

FOCUS

Securities Law

To be or not to be: a national securities regulator

The federal government's determination to follow the lead of virtually every other developed country in the world by creating a federal securities regulatory regime appears to be headed for a constitutional showdown in the Supreme Court of Canada later this year. At issue is the jurisdiction of the federal Crown to create a federal *Securities Act* and a national securities regulator over the objection of two holdout provinces.

The legislation will likely allow individual provinces to opt in to the federal regime, to the exclusion of existing provincial legislation. While the rest of the provinces and territories have either lent their support or withheld their objections to this long overdue and much debated initiative, Alberta and Quebec have been steadfast in their opposition.

In a transparent attempt at a pre-emptive strike, in July 2009 Quebec referred three constitutional questions to its own Court of Appeal for determination, based on its belief that federal securities legislation would encroach on the jurisdiction of Quebec over property and civil rights. Alberta has taken the same position, and in February 2010 referred to the Alberta Court of Appeal questions including whether the federal government has the legislative authority to pass legislation that covers the same substance as Alberta's *Securities Act*.



LINDA FUERST

“

Most commentators are of the opinion that this is a fight that Quebec and Alberta will not, and should not, win.

The strategy pursued by Quebec and Alberta is questionable. The references they bring are, arguably, premature in the absence of actual federal legislation. The wording of the questions that those provinces have referred to their own courts of appeal is such that even if they are answered in their favour, the application of the answers to the federal legislation to be tabled later is uncertain.

Unlike Quebec and Alberta, the questions that the federal government will refer to the Supreme Court of Canada for determination will be based on the actual legislation that it proposes to

enact. The federal Crown's strategy enhances the likelihood that the answers obtained will provide clarity and certainty concerning the validity of the federal legislation, and that the risk of further legal challenges to the new regime will be minimized.

One of the federal government's strongest arguments is that its jurisdiction over trade and commerce in s. 91(2) of the *Constitution Act, 1867* authorizes it to regulate the securities industry. This position is supported by the 1989 decision of the Supreme Court of Canada in *General Motors of Canada Ltd. v. City National Leasing Ltd.*, [1989] 1 S.C.R. 641 that the *Combines Investigation Act* is *intra vires* Parliament under the federal trade and commerce power in s. 91(2). The court will likely reach the same conclusion for the proposed federal securities legislation.

Most commentators are of the opinion that this is a fight that Quebec and Alberta will not, and should not, win. While the current system of securities regulation in Canada is not horribly broken, and there is a high level of cooperation among the provincial regulators in rule making for the clearing of prospectuses and enforcement, the advantages of a national securities regulator are apparent.

As many observers have already noted, a federal system of securities enforcement will almost certainly be more effec-

tive than the existing, fragmented regime. While provincial regulators typically cooperate in investigating suspected securities offences that cross provincial boundaries, unnecessary duplication of effort inevitably results. Differences in statutory regimes for the sharing of information obtained during a formal investigation can create challenges. Orders to cease trading, to prohibit persons from acting as an officer or director of an issuer or to remove exemptions do not have extra-provincial effect and may allow wrongdoers to avoid the effect of an order by switching their activities to another province, at least for a while. A more efficient enforcement regime can only enhance investor confidence in the capital markets.

A national securities regulator will also reduce costs to issuers and other market participants. They will have to answer to one regulator, not many. In turn, this should make Canada a more attractive jurisdiction to both foreign and domestic issuers seeking to raise capital.

Apart altogether from the advantages of a system of federal regulation, a national securities regulatory system would reflect the practical reality of the capital markets. Securities markets play an essential role in the Canadian economy. Indeed, the interprovincial and international nature of the securities industry was

recognized in the majority decision of the Supreme Court of Canada in *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161, which determined that the insider trading provisions of the Canada *Business Corporations Act* were *intra vires* Parliament. It is incongruous that anti-competitive commercial activity and the business of banking and insurance are policed federally, but the securities industry still is not.

Quebec and Alberta may be playing a dangerous game. Whether opposition to federal securities legislation is due to a genuine concern about the ability of a federal regulator to supervise the securities industry in a way that recognizes regional differences, or is part of a strategy to pressure the federal government into agreeing to base the offices of the new regulator in a province other than Ontario is difficult to determine.

Whatever the reason, there is at least some risk that one of the consequences of refusing to participate in the new regime is that issuers and investors will decide to avoid the cost of dealing with these “hold out” jurisdictions in favour of the federal regulator, to the detriment of those provinces. ■

Linda Fuerst is a partner at Lenzner Slaughter Royce Smith Griffin LLP in Toronto, with significant experience in securities litigation and regulatory issues.

Defendants cannot rely on business judgment rule as part of their defence

IMAX

Continued From Page 14

Commission (SEC). The day after a subsequent press release in which Imax stated that it was responding to an informal inquiry from the SEC regarding its revenue recognition practices, the market price of Imax shares fell 40 per cent.

The decision granting leave

Justice van Rensburg granted the plaintiffs leave to commence their claim, finding that they had met the statutory threshold to establish that they are bringing the action in good faith and that there is a “reasonable possibility of success at trial.”

Justice van Rensburg held that the good faith branch of the test requires plaintiffs to “establish that they are bringing their action in the honest belief that they have an arguable claim.” In setting out a test that only a rare plaintiff will fail, she rejected the more robust good faith requirement that applies to derivative actions.

She also interpreted the “reasonable possibility of success” branch of the test as a relatively low threshold, holding that a reasonable possibility is more than a “mere” or *de minimis* possibility, and the conclusion that a reasonable possibility exists must be based on a reasoned consideration of the evidence, bearing in mind the limitations of motion procedure.

Higher burden on defendants

While it is not surprising that the burden of disproving the reasonable possibility of something is higher than that for proving it, the way that difference is expressed is crucial. Justice van Rensburg held that to defeat a motion for leave, a defendant must satisfy the court that the evidence will “preclude the possibility of success at trial.” Only two of the defendants — both external directors — met this test. The judge also outlined certain limits on the available statutory defences.

Justice van Rensburg found that the defendants could not rely on the business judgment rule as part

“

Imax signals to shareholders who think they are aggrieved by secondary market misrepresentation... that Ontario's courts are “open for business.”

of their reasonable investigation defence, because the business judgment rule has been held not to apply to disclosure obligations under securities laws.

She further concluded that reliance on experts cannot be used as a defence where the misrepresentation does not originate with the expert or where the expert's opinion is based on misleading information that has been provided to it by the corporation. Consequently, she held that the

defendants could not rely on the audit opinion of Imax's auditors.

Class certification

Justice van Rensburg certified the plaintiffs' statutory and common law claims for negligent and fraudulent misrepresentation. In a move that may be seen as inconsistent with the Ontario courts' previous rejection of the “fraud on the market” theory, she essentially accepted the efficient market argument, to the effect that reliance could be established by the act of purchasing the corporation's securities.

Although only approximately 10 to 15 per cent of the proposed class members are Canadian residents, Justice van Rensburg certified a global class, finding that there was a real and substantial connection to Ontario in light of the fact that Imax is an Ontario corporation that trades on the TSX.

By setting a low threshold for leave to commence the statutory claim and demonstrating a will-

ingness to certify a global class, *Imax* signals to shareholders who think they are aggrieved by secondary market misrepresentation (or, more accurately, the worldwide plaintiffs' class action bar) that Ontario's courts are “open for business.”

Imax is seeking leave to appeal to the Ontario Divisional Court from the granting of the plaintiffs' certification motion and has commenced an appeal to the Court of Appeal for Ontario from the order granting leave to the plaintiffs to commence the action. The outcome of those appellate proceedings will provide important direction to the burgeoning field of “Bill 198” litigation for years to come. ■

*Mark Gelowitz is a partner in the Litigation Department of Osler, Hoskin & Harcourt LLP in Toronto and chair of the firm's National Corporate Governance and Securities Litigation Group. He is co-author of *Sopinka & Gelowitz, The Conduct of an Appeal, Second Edition* (Butterworths 2000).*