continued to be a priority for the CSA, but the earliest that any proposal is expected to apply is to financial years ending June 30, 2006.[150]

c. Multilateral Instrument 52-110—Audit Committees

Every Canadian jurisdiction, other than British Columbia, has adopted Multilateral Instrument 52-110—*Audit Committees*. This instrument is based upon U.S. audit committee requirements.[151] It is intended to encourage reporting issuers to establish and maintain strong, effective, and independent audit committees.[152]

This rule requires every reporting issuer to have an audit committee to which its external auditor reports directly.[153] Additionally, it provides that every audit committee must be responsible for: (1) overseeing the work of the external auditor engaged for the purpose of preparing or issuing an audit report or related work; (2) pre-approving all non-audit services to be provided to the issuer, or any of its subsidiaries, by the issuer's external auditor; (3) reviewing the issuer's financial statements, MD&A, and earnings press releases before they are publicly disclosed by the issuer; (4) being satisfied that adequate procedures are in place for the review of the issuer's public disclosure of information derived from its financial statements; (5) establishing procedures for the receipt, retention, and treatment of complaints received by the issuer regarding accounting and auditing matters, as well as establishing procedures that enable employees of the issuer to confidentially and anonymously submit concerns as to questionable accounting or auditing matters; and (6) reviewing and approving the issuer's hiring policies regarding partners, employees, and former partners and employees of the present and former external auditor.[154] Further, the audit committee must recommend to the board of directors the external auditor to be nominated for preparing or issuing an auditor's report, as well as the compensation to be paid to that external auditor.[155]

The rule also requires every audit committee to have a minimum of three members, and each member must be financially literate and independent.[156] A committee member is independent if the member has no direct or indirect material relationship with the issuer.[157]

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148. *Id.*

149. *Id.*

150. CSA/ACVM, *Notice of National Instrument 52-110 Audit Committees, available at* http://www.albertasecurities.com/dms/1144/3140/9205__1405914v2_-_CSA_NOTICE_52-110_-_PUB_JAN_16,_2004.pdf (Jan. 16, 2004).

151. *Id.*

152. *Id.*

153. Multilateral Instrument 52-110 Audit Committees, 27 O.S.C.B. 837, § 2.1 (2004).

154. *Id.* § 2.3.

155. *Id.*

156. *Id.* § 3.1.

157. *Id.* § 1.4.

A "material relationship" is a relationship that could, in view of the issuer's board of directors, reasonably interfere with the exercise of a member's independent judgment.[158] Section 1.4(3) provides a list of persons considered to have a material relationship with the issuer, such as a person who is or who has a family member that is an officer or employee of the issuer.[159] Venture issuers and U.S. listed issuers, however, are exempt from the composition requirements for the audit committee.[160]

In addition, to allow an independent audit committee to perform its role without reliance on management, the rule requires that every audit committee have the authority to engage and compensate independent counsel, along with other advisers that the committee determines are necessary to carry out its duties.[161] Also, audit committees must have the authority to directly communicate with the internal and external auditors.[162]

2. *Uniform Securities Legislation Project*

Recognizing the need for a more streamlined system of securities regulation, as well as increased efficiency in administering and regulating capital markets in Canada, the CSA launched the Uniform Securities Legislation (USL) Project in the spring of 2002.[163] The expressed mandate of the USL Project is to "develop a uniform act and uniform rules within two years that would be adopted across Canada."[164] Therefore, each jurisdiction in Canada will have identical securities legislation with only minor variations where necessary. Because the goal of this project is harmonization, the resulting securities regime does not contain many substantive changes from current securities legislation.

Specifically, the CSA and its members have proposed an alternative, the provincial and territorial co-operative approach, which commonly referred to as the "passport" model.[165] Under this model, each of the thirteen jurisdictions maintains its own legislation and regulations; however, issuers and registrants need deal with only one of them, presumably determined by the location of the company's headquarters.[166] Once one jurisdiction grants approval or makes a ruling, it is deemed to be accepted by all other jurisdictions.[167] This model seeks to create an efficient unitary-like system without forfeiting the current jurisdictional structure or requiring too many legislative changes.[168]

Uniformity is a necessary element to effectively implement this "passport" system. Therefore, on December 16, 2003, the CSA released consultation drafts of a *Uniform Securities Act* (USA) and a *Model Securities Administration Act* (MAA) for comment.[169] The comment

158. *Id.*

159. Multilateral Instrument 52-110 Audit Committees, 27 O.S.C.B. 837, § 1.4.

160. *Id.* §§ 6.1, 7.1.

161. *Id.* § 4.1.

162. *Id.*

163. CSA/ACVM, *Uniform Securities Legislation Project: Commentary on Consultation Drafts, available at* http://www.albertasecurities.com/dms/2990/10694/10707__1389255_v1_-_USL_COMMENTARY_-_DEC_16.pdf (Dec., 16, 2003).

164. *Id.*

165. Glover, *supra* note 35, at 2.

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*; citing CSA/ACVM, *CSA Release Proposed Uniform Securities Legislation, available at* http://www.csa-acvm.ca/html_CSA/news/uniform_securites_32.htm (Dec. 16, 2003).

period is expected to remain open until March 16, 2004.[170] The USA contains the "core, substantive provisions of securities laws," while the MAA contains the "procedural components of securities laws."[171] The key features of the USA and MAA include: (1) a legislative foundation for each jurisdiction to which detailed rules will be added; (2) "one stop shopping for issuers and registrants;" (3) uniformly defined terms; (4) expanded enforcement powers; and (5) uniform rule making powers.[172]

This is one of several initiatives taken by Canadian capital market players to de-fragment securities laws in Canada and provide for a more efficient system. "The CSA and, more importantly, their legislative masters, the provincial and territorial governments, have been loath to cede legislative authority over securities regulation to the federal government."[173] The federal government, however, has taken a bold step forward with regards to this issue.

### C. The Federal Response: The Wise Persons Committee

Despite the fact that Canadian federal jurisdiction over corporate and securities matters is currently exercised through corporate legislation applicable only to federally incorporated corporations, the federal government in Canada has shown interest in the reforms taking place. In particular, the Federal Minister of Finance of Canada established the Wise Persons' Committee (WPC) to make an independent assessment of what securities regulatory structure will best meet Canada's needs.[174] With hopes of recommending an efficient and innovative regulatory structure, the WPC set out with the objectives of protecting investors and creating confidence in Canada's capital markets.[175] The Wise Persons Report (Report) was released in mid-December 2003.[176]

The Report recommends federal enactment of a new Canada Securities Act (Act), which would implement a comprehensive scheme of capital markets regulation for Canada.[177] Thereafter, the WPC suggests that the provinces and territories pass complementary legislation recognizing the unitary Canadian Securities Commission, which would be established under the federal Act. Despite this suggestion, the Report claims that provincial and territorial cooperation is not essential and that the federal government has the power to impose its federal regime pursuant to its constitutional power to legislate "the general regulation of trade."[178]

Although the Report does not detail the substance of its proposed federal legislation, it does highlight key structural features. As mentioned, there would be one Canadian securities law.[179] Amendments to the Act would require approval by a majority of the provinces representing a majority of the population of Canada.[180] The Act would be administered by

170. CSA/ACVM, *CSA Release Proposed Uniform Securities Legislation, available at* http://www.csa-acvm.ca/html_CSA/news/uniform_securites_32.htm (Dec. 16, 2003).

171. *Id.*

172. Glover, *supra* note 35, at 3.

173. *Id.*

174. Wise Persons Committee, *It's Time, available at* http://www.wise-averties.ca/finalreport_en.html (December 2003) [hereinafter Wise Persons Committee].

175. *Id.*

176. *Id.*

177. Glover, *supra* note 35, at 1.

178. Wise Persons Committee, *supra* note 174.

179. *Id.* at 57.

180. *Id.*

a single Canadian Securities Commission, which would consist of nine full-time commissioners.[181] The nine commissioners would be regionally representative consisting of two from Ontario and Quebec, one from B.C. and Alberta, two from the remaining provinces and territories, and one with no geographical restriction.[182] These commissioners would be appointed by the Federal Minister of Finance from nominees recommended by a Nominating Committee.[183] The Nominating Committee would be comprised of ten members designated by province (one from each) and three members designated by the Federal Minister of Finance (one representing investors, one representing registrants, and one representing issuers).[184] In addition, a Securities Policy Ministerial Committee would be established to provide a forum for policy and administrative input under the new system.[185] This committee would consist of ministers responsible for securities regulation in each province and the Federal Minister of Finance.[186]

Several steps would be taken to ensure responsiveness to the needs of Canada's capital markets, to utilize existing expertise, and to provide excellent on-the-ground service delivery by the Canadian Securities Commission. The head office of the Commission would be in the Nation's Capital Region, and regional offices would be in Vancouver, Calgary, Winnipeg, Toronto, Montreal, and Halifax.[187] District offices would be established as needed.[188] The head office would be responsible for policy development, coordination of regional and district office activity, dealings with other Canadian financial sector regulators, and international matters.[189] The regional offices would be responsible for reviewing prospectuses and registration applications, granting exemptions, conducting compliance reviews and investigations, and initiating enforcement proceedings, as well as contributing to policy development.[190] Where district offices are needed, they would ensure effective, consistent issuer and investor treatment across Canada.[191] Also, capital markets advisory committees, representative of issuers, and investors would be set up to represent sectoral interests and provide knowledgeable feedback to the Commission.[192] Finally, a separate federal body would be set up for the adjudicative aspects of securities regulation, in essence, preventing the Commission from serving as rule maker, prosecutor, and judge and jury.[193]

It can be argued that the WPC and CSA proposals seek to accomplish the same objective, but it is clear that they are two completely separate legislative tracks.[194] Regardless of indications that the federal government has the authority to supersede the provinces in the field of securities regulation, it is almost certain that there will be constitutional challenges to any proposed federal initiative to do so.[195]

181. *Id.*
182. *Id.*
183. *Id.* at 58.
184. Wise Persons Committee, *supra* note 174, at 58.
185. *Id.*
186. *Id.*
187. *Id.*
188. *Id.*
189. *Id.*
190. Wise Persons Committee, *supra* note 174, at 58.
191. *Id.*
192. *Id.*
193. *Id.* at 59.
194. Glover, *supra* note 35, at 3.
195. *Id.*

### D. British Columbia's Alternative Approach

Despite the efforts to achieve uniform securities laws across Canada, the British Columbia Securities Commission (BCSC) is re-writing its securities legislation and has proposed a new regulatory model that is inconsistent actions taken by Ontario, the CSA, and the Wise Persons Committee. Unlike the other reviews, which focus on eliminating differences among jurisdictions, the B.C. model aims to attack more acute threats to effectiveness and efficiency caused by excessive regulatory volume and complexity.[196] On April 15, 2003, after eighteen months of work, the BCSC published for comment a draft Securities Act that would replace the existing one.[197] The draft contains new requirements and powers to make regulation more effective, eliminate redundant and outmoded requirements, simplifies those that remain, and writes it all in plain language.[198] It moves away from a system of regulation based on detailed, prescriptive rules, towards a responsive and flexible principles-based system.

#### 1. *Contemporary Regulation*

The proposed legislation eliminates out-dated requirements and simplifies others. It consists of organized securities rules that are drafted in "plain language" and are accompanied by two guides, one for issuers and one for registrants.[199] The system is designed so that issuers and registrants can read and understand requirements and then make their own determination on how to comply.[200]

Although the system is simplified considerably, the draft legislation recognizes that the complex nature of securities markets and regulation still necessitate professional advice. Routine compliance matters, however, should be significantly streamlined.[201] The theory behind this model is that, because the rules are simple and plainly written and guidance is easily accessible, market participants should better understand what is expected. Based on this increased understanding, market participants should be held to high standards of conduct and disclosure, thereby providing better protection for investors and increasing the integrity of the market.[202]

#### 2. *Needed Changes*

Because most of the current elements of regulation were designed in the 1930s, the proposed legislation attempts to make significant changes that will fit the needs of today's

196. British Columbia Securities Commission, *The BC Model: Commentary on Draft Legislation available at* http://www.bcsc.bc.ca/Publications/BC_Model/Commentary.pdf (Apr. 15, 2003) [hereinafter *The B.C. Model Commentary*].

197. On May 5, 2004, the BCSC announced the introduction of a New *Securities Act*, known as Bill 38, to the Legislative Assembly. British Columbia Securities Commission, *BC Notice 2004/20: New Securities Legislation, available at* http://www.bcsc.bc.ca/bcproposals/history.asp (May 5, 2004). While the new Act appears to be in final form, the BC government announced in November 2004, that it was delaying the proclamation of *Securities Act*, S.B.C. 2004, c. 43. British Columbia Securities Commission, *BC Notice 2004/43: Delay in Implementing New British Columbia Securities Legislation, available at* http://www.bcsc.bc.ca/bcproposals/history.asp (Nov. 18, 2004).

198. *Id.*

199. British Columbia Securities Commission, *The BC Model in Brief: Securities Regulation that Works, available at* http://www.bcsc.bc.ca/Publications/BC_Model/Model_Brief.pdf (May 30, 2003) [hereinafter *The B.C. Model in Brief*].

200. *Id.*

201. *Id.*

202. *Id.*

markets and investors. For example, many regulatory burdens are minimized. The legislation would replace the current prospectus disclosure system with a process that streamlines initial public offerings (IPO) and eliminates regulatory approval for offerings after the IPO.[203] It eliminates the complex and burdensome regime of hold periods and resale restrictions for securities of public issuers.[204] It also puts investors in public companies on an equal footing regardless of whether they purchase securities from the company in a public offering or private placement or in the market from other investors.[205] Other notable changes include the creation of a continuous market access system, codes of conduct, firm-only registration requirements, broader terms for civil liability, and increased enforcement powers.

a. Continuous Market Access System

The B.C. model introduces a new system for raising capital that takes advantage of high disclosure standards. The current prospectus system has become somewhat redundant, as the Internet can be used to access public companies' continually updated material disclosures.[206] Therefore, this system is being replaced by the system known as continuous market access (CMA).[207] The CMA system puts investors of public companies on an equal footing, regardless of whether they purchase securities from the company in a public offering, private placement or in the market from other investors.[208] It also enables issuers to access the public markets faster and at a lower cost.[209]

Under the CMA system, issuers must file an annual information form (AIF), annual and quarterly financial statements containing MD&A, and timely news releases disclosing any new material information.[210] These requirements will allow issuers to expeditiously offer securities simply by issuing a news release disclosing relevant material information.[211] Any offering documents provided form part of the issuer's public record, and all issuer disclosures are subject to the general prohibitions against misrepresentations and fraud.[212]

A cost-benefit analysis of the CMA system shows that public companies could cut time-to-market and costs in half.[213] Investors will also benefit from additional disclosure and improved performance since companies will be able to dedicate more time and resources to operating their business.[214]

b. Guiding Principles

This legislation has been proposed assuming that investors are best protected when dealers and advisers fully understand and are held accountable for their obligations to clients and the market.[215] Therefore, a large number of the detailed rules and prescriptive require-

203. *The B.C. Model Commentary*, *supra* note 196.
204. *Id.*
205. *Id.*
206. *Id.*
207. *Id.*
208. *Id.*
209. *The B.C. Model Commentary*, *supra* note 196.
210. *Id.*
211. *Id.*
212. *Id.*
213. *Id.*
214. *Id.*
215. *The B.C. Model Commentary*, *supra* note 196.

ments currently governing the behavior of securities dealers and advisers will be replaced by a principles-based Code of Conduct.[216] The Code of Conduct contains eight general principles that call for firms and their representatives to concentrate on the purposes and reasons behind the regulatory standards, thereby allowing firms to use its resources more efficiently[217] Rather than focusing on meeting technical requirements and searching for loopholes, the legislation hopes that participants will focus on what is right for investors, clients, and markets.[218]

c. Less Burdens on Registration

The proposed legislation eases registration requirements. Only dealer and adviser firms are registered, not individual representatives.[219] This eliminates the burdens and delays that firms incur when they are required to register each individual representative. It also makes employers clearly accountable for the proficiency and conduct of their representatives.[220] To help deter misconduct and encourage firms to use selective hiring criteria, both employees and employers are exposed to administrative sanctions and civil liability.[221]

d. Remedies and Civil Liability

The B.C. model attempts to create a new system of liability for securities law violations that strikes a balance between providing fair and meaningful remedies and preventing unfair exposure to liability.[222] This system will replace the existing and proposed statutory remedies with a broader set of remedies.[223]

Under the proposed legislation, an investor or client can sue any person who materially violates securities law.[224] In particular, the legislation prohibits misrepresentations, fraud, market manipulation, unfair practices, insider trading, and front running.[225] To shield abusive litigation, the legislation provides clear defenses and procedural protections for defendants and limits the amount of damages that can be awarded.[226]

e. Enforcement Powers and Penalties

The B.C. model also increases enforcement powers and penalties, in order to discourage misconduct, while offering predictable penalties for violations.[227] To strengthen enforcement, the proposed legislation provides commission staff with broad powers to obtain information from market participants and to ban participants from the market.[228] It also grants the commission staff authority to order disgorgements.[229] Furthermore, maximum penalties are increased. Specifically, administrative penalties are increased to one million dollars per

216. *Id.*
217. *Id.*
218. *Id.*
219. *Id.*
220. *Id.*
221. *The B.C. Model Commentary*, *supra* note 196.
222. *Id.*
223. *Id.*
224. *Id.*
225. *Id.*
226. *The B.C. Model in Brief*, *supra* note 199.
227. *Id.*
228. *The B.C. Model Commentary*, *supra* note 196.
229. *Id.*

infringement, and the maximum fine that a court may order for an offense is increased to three million dollars.[230]

## V. Conclusion

It should be evident at this point that many parties have significant interests in the changes that have taken place and are currently under consideration. The future of Canada's capital markets lies in the hands of the regulators and authorities discussed above. Depending on which initiative garners the most support, the country's capital markets could be regulated in a number of different ways.

Ontario has taken the most aggressive stance by not only proposing change to its regulatory scheme, but also implementing those changes rapidly. The creation of new offenses, addition of stricter penalties, and enhancement of rule-making authority of the OSC are very similar to changes made in the United States. The underlying question is whether these changes will be too burdensome for market participants and result in inefficiencies. Although it remains uncertain whether these reforms are right for Canada, Ontario does have the advantage of being the first province to act.

The CSA took similar steps to quickly remedy perceived problems in Canada's capital markets. Because the CSA is a representative body of Canadian regulators, it has more of a nationwide impact. The national and multilateral instruments, which have been adopted in virtually all provinces and territories in Canada, are nearly carbon copies of the legislative reforms imposed by SOX in the United States. Like the reforms in Ontario, this legislation could arguably impose compliance burdens on market participants, resulting in inefficiencies. In addition to instrument proposals, the CSA initiated the USL Project to consider harmonizing securities laws in Canada. This project is the provincial/territorial model for uniformity of laws, and it runs counter to the initiatives taken by the federal government.

The federal government established the WPC to make an independent assessment of Canada's regulatory structure. The WPC report released December 2003 contains a proposal to create a federal *Canada Securities Act*, enforced by a unitary Canada Securities Commission. Although the federal government does not have a significant presence in securities regulation at present, the report claims that it does have the constitutional authority to overhaul the system. It is probable, however, that any federal initiative to follow through with this threat will be vigorously challenged by the provinces and territories.

British Columbia developed the final reform effort taking place in Canada. It proposed a different method of reform that focuses on deregulation rather than invoking more rules and procedures. The B.C. model claims that excessive regulatory legislation is counterproductive and results in more costs than benefits. By streamlining regulation and modernizing requirements, this model seeks to create a system based on principles. A principles-based regime, although convincing in theory, has received criticisms because of the possible uncertainties it would create.

Currently, it seems more probable that Canada will continue to invoke U.S.-type reforms, creating more rules and imposing more oversight on its markets. In addition, it is likely that the efforts to achieve uniform securities laws will persist, but there is less certainty as to whether the provincial or federal proposals will prevail. In sum, change is coming, but it is yet to be determined whether it will result in the investor confidence and comparative advantage that has been called for.

230. *Id.*