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CHAPTER 1 - REGULATORY FRAMEWORK

1.01 *Provincial Securities Commissions*

The responsibility for the administration and enforcement of securities legislation in Canada rests with provincial regulatory agencies. Due to the vagaries of Canadian constitutional law, to date, the federal authorities have not yet attempted to exercise jurisdiction in the field of securities regulation, apart from occasional proposals to merge provincial commissions into a national agency.[1] As a result, interprovincial cooperation and administrative integration — notably in the use of national policy statements to facilitate the filing and approval of prospectuses on a national basis in each of the separate jurisdictions[2] — have been necessary to secure the orderly distribution of securities in Canada.

The ten provinces and two territories of Canada each have administrative agencies or officials responsible for securities legislation, which vary both in size and sophistication, and in their relationship with the appropriate elected government. The majority of provinces have a two tiered structure consisting of an upper appointed commission, and a lower level director and supporting staff.[3] Commissions have not been es-

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1. PETER W. HOGG, CONSTITUTIONAL LAW OF CANADA, 312-314, 355 (1977). *See also* CONSUMER AND CORPORATE AFFAIRS, CANADA, PROPOSALS FOR A SECURITIES MARKET LAW FOR CANADA (3 volumes which include a draft federal act).

2. National Policy No. 1: Clearance of National Issues, III Canadian Securities Law Reporter (CCH) ¶ 470-001 [hereinafter cited as Can. Sec. L. Rep. (CCH)].

3. British Columbia, Alberta, Manitoba, Saskatchewan, Ontario, Quebec, and Nova

tablished in the other provinces or the two territories where either a government department administers the relevant legislation,[4] or the securities legislation is administered by government officials.[5] The provincial agencies are a hybrid in the functions they perform, in that they assume the duties carried out by both the SEC and the "blue sky" state authorities in the United States.

The over-all policy objectives of the provincial agencies are akin to their American counterparts in that the basic functions served by each are similar. These include (1) the registration of persons and institutions trading in securities, and maintenance of the minimum standards necessary to retain registration; (2) the registration of securities distributed to the public by issuer corporations; (3) the continuous and timely disclosure of relevant information to the investing public; and (4) the provision of the necessary investigative, preventative, and punitive mechanisms for the proper enforcement of the legislation. In addition, the agencies have assumed the authority to promulgate policy statements for the proper functioning of their role, and have been delegated duties of supervision and review of the various self-regulatory authorities involved in the area of securities.

1.02 *Securities Legislation*

Each of the Canadian jurisdictions has enacted its own legislation dealing with trading in securities within its geographical boundaries. Possible constitutional limits on the extent of provincial jurisdiction over interprovincial transactions have been liberally construed by the Canadian courts so that they do not present any practical barrier.[6] Four provinces have modelled their legislation on that of Ontario, and together with Ontario are commonly known as the Uniform Act provinces.[7] More recently, the provinces of Newfoundland and Nova Scotia have passed securities legislation which is similar to the present securities law in Ontario.[8] The other Atlantic provinces form their own separate group in that their legislation is basically modelled on the predecessor legislation in Ontario,[9] while the province of Quebec combines features of both the predecessor

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Scotia.

4. New Brunswick.

5. Newfoundland, Prince Edward Island, Northwest Territories and Yukon Territories.

6. *Cf.* Gregory v. Quebec Sec. Comm'n, 584 S.C.R. (1961). R. v. McKenzie Sec. Ltd., Man. R., 56 D.L.R. 2d (1966).

7. Ontario Securities Act, 111 Can. Sec. L. Rep. (CCH) 55,101. Revised Regulations of Ontario, Ch. 910/80, 111 Can. Sec. L. Rep. (CCH) 55, 251 (1988), *as amended by* R.R.O. ch. 84/81 (1988) [hereinafter Regulations]. The Uniform Act provinces are Alberta, S.A. ch. 2-6.1 (1981), *as amended*; British Columbia, S.B.C. ch. 83 (1985), *as amended*; Manitoba, R.S.M. ch. S-50 (1988), *as amended*; Saskatchewan, S.S. ch. S-42.2 (1988), *as amended*.

8. Newfoundland, S. Nfld. ch. 48 (1990); and Nova Scotia, R.S.N.S. ch. 418 (1989).

9. Securities Act, R.S.O. ch. 22 (1945), *as amended*; New Brunswick, R.S.N.B. ch. S-6 (1973), *as amended*; Prince Edward Island, R.S.P.E.I. ch. 5-4 (1974), *as amended*.

and the present Ontario securities legislation.[10] In that the Ontario legislation provides the basic foundation for provincial securities regulation in Canada, it will be utilized as the basis for discussion in this material. Considerable movement towards reform was accomplished in Ontario with the enactment of a completely revised Securities Act (effective as of September 15, 1979) and regulations, which governed all aspects of securities regulation in Ontario.[11] The Securities Act and the regulations thereunder have also been further amended more recently in Ontario. The reader is cautioned, however, that the legislation of the separate provincial jurisdictions will not always be similar insofar as details of the legislation are concerned, and reference must be made to the legislation of the appropriate jurisdiction.[12]

In addition, regulations are enacted by each jurisdiction under the delegated authority of the provincial legislation, detailing procedures and requirements for the various functions performed by the provincial agencies. Amendments are frequently made to the regulations, and the reader is cautioned to ensure that reference is made to the current regulations. The regulations are supplemented by the issuance of more detailed and explanatory policy statements[13] which are classified as either national, uniform, or local. Local policies apply only within an individual jurisdiction; uniform statements are issued jointly by the Uniform Act provinces, while national policy statements are adopted by all ten provinces acting in concert.

1.03 *Related Legislation*

Securities legislation must be placed within the context of the legislative provisions which relate to corporate and commercial affairs in general. The distinction between company law and securities law, however, has become somewhat less clear-cut. Because of the flexibility given to and the discretion exercised by securities administrators, innovative techniques that are first developed in the area of securities law may take some time before they emerge as substantive provisions of statutes regarding companies.

Both federal and provincial governments have enacted companies legislation which deals, inter alia, with matters related to securities — including the issuance of shares, proxy solicitation, disclosure by public corporations, insider trading provisions, derivative actions, and issuer and take-over bids (the latter two for federally incorporated companies) and

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10. R.S.Q. ch. V-1.1 (1982), *as amended.*

11. S.O. ch. 47 (1978). For a detailed examination of the Legislation, *see* ALBOINI, ONTARIO SECURITIES LAW (1984) [hereinafter ALBOINI).

12. For a collection of the applicable legislation, *see generally* I-V Can. Sec. L. Rep. (CCH).

13. *See, e.g.*, National Policy Statements, Can. Sec. L. Rep. (CCH) ¶¶ 470-001-472-501, at 57,525-58,313 (1971-1991).

which are administered by the appropriate government department.[14] In addition, federal and provincial legislation dealing with corporate taxation and loan, trust, insurance, and investments corporations must also be included within the purview of the securities practitioner.[15] In that chartered banks are subject to the exclusive jurisdiction of the central government, and are governed by the provisions of the federal Bank Act,[16] their regulation is a matter separate from that of provincial securities legislation.

1.04 *Self-Regulatory Authorities*

Self-regulatory authorities of the securities industry in Canada can be divided into two basic groups: stock exchanges and industry associations. In the former category are the six functional exchanges in Canada: the Toronto, Montreal, Vancouver, Alberta, and Winnipeg Stock Exchanges, and the Toronto Futures Exchange.[17] These are established by provincial legislation and exercise power to regulate and establish rules as to membership, listed issuers, and the trading of listed securities.[18] Their function is to ensure that the qualifications, financial condition, and standards of business and corporate conduct of both members and listed issuers are sufficiently maintained so that the market in listed securities is both fully informed and orderly.

Apart from establishing rules providing for the disciplining of members for violations of the applicable legislation or bylaws, the important role of the exchanges is to regulate the trading that occurs on their floors. The provincial securities authorities generally have the power to make directions and orders concerning the manner in which the exchanges carry on business, their bylaws and regulations, trading on or through exchange facilities, and whether listed issuers comply with the relevant securities legislation.[19] In addition, they possess a general right to review any decision, order, or ruling made under any bylaw, rule, or regulation of

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14. For federal companies, *see* Canada Business Corporations Act, R.S.C. ch. C-44 (1985), *as amended* [hereinafter CBCA). For a typical provincial statute, *see* Business Corporations Act, S.O. ch. 4 (1982), *as amended* [hereinafter OBCA].

15. *E.g.*, in Ontario: Insurance Act, R.S.O. ch. 218 (1980), *as amended*; Investment Contracts Act, R.S.O. ch. 221 (1980); Loan & Trust Corporations Act, R.S.O. ch. 249 (1980), *as amended*; Pension Benefits Act, R.S.O. ch. 373 (1980); Trustee Act, R.S.O. ch. 512 (1980), *as amended*; Corporations Tax Act, R.S.O. ch. 97 (1980), *as amended*. For federal legislation *see* Foreign Insurance Companies Act, R.S.C. ch. I-13 (1985), *as amended*; Canadian & British Insurance Companies Act, R.S.C. ch. I-12 (1985), *as amended*; Investment Companies Act, R.S.C. ch. I-22 (1985), *as amended*; Loan Companies Act, R.S.C. ch. L-12 (1985); Income Tax Act, S.C. ch. 63 (1970-1972), *as amended*.

16. Bank Act, R.S.C. ch. B-1 (1985), *as amended*.

17. A sixth, the Atlantic Stock Exchange, exists only in legislation, and has never operated.

18. *See, e.g.*, Toronto Stock Exchange Act, S.O. ch. 27 (1982), *as amended*; General Bylaw, IV Can. Sec. L. Rep. (CCH) ¶ 801-001.

19. *E.g.*, Conflicts of Interest: Statement of Policies, § 22, Can. Sec. L. Rep. (CCH) ¶ 450-321, at 55,124 (1987); *Id.* § 23, ¶ 450-324, at 55,125.

the exchange that affects a party thereto.[20]

Industry associations are not subject to the same broad supervision by provincial regulatory authorities as are stock exchanges.[21] The major national organization is the Investment Dealers' Association of Canada, which is further divided into regional districts. It exists to protect the investing public and its members by (1) establishing financial requirements for its members; (2) promoting and maintaining high standards of business ethics, conduct, and competence; and (3) organizing and administering educational courses for members, employees, and the public. On a more local basis, there exist bond traders associations — which are associated with secondary trading in unlisted securities, treasury bills, bonds, and debentures. These associations have established codes and procedures to promote and maintain professional competence, financial stability, and ethical conduct.

CHAPTER II - SECURITIES LAWS

2.01 *Provincial Securities Laws*

Each of the ten provinces and two territories which comprise Canada maintains its own securities legislation. The applicable statute in each of these jurisdications must be reviewed where a securities issue arises in that jurisdiction. While some groups, provinces or territories maintain securities legislation which is similar, the disparity between the various groups can be quite pronounced.[22] The following list contains the applicable securities legislation in each of the jurisdictions in Canada:

1. Securities Act (Northwest Territories), R.O.N.W.T., 1974 (as amended);

2. Securities Act (Yukon Territories), S.Y.T., 1986;

3. Securities Act (Alberta), R.S.A., 1981 (as amended);

4. Securities Act (British Columbia), R.S.B.C., 1985 (as amended);

5. Securities Act (Manitoba), R.S.M., 1988 (as amended);

6. Security Frauds Prevention Act (New Brunswick), R.S.N.B., 1973 (as amended);

7. Securities Act, 1990 (Newfoundland), NFLD. R.S., 1990;

8. Securities Act (Nova Scotia), R.S.N.S., 1989;

9. Securities Act (Ontario), R.S.O., 1980 (as amended);

10. Securities Act (Quebec), R.S.Q., 1982 (as amended); and

11. Securities Act, 1988 (Saskatchewan), S.S., 1988, as amended.

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20. *Id.* § 22(3), ¶ 450-323, at 55,125-55,126.

21. The subject of self-regulation is more fully detailed in JOHNSTON, CANADIAN SECURITIES REGULATION, 386-403 [hereinafter JOHNSTON]. *See also* Self-Regulation Generally, § 19, Can. Sec. L. Rep. (CCH) ¶ 450-491, at 55,124 (1987); *Id.* § 20, ¶ 450-492, at 55,124 (1987); *Id.* § 21, ¶ 450-294, at 55,124 (audit requirements).

22. *See generally* § 1.02 *infra*.

2.02 *Other Applicable Statutes and Legislation*

In addition to securities legislation which exists in each of the ten provinces and two territories of Canada, there are many other statutes which affect securities laws in Canada. In particular, the company law in each jurisdiction, including federal corporate legislation applies in areas such as takeover bids, proxy solicitation and disclosure requirements.[23]

Federal legislation in Canada which impacts directly on securities law includes insurance, loan and trust company legislation, competition (anti-trust) legislation, foreign investment provisions and federal criminal law. Many of the provinces have also enacted legislation in these areas, particularly insurance, loan and trust company laws which may impact in the realm of securities law. A comprehensive review of this legislation affecting securities laws in Canada cannot be adequately covered within the confines of these materials. Reference should be made to the applicable legislation within the jurisdication in Canada where a securities issue arises.

CHAPTER III - SECURITIES MARKETS AND SECURITIES DEALERS

Securities markets in Canada are basically similar to those in the United States, varying only in size, volume, and level of sophistication. To the extent that current communications technology and the interlisting of shares (e.g., on both the Toronto and New York Stock Exchanges) permits, an increasingly integrated North American market system exists.

3.01 *Distribution Markets*

The initial distribution of securities in Canada is effected in a variety of ways, much of it occurring by means of negotiated public offerings underwritten on a fixed take-down or best-efforts basis, exempt private placements with institutional investors, or stock offerings to existing shareholders by the issuance of rights to purchase additional shares. Secondary distributions may occur when control persons sell blocks of outstanding shares, generally in the over-the-counter market. In addition, stock exchanges may permit the distribution of mining and some industrial issues through the facilities of the exchange. The practice and procedure governing this latter type of distribution vary according to jurisdiction; in Ontario, a statement of material facts satisfactory to the Ontario Securities Commission and the Toronto Stock Exchange must be filed.[24]

3.02 *Trading Markets*

Trading markets are generally divided into readily distinguishable

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23. *See, e.g.*, CBCA *supra* note 14, §§ 127-131 (Insider Trading), §§ 147-154 (Proxies), and §§ §§ 194-203 (Take-over bids).

24. Exemptions from Prospectus Requirements, § 72(1), Can. Sec. L. Rep. ¶ 450-721, at 55,169 (1988).

types, which may be generally classified as stock exchange markets or as over-the-counter markets.

[a]Securities that are listed and traded on recognized stock exchanges form the first major group. Purchases are transacted by members of the exchanges during exchange business hours on either an agency or principal basis. The listing requirements of the exchanges generally relate to minimum standards of net assets, earnings history, and the extent of share distribution. These are usually lower than those required in the United States, since less mature securities may be listed on Canadian stock exchanges.

[b]The over-the-counter market consists mainly of transactions in unlisted equity securities, although some government and corporate debt securities are also traded. The over-the-counter market in Canada is considerably smaller than its U.S. counterpart. The smaller Canadian market, together with the more concentrated ownership of public securities in Canada, delayed the growth of an extensive system of market-makers or sophisticated electronic trading technology to the extent that it exists in the United States, although over-the-counter market trading is extensively regulated and trades fully reported. Similarly, the existence of a third market for the over-the-counter sales of listed securities is generally of concern only in the United States. The rise of the so-called "fourth market," whereby block trades are made by institutional investors without the intervention of a dealer, led the Ontario Securities Commission to order a mutual fund to cease its relationship with Institutional Network Inc. on the ground that the latter was not registered to trade in Ontario.[25]

3.03 *Commission Rates and Markups*

In contrast to the U.S. situation, a fixed commission rate structure maintained its existence in Canada for a longer period, although it was subject to the supervision of the provincial securities commissions. In the past, increases were permitted once it was established that they would not be prejudicial to the public interest. However, as a result of detailed and sophisticated scrutiny to which commission rate proposals were subjected over the years, and serious consideration of the feasibility of fully negotiated rates,[26] a fixed commission rate structure no longer exists in the securities industry of Canada.

CHAPTER IV - WHAT IS A SECURITY?

4.01 *Introduction*

Like its U.S. counterpart, Canadian securities legislation only applies to trading in securities. Although semantic and technical distinctions can be made in comparing the particular legislation of the various provincial

25. *See* JOHNSTON, *supra* note 21, at 88.
26. *Id.* at 397.

jurisdictions, the definition of a security is basically similar.[27] The securities need not be written documents, but may be oral agreements and may be evidenced by the existence of a legal relationship. They can relate to both individuals and companies.

4.02 *Characteristics of a Security*

In their interpretation of the meaning of a "security," Canadian courts have taken a broad and liberal approach to statutory definitions and have tended to place a higher priority on substance, as opposed to form, in general deference to U.S. jurisprudence on this topic. Standard corporate securities are easily recognized. Evidence of an interest in options, trusts, estates, associations, profit-sharing agreements, oil, natural gas, or mining leases, or scholarship or educational plans or trusts, are also included within the definition. Documents of title - for instance, warehouse receipts for scotch whiskey - which are purchased for speculative or investment purposes will fall within the purview of the legislation.[28] The concept of the "investment contract," whereby any arrangement in which money is invested in a common enterprise with the expectation that profit will be generated solely or primarily by the efforts of third parties is used as a residual and all-inclusive means to retain legislative supervision over most speculative investment schemes.[29] The Ontario legislation specifically adds to the definition of security commodity futures contracts or options that are not traded on a commodity futures exchange registered with or recognized by the Commission under the Commodity Futures Act, Ontario.[30]

CHAPTER V - REGISTRATION OF SECURITIES PROFESSIONALS

5.01 *Registration Requirements*

As a general rule, Canadian securities legislation prohibits any person or company from trading, or being connected with a trade, in securities unless they are registered, and the registration must have been made in accordance with the applicable statute or regulations.[31] The granting, renewal, and revocation of registration are matters delegated to the discretion of administrative officials or the commissions, to be exercised accord-

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27. *See, e.g.*, Interpretation, § 1(1)40, Can. Sec. L. Rep. (CCH) ¶ 450-001 at 55,104 (1988)[hereinafter Interpretation]. For a detailed examination, *see* ALBOINI, *supra* note 11, at 0-24-0-63.

28. In re Brigadoon Scotch Distributors (Canada) Ltd., 3 O.R. 714 (1970).

29. Interpretation, *supra* note 27, § 1(1)40xiv, ¶ 450-001, at 55,105; *see also* Pacific Coast Exch. Ltd. V. Ontario Sec. Comm'n, 2 S.C.R. 3d 112 (1977) (held by the Supreme Court of Canada that a margin contract for the purchase of bags of silver coins was an investment contract and, hence, was a security).

30. Interpretation, *supra* note 27, § 1(1) 40 xiv, ¶ 450-001, at 55,105. Note that the Winnipeg Commodity Exchange is not recognized by the Commission for these purposes.

31. Exemptions from Prospectus Requirements, *supra* note 24, § 24, ¶ 450-721, at 55,169.

ing to broad standards of the public interest, of suitability, or of being nonobjectionable. Procedural requirements for hearings are incorporated into the legislation in an attempt to limit the ambit of the discretion involved in dealing with registration.[32] The basic objective of the registration procedure is to ensure that those people involved in the securities business are honest and of good repute, in order that the public may be protected from fraudulent behaviour.[33] Canadian terminology differs from U.S. terminology to some extent. The licensing of securities professionals in Canada, as in the United States, is referred to as registration. The process by which securities are qualified for public distribution is not referred to as registration, but rather involves the filing of a prospectus and the issuance of a receipt by the regulatory authority, which may be withheld on statutory grounds.[34] Reference herein to "registration" is confined to registration of securities professionals. The term "trade" or "trading" includes any sale or disposition of a security for value.

The actual registration process functions according to a scheme of classification. The legislation generally delineates major classes of participants that must be registered for trading in securities. The major categories are dealers, advisers, underwriters, and salesmen.[35] These are usually defined in broad terms,[36] however, the categories of dealers and advisers are further classified into subcategories according to differences in function and membership in recognized and self-regulatory organizations.[37] Partners or officers of dealers and advisers must register[38] although discretion is often allowed for designation of employees other than salesmen as "nontrading employees."[39] Due to the scope and nature of the varying definitions, there may be some overlapping in function. Thus, while underwriters are normally prohibited from dealing with the public on the sole basis of their registration as underwriters, the more important classes of registered dealers are deemed to be registered underwriters as well.[40] Large dealers may often be registered in a variety of classifications because of the divisions within their firms. In addition, some jurisdictions

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32. Registration, § 25 Can. Sec. L. Rep. (CCH) ¶ 450-356, at 55,126 (1987).

33. Lymburn v. Mayland, 318 A.C. (1932).

34. *See* § 7.05 *infra*.

35. Registration, *supra* note 2, § 24(1), ¶ 450-351, at 55,126 (1987).

36. Interpretation, *supra* note 27, § 1(1)1, ¶ 450-001, at 55,101; The Director, § 7, Can. Sec. L. Rep. (CCH) ¶ 450-132, at 55,108 (1988); Trading Securities Generally, § 39, Can. Sec. L. Rep. (CCH) ¶ 450-458, at 35,143 (1986); *Id.* § 43, ¶ 450-472, at 55,144.

37. Registration Requirements, § 86, Can. Sec. L. Rep. (CCH) ¶ 452-506, at 55,328 (1987). Registration Requirements: Categories of Registration, § 87, Can. Sec. L. Rep. (CCH) ¶ 452-507, at 55,328 (1987). Advisers may be investment counsel, portfolio managers, or securities advisers. Dealers are divided into seven categories: broker, broker-dealer, investment dealer, mutual fund dealer, securities dealer, and securities issuers, the latter referring to those who desire to "self-underwrite."

38. Registration, *supra* note 32, § 24(1)(a)(c), ¶ 450-351, at 55,126.

39. *Id.* § 24(3), ¶ 450-353, at 55,126.

40. Broker-dealers, investment dealers, and securities dealers: § 87, Can. Sec. L. Rep. (CCH) ¶ 450.

have elaborated policies to permit and regulate dual registration in some situations and to prohibit the practice in others.[41]

In May of 1987, the Ontario securities regulators instituted a program known as "Universal Registration", which required the registration of market intermediaries. The introduction was designed to implement the registration of all those in the business of trading in securities in a number of situations which formerly were exempt from the registration requirement as contained in the legislation. For these purposes, virtually all of the registration exemptions described in Section 5.04 *infra* were removed from individuals or companies who fell within the definition of market intermediary.[42] The amendments created four new categories of dealer registrants, Financial Intermediary, Foreign Dealer, International Dealer and Limited Market Dealer.[43]

The breadth of the definition of marketing intermediary has elicited numerous criticisms and comments from participants in the capital markets in Ontario. The universal registration and market intermediary concept have lead to uncertainty and complexity in the registration system. The regulators are currently reviewing this program and it is contemplated that the extent of the definition will be restricted, or that information on market intermediaries will be acquired using methods other than the removal of registration exemptions. At the present time however, the universal registration provisions still exist in the legislation applicable to Ontario securities.

5.02 *Application Procedures*

All jurisdictions of Canada have made extensive provisions for the procedure governing registration of securities professionals and their continued fitness for registration. Considerable amounts of information as to personal history and financial and business experience are elicited by requiring registrants to complete and execute forms according to statutory classification.[44] In addition, the authorities have a general discretion to require further information to be filed.[45] These forms provide the administrative officials with a detailed picture of corporate structure and financial capabilities of the proposed registrants as well as an indication of the background of their principals and officers. Of equal importance to most principal classes of registrants are the required conditions of registration which are intended to ensure that registrants will have continued ability to serve their clients. These generally relate to adequate levels of minimum free capital, bonding and insurance, proper maintenance of business

41. Self Regulatory Organizations: Dual Registration under the Securities Act, Ontario Policy No. 4.4, Can. Sec. L. Rep. (CCH) ¶ 471-404, at 57,943 (1989).

42. Universal Registration, §§ 176-178, Can. Sec. L. Rep. (CCH) ¶ 453-101-453-105, at 55,358-55,362 (1988).

43. *Id.* §§ 179-182, ¶ 453-107-453-141, at 55,360-55,362.

44. Registration, *supra* note 32, § 28, ¶ 450-372, at 55,127.

45. *Id.* § 30, ¶ 450-374 at 55,127.

records and accounting procedures (including a "know your client" rule), audit requirements and procedures to the extent that they are not imposed by the self-regulatory associations, segregation of funds and securities, proficiency requirements, and, for dealers, participation in a compensation or contingency trust fund.[46]

Applications for registration as salesmen require successful completion of approved courses of instruction and study.[47] Registration is withdrawn upon the transfer by a salesman from one firm to another until the new employment situation is approved by the appropriate official.[48]

5.03 *Non-resident Ownership of Registrants*

Of interest to non-Canadian readers are the limits placed upon foreign resident ownership or control of registrants. On the basis of various government and industry reports which indicated the necessity of maintaining substantial Canadian ownership of the investment community in this country, foreign ownership restrictions were introduced in Ontario in the early 1970's.[49] Non-Canadian ownership of registrants formerly could not exceed 10 percent, in cases of individual owners, or 25 percent, in total.

In 1987, amendments to the legislation introduced at the same time as the Universal Registration category described in Section 5.01 *infra*, revised the non-resident ownership restrictions. The new rules remove the non-resident ownership restrictions and provide that a registered dealer that is not an individual, except for an international dealer or security issuer, must be a company incorporated, or a person formed or created, under the laws of Canada or a province or territory of Canada.[50] The Commission also retains discretionary power with respect to designating a person or company to be a non-resident or not to be a non-resident after examining the manner in which the person carries on business.[51] The designation primarily effects whether the registered dealer may be eligible in

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46. Registration Requirements, *supra* note 37, § 101-111, ¶ 452-561-452-667, at 55,333-55,339. For requirements in other jurisdictions, *see* JOHNSTON, *supra* note 21, at 107-108. *See also* Violations of Securities Laws of Other Jurisdictions - Conduct Affecting Fitness for Continued Registration, Ontario Policy No. 17, Can. Sec. L. Rep. (CCH) ¶ 470-017, at 57,577 (1991); Conflict of Interest - Registrants Acting as Corporate Directors, Ontario Policy No. 18, Can. Sec. L. Rep. (CCH) ¶ 470-018, at 57,577-57,578 (1991); Use of information and Opinion re Mining and Oil Properties by Registrants and Others, Ontario Policy No. 22, Can. Sec. L. Rep. (CCH) ¶ 470-002, at 57,595-57,596 (1988); Registrants Advertising: Disclosure of Interest, Ontario Policy No. 25, Can. Sec. L. Rep. (CCH) ¶ 470-025, at 57,611 (1990).

47. Registration Requirements: Conditions of Registration - Proficiency Requirement, § 110, Can. Sec. L. Rep. (CCH) ¶ 452-661, at 55,338 (1987).

48. Registration, *supra* note 32, § 24(2), ¶ 450-352, at 55,126.

49. R.R.O. secs. 132-136, *revoked by* R.R.O. 345/87, s.6 (June 30, 1987).

50. Dealer Ownership Restrictions: Non-Resident Ownership, § 185, Can. Sec. L. Rep. (CCH) ¶ 453-205 at 55,365 (1988).

51. *Id.*, § 188, ¶ 453-222, at 55,365.

the category of foreign dealer registration.[52] In addition, the determination of non-resident status may provide a specific registration exemption or condition relating to the market intermediary categories of registration.[53]

There are also provisions for the Commission to exempt any person from the requirements of any part of the dealer ownership restrictions of the regulation where the Commission is satisfied that to do so would not be prejudicial to the public interest.[54]

5.04 *Exemptions From Registration*

The wide scope of the registration of securities professionals and the prospectus requirements of Canadian securities legislation has necessitated a series of exemptions from their potentially extensive provisions. There are two basic groups of exemptions: The first concerns exemptions only from the registration requirement relating to dealers and other securities professionals, while the second relates to the so-called "dual exemption," which exempts those affected from both the prospectus and registration requirements. The exemptions from the registration requirement can be divided into three basic functional categories: (1) those which relate to the professional qualifications or nature of the parties involved; (2) those which concern certain types of trade which, because of their particular nature, do not require registration; and (3) those which involve particular types of securities.

[a] Underwriters and Advisers

Under the Ontario legislation, registration is not required in order to act as an underwriter where the registrant is registered as a broker, investment dealer or securities dealer; where the registrant is registered as a mutual fund dealer, scholarship plan dealer, and security issuer but only for the purpose of distributing the securities in which it is registered to trade; or where the registrant is registered as a limited market dealer, international dealer, financial intermediary dealer or foreign dealer but only for the purposes of a distribution which it is authorized to make by the Regulations.[55] Banks to which the federal Bank Act applies are exempted from being required to register to Act as underwriters with respect to certain types of bonds and debentures of governments, banks, and loan, trust, or insurance companies exempted from prospectus requirements, and with respect to certain banking transactions designated by regulations.[56]

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52. Universal Registration: Foreign Dealer Registration, § 182(3), Can. Sec. L. Rep. (CCH) ¶ 453-143, at 55,362-55,363 (1988).

53. *Id.*, § 182(7)(d), ¶ 453-146, at 55,363.

54. Dealer Ownership Restrictions: Miscellaneous, § 192, Can. Sec. L. Rep. (CCH) ¶ 453-229, at 55,366 (1988).

55. Regulations, *supra* note 7, § 88, ¶ 452-510, at 55,329.

56. This is accomplished by the definition of "underwriter." Interpretation, *supra* note

In addition, certain categories of persons or companies are exempted from registration as advisers. The first relates to various financial institutions, i.e., banks, loan, trust, or insurance companies which are otherwise regulated by provincial or federal statutes.[57] Second, various classes of professionals, such as lawyers, accountants, engineers, or teachers, are exempted.[58] Third, registered dealers or partners, officers, or employees thereof are also exempt.[59] Fourth, publishers with general and paid circulations, who obtain no direct or indirect interest in any of the securities upon which advice is given, and who give the advice solely as an incidental to the conduct of their business as publishers obtain the benefit of a similar exemption.[60] In all four categories, the exemption is conditional upon the performance of the service as advisor being solely incidental to the advisor's principal business or occupation.

[b] Trades Exempt From Registration

Certain types of trades in securities are exempt from the registration requirements because of their peculiar nature. Thus, transactions initiated by public administrators, such as executors, receivers, liquidators, or custodians acting under various federal or provincial statutes, are exempt from this requirement.[61] Trades in which a person or company acts solely through a registered dealer are also exempt, as are trades between companies and underwriters, and those made between underwriters.[62] Specific banks and registered trust companies may also execute unsolicited purchase or sale orders through a registered dealer without the need for registration.[63]

Isolated trades in specific securities, by or on behalf of an issuer or an owner, for the issuer's or owner account, are also exempt, and are utilized as a means to avoid the necessity of registration. However, they must also not be made in the course of continued and successive transactions of a like nature, or made by one whose usual business is trading in securities.[64]

27, § 1(1)43(iv), ¶ 450-001, at 55,106 (1988).

57. Exemptions from Registration Requirements, § 33(a), Can. Sec. L. Rep. (CCH) ¶ 450-401, at 55,128 (1987).

58. *Id.* § 33(b), ¶ 450-401, at 55,128.

59. *Id.* § 33(c), ¶ 450-401, at 55,128. Broker or investment dealers acting as portfolio managers are exempt from registration as advisors, subject to conditions respecting supervision or recommendation by self-regulatory associations or the Toronto Stock Exchange. Regulations, *supra* note 7, § 137, ¶ 452-781, at 55,342 (1988).

60. Exemptions from Registration Requirements, *supra* note 57, § 33(d), ¶ 450-401, at 55,128 (1987).

61. *Id.* § 34(1)1, ¶ 450-402, at 55,129.

62. *Id.* § 34(1)9,10, ¶ 450-402, at 55,129.

63. *Id.* § 34(1),11, ¶ 450-402, at 55,129.

64. *Id.* § 34(1)2, ¶ 450-402, at 55,128. *See* JOHNSTON, *supra* note 21, at 122-126 for a discussion of the various issues raised in the interpretation of the defined terms in this exemption, especially concerning the question whether an issuer can use this exemption for its authorized, but unissued capital. Ontario corporations may purchase their common

Trades in which the purchaser is a bank, loan, trust, or insurance company, a government agency or a municipality, and the party is purchasing as principal, but not as underwriter, or a company or person, other than an individual, who is recognized by the Commission as an exempt purchaser, are also exempt from the registration requirements.[65] Creditors who sell securities which have been pledged, mortgaged, or otherwise encumbered in good faith as a security for a debt, or for the purpose of liquidating a bona fide debt, are also exempt.[66]

Companies can distribute their own securities to holders of their securities without registration as a dealer if they are distributed or issued as a stock dividend, as incidental to a bona fide organization or winding up of a company (in this latter case, the security need not be of its own issue), or securities of their own issue transferred or issued through the exercise of a right to purchase, convert, or exchange which was previously granted.[67] Distributions by the issuer of purchase rights (a rights offering) granted to holders of its securities and the issue of securities pursuant to the exercise of the right are exempt, provided the issuer has given written notice to the Commission of the date, amount, nature, and conditions of the proposed trade, which the Commission accepts or fails to object to in writing within ten days.[68] The same conditional exemption is available for trades by an issuer in securities of a reporting issuer held by it through the exercise of a previously granted right to purchase, convert, or exchange.[69] An issuer is exempt if it distributes securities of a reporting issuer to holders of the issuer's securities as a dividend in specie.[70] In addition, the exchange of securities in connection with a statutory amalgamation, a merger, or a take-over bid, as well as the issuance of a company's own securities to its incorporators, is exempt from registration.[71]

Ontario legislation provides an exemption from registration for a "limited offering" made without any advertisement or promotion, to no more than fifty prospective purchasers resulting in sales to twenty-five persons or less, who (1) purchase as principals within a six-month period, and are either senior officers or close relatives of a senior officer of the issuer; (2) possess the necessary net worth and investment experience; or (3) have access to the advice of a registered adviser.[72] This exemption is available only once to the issuer, and no promoter of the issuer, other than a registered dealer, can have acted in the previous twelve months as

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shares without cancelling them, and this is recognized in the definition of a "distribution." Interpretation, *supra* note 27, § 1(1)11(ii), ¶ 450-001, at 55,101 (1991).

65. Exemptions from Registration Requirements, *supra* note 57, § 34(1)(3)-(4), ¶ 450-402, at 55,129 (1987).

66. *Id.* § 34(1)(3)-(4), ¶ 450-402, at 55,129.

67. *Id.* § 34(1)(12), ¶ 450-402, at 55,129 (1987).

68. *Id.* § 34(1)(14)(i), ¶ 450-402, at 55,130.

69. *Id.* § 34(1)(14)(ii), ¶ 450-402, at 55,130.

70. *Id.* § 34(1)(13), ¶ 450-402, at 55,130.

71. *Id.* § 34(1)(15)-(17),20), ¶ 450-402, at 55,130.

72. *Id.* § 34(1)(21), ¶ 450-402, at 55,131.

promoter of any other issuer that utilized the exemption.

The exchange by an issuer of its securities as consideration for the purchase of a portion or all of the assets of any person or company with a face value of $150,000 or more is exempt.[73] In addition, private placements to a purchaser with an aggregate acquisition cost of not less than $150,000 are exempt, so long as the purchase is made by the purchaser as principal.[74] A trade in a security occasionally transacted by employees of a registered dealer where the employees do not usually sell securities and have been designated under the Act as non-trading employees are exempt.[75] Registration is not required to issue securities to employees if it is not an inducement to employment or continued employment.[76] An exemption from registration also exists for a trade in a commodity futures option or a commodity futures contract by a hedger through a dealer, within the meaning of the Commodity Futures Act.[77]

A final general category of trades exempt from registration is that which is provided for by the regulations promulgated under the authority of the securities legislation.[78] The enacted regulations exempt certain distributions of and "first trades" in securities which are exempted by the regulations from the requirement of filing a prospectus.[79] Other trades exempted from registration by regulations include (1) trades by a liquidator under federal company legislation, or by a sheriff under specified legislation; (2) trades effected through the facilities of a Commission recognized stock exchange by registered dealers; (3) trades by a registered trust company in the securities of a mutual fund promoted and managed by the trust company; (4) trades by a person or company with a registered dealer acting as principal; (5) trades in bonds or debentures by way of unsolicited orders to banks or trust companies, provided they Act as principal and acquire from or sell to a registered dealer; and (6) trades made by an offeree in securities being disposed of to a person or a company making a take-over bid.[80]

[c] Securities Exempt From Registration

Registration is not required for trading in certain defined categories of securities. Trades in bonds, debentures, or other debt obligations of or guaranteed by federal, provincial, municipal, or foreign governments, as well as those of the International Bank for Reconstruction and Development as approved by the Bretton Woods Agreement Act (Canada), Asian Development Bank, or Inter-American Development Bank (if the latter

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73. *Id.* § 34(1)(18), ¶ 450-402, at 55,130.
74. *Id.* § 34(1)(5), ¶ 450-402, at 55,129.
75. *Id.* § 34(1)(8), ¶ 450-402, at 55,129.
76. *Id.* § 34(1)(19), ¶ 450-402, at 55,130.
77. *Id.* § 34(1)(22), ¶ 450-402, at 55,131.
78. *Id.* § 34(1)(23), ¶ 450-402, at 55,131.
79. Regulations, *supra* note 7, § 140(1)(a), ¶ 452-787, at 55,343.
80. *Id.* § 140(1)(a)-(f), ¶ 452-787, at 55,343.

three categories are payable in Canadian or American currency and also if required filings with the Commission are completed), are exempt from the registration requirements.[81] Trades in similar securities of or guaranteed by institutions which are regulated by their own particular legislation, including chartered banks, loan and trust corporations, and insurance companies, also enjoy the benefit of the exemption.[82] In addition, trades in guaranteed investment certificates or receipts of trust companies, the shares of cooperative corporations, and shares of credit unions or caisse populaires do not require registration.[83]

Securities issued by nonprofit organizations, so long as no part of their net earnings enure to the benefit of any security holder and no commission or other remuneration is paid in connection with the sale thereof, are also exempt.[84] Ontario's legislation adds an exemption for securities issued by a "private mutual fund," which includes private investment clubs of fifty persons or less, and pooled funds maintained and administered by trust companies for registered savings plans or for estates and trusts in their care, provided there is no promoter or manager of the private mutual fund other than the trust company.[85]

Mortgages or other encumbrances upon real or personal property, other than those secured by a bond, debenture, or trust deed, are exempt so long as they are offered for sale by a registered mortgage broker.[86] A similar exemption is available for securities indicating indebtedness under conditional sales or title retention contracts if such securities are not offered for sale to an individual.[87] In addition, trading in securities issued by a private company does not require registration so long as they are not offered for sale to the public.[88]

Promissory notes or commercial paper maturing within one year from the date of issue and which have a denomination or principal amount of at least $50,000 are also exempt.[89] Exemption from registration is available for securities issued and sold (1) by a prospector for financing prospecting expeditions; (2) by prospecting syndicates who have qualified an agreement under Part XIII of the Ontario legislation discussed below;

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81. Exemptions from Registration Requirements, *supra* note 57, § 34(2)(1)(a),(b),(d),(e), ¶ 450-403, at 55,131.

82. *Id.* § 34(2)(1)(c), ¶ 450-403, at 55,131.

83. *Id.* § 34(2)2,8,9, ¶ 450-403, at 55,131. *See also* Ontario Co-operative Corporations Act, Ont. Rev. Stat. 1980, ch.91, *as amended*; Credit Union and Caisse Populaires Act Ont. Rev. Stat. 1980, ch. 102, *as amended.*

84. Exemptions from Registration Regulations, *supra* note 57, § 34(2)(7), ¶ 450-403, at 55,141.

85. *Id.* § 34(2)(3), ¶ 450-403, at 55,131; Interpretation, *supra* note 27, ¶ 1(1)(32), ¶ 450-001, at 55,103.

86. Exemptions from Registration Requirements, *supra* note 57, § 34(2)(5), ¶ 450-403, at 55,141 (1987).

87. *Id.* § 34(2)(6), ¶ 450-403, at 55,141.

88. *Id.* § 34(2)(10), ¶ 450-403, at 55,141.

89. *Id.* § 34(2)(4), ¶ 450-403, at 55,141.

or (3) by a mining or mining exploration company as consideration for mining claims, where the vendor has entered into escrow or pooling agreements which the Director considers necessary.[90]

Prospecting syndicates are dealt with in a separate registration system in Part XIII of the Act, under which a receipt is issued upon the acceptance of a prospecting syndicate agreement. The legislation governs the content of the agreement and limits the applicability of this exemption to those agreements whose sole purpose is the financing of prospecting expeditions, preliminary mining developments, or the acquisition of mining properties, and whose capital is limited to no more than $250,000.[91] Limits are placed upon the maximum commission that can be taken upon the sale of units in the syndicate, the maximum number of units that can be issued in exchange for the transfer of mining properties to the syndicate, and the amount of administrative expenditures charged against proceeds of the sale of the syndicate's units. Further acquisitions or dispositions of mining properties require approval of members of the syndicate holding at least two-thirds of the issued units.[92] The Director has a discretion to accept the syndicate agreement and is not required to determine if these requirements have been met in every case.[93]

Securities issued by a prospecting syndicate and sold by the prospector who stakes a claim belonging to the syndicate are exempt from the registration requirement so long as a copy of the syndicate agreement is delivered to the purchaser before payment is accepted.[94] Similarly, securities issued by the syndicate are exempt if an agreement is filed and accepted by the Director, the securities are not offered to the public, and they are sold to not more than fifty persons or companies.[95]

A final exemption is that provided by Commission order, whereby upon application of an interested person or company, the Commission may rule that any trade, intended trade, security, person, or company is not subject to the registration requirement if the Commission is satisfied that to do so would not be prejudicial to the public interest.[96]

CHAPTER VI - THE DISCLOSURE SYSTEM

6.01 *Required Disclosure*

The concept of "reporting issuer"[97] is central to the disclosure re-

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90. *Id.* § 34(2)(11)-(14).

91. Prospecting syndicates, § 150(1)(c), Can. Sec. L. Rep. (CCH) ¶ 450-525, at 55,147 (1986).

92. *Id.* § 50(1)(b), ¶ 450-525. at 55,146.

93. *Id.* § 50(2), ¶ 450-525, at 55,147.

94. Exemptions from Registration Requirements, *supra* note 57, § 34(2)(12), ¶ 450-403, at 55,141 (1987).

95. *Id.* § 34(2)(13), ¶ 450-403, at 55,141.

96. Exemptions from Prospectus Requiremnts, *supra* note 24, § 73(1), ¶ 450-723, at 55,169.

97. Interpretation, *supra* note 27, § 1(1)(38), ¶ 450-001, at 55,104.

quirements under securities legislation. The required disclosure may be categorized as:

1. financial disclosure;
2. timely disclosure;
3. insider reporting; and
4. proxy solicitation and information circular requirements.

The financial disclosure obligations for a reporting issuer include the obligation to file and mail to security holders annual audited financial statements, as well as interim financial statements.[98]

Timely disclosure, which typically involves a release to the public of any information concerning changes in the business or affairs of the reporting issuer which would be likely to have a significant effect on the market price or value of the reporting issuer's securities, occurs in a variety of situations. Where a material change occurs in the affairs of a reporting issuer, a press release must be issued and filed forthwith, authorized by a senior officer of the reporting issuer, and disclosing the nature and substance of the change.[99] The press release is then to be followed with a report of the material change with the Commission. Relief from this provision may be sought where the information is considered confidential, and written reasons are provided for the non-disclosure.

The insider trading rules[100] are designed to protect the equal opportunity for investment concept so that advantage cannot be taken by individuals who have access to information which is material and has not been disseminated to the marketplace. The insider reporting obligations include the requirement to file with the Commission upon achieving the status of an insider, and where a change occurs in an insider's direct or indirect beneficial ownership over securities of the reporting issuer.

The Ontario legislation also requires continuous disclosure in the form of a proxy for use at all meetings of shareholders of the reporting issuer.[101] The proxies must be sent concurrently with or prior to the giving of the notice, and must also be accompanied with an Information Circular.[102]

6.02 *A Glossary of Key Disclosure Forms*

Reporting issuers, in complying with required disclosure obligations, may also be subject to the use of specific disclosure forms:

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98. Continuous Disclosure, §§ 76-78, Can. Sec. L. Rep. (CCH) ¶ 450-774, at 55,171 (1988).

99. *Id.* § 74, ¶ 450-751, at 55,169.

100. Insider Trading and Self Dealing, §§ 101-105, Can. Sec. L. Rep. (CCH) ¶ 450-925-450-934, at 55,209 (1987).

101. Proxies and Proxy Solicitations, § 84, Can. Sec. L. Reg. (CCH) ¶ 450-802, at 55,173 (1988).

102. *Id.* § 85, ¶ 450-803, at 55,173.

(a)While there are no specific requirements in the securities legislation with respect to the form in which financial statements are to be presented, the statements must be prepared in accordance with "GAAP" as defined in the Canadian Institute of Chartered Accountants Handbook. While the form of financial statements is not legislated, provision is included for specific types of statements and where comparative materials are to be filed.[103] In addition, the legislation provides that financial statements not prepared in accordance with GAAP may be accepted by the Commission.[104]

(b)Where a reporting issuer is required to file a report in connection with a material change, the report is to be completed as required in Form 27.[105] Form 27 provides for the inclusion of information concerning the name and address of the reporting issuer, date of the material change and of the press release, a summary and full description of the material change, and where the report is being filed on a confidential basis, the basis for such claim. The form must include the name of a senior officer who may be contacted concerning the material change, a statement that the report accurately discloses the material change, and a signature by a senior officer of the reporting issuer.

(c)Where an insider of a reporting issuer is required to file a report, the report must be provided in Form 36.[106] Form 36 requires information concerning the reporting issuer, the identification of the insider, the relationship of the insider with the reporting issuer, and a detailed summary of the insider's holdings and changes, if any.

(d)Where a proxy is solicited in respect of a reporting issuer, the information circular which must accompany a proxy must comply with Form 30.[107] Reference is made to Chapter 14 - Proxy Requirements, *infra*.

CHAPTER VII - PUBLIC OFFERINGS OF SECURITIES

7.01 *Prospectus Requirements*

Canadian securities legislation generally prohibits any person or company from trading in (selling) a security where that trading would be in the course of a distribution of such security until there has been filed with the appropriate agency both a preliminary prospectus and a prospectus for which a receipt has been obtained. The prospectus requirements incorporate both the concept of full, true, and plain disclosure of all material facts found in the U.S. federal securities legislation, as well as discretionary provisions for the refusal of prospectuses that are akin to U.S. state blue sky laws. The distribution of securities offered to the public functions on a basis similar to that which exists in the United States,

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103. Regulations, *supra* note 7, § 7-13, ¶ 452-075-452-100, at 55,255 (1988).
104. *Id.* § 2(4), ¶ 452-024, at 55,253.
105. *Id.* form 27, ¶ 454-027, at 55,774.
106. *Id.* § 148, ¶ 452-862, at 55,342; *Id.* form 36, ¶ 454-036, at 55,888.
107. *Id.* § 151, ¶ 452-805, at 55,347; *Id.* form 30, ¶ 454-030, at 55,838.

in that the issuing company usually negotiates either a firm, standby, or best efforts underwriting agreement with an investment dealer. Depending on the complexity and size of the offering, the underwriter may organize purchase, banking, and selling groups to assist in assuring a successful distribution of the issue.

7.02 *Distribution*

The prospectus requirement in most jurisdictions applies to all sales that are in the course of a distribution. The legislative definition of this phrase generally extends the requirement to the primary distribution of securities of an issuer that have not been previously issued, the distribution in previously issued securities of an issuer that have been redeemed or purchased by or donated to that issuer, and the secondary distribution of previously issued securities held by control persons. It includes sales made directly to the public or indirectly through an underwriter, or otherwise, as well as transactions or a series of transactions involving purchases and sales in the course of or incidental to that distribution. This latter requirement indicates that the "staging" of a distribution through exempt purchasers or market support operations in which underwriters purchase part of an issue are part of a distribution to the public.

Insofar as a secondary distribution by a control person holding is concerned, it is important to note that a control person is deemed to be a person or company, or any combination of persons or companies, holding a sufficient number of any of the securities of a company to "affect materially" the control of that company.[108] In that the issue here is not control, per se, but the material affect on that control, in the interest of providing a more objective standard, the legislation provides that a holding of more than twenty percent of the outstanding equity shares in the company, in the absence of evidence to the contrary, will be deemed to materially affect the control of the company.[109] In addition, provisions are made for a ruling by the Commission that, where it is not prejudicial to the public interest, a trade, intended trade, security, person, or company is not subject to the prospectus requirements.[110]

In essence, the Ontario legislation creates a "closed system," in that all sales which are part of a distribution will require a prospectus to be filed unless a specific exemption exists.[111]

7.03 *Preliminary Prospectus*

Assuming that no exemptions are available, the actual distribution process commences with the filing of a preliminary prospectus. The Di-

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108. Interpretation, *supra* note 27, § 1(1)(11)(iii), ¶ 450-001, at 55,101 (1988).

109. *Id.*

110. Exemptions from Prospectus Requirements, *supra* note 24, § 73(1), ¶ 450-723, at 55,169 (1987).

111. *See* § *infra*.

rector must issue a receipt upon filing, although there is power to order the limited form of solicitation permitted, as discussed below, upon such filing to cease if it appears to him that a preliminary prospectus is defective in both form and content.[112] The legislation requires a "waiting period" of a minimum of ten days between the filing of a preliminary prospectus and the issuance of a final receipt for the actual prospectus, to enable information to be disseminated to the market place.[113]

During the waiting period, it is permissible to distribute notices, circulars, advertisements, or letters to prospective purchasers so long as they identify the proposed security and its price, if determined, and state the name and address of the person or company from whom purchases can be made, and from whom a preliminary prospectus can be obtained.[114] In addition, preliminary prospectuses may be distributed, and expressions of interest may be solicited, so long as a copy of the preliminary prospectus is provided to the intended purchaser. The dealer distributing the security is obligated to provide a copy of a preliminary prospectus to any person who indicates an unsolicited interest in purchasing the security and requests a copy and the dealer must maintain a record of those to whom a preliminary prospectus has been distributed.[115]

The form and content of this document must substantially comply with the requirements respecting the final prospectus, except that auditors' reports, and the underwriter's and offer prices may be excluded.[116] In addition, the preliminary prospectus must have a prescribed statement in red ink on the outside front cover page indicating that it is not a final prospectus, the information contained is subject to completion or amendment, and that no securities may be sold until the final prospectus is accepted.[117] There must also be on the outside front cover page a prescribed statement indicating that no securities commission has in any way passed upon the merits of the securities offered.[118] Any material adverse change that occurs after the filing of the preliminary document necessitates the filing of an amendment within at least ten days, which also must be sent to each recipient of a preliminary prospectus.[119]

7.04 *Content of Prospectus*

Every prospectus must provide full, true, and plain disclosure of all material facts relating to the security proposed to be issued, and must comply as to form and content with the requirements of the legislation

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112. Prospectuses - Distribution, § 54, Can. Sec. L. Rep. (CCH) ¶ 450-560, at 55,142 (1986); Distribution - Generally, § 67 Can. Sec. L. Rep. (CCH) ¶ 450-665, at 55,163 (1986).

113. Distribution - Generally, *supra* note 112, § 64(1), ¶ 450-661, at 55,162.

114. *Id.* § 64(2), ¶ 450-662, at 55,162.

115. *Id.* §§ 65, 66, ¶ 450-663-450-664, at 55,162.

116. Prospectuses - Distribution, *supra* note 112, § 53, ¶ 450-558, at 55,147 (1986).

117. Regulations, *supra* note 7, § 38, ¶ 452-247, at 55,277 (1987).

118. *Id.* § 39, ¶ 452-248, at 55,278.

119. Prospectuses - Distribution, *supra* note 112, § 56, ¶ 450-563, at 55,148.

and the regulations.[120] Different forms of prospectuses are required for each of the following types of companies: finance, industrial, natural resource, and mutual fund. The Director may designate into which category a proposed issuer falls, and can direct that the disclosure called for by the prospectus form for one or more of the other types of companies be complied with.[121]

Upon filing, the prospectus will be assigned to a review team consisting of a lawyer and an accountant, and other staff, if necessary, to ensure compliance with the legislation. Consultation with technical experts and financial analysts may occur in more complicated filings, and prefiling conferences and deficiency letters are utilized to facilitate the processing of a prospectus. If a prospectus is rejected, this decision is made in writing after the issuer has been given a hearing, and the determination is subject to an appeal to the Commission.[122]

The legislation requires that an income statement, a statement of surplus, and a statement of changes in financial position for each of the last five completed financial years (or such shortened period as is permitted), together with a balance sheet as at a date of not more than 120 days prior to the filing of the preliminary prospectus of the issuing company and as at the corresponding date of the previous financial year, be included in the prospectus of an issuer other than a mutual fund.[123] Where the Director is satisfied there is sufficient justification, he may permit the omission of any financial statement required by this section.[124]

Each financial statement must be prepared in accordance with generally accepted accounting principles, unless dispensation has been received from the Director to revise the presentation in the statement, or from the Commission to vary from generally accepted accounting principles.[125] Unless expressly excepted, each financial statement must include an auditor's report which must be prepared in accordance with generally accepted auditing principles, and the Act and regulations.[126] The financial statements must also be submitted for review to the audit committee, if the issuer has or is required to have such a committee, and be approved by the board of directors of the issuer, as evidenced by the signature of

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120. *Id.* § 35, ¶ 450-561, at 55,147; *see generally id.* §§ 55-63, ¶ 450-581-450-633, at 55,147-55,162; Regulations, *supra* note 7, §§ 14-70, ¶ 452-125-452-387, at 55,257-55,295; *Id.* forms 12-15A, ¶ 454-012-454-015, at 55,534-55,701; National Policy Statements 1,12, and 13, Can. Sec. L. Rep (CCH) ¶¶ 470-001, 470-012, 470-013, at 57,525, 57,573, 57,574 (1991); Uniform Act Policies 2-01, 2-03, 2-04, Can. Sec. L. Rep (CCH) ¶¶ 470-201, 470-203, 470-204, at 57,775, 57,776 (1987); National Policy Statements, *supra*, no. 5.1, 5.2, ¶¶ 471-501, 471-502, at 57,965, 57,987.

121. Regulations, *supra* note 7, §§ 28-33, ¶ 452-205-452-221, at 55,276.

122. Proceedings, Reviews and Appeals, § 8, Can. Sec. L. Rep. (CCH) ¶ 450-661, at 55,108 (1988); Prospectuses - Distribution, *supra* note 112, § 60(2), ¶ 450-602, at 55,149.

123. Regulations, *supra* note 7, § 31, ¶ 452-208, at 55,276.

124. *Id.* § 41(6), ¶ 452-266, at 55,278.

125. *Id.* § 2(4), ¶ 452-024, at 55,253.

126. *Id.* § 2(2), ¶ 452-022, at 55,253.

two authorized directors.[127] Separate financial statements of subsidiaries may be required by the Director whether or not they are consolidated with those contained in the prospectus, and unconsolidated statements may be permitted to be included as supplementary information.[128]

Any experts, such as solicitors, auditors, accountants, engineers, or appraisers, whose profession gives authority to any statement that has been prepared for or is certified as part of the prospectus, or is named as having prepared or certified a report or valuation connected with the prospectus, must file a written consent to the inclusion of such a statement or report in the document.[129] The auditor or accountant must also state he has read the prospectus and has no reason to believe that there are any misrepresentations in the information contained therein that is derived from the financial statements upon which he reported or that is within his knowledge as a result of his audit.[130] The consents may be dispensed with if their filing may be impractical or involves undue hardship.[131] These persons must also disclose any direct or indirect interest in the issuer or any of its affiliates, or where any of such persons is or expects to be elected, appointed or employed as a director, officer or employee of the issuer or any affiliates or where any of such persons is or expects to be elected, appointed or employed as a director, officer or employee of the issuer or any affiliate.[132] The Director may require a further consent to be filed should any change be proposed to the prospectus that in his opinion materially affects the earlier consent filed.[133] Finally, the Director may refuse to accept a prospectus if the person or company whose consent is required is not acceptable to him.[134]

In addition, each prospectus must contain a certificate signed by the chief executive officer, the chief financial officer, two authorized directors, and any promoter, that the prospectus constitutes full, true, and plain disclosure of all material facts relating to the securities offered.[135] A similar certificate is required from the underwriter, although it is qualified to the extent that it is based on the best of its knowledge, information, and belief.[136] The Director has discretion to dispense with the signatures of certain persons, to require any person who was a promoter of the issuer within the two preceding years to sign the certificate, or to allow a promoter or an underwriter to sign by a duly authorized agent.[137]

The prospectus forms for the varying types of companies described

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127. *Id.* § 52, ¶ 452-302, at 55,291.
128. *Id.* §§ 50,51, ¶ 452-289,452-301, at 55,291.
129. *Id.* § 23(1), ¶ 452-187, at 55,273.
130. *Id.* § 23(3), ¶ 452-189, at 55,273.
131. *Id.* § 23(2), ¶ 452-188, at 55,273.
132. *Id.* § 23(4),(5), ¶ 452-190, 452-191, at 55,273.
133. *Id.* § 24, ¶ 452-192, at 55,273.
134. Prospectuses- Distribution, *supra* note 112, § 60(2)(i), ¶ 450-602, at 55,149.
135. *Id.* § 57, ¶ 450-576, at 55,148.
136. *Id.* § 58, ¶ 450-583, at 55,149.
137. *Id.* § 57(4)-(7), ¶ 450-579-450-582, at 55,148; *Id.* § 58(2), ¶ 450-584, at 55,149.

above require, in addition to the financial statements, the following general information:

(1) The number of shares being offered;

(2) On the outside front cover page, the distribution spread on a per unit and aggregate basis of the offer price, underwriting discounts or commission, and proceeds to issuer;

(3) The plan of distribution giving the names of the underwriters and the nature of their obligations to take up and pay for the securities;

(4) A summary of the prospectus giving a synopsis of the information contained which in the opinion of the issuer would be most likely to influence the investor's decision to purchase the security;

(5) The estimated net proceeds to be derived and principal purposes for which the proceeds are intended to be used and the approximate amount intended to be used for each purpose;

(6) If any of the securities are offered otherwise than for cash, the general purposes of the issue and the basis upon which they are offered;

(7) The share and loan capital structure of the issuer;

(8) Full corporate name, and nature and jurisdiction of the incorporation of the issuer;

(9) A description of the business carried on or intended to be carried on by the issuer and its subsidiaries and the general development of such business within the last five preceding years, together with, so far as is practical, principal products or services of the issuer (for financial companies, a breakdown of the operations of the issuer, its subsidiaries and affiliates, e.g., analysis and maturity of receivables, funding requirements, schedule of current liquid capital position, is required);

(10) Where appropriate, an introductory statement must be made on the first page or in the summary summarizing the factors which make the purchase a risk of speculation;

(11) Description of material acquisitions and dispositions of shares or assets by the issuer or its subsidiaries during the past two years, and where practicable, their impact on operating results and financial position;

(12) Explanation of substantial variations in operating results over the preceding three years;

(13) A description of the location and general character of the principal property, including buildings and plants, of the issuer and its subsidiaries;

(14) Names and amounts of anything of value received by any promoters of the issuer or its subsidiaries within the preceding five years;

(15) Pending legal proceedings material to the issuer;

(16) If shares or obligations are offered, the description, designation, and characteristics of the classes offered;

(17) A record of dividends paid by the issuer during the last five completed years;

(18) Names and addresses and remuneration of directors and senior officers, including estimated cost of pension benefits proposed to be paid to these persons and indebtedness of directors and senior officers;

(19) Details of options to purchase securities from the issuer or its subsidiaries;

(20) Details of equity shares held in escrow;

(21) Details of holdings of the issuer's securities by persons or companies directly or indirectly holding greater than 10 percent of the equity shares, plus the percentage of shares of each class of equity shares held directly or indirectly by all the directors and senior officers of the issuer as a group;

(22) Ownership and inter-corporate relationship with subsidiaries and parent corporations;

(23) Prices at which securities of the shares being offered have sold in the preceding twelve months by the issuer if different from that being offered and number of shares sold;

(24) A brief description of any interest of management, or shareholders with more than 10 percent equity, in any transaction within the past three years or any proposed transaction that has materially affected or will materially affect the issuer or its subsidiaries;

(25) Names and addresses of auditors, transfer agents and registrars;

(26) Particulars of every material contract entered into within the last two years by the issuer or any subsidiary;

(27) Particulars of any other material facts not already disclosed.

In addition, the Uniform Act provinces require undertakings from issuers not incorporated within their jurisdiction that they will comply with the proxy, insider trading, and financial disclosure requirements of their legislation.[138]

7.05 *Projections, Estimates, and Forecasts*

In contrast to SEC policy with regard to forecasts in prospectuses, estimates of future earnings may be included in the prospectus only if identified as such and only with the permission of the Director.[139] This is despite the fact that the legislation expressly requires the Director to refuse a prospectus that contains any promise, estimate or forecast only if it is misleading, false, or deceptive.[140]

The Ontario Securities regulators have enacted a policy,[141] which

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138. Uniform Act Policies, *supra* note 120, no. 2-01, ¶ 470-201, at 57,775.

139. Regulations, *supra* note 7, § 48, ¶ 452-287, at 55,291.

140. Prospectuses - Distribution, *supra* note 112, § 60(2)(a)(ii), ¶ 450-602, at 55,149.

141. National Policy Statements, *supra* note 120, no. 5.8 (III), ¶ 471-508, at 58,050

deals with future oriented financial information ("FOFI"). The policy rests the responsibility of deciding whether to publish FOFI with the issuer, although it provides factors to be considered in the decision, as well as requirements to be followed where FOFI is utilized. Besides prospectuses, the policy applies to rights offering circulars, continuous disclosure documents, proxy solicitation documents, take-over bid or issuer bid documents, and offering memoranda.[142]

The general requirements where FOFI are included in any of these documents include that the material be presented in the form of a forecast. Projections may only be utilized for issuers engaged in business with less than 24 months of relevant operating history. It is not permissible to include both a forecast and a projection.[143] The duration of the FOFI may not normally extend beyond the maximum of 24 months, a period over which information can be reasonably estimated. FOFI are to be prepared in accordance with the Canadian Institute of Chartered Accountants Handbook[144] and must be pre-filed with the Commission and pre-approved by the Director where either the issuer is not a reporting issuer, or the issuer is making a distribution of securities in Ontario by prospectus for the first time. In all other instances where FOFI is being included, pre-filing and approval by the director is generally not required.[145]

Where FOFI is included, it must be updated when significant changes occur during the filing period of required documents. In addition, FOFI must be reviewed each time the issuer is required to file historical financial statements with the Commission to identify significant changes resulting from events that have occurred since the forecast of projection was issued. FOFI must be compared to annual audited actual results and the reasons for significant differences, if any, must be disclosed to security holders. This also applies to interim period FOFI.[146]

If FOFI is included in a prospectus, offering memorandum, take-over bid circular, or issuer bid circular, it must be accompanied by an auditor's report. The policy also allows that where it is not practicable in a take-over bid to provide an auditor's report on FOFI, the Director will allow a statement signed by the chief financial officer of the issuer stating that the FOFI was prepared in accordance with the appropriate accounting requirements.[147]

7.06 *Discretion to Reject Prospectus*

In addition to the requirements of full, plain, and true disclosure, the acceptance or rejection of a prospectus by issuing or withholding a receipt

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(1990).

142. *Id.* no. 5.8 (II), ¶ 471-508, at 58,049.

143. *Id.* no. 5.8(III), ¶ 471-508, at 58,050.

144. Canadian Institute of Chartered Accountants Handbook, § 4250.

145. National Policy Statements, *supra* note 120, no. 5.8 (III), ¶ 471-508, at 58,050.

146. *Id.* no. 5.8 (V), ¶ 471-508, at 58,051.

147. *Id.*, Section VII.

is also subject to the discretion of the securities regulators. The amount and nature of the discretion vary according to the jurisdiction and reference should be made to the relevant legislation. In Ontario, the Director can refuse to issue a final receipt if it appears to him that it is not in the public interest to do so. In addition, the Director is not to issue a receipt for any prospectus filed if it appears to the Director that certain prescribed situations exist.[148] These situations are outlined in the legislation, and include: (1) noncompliance with statutory requirements, or misleading, false, or deceptive statements; (2) unconscionable consideration paid for promotional purposes or the acquisition of property; (3) net proceeds of the distribution are insufficient for the purposes stated in the prospectus; (4) failure to enter necessary escrow or pooling agreements or to lodge proceeds in trust; (5) in the case of a finance company, if the director is not satisfied with the plan of distribution of the securities, the manner, terms, and means by which they are secured, or if it has failed to meet the requirements and conditions specified in the regulations; (6) if having regard to the financial condition of the issuer, its officers, directors, promoters, or control persons, the issuer cannot reasonably be expected to be financially responsible in the conduct of its business; (7) the past conduct of the issuer, or its officers, directors, promoters, or control persons affords reasonable grounds for belief that the business of the issuer will not be conducted with integrity and in the best interests of its security holders; and (8) a person or company who has prepared or certified any part of the prospectus or is named as having prepared or certified a report or valuation used in or in connection with a prospectus, is not acceptable to the Director. With regard to special types of companies, especially the financing of junior mining companies, there are detailed policy statements relating to the conditions of acceptance of a prospectus.

Upon the issuance of a final receipt for the prospectus, the securities may then be distributed to the public for a period of twelve months. Should the distribution continue for more than twelve months, a new prospectus must be filed within ten days and accepted within twenty days, or within such a longer period as the Commission permits, from the lapse date of the previous prospectus. This is to be preceded by filing a pro forma prospectus at least thirty days prior to the lapse date of the previous prospectus.[149] If a material change occurs during the period of distribution that makes untrue or misleading any statement of material fact contained in the prospectus, an amendment must be filed as soon as practicable and in any event within ten days from the date the change occurs.[150]

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148. Prospectus-Distribution, *supra* note 112, § 60(1), ¶ 450-601, at 55,149 (1986).

149. Prospectus-Distribution, *supra* note 112, § 61, ¶ 450-609, at 55,150 (1986).

150. Prospectus-Distribution, *supra* note 112, § 56, ¶ 450-563, at 55,148 (1986).

7.07 *Debt Securities*

Borrowing from the U.S. experience, several Canadian jurisdictions have incorporated in their company legislation mandatory trust indenture provisions relating to the public offering of debt securities.[151] They provide a basic framework only, and do not prevent the imposition of more onerous obligations in the trust indenture. These provisions apply if a company issues or guarantees debt obligations under the terms of a trust indenture in which a trustee is appointed for the holders of the debt obligation. In Ontario, they apply to all corporations which have issued or guaranteed debt obligations under a trust indenture and which have filed a prospectus exchange or securities issuer or take-over bid circular under the applicable securities or corporations legislation. However, there is no scrutiny or qualification of the trust indenture by the securities commission as is the case in the United States.

The trustee is required, in exercising the powers and discharging the duties prescribed by the trust indenture, to "act honestly and in good faith with a view to the best interests of the holders of the debt obligations issued under the trust indenture" and "exercise the care, diligence and skill of a reasonably prudent trustee," regardless of any exculpatory clause in the indenture. The legislation also prohibits material conflicts of interest to exist in the trustee's role as fiduciary, and either prohibits the appointment of such trustee or requires his resignation. It expressly prohibits the appointment of trustees as receivers or liquidators of the assets or undertakings of the issuer of the debt obligation.

The issuer must furnish to the trustee evidence of compliance with the conditions precedent provided for in the trust indenture, as well as an annual certificate of compliance with all covenants, conditions, or other requirements contained in the indenture, the noncompliance of which would constitute an event of default. The trustee is permitted to rely on the certificates and evidence of compliance so long as he acts in good faith and examines the material to ensure that it does comply with the applicable requirements. Finally, the trustee must give notice to the securities holders of every event of default arising under the indenture within a reasonable period of time but not exceeding thirty days, unless the trustee in good faith determines the withholding of such a notice is in the best interests of the securities holders and the trustee so notifies the issuer in writing.

7.08 *Summary Statements and Short Form Prospectus*

Ontario securities legislation provides that, where permitted by the regulations, a person or company may file a summary statement in the

151. E.g., Ontario Business Corporations Act, 1982 (hereinafter OBCA) Indenture Trusters, §§ 46-52, Can. Sec. L. Rep (CCH) ¶¶ 460-136 to 460-180, at 57,021 to 57,024 (1987); Canada Business Corporations Act §§ 82-93.

prescribed form together with a prospectus filed under the Act.[152] The Director has discretion to not issue a receipt for the prospectus where the summary statement which accompanies the prospectus does not comply with the applicable regulations. The summary statement may be forwarded to a purchaser of the security instead of a prospectus.[153]

Under current legislation, the regulations provide for a summary statement solely in respect of mutual funds.[154] The summary statement for a mutual fund does not replace the filing of a required prospectus, but instead is an optional disclosure document which may be filed with and following clearance of the mutual fund prospectus, may be delivered to prospectus inventors in lieu of the prospectus. Investors receiving the summary statement have the right to request and receive the delivery of the prospectus.[155]

While the Ontario legislation contains provision for the use of a short-form prospectus, there have not been any regulations passed which permit its use as a disclosure document.[156]

However, a version of the short-form prospectus has been authorized through the prompt offer and qualification system (known as the POP System). The POP System has been implemented by means of a blanket order and ruling by the Commission, which ruling exempts eligible issuers making an offering under the POP System from the form and content requirements of the prospectus provisions provided that there is compliance with requirements of the POP System.[157]

The POP System is designed to streamline procedures and shorten the time period required for the distribution of securities of senior reporting issuers. In essence, the POP System integrates the offering document with previously published issuer oriented information concerning the senior reporting issuer. The public information is referenced in the short-form prospectus at the time of distribution. In order to be eligible to utilize the POP System, the issuer must be a reporting issuer for at least thirty six months and must file an annual information form prepared in accordance with the applicable policy.[158] The issuer must not be in default of any requirement under the Ontario securities legislation, and must have an aggregate market value of common shares, excluding preferred shares, listed and posting for trading on a stock exchange in Canada and held by "non-insider" security holders of the issuer, of $75,000,000 or more as of the last calendar month of the issuer's most

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152. Prospectus-Distribution, *supra* note 112, § 62(3), ¶ 450-627, at 55,161 (1986).

153. *Id.*, § 62(6), ¶ 450-629, at 55,161 (1986).

154. Content of Prospectus Non-Financial Matters Interpretation, Regs. § 32(2), Form 15A, Can. Sec. L. Rep. (CCH) ¶ 452-211, at 55,276 (1987).

155. Prospectus-Distribution, *supra* note 112, § 62(5), ¶ 450-630, at 55,161 (1986).

156. *Id.*, § 62(1), ¶ 450-625, at 55,161 (1986).

157. Prompt Offering Qualification System, Ontario Policy 5-6, III Can. Sec. L. Rep. (CCH) ¶471-506, at 55,015-16 (1991).

158. *Id.*, ¶471-510, at 58,073 (1991).

recently completed financial year for which audited financial statements have been prepared.[159]

In certain circumstances, the Commission will allow a reporting issuer that is unable to meet all of the prescribed criteria to utilize the POP System notwithstanding its otherwise ineligible status. These exemptions are normally based upon modifications to the three-year eligibility requirement, and modifications to the calculation of the $75,000,000 "public float" requirement.[160]

7.09 *Simplified Prospectus and Annual Information Form*

An additional form of disclosure is permitted in place of the prospectus requirements under the securities legislation. This method allows the use of a simplified prospectus and annual information form, and is currently only applicable for qualification of the distribution of mutual funds.[161] Under a blanket ruling, distributions of shares or units of mutual funds affected in compliance with a specific policy statement[162] will not be subject to the otherwise required filing of a prospectus.

The policy statement provides the form and content for both the simplified prospectus and for the annual information form which is to be filed in conjunction therewith. The disclosure required in the simplified prospectus requires, in addition to certain basic material, references to the annual information form which contains a more comprehensive summary of the issuer and the proposed distribution of securities. In addition, financial statements maintain an integral function with the filing.

CHAPTER VIII - EXEMPTION FROM PROSPECTUS REQUIREMENTS

To avoid the necessity of filing a prospectus for a distribution of securities, it is necessary to make use of one of the statutory exemptions available. As noted previously, many of the exemptions are dual in that they apply to both the registration and prospectus requirements. Generally speaking, the existing exemptions from the prospectus rules incorporate by reference certain of the exemptions from registration discussed earlier. These may be classified into two general categories; exempt transactions and exempt securities. As noted earlier, the current Ontario legislation is significantly different from its predecessor; other provincial jurisdictions that have legislation modelled on the earlier Ontario statute will have different requirements, and specific reference must be made to the applicable legislation.

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159. *Id.*, § 5-¶471-506, §B, at 58,016.

160. Alboini, *supra* note 11, 14-40-14-49.

161. 1984, 7 Ontario Securities Commission Bulletin 5333.

162. Mutal Fund-Simplified Disclosure System, National Policy 36, Can. Sec. L. Rep. (CCH) ¶470-036, at 57,639 (1990).

8.01 *Exempt Transactions*

In Ontario, no prospectus is required for sales in the course of a distribution to the public where the purchaser is a specified type of bank, a registered loan or trust, or a licensed insurance company, a government agency or municipality, or an exempt purchaser recognized as such by the Commission, provided they purchase as principal.[163] Exempt purchaser status is not available to individuals, and is usually granted only to established institutional investors, such as mutual or pension funds, which satisfy a number of tests relating to amount of assets, investment expertise, and number of contributors involved.[164] Reports must be filed within ten days of such sales.[165]

The private placement exemption from registration (see Section 5.04(b) *supra*) applies to the prospectus requirement as well. Thus, where the purchaser purchases as principal and the aggregate acquisition cost is not less than $150,000, no prospectus is required.[166] Other jurisdictions may still exclude individuals from this exemption and require that the purchase be made for investment only and not with a view to resale or distribution.

Sales between a person or company and underwriters acting as purchasers or between or among underwriters are exempt, as are those between registered dealers, so long as the registered dealer purchases only as principal.[167]

Issuers may issue their own securities without a prospectus if they are distributed as stock dividends, as incidental to a bona fide reorganization or winding up of the company (in which case the security need not be of its own issue), or if they are transferred or issued through the exercise of a right to purchase, convert, or exchange previously granted by the issuer.[168] The exemption requires that no commission or other remuneration be paid in respect of such trades except for ministerial or professional services or for services performed by a registered dealer. If rights are issued or securities are sold pursuant to the exercise of a right granted to holders of a security to purchase additional securities of its own issue,

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163. Exemptions From Prospectus Requirements, *supra* note 24, §§ 71(1)(a)(c), Can. Sec. L. Rep. (CCH) ¶450-701, at 55,164 (1986).

164. *Id.*, § 71(1)(c), ¶ 450-701, at 55,114 (1986); Further Exemptions From Regulation Requirements, Regs. §137, Can. Sec. L. Rep. (CCH) ¶ 452-781, at 55,342 (1988).

165. Exemptions From Prospectus Requirements, *supra* note 24, § 71(3), ¶450-703, at 55,166-55,167 (1987).

166. *Id.*, § 71(1)(d), ¶450-701, at 55,164 (1986). A report must be filed within ten days of the trade. In addition, the exemption is unavailable for a trade made through an advertisement in the general media unless an offering memorandum is furnished to the investor concurrently with or prior to the completion of the investment in which the investor is given a contractual right of action similar to those discussed in Section 10.01 *infra*. Regs. § 21(2).

167. Exemptions From Prospectus Requirements, *supra* note 24, § 71(1)(q)(r), ¶ 450-701, at 55,166 (1987).

168. *Id.*, § 71(1)(f), ¶ 450-701, at 55,165 (1987).

and written notice has been provided to the Commission disclosing the date, amount, conditions of the proposed sale, and approximate net proceeds, then so long as the Commission does not object within ten days or accepts as satisfactory further disclosure requested, those sales will be exempt.[169] The requirement of Commission approval permits it to exercise some discretion over the suitability of such a scheme of distribution, especially as securities acquired under this exemption may then be sold to non-shareholders without the need for a prospectus. In addition, where an issuer transfers or issues securities of a reporting issuer in the exercise of a right to purchase, convert, or exchange previously granted by it, the same requirement must be met.[170] This section creates some hardship for U.S. resident shareholders of Canadian corporations, in that a trade in such securities in the United States requires registration with the SEC. As a result, rights offerings may be restricted to non-U.S. shareholders to avoid the expense of compliance with the U.S. requirements.[171]

Corporate acquisitions, mergers, amalgamations, and similar combinations in which securities are distributed are exempted in a variety of ways. First, the issuance of securities of a corporation that are exchanged in connection with statutory amalgamation arrangements or other procedures resembling mergers are exempt.[172] Unfortunately, these procedures are nowhere defined in the statute and resort must be had to the appropriate companies legislation in the relevant jurisdiction for assistance in defining and structuring the permissible reorganizations and combinations. A separate exemption exists for the issuance of securities as consideration for the purchase of some or all of the assets of any person or company, so long as the fair value of the assets is at least $150,000.[173]

Take-over bids involving an exchange offer are exempt, since provision is made for disclosure of relevant information in a separate part of the legislation.[174] Some caution is advised in the use of this exemption, in that a definition of take-over bid restricts its applicability to an offer to purchase the equity shares of a company that together with the offeror's holdings will in the aggregate exceed twenty percent of the outstanding voting shares of the company.[175] An exemption from the prospectus re-

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169. *Id.*, § 71(1)(h)(i), ¶ 450-701, at 55,165 (1987); Cf. Uniform Policy 2-05 outlining the nature of information required, III Can. Sec. L. Rep. (CCH) ¶ 470-205, Ontario Policy 6-2, Can. Sec. L. Rep. (CCH) ¶ 471-602.

170. Exemptions From Prospectus Requirements, *supra* note 24, § 71(1)(h)(ii), ¶ 450-701, at 55,165 (1987).

171. See JOHNSTON, *supra* note 21, at 210, who notes the SEC practice of permitting the offering documents, with appropriate warnings to be sent to U.S. resident shareholders.

172. Exemptions From Prospectus Requirements, *supra* note 24, § 71(1)(i), at 55,165 (1987).

173. *Id.*, § 71(1)(l), at 55,165 (1987); Restriction of Exemptions Requirements, §19(f), Can. Sec. L. Rep. (CCH) ¶452-173, at 55,271 (1987).

174. Exemptions From Prospectus Requirements, *supra* note 24, § 71(1)(j), ¶450-701, at 55,165 (1987). See the discussion of take-over bids at Section 13.02 *infra*.

175. Take-Over Bids and Issuer Bids, § 88(1), Can. Sec. L. Rep. (CCH) ¶450-821, at 55,181 (1987).

quirement is provided as well for a trade in a security to a person or company pursuant to a take-over bid or an issuer bid.[176] As a result, since an offer to purchase any and not necessarily all securities of a private company is an exempt take-over bid, it is exempted from the take-over bid disclosure rules and from the prospectus requirement,[177] as is the acquisition of not more than five percent of the voting securities of an offeree company by an offeror or its associates or affiliates, within any twelve-month period, provided the purchase price is not in excess of market value,[178] where there is a published market for the securities acquired.[179] In addition, take-over bids made through the facilities of a recognized stock exchange are exempt.[180] Purchase agreements with not more than five shareholders is only an exempt take-over bid if the bid is not made generally to security holders of the class of securities that is the subject of the bid, and consideration paid for any of the securities, including any commissions, does not exceed one hundred and fifteen percent of the market price of the class of securities. For purposes of this exemption, the offeror must make reasonable enquiry both that none of the proposed vendors are acting on behalf of others who have a direct beneficial interest in the securities, and that none of the vendors acquired the securities in order that the offeror may use this exemption. If either situation be the case, the beneficial owners or the prior owners must be included in the determination of the number of security holders from whom a private purchase has occurred.

A take-over bid is also exempt if the number of security holders in Ontario is fewer than fifty and the aggregate securities held by them is less than two percent of the outstanding shares of the class which is the subject of the bid, provided the bid is made in compliance with the laws of a recognized jurisdiction, and all materials sent to security holders in connection with the bid is also sent to any security holders in Ontario.[181]

Finally, a take-over bid is exempt where there is no published market for the securities, purchases are made from not more than five persons or companies, and the bid is not generally made to a security holder of the class of securities which is the subject of the bid.[182]

Reference is made to Chapter 19 — Take-over Bids, *infra.*, regarding take-over bids generally. In addition, please see Section 18.03 — Issuer Bids and Going Private Transactions, *infra.*, for further details concerning issuer bids.

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176. Exemptions From Prospectus Requirements, *supra* note 24, § 71(1)(k)m ¶450-701, at 55,165 (1987).

177. Take-Over Bids and Issuer Bids, *supra* note 175, § 92(1)(d), ¶ 450-840, at 55,184 (1987).

178. *Id.*, § 92(1)(b), ¶ 450-840, at 55,184 (1987).

179. *Id.*, § 92(1)(a), ¶ 450-840, at 55,184 (1987).

180. *Id.* at § 92(2), ¶450-841, at 55,184.

181. *Id.*, § 92(1)(e), ¶ 450-841, at 55,184 (1987).

182. Proxies and Proxy Solicitation, *supra* note 101, § 165, ¶ 452-986, at 55,354 (1988).

Sales by an issuer of its own securities are exempt if made to its employees so long as they are not induced to purchase by expectation of employment or continued employment.[183] The issuance of securities that are reasonably necessary to facilitate the incorporation or reorganization of the issuer, provided the securities are issued for nominal consideration to not more than five incorporators, unless the incorporating statute requires a greater consideration or larger number of incorporators, are exempt as well.[184] The issuance of securities in exchange for mining claims are exempt, provided the vendor enters into such escrow or pooling agreements as the Director considers necessary.[185]

A distribution by an issuer of securities of another reporting issuer to the issuer's securities holders as a dividend in specie is exempt.[186] Of greater importance is the exemption provided for isolated sales which formerly were exempt only from the dealer registration requirement. The exemption applies to an isolated sale in a specific security by or on behalf of an issuer's account, where such sale in a specific security by or on behalf of an issuer, for the issuer's account, which such a sale is not made in the course of continued and successive transactions of a like nature, provided that it is not made by a person or company whose usual business is trading in securities.[187]

One of the more recently enacted exemptions has been termed a "seed capital" exemption.[188] Insofar as its objectives and concept are concerned there is a considerable resemblance between this exemption and rule 14b of the SEC. Solicitations must not be made to more than fifty prospective purchasers, resulting in not more than twenty-five purchases by persons who purchase as principals. The purchases must be completed within six months of the first sale or made pursuant to written agreements entered into in that period. No advertising is to accompany the offer and sale, and no selling or promotional expenses may be incurred or paid except for professional services or those performed by a registered dealer. Perhaps the most restrictive aspect of the exemption is that no promoter of the issuer (apart from a registered dealer) may have acted as a promoter for any other issuer that utilized the exemption within the previous twelve months, and no issuer may use the exemption more than once. Each purchaser must have access to substantially the same information concerning the issuer that a prospectus filed under this Act would

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183. Exemptions From Prospectus Requirements, *supra* note 24, § 71(1)(n), ¶450-701, at 55,165.

184. *Id.* at § 71(1)(o).

185. *Id.* at § 71(1)(m).

186. *Id.* at § 71(1)(g). Formerly, stock dividends were only permitted if they were securities of its own issue. Securities not of its own issue could only be distributed on an exempt basis as incidental to a bona fide reorganization or winding up of the company.

187. *Id.*, § 71(1)(b), at 55,164; A report must be filed within ten days of such trades, *Id.*, § 71(3), at 55,166-67. For judicial consideration of the meaning of "isolated", see R. v. McKillop [1972] 1 O.R. 2d 164-167; Zinmann v. Baldry [1964] 13 W.W.R. 622, 627.

188. *Id.*, § 71(1)¶, ¶450-701, at 55,166 (1987).

provide. This provision appears to incorporate the relevant U.S. jurisprudence deriving from the *Ralston-Purina* decision requiring, in addition to the provision of such information to the purchaser, the existence of sufficient economic bargaining power to compel its disclosure.[189] It is not clear, however, how the Canadian courts will react to this access test.[190] In addition, each investor, either by virtue of (1) his net worth and investment experience; (2) consultation with or advice from a registered adviser or dealer; or (3) being a senior officer or director (or a close relative thereof) of the issuer, must be able to evaluate the prospective investment on the basis of the information provided to him by the issuer. Although this exemption was designed to replace the more subjective concept of "the public" with more objective criteria, the range of information to be provided and the types of investors that may be involved still require a careful elaboration of rules and policies which still restricts the availability of the exemption to only the most obvious cases.

A trade of securities to a lender, pledgee, mortgagee, or other encumbrancer from the holdings of control persons or companies for the purpose of giving collateral for a bona fide debt, and trades in commodity futures options or commodity contracts which are those of a hedger through a dealer, are exempt.[191]

A final category of exemption from prospectus requirements is the sale of securities exempted by the regulations.[192] The Ontario regulations presently exempt the following:[193]

(1) Trades in a variable insurance contract by licenced insurance companies, provided the contract is of a specified kind;[194]

(2) Transactions in which each party is a control person of the issuer of the security;

(3) Transactions involving the purchase, redemption, or acquisition by the issuer of its securities;

(4) Issuances of securities to promoters of the company or the sale of securities from one promoter to another promoter of the same company;

(5) Trades under a plan available to holders of publicly traded securities of the issuer, which permit holders to direct that dividends or interest

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189. *See*, SEC v. Continental Tobacco Co., 463 F.2d 137 (5th Cir. 1972); Doran V. Petroleum Management Corp., 545 F.2d 893 (5th Cir. 1977); Lively v. Hirschfeld, 440 F.2d 631 (10th Cir. 1970).

190. *See generally*, JOHNSTON, *supra* note 21; See also R. v. Piepgrass and Shelter Corp. of Canada Ltd., 1977 Ontario Securities Commission Bulletin 6.

191. Exemptions From Prospectus Requirements, *supra* note 24, §§ 71(1)(e)(s), ¶ 450-701, at 55,164-66 (1987).

192. *Id.*, § 72(1)(d).

193. Prospectus Requirements, § 14, Can. Sec. L. Rep. (CCH) ¶452-125, at 55,257 (1988).

194. *Id.*, § 14(a), ¶ 452-125, at 55,257.

on the issuer's securities be applied to the holders purchase of publicly traded securities of the issuer, or any other securities of the issuer which are redeemable at the option of the holder;

(6) Sales of securities of a mutual fund made by a financial intermediary[195] if the sales are solely to retirement savings plans, deferred profit sharing plans, and pension plans, maintained by the sponsor of such plan for its employees, where the decision to purchase the securities is not made by an employee;

(7)Sales by a promoter of an issuer or the issuer in government incentive securities[196] on a "limited offering" basis if solicitations are restricted to not more than seventy-five prospective purchasers and result in sales to not more than fifty purchasers and the latter are provided with an offering memorandum and meet access and sophisticated investor tests similar to that required under the seed capital exemption;[197] and

(8)Resales of securities acquired pursuant to the "seed capital" exemption, provided each of the parties is one of the not more than twenty-five original purchasers in a limited offering, or one of the not more than fifty original purchasers of government incentive securities, and a vendor relying on this exemption files a required report.[198]

8.02 *Exempt Securities*

The prospectus requirement does not apply to the sale of securities exempt from dealer registration which has previously been discussed.[199] Securities listed on recognized stock exchanges that are sold through the exchange and the Commission are exempt if an acceptable statement of material facts if filed with and accepted by those authorities.[200] The basic content required in these statements is similar to, but is not as extensive as, that contained in a prospectus, and is detailed in the relevant regulations and policies.[201]

An exemption is provided for options to sell or purchase puts and calls from an option writer, provided the option is written or guaranteed

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195. Universal Registration, *supra* note 52, § 176(1)(a), Can. Sec. L. Rep. (CCH), ¶ 453-101, at 55,358 (1988).

196. Prospectus Requirements, *supra* note 194, §15(2), ¶452-128, at 55,258. Defined by Section 15(2) of the Regulations to mean a security designed to enable the holder to receive a grant or other monetary benefit, such as a credit or deduction against taxes.

197. See § 8.01 *supra*.

198. Prospectus Requirements, *supra* note 194, § 14(e), ¶452-128, at 55,257 (1987).

199. Exemptions From Prospectus Requirements, *supra* note 24, § 72(1)(a), ¶450-721, at 55,169 (1988). *See* Section 72(1)(a) incorporating securities referred to in § 34(2), excepting §34(2) 14, which is exempted by § 71(1)(m), and § 34(2) 15, registration exemptions contained in the Regulations, in which there currently are no registration exemptions.

200. *Id.*, § 72(1)(b), ¶ 450-721, at 55,169 (1988).

201. Reporting Requirements, §§ 59-65, Can. Sec. L. Rep. (CCH), ¶452-541, at 55,293 (1987). E.g., see also Alberta Policy 4.7 and 5.3, II Can. Sec. L. Rep (CCH) ¶¶170-407, 170-503.

by a member of a recognized stock exchange, and the securities which are the subject of the option are listed and posted for trading on a recognized exchange, and are in the form prescribed by the regulations.[202]

8.03 *Secondary Distributions and Resale Rules*

In some jurisdictions, subsequent sales by purchasers of securities that are themselves exempt from the prospectus requirement are not subject to prospectus disclosure, unless of course, the securities are not permitted to be offered for sale to the public (e.g., securities of a private company). Sales of securities acquired in exempt trades may, however, still require a prospectus. If the purchaser was not a member of the public in the initial sale, then a subsequent sale to a member of the public would be one to which the prospectus provisions apply. If an exempt sale is made to a member of the public, a subsequent sale may be made without filing a prospectus unless the original exemption prohibits an offer to the public, requires an investment intent, or involves a control person. As a result, in such jurisdictions, securities may be distributed to the public on resales without adequate or continuous disclosure by the issuer.

As part of its "closed system," Ontario places restrictions on the ability to resell securities acquired under exemptions. As noted earlier, the concept of a distribution to the public has been replaced by that of a distribution. In general, the first sale of securities previously acquired pursuant to an exemption is a distribution to which the prospectus requirement applies, unless the resale is also the subject of an exemption, or unless specified conditions are met. Different conditions apply to different types of transactions and these may be classified in general categories.

Under section 71(4), the first subsequent sale of securities previously acquired in eight categories of exempted transactions[203] are exempt from the prospectus requirement if they involve securities of a reporting issuer that is not in default, and which have been held for a prescribed time period, provided that no unusual effort is made to prepare the market or create a demand for the securities, no extraordinary commission or consideration is paid in respect thereto, and a report is filed by the seller within ten days. The burden is placed upon the seller to ensure that the reporting issuer is not in default and, in this regard, he can rely on a certificate issued by the Commission or a list of defaulting reporting issuers maintained by the Commission.[204] The prescribed holding period de-

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202. Exemptions From Prospectus Requirements, *supra* note 24, § 72(1)(c), ¶450-721, at 55,169 (1988).

203. These include (1) specified banks, registered loan or trust companies, licensed insurance companies, and government institutions which purchase as principals, (2) isolated trades, (3) exempt purchasers, (4) private placements, (5) exempt asset purchases exceeding $150,000, (6) purchase of mining claims, (7) limited offerings, and (8) trades between registrants.

204. Exemptions From Prospectus Requirements, *supra* note 24, §§ 71(8)(9)(10), ¶¶

pends upon the types of security involved, and runs from the date of the initial exempt transaction or the date the issuer became a reporting issuer, whichever is later. Six months is required for securities listed on a recognized exchange and for debt securities or preferred shares of an issuer, provided both are authorized by legislation for investment by insurance companies.[205] One year is required for both listed securities and for debt securities that are not so authorized, but which are issued or guaranteed by a reporting issuer whose securities are listed on a recognized exchange. A hold period of eighteen months is required for all other securities.

Section 71(5) provides an exemption for the first trades in securities acquired in five other categories of exempt transactions,[206] and the first trade in previously issued securities of a company that ceased to be a private company, provided the securities do not come from a control person holding. No prospectus is required if (1) the issuer of the securities has been a nondefaulting reporting issuer for the previous twelve months; (2) disclosure has been made to the Commission of the exempt transaction, or, in the case of a private company which has gone public, the issuer has filed a report with respect to its outstanding securities; and (3) no unusual effort is made to prepare the market or to create a demand, and no extraordinary commission or consideration is paid in respect thereto.

Section 71(6) deems the first trade in securities acquired by incorporators and registered dealers who purchased as principal to be a distribution, thereby requiring the filing of a prospectus. No resale exemption is available for these trades, unless, of course, they themselves are the subject of a specific exemption in section 71(1).

The regulations have created further refinements. A prospectus is not required for the first trade in securities acquired as a result of a take-over bid, provided that at the time of the take-over a securities exchange take-over bid circular was filed, and the first trade is not in securities from a control person's holding.[207] A first trade in securities acquired pursuant to the "incorporator's" exemption is also exempt if the purchaser is a promoter of the issuer.[208] Finally, first trades in securities acquired pursuant to certain exemptions in the regulations are only exempt if they are made in accordance with provisions in the Act exempting first trades of previ-

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450-708 to 450-710, at 55,168 (1987).

205. *Id.*, §§ 71(4)(b)(i) and (ii), ¶450-704, at 55,167; Insurance Act, Ont. Rev. Stat. 1980, ch. 218 as amended. These provisions relate to seasoned companies with an acceptable earnings or dividend record for the previous five years.

206. These include provisions relating to (1) corporate wind-ups, purchase or exchange rights, and stock dividends, (2) amalgamations and mergers, (3) share exchange in connection with a take-over bid, (4) take-over bid or issuer bid, and (5) trades with employees.

207. Prospectus Requirements, *supra* note 194, § 16(a), ¶452-130, at 55,259 (1988).

208. *Id.*, § 16(b), ¶452-131, at 55,259.

ously exempted trades.[209]

These provisions are designed to encourage issuers to become reporting issuers so that there is continuous disclosure of information relating to the securities. In addition, they represent an intent to increase both the liquidity and efficiency of the securities markets in an attempt to resolve the problems of locked-in investments and sudden price fluctuations when blocks of securities are put on the market.[210]

8.04 *Resale by Control Persons*

Prior to reforms in Ontario securities legislation a resale by a control person of a previously issued security was deemed to be a distribution to the public requiring the filing of a prospectus unless a specific exemption was available.[211] Some relief was provided through the provision of a separate exemption for sale of listed securities by control persons through the facilities of a recognized stock exchange by using isolated sales not made in the course of continued and successive transactions of a like nature.[212] The current legislation replaced this latter exemption with a more comprehensive right of resale. Section 71(7) permits a prospectus-free distribution by a control person in either of two situations: (1) if a section 71(1) exemption exists (see Sections 8.01 and 8.02 *supra*) or (2) if certain conditions are met. These latter requirements stipulate that the issuer have been a reporting issuer for at least eighteen months and is not in default of regular disclosure, and that the control person files with the Commission a notice of intent to sell in proper form and content within seven to fourteen days prior to the proposed sale. In addition, a declaration certifying that the seller has no knowledge of any material change or material adverse information concerning the affairs or operation of the issuer must be filed within the same time period. Within three days of the trade, an insider report must also be filed. The notice of intent must be renewed at the end of sixty days, and thereafter, each twenty-eight days, until the securities have been sold or are no longer for sale. Finally, there must be no unusual effort made to prepare the market or to create a demand for the securities and no extraordinary commission paid.[213] Since pledges by control persons of their securities for the purposes of giving collateral for a bona fide debt are also exempt from the prospectus requirements,[214] sales by the lender, pledgee, mortgagee, or other encum-

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209. *Id.*, § 17, ¶452-141, at 55,259.

210. JOHNSTON, *supra* note 21, at 234.

211. Ont. Rev. Stat. 1970, ch. 246, § 1(1)6a.

212. *Id.* at § 58(2)(c).

213. Exemptions From Prospectus Requirements, *supra* note 24, § 71(7), ¶ 450-707, at 55,168. Control persons of non-reporting issuers will have restricted rights of resale in that only a few exemptions (notably, trades with financial or government institutions or exempt purchasers and private placements) will be available. However, control persons, where the acquisition of their securities was pursuant to an exempt trade, may be subject to the resale provisions of Section 71(4)(5)(6).

214. *Id.*, § 71(1)(e), ¶450-701, at 55,164-65.

brancer of securities are subject to the same resale restrictions of Section 71(7) that are noted above.

The regulations also provide a means by which a control person may distribute control securities without filing a prospectus, where the securities were acquired pursuant to a take-over bid,[215] and the issuer which was the subject of the take-over bid had been a reporting issuer for at least 12 months at the date of the bid, the take-over bid circular disclosed the intention by the control person to make the trade, the trade occurs within twenty days of the expiry of the take-over bid, a notice of intention, a declaration, and report are filed as required, and no unusual effort has been made to prepare the market.[216]

8.05 *Exemption by Commission Ruling*

The Commission, upon the application of an interested person or company, can rule that any trade, intended trade, security, person, or company is not subject to dealer registration and prospectus requirements if it is satisfied that to do so would not be prejudicial to the public interest, and can impose terms and conditions which it considers necessary.[217] The availability of this procedure, however, varies with each jurisdiction. A decision under this section is final, and no appeal therefrom is available. The Commission also has the power to order that the dealer registration or prospectus exemptions do not apply to a named person or company, provided that a hearing is given to the affected party, where in its opinion such an action is in the public interest.[218]

CHAPTER IX - CONTINUOUS DISCLOSURE

9.01 *Introduction*

As indicated earlier, the concept of the "reporting issuer" is fundamental to most Canadian securities legislation. In Ontario, it is defined to include issuers that (1) have issued voting securities under a prospectus or take-over bid filed on or after May 1, 1967, (2) have filed a prospectus or take-over bid under the new legislation, (3) have had any of their securities listed on a recognized stock exchange since the coming into force of the new legislation, regardless of when the listing commenced, (4) are subject to and are deemed by Ontario's company legislation to be offering their securities to the public, or (5) are the successor by way of amalgamation, merger, or other statutory combination to a company which has been a reporting issuer for at least twelve months.[219]

The disclosure legislation is considerably wider in scope than prede-

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215. Prospectus Requirements, *supra* note 194, § 16a, ¶452-130, at 55,259.

216. *Id.*, §§ 16a (a)(b)(c)(d)(e)(f), at 55,259.

217. Exemptions From Prospectus Requirements, *supra* note 24, § 73(1), ¶ 450-723, at 55,169 (1987).

218. Enforcement, § 124, Can. Sec. L. Rep. (CCH) ¶451-024, at 55,215 (1988).

219. Interpretation, *supra* note 27, § 1(1)(38), ¶ 450-001, at 55,104 (1988).

cessor provisions, in that exemptions for banks, regulated financial institutions, and companies otherwise required by company legislation to make disclosure have been removed, so that these institutions are subject to the continuous disclosure and insider reporting provisions of the securities legislation. The Commission is permitted to order that a reporting issuer has ceased to be a reporting issuer if it is not prejudicial to the public interest and there are fewer than fifteen shareholders in total.[220]

9.02 *Continuous Financial Disclosure*

A distinction is drawn between reporting issuers that are mutual funds and those that are not. Basically, however, both types of entity must file annually, within 140 days of financial year-end, audited financial statements.[221] All filed financial information is open for public inspection at Commission offices during normal business hours.[222] The annual statements must be filed on a comparative basis with the immediately prior financial year. Requirements as to type and content of financial statements are detailed in the regulations. For nonmutual fund reporting issuers, the financial statements must be approved by the board of directors and include an income statement, a statement of surplus, a statement of changes in financial position, and a balance sheet.[223] Finance companies are subject to further requirements, as are industrial and natural resource companies that are in the promotional, exploratory, or developmental stage.[224] For mutual funds, the financial statements must include an income statement, a balance sheet, a statement of investment portfolio, a statement of portfolio transactions, and a statement of changes in net assets.[225]

The annual statements must be audited and accompanied by a proper report after a full review in accordance with generally accepted accounting principles.[226] It is in this area of securities legislation that reliance is placed upon the self-regulatory and professional associations, and the legislation ensures conformity with the principles and practices recognized by the Canadian Institute of Chartered Accountants or by an equivalent association in the jurisdiction of the issuer.[227] Provision is made for deviation from generally accepted accounting principles and

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220. Continuous Disclosure, *supra* note 98, § 82, ¶ 450-779, at 55,173 (1988).

221. *Id.*, § 77, ¶ 451-176, at 55,171 (1988).

222. General Provisions, § 137, Can. Sec. L. Rep. (CCH) ¶ 451-176, at 55,232 (1988). The information may be kept in confidence if the Commission is of the opinion that it discloses intimate financial, personal, or other information and the desirability of avoiding disclosure outweighs the desirability of adherence to the principle that material filed be available to the public.

223. Continuous Disclosure for Isuers Other Than Mutual Funds, §§ 10 & 11, Can. Sec. L. Rep. (CCH) ¶ 442-079 & 452-081, at 55,255 (1987).

224. *Id.* §§ 10 & 11, ¶ 452-091, at 55,235 & 55,256.

225. Mutual Funds, § 80, Can. Sec. L. Rep. (CCH) ¶ 452-466 at 55,312 (1988).

226. Continuous Disclosure, *supra* note 98, § 77, ¶ 450-763, at 55,171.

227. Interpretation, *supra* note 27, § 1(3) & (4), ¶ 452-003 & 452-024 at 55,252 (1988).

practices if they are accepted by the Director or the Commission.[228]

Interim financial statements must be filed quarterly by nonmutual fund reporting issuers, within sixty days. Comparative statements for the previous corresponding period are required if the reporting issuer has completed its first financial year.[229] More detailed requirements are contained in the regulations, which require filing of a statement of changes in financial position (or a statement of changes in net assets for investment companies) and an income statement.[230] The interim financial statements need not include an auditor's report.[231]

Similar provisions are made for mutual funds, except that the statements need be filed only semi-annually,[232] and must include statements of income, investment portfolio, portfolio transactions, and changes in net assets.[233]

The legislation also makes provision for exemptions from disclosure requirements to be granted by the Commission. It may (1) permit the omission of certain information usually contained in the required financial statements;[234] (2) permit the exemption from disclosure requirements if the reporting issuer normally distributed to holders of its securities financial information different from that required by the Act; (3) exempt an issuer, in full or in part, from disclosure requirements, if they are in conflict with the requirements of the issuer's home jurisdiction; or (4) if the Commission is satisfied that there is adequate justification for so doing.[235]

Where the laws of the jurisdiction in which the reporting company is incorporated contain substantially similar requirements, the reporting issuer may comply with the disclosure filing requirements by filing with the Commission copies of the material required by the incorporating jurisdiction.[236] Reporting issuers must also file copies of information circulars forwarded to security holders pursuant to proxy solicitation requirements of the Act and, if it is not subject to the proxy requirements, it must file, within 140 days of its financial year end, a report in accordance with the

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228. *Id.*, § 2(4), ¶ 452-024 at 55,253 (1988).

229. Continuous Disclosure, *supra* note 98, § 76, ¶ 450-761 at 55,171.

230. Continuous Disclosure For Issuers Other Than Mutual Funds, *supra* note 224, § 7, ¶ 452-075 at 55,255 (1987).

231. *Id.*, § 9, ¶ 452-078 at 55,255 (1987).

232. Continuous Disclosure, *supra* note 98, § 76, ¶ 450-762, at 55,171.

233. Mutual Funds, *supra* note 226, § 77(1), ¶ 452-462 at 55,312 (1987).

234. Section 79(a) of the OSA restricts the exemption to comparative financial statements, sales or gross revenue if unduly detrimental to the interest of the reporting issuer, and basic or fully diluted earnings per share. Proxies and Proxy Solicitations, *supra* note 101, § 79, ¶ 450-775, at 55,172. Perhaps the most controversial is the sales or gross revenue disclosure exemption, which is complicated by various court decisions and the inconsistency of provincial legislation. For a discussion of the problems, see JOHNSTON *supra* note 21, at 253-57.

235. *Id.* § 79, ¶ 450-775, at 55,172.

236. *Id.* § 81, ¶ 450-778, at 55,173.

regulations.[237]

9.03 *Timely Disclosure*

Prior to legislative reforms, timely disclosure provisions were not contained in the securities legislation per se, but were governed by policy statements only. In the Uniform Act provinces, immediate disclosure had to be made of all material and significant information concerning the operations and affairs of an issuer.[238] This would occur when a decision accepting or recommending acceptance of a proposed change was made, or when a material change had occurred or had been agreed upon by the relevant parties. Material changes or developments include: changes in control; acquisitions or dispositions of material assets; proposed takeovers, mergers, consolidations, amalgamations, or reorganizations; proposed changes in capital structure; proposed changes that would materially affect earnings; and material changes in earnings. The first four categories of changes had to be discussed with the Commission prior to disclosure to the investing public so that the Commission could stop the trading where necessary to allow proper dissemination of the information. The policy statement provided a common standard of materiality, classifying a material change as one "which could reasonably be expected to affect materially the value of the security." It also explicitly recognized that disclosure of confidential information which may damage the issuer might outweigh the possible harm of withholding the information. In such situations, management had to take "every possible precaution" to ensure that no insider trading took place on the basis of that information, and was encouraged to discuss any unusual or difficult situation with the Commission.

The Ontario Securities Act gives legislative sanction to the current requirements of timely disclosure. When a material change occurs in the affairs of a reporting issuer, it must forthwith issue and file a press release authorized by a senior officer disclosing the nature and substance of the change.[239] A report of the material change is to be filed as soon as practicable and, in any event, within ten days of the date of the change. A material change is defined with reference to a market oriented test, in that it means a "change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer."[240] It includes a decision by a board of directors to implement such a change, or a decision by a senior manager who believes that confirmation by the board is probable. In the case of changes of a confidential nature where disclosure

237. *Id.* § 80, ¶¶ 450-776 & 450-777, at 55,172 & 55,173.

238. Uniform Policy 2-12, repealed December 1, 1987.

239. Continuous Disclosure, *supra* note 98, § 74, ¶ 450-751, at 55,169.

240. Interpretation, *supra* note 27, ¶ 450-004, at 55,102 (1992). Note that there is no requirement to disclose material "facts", which are separately defined, but in terms similar to those of material changes. *Id.*

would be unduly detrimental to interests of the reporting issuer, it can file a confidential report with the Commission, the confidentiality of which must be confirmed every ten days thereafter.[241] However, a cease-trading order can still be made despite the filing of a confidential report.[242]

The Act also prohibits a person or company in a "special relationship"[243] with a reporting issuer from buying or selling securities of the reporting issuer where they have knowledge of material facts or material changes in the affairs of the issuer which have not been generally disclosed.[244] The Act also prohibits knowingly tipping another person or company about material facts or changes, other than in the necessary course of business, before general disclosure is made.[245] As to whether general disclosure requires time for dissemination or evaluation, Canadian jurisprudence is lacking when compared with its U.S. counterpart, although the wording of the Act suggests a test closer to that which is prevalent in the United States.[246]

CHAPTER X - SECURITIES LAWS CIVIL LIABILITY

10.01 *Prospectus Liability*

The Ontario legislation gives a right of action for damages for a "misrepresentation" contained in a prospectus at the time of purchase against (1) the issuer or a selling security holder on whose behalf the distribution was made, (2) the underwriter who signed the underwriter's certificate required to be included in the prospectus, (3) every director of the issuer at the time the prospectus or its later amendment was filed, (4) every person or company whose consent was required and filed (but only with respect to reports, opinions, or statements made by them), and (5) every person or company who signed the prospectus other than those already

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241. Continuous Disclosure, *supra* note 98, § 74, ¶¶ 450-753 & 450-754, at 55,169 & 55,170.

242. Civil Liability, § 123, Can. Sec. L. Rep (CCH) ¶ 451-021, at 55,215 (1988).

243. Continuous Disclosure, *supra* note 98, § 75, ¶ 450-759, at 55,170. This definition includes insiders, affiliates or associates of the reporting issuer, of a person or company proposing to make a take-over bid for the securities of the reporting issuer, or of a person or company proposing to become party to a reorganization, amalgamation, merger or arrangement with the reporting issuer (and their directors, officers and employees), persons engaged or proposing to engage in business or professional activities with or on behalf of the reporting issuer or any of the aforementioned, or a person or company that learns of a material fact or material change with respect to the reporting issuer from any of the aforementioned, and knows or ought reasonably to have known that the other person or company is in such a relationship.

244. *Id.*, § 75, ¶ 450-755, at 55,170. A defence is provided to those who can prove they reasonably believed that the material fact or material change had been generally disclosed. *Id.*

245. *Id.* § 75, ¶¶ 450-756 & 450-757 , at 55,170

246. Compare Green v. Charterhouse Group Canada Ltd., [1973] O.R. 2d 677, aff'd., (1976) 68 D.L.R. 3d 592, a case dealing with insider liability, with SEC v. Texas Gulf Sulphur, 401 F. 2d 833 (1963).

listed.[247] Every prospectus must contain a statement of this right given to the purchaser.[248] Misrepresentation is defined to mean an untrue statement of material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made.[249] A "material fact" is a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of the securities.[250] Every person who purchases a security offered by the prospectus during the period of distribution is deemed to have relied upon the misrepresentation if it was a misrepresentation at the time of purchase.[251]

The general defense available to such an action is proof by the defendant that the purchaser purchased the securities with knowledge of the misrepresentation.[252] In addition, specific defenses are available to defendants other than the issuer or selling security holder. These include:

(1)The prospectus was filed without their knowledge and consent and reasonable general notice was given on becoming aware of the filing.

(2)Prior to the purchase of the securities, they withdrew their consent and gave reasonable general notice thereof and the reason therefor.

(3)With respect to expert authority reports, opinions, and statements, there was no reasonable ground to believe, and they did not believe, that there had been a misrepresentation or that the position of the prospectus did not fairly represent the report, opinion, or statement of the expert.

(4)With respect to a false statement purporting to be a statement by an official person or an extract from an public official document, it was a correct and fair representation of the material and they had reasonable grounds to believe, and did believe, that the statement was true.[253]

A defendant other than the issuer or selling security holder can also avoid liability if he did not believe, as to the nonexpertised portion of the prospectus, the representation to be false or misleading and if he conducted a reasonable investigation so as to provide reasonable grounds for belief that there had been no misrepresentation.[254]

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247. Civil Liability, *supra* note 243, § 126, ¶ 451-055, at 55,216.

248. Prospectuses - Distribution, *supra* note 112, § 59, ¶ 450-585, at 55,149. If securities are distributed pursuant to an exempt purchaser, private placement or "seed capital" exemptions by the issuer or an affiliate, control persons, or underwriters who acquired the securities from those persons, and an offering memorandum is delivered, it must contain a "contractual right of action" or else the exemption is not available. This right of action for rescission or damages if the offering memorandum contains a misrepresentation is approximately similar to the rights discussed in this Section. See Self Regulation - Generally, § 21, Can. Sec. L. Rep (CCH) ¶ 450-294, at 55,124 (1987).

249. Interpretation, *supra* note 27, § 1, ¶ 450-001, at 55,103.

250. *Id.* at 55,102.

251. Civil Liability, *supra* note 243, § 126, ¶ 451-055, at 55,216.

252. *Id.* § 126, ¶ 451-056, at 55,216.

253. *Id.* § 126, ¶ 451-057, at 55,216.

254. *Id.* § 126, ¶ 451-059, at 55,225.

Separate defenses are also available to experts and those whose reports are referred to or contained in a prospectus. If a misrepresentation results from failure to fairly represent a report, opinion, or statement of an expert, a defense is established if, after reasonable investigation, the expert had reasonable grounds to believe and did believe that the prospectus fairly represented his report, opinion, or statement, of it, or, after becoming aware of the misrepresentation, he forthwith advised the Commission and gave reasonable general notice that such a use had been made and that he would not be responsible for it.[255] In addition, no expert is liable for portions of a prospectus purporting to be made on his authority or as an extract or copy of his report, opinion, or statement unless he failed to conduct such a reasonable investigation as to provide reasonable grounds for a belief that there had been no misrepresentations.[256] The test for reasonableness, for both investigation and grounds for belief, is that standard of reasonableness required of a prudent man in the circumstances of the particular case.[257]

The limitation period for this and other civil liabilities sections of the legislation is the earlier of three years from the date of the transaction that gave rise to the liability or 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action.[258] Damages are limited in three ways:

(1)An underwriter will not be liable for more than the total offering price of the portion underwritten by it.

(2)A defendant will not be liable for those damages he proves do not represent the depreciation in the value of the security as a result of the misrepresentation.

(3)The total damages cannot exceed the total offering price.[259]

Liability is joint and several, and a defendant will be able to seek contribution from any person or company who, if sued separately, would be liable to make the same payment, unless a court orders otherwise in circumstances where it would not be just and equitable.[260] Finally, the right of action for damages is in addition to and without derogation from any other right the purchaser may have at law, except for the right of rescission.[261]

10.02 *Prospectus: Rights of Withdrawal and Rescission*

The legislation provides for a forty-eight-hour automatic right of

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255. *Id.* § 126, ¶ 451-057, at 55,216.
256. *Id.* § 126, ¶ 451-058, at 55,225.
257. *Id.* § 128, ¶ 451-101, at 55,228.
258. *Id.* § 135, ¶ 451-151, at 55,232.
259. *Id.* § 126, ¶¶ 451-060, 451-061 & 451-062, at 55,225.
260. *Id.* § 126, ¶ 451-062, at 55,225.
261. *Id.* § 126, ¶ 451-064, at 55,226. See Section 11.02 *infra.* regarding the right of rescission.

withdrawal from agreements of purchase and sale executed in the course of a distribution to the public.[262] The time period commences upon the receipt of the prospectus, and ends at midnight the second day thereafter, exclusive of Saturday, Sundays, and holidays. Receipt by an agent is receipt by the principal, who must continue to retain the beneficial ownership, and every prospectus must contain a statement of this right of withdrawal.[263]

An automatic right of rescission is given to a purchaser of securities if as of the date of receipt a prospectus contains a "misrepresentation," the definition of which is discussed in Section 10.01 *supra*. However, the exercise of this right is an alternative to an action for damages and is only available against the issuer, security holder, or any underwriter of the securities.[264] Provisions concerning time of receipt by an agent and disclosure of the right of rescission are similar to those relative to the right of withdrawal.[265] An action to enforce this right must be commenced within 180 days after the date of the transaction that gave rise to the cause of action.[266] The defenses available to a defendant in an action for damages are also available in the case of an action for rescission.

10.03 *Take-Over Bid Circular Liability*

A right of action for damages for misrepresentation in a take-over bid, an issuer bid, a directors' or a director's or officer's circular, similar to that concerning prospectuses, is conferred upon all recipients of the circular.[267]

Each offeree will be entitled to enforce this right against the offeror and its directors, experts, and those persons who sign certificates in the circular. In addition, a right of rescission may be enforced against the offeror.[268] The defenses available are similar to those concerning prospectuses, one of which applies to all defendants (proof by the defendant that the offeree had knowledge of the misrepresentation)[269], while the rest are not available to the offeror.[270] The prospectus liability provisions limiting liability to damages from misrepresentation only and those providing for joint and several liability are also applicable to take-over bids.[271] The limitation period for commencing an action is also the same.[272] Similarly, the right of action for rescission or damages is in addition to and without

262. Distribution - Generally, *supra* note 112, § 70, ¶ 450-671, at 55,163.
263. Prospectuses - Distribution, *supra* note 112, § 59, ¶ 450-585, at 55,149.
264. Civil Liability, *supra* note 243, § 126, ¶ 451-055, at 55,102.
265. Distribution - Generally, *supra* note 112, § 70, ¶ 450-671, at 55,163.
266. Civil Liability, *supra* note 243, § 135, ¶ 451-151, at 55,232.
267. *Id.* § 127, ¶ 451-075, at 55,226.
268. *Id.*
269. *Id.* § 127, ¶ 451-078, at 55,226.
270. *Id.* § 127, ¶ 451-079, at 55,226.
271. *Id.* § 127, ¶ 451-082 & 451-083, at 55,227.
272. *Id.* § 135, ¶ 451-151, at 55,232.

derogation from any other right the offeree may have at law.[273]

The legislation provides for a right of rescission for misrepresentation against only the offeror as an alternative to the action for damages.[274] Defenses available are those that apply to the action for damages, but the relevant limitation period is 180 days after the date of the transaction that gave rise to the cause of action.[275]

Finally, a purchaser of a security to whom a prospectus, take-over bid circular, or issuer bid circular was requested to be sent who did not receive the material has a right of action for rescission or damages against the dealer or offeror who failed to comply with the applicable requirement.[276]

10.04 *Other Rights of Rescission and Withdrawal*

Where a registered dealer issues, publishes, or sends a document with intent to trade with someone other than another registered dealer and proposes to act in that trade as a principal, this must be disclosed in writing before entering into the contract for the purchase and sale of the security and before receiving payment or security or other consideration under or in anticipation of any such contract.[277] Failure to comply entitles the other party to rescind by serving written notice of rescission on the registrant within sixty days of the delivery of the security, unless they are no longer the owner of the security purchased.[278] Failure to confirm in writing that a trade made pursuant to an oral offer or invitation for an offer was effected by a registrant acting as a principal entitles the opposite party, unless it is a registrant, to a similar right of rescission if written notice is served within seven days of delivery of the written confirmation.[279] No action for rescission call be commenced after ninety days from the date of the service of the notice.[280] Finally, short sales against margin accounts by registrants are void at the action of the customer, and the customer can recover all monies paid with interest or the securities deposited.[281]

The legislation also permits a contractual plan holder to withdraw from the plan by written notice within sixty days after receipt of the confirmation for the initial payment under the plan. A similar right of rescission exists for lump-sum purchases of mutual fund securities if exercised in writing within forty-eight hours after receipt of the confirmation of the purchase. However, this latter right will apply only with respect to

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273. *Id.* § 127, ¶ 451-085, at 55,228.
274. *Id.* § 127, ¶ 451-075, at 55,226.
275. *Id.* § 135, ¶ 451-151, at 55,232.
276. *Id.* § 130, ¶ 451-103, at 55,228.
277. Trading in Securities - Generally, *supra* note 36, § 38, ¶ 450-455, at 55,143 (1986).
278. Civil Liability, *supra* note 243, § 133, ¶ 451-141, at 55,231.
279. *Id.* § 133, ¶ 451-142, at 55,231.
280. *Id.* § 133, ¶ 451-145, at 55,231.
281. Trading in Securities - Generally, *supra* note 278, § 46, ¶ 450-475, at 55,144.

purchases that do not exceed $50,000.[282] In both cases, the purchaser's recovery cannot exceed the net asset value of the purchased securities at the time the right is exercised.[283] Registered dealers will be required to reimburse sales charges and other fees relevant to the investment of the purchaser in the mutual funds.[284]

10.05 *Insider Trading Liability*

legislation extends insider trading liability to persons or companies that are "in a special relationship" with a reporting issuer if they sell securities of the latter with knowledge of a material fact or material change with respect to the reporting issuer that has not generally been disclosed. The same persons or companies are liable if they directly or indirectly, other than in the necessary course of business, communicate knowledge of the material fact or material change to a person or company who thereafter sells securities of the reporting issues.[285] These persons or companies are liable to compensate the purchaser of the securities for damages as a result of the trade. Similar liability extends to those who purchase securities with knowledge of a material fact or material change, or who "tip" others, who thereafter purchase the securities, the result being that both classes of defendant are liable to the vendor of the securities.[286]

The legislation defines those "in a special relationship" with a reporting issuer to be (1) insiders or affiliates of the reporting issuer, (2) directors, officers, or employees of the reporting issuer or of a company that is an insider or affiliate of the reporting issuer, (3) persons or companies who, by virtue of their past, current, or proposed business or professional activities with or on behalf of the reporting issuer, have acquired knowledge of the material fact or material change, and (4) an associate of the reporting issuer or of any of those just listed.[287] As defined in the Act, a material fact is one that "significantly affects, or would reasonably be expected to have a significant effect on the market price or value" of the securities.[288] A material change is one in the business, operations, or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of the securities, and includes a decision to implement such a change by the board of directors or by senior management who believe that confirmation of the decision by the board of directors is probable.[289]

Liability is attached to the special relationship persons or companies in such circumstances, including tipping, unless they can prove they rea-

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282. Civil Liability, *supra* note 243, § 134, ¶ 451-146, at 55,231.
283. *Id.*
284. *Id.* § 134, ¶ 451-150, at 55,232.
285. *Id.* § 131, ¶ 451-104, at 55,228.
286. *Id.* § 131, ¶ 451-105, at 55,228.
287. *Id.* § 131, ¶ 451-127, at 55,231.
288. *Id.*, § 1(1), ¶ 450-001, at 55,102 (1992).
289. *Id.*, § 1(1), ¶ 450-001, at 55,102 (1992).

sonably believed the information had been generally disclosed[290] or if they had reasonable grounds to believe that the information had been known to the other party to the transaction. Where tipping is alleged, further defenses are available if the information was given in the normal course of business.[291] Liability, in the case of more than one defendant, is joint and several.[292] If no defenses are available and proven, the statutory measure of damages is the difference between the price paid or received in the transaction and the average market price of the security in the twenty trading days following general disclosure of the material fact or material change, although provision is also made for the court to instead consider such other measures of damages as may be relevant in the circumstances.[293]

In addition, if the defendant is also an insider or an associate or affiliate of the reporting issuer, he or it is accountable to the reporting issuer for any benefit or advantage received or receivable as a result of the purchase or sale of the securities, or communication of the material fact or material change, as the case may be unless he can prove he reasonably believed the information had been generally disclosed.[294] Similar defenses to those listed above are also available.

The right of action given to the reporting issuer is an added incentive for those in a special relationship with the reporting issuer to obey the insider trading prohibitions. Quite naturally, the board of directors of the reporting issuer may be reluctant or unwilling to proceed against one or several of their associates or members. Consequently, the legislation entitles security holders, the reporting issuer, or the Commission, to apply to the courts for an order requiring the Commission or authorizing the security holders to commence or continue an action in the name of and on behalf of the reporting issuer to enforce the insider trading liability.[295] The court has a discretion to issue such an order, if it is satisfied there are reasonable grounds for believing the reporting issuer has a cause of action, and the reporting issuer has failed to commence an action within sixty days of a written request or has failed to diligently prosecute an action commenced by it.[296] Every order of this sort will require the reporting issuer to cooperate fully in the institution and prosecution of the action and to make available all books, records, documents, and other material information known to it, which is relevant to such an action.[297] The legislation also permits the courts to require that the reporting issuer pay the costs incurred by the board of directors or the security holder if it

290. Civil Liability, *supra* note 243, §§ 131(1) & 131(5)(a), (b), (c), (d) & (e), ¶451-075 & 451-079 at 55,215 & 55,216 (1992).

291. Civil Liability, *supra* note 243, § 131, ¶ 451-105, at 55,228.

292. *Id.* sec. 131, para. 451-108, at 55,229.

293. *Id.* § 131, ¶ 451-109, at 55,229.

294. *Id.* § 131, ¶ 451-107, at 55,229.

295. *Id.* § 132, ¶ 451-121, at 55,230.

296. *Id.*

297. *Id.* § 132, ¶ 451-128, at 55,231.

is satisfied the action is prima facie in the best interests of the reporting issuer and its security holders.[298] Where the Commission prosecutes the action, the court will order the reporting issuer to pay all costs properly incurred by the Commission.[299] Finally, an action to enforce the liability provisions must be commenced within the earlier of 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action or three years after the date of the transaction.[300]

Similar liability is applicable to any person or company who has access to information concerning the investment program of a mutual fund, or the investment portfolio managed for a client by a portfolio manager, and who uses that information for their direct benefit or advantage to trade in securities of an issuer for their own account where the mutual fund portfolio or investment portfolio of the client includes securities of that issuer. These persons or companies are accountable to the mutual fund or the client of the portfolio manager for any benefit or advantage received or receivable as a result of such a transaction.[301] No specific defenses to this liability are contained in the legislation. Provision is also made for application to the courts to require or authorize the Commission or the security holders of the mutual fund to commence or continue an action in the name of and on behalf of the mutual fund to enforce the liability.[302]

10.06 *Derivative Actions*

In addition to the provisions of the Ontario Securities Act permitting shareholder application to the courts to require an action to be commenced to enforce the insider liability sections, relevant companies legislation may make provision for derivative actions to be commenced on behalf of corporations.[303] These permit shareholders, with leave of a court, to maintain an action on behalf of themselves and the corporation to enforce any right, duty, or obligation that could be enforced by the corporation itself, or to obtain damages for any breach of any that right, duty, or obligation. A number of court decisions concerning the procedure to be utilized, and its exclusiveness, have rendered this area of shareholder and investor protection one of continuing development.[304]

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298. *Id.* § 132, ¶¶ 451-123 & 451-124, at 55,230. To determine what is prima facie in their best interest, the court is directed to consider the relationship between the potential benefit to be derived and the cost involved in the prosecution of the action. *Id.* § 132, ¶ 451-126, at 55,231.

299. *Id.* § 132, ¶ 451-125, at 55,230.

300. *Id.* § 135, ¶ 451-151, at 55,232.

301. *Id.* § 131, ¶ 451-104, at 55,228.

302. Action by Commission on behalf of issuer, § 132(2), CAN. SEC. L. REP.(CCH) ¶ 451-123, at 55,230(1988). Provision respecting costs, similar to those discussed above, are also applicable. *Id.* at §§ 132(3),(4), & (6), ¶¶ 451-123, 451-124, & 451-126, at 55,230.

303. Derivative actions, § 245, CAN. SEC. L. REP.(CCH) ¶ 460-722, at 57,101(1986); CBCA § 238.

304. *See Farnham v. Fingold*, 2 O.R.2d 132 (C.A. 1975); *Golden Mines Ltd. v. Revill*, 7

CHAPTER XI - INSIDER TRADING

11.01 *Introduction*

Canadian insider trading provisions can be divided into two categories: (1) the duty to report trades by insiders; and (2) liability for misuse of insider information. This section deals only with reporting requirements for insiders of reporting issuers; liability for insider trading is discussed in Section 10.05 *infra* on Civil Liability. Insiders are defined to include any person or company who beneficially owns, indirectly or directly, or exercises control or direction over more than 10 percent of the voting equity shares of a reporting issuer.[305] Directors and senior officers[306] of a reporting issuer and those of a company which is itself an insider or subsidiary of a reporting issuer are deemed to be insiders of the reporting issuer.[307] To further exacerbate the problem of definition, companies are deemed to own securities beneficially owned by their affiliates, and persons are deemed to own beneficially securities beneficially owned by a company controlled by them or by an affiliate of that company.[308] In addition, the definition includes the reporting issuer itself if it has acquired any of its own shares and still holds them.[309] Where an issuer or a reporting issuer becomes an insider of another reporting issuer, directors and senior officers are deemed to have been insiders of the latter for the previous six months or lesser period that they occupied such a position.[310] As result, they must file insider reports for changes occurring within that time period.[311]

11.02 *Insider Trading Rules*

A person or company that becomes an insider of a reporting issuer, other than a mutual fund, must file a report of his direct or indirect beneficial ownership, control, or direction over securities of the reporting issuer as of the date upon which he became an insider.[312] However, if no such relationship, control, or direction exists, no initial report need be filed until one is acquired.[313] Subsequent changes in the ownership, con-

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O.R.2d 216 (1974); *re Goldbar and Quebec Manitou Mines Ltd.*, 9 O.R.2d 740 (1975); Beck, The Shareholder's Derivative Action, 52 CAN. B. REP. 159 (1974).

305. Interpretation, *supra* note 27, § 1(1)17iii, CAN. SEC. L. REP. (CCH) ¶ 450-001, at 55,101 (1988).

306. As defined in § 1(1)41i,&ii of the Act to include various named positions and the five highest paid employees of the company. *Id.* at 55,105.

307. *Id.* § 1(1)17iv, ¶ 450-001, at 55,101 & 55-102.

308. Interpretation, *supra* note 27, §§ 1(5) & (6), ¶¶ 450-005 & 450-006 at 55,106 (1992). Controlled companies and affiliates are further defined in the Act in §§ 1(2) &(3). *Id.*, §§ 1(2) &(3), ¶¶ 450-002 &450-003 at 55,106 (1992).

309. Interpretation, *supra* note 27, § 1(1)17iv, ¶ 450-001, at 55,102.

310. *Id.*, §§ 1(8) & (9), ¶¶ 450-008 & 450-009 at 55,106 (1992).

311. Insider Trading and Self-Dealing - Report, *supra* note 100, § 102, CAN. SEC. L. REP. (CCH) ¶ 450-929, at 55,210 (1987).

312. *Id.* ¶ 450-927, at 55,209.

313. Insider Trading, § 149 CAN. SEC. L. REP. (CCH) ¶ 452-863, at 55,347 (1988).

trol, or direction of securities by insiders must also be reported.[314] All insider reports must be filed within ten days following the end of the month in which such a change occurs.[315] The report must be in accordance with the regulations[316] and must designate (1) the category of insider, (2) the class of security, (3) the amount held, (4) the nature of ownership, (5) the transaction date, and (6) the nature of the transaction.[317]

Information concerning insider reports is contained in the various policy statements as well.[318] In addition, if an insider of a reporting issuer transfers securities into the name of an agent, nominee, or custodian, unless the transfer is for the purpose of giving collateral for a bona fide debt, a report must be filed.[319] Where voting securities are registered in the name of a person or company other than the beneficial owner and that person knows the securities are owned by an insider that has failed to file a report, that person must file a report, unless he holds those securities as collateral for a bona fide debt.[320] To ease the reporting requirements of large corporations with complicated intracorporate and intercorporate holdings, the regulations provide that the report filed by a company can be deemed to be a report filed by subsidiaries, affiliates, and controlled companies, and the latter need not file separate reports.[321] In addition, the Commission can exempt an applicant from the reporting requirements if the requirements conflict with those of the incorporating jurisdiction, or if there is otherwise adequate justification for so doing.[322] There is no need to apply for exemption if the incorporating jurisdiction has substantially similar requirements. Compliance is effected by filing the reports required by the incorporating jurisdiction.[323] Summaries of

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314. Insider Trading and Self-Dealing - Report, *supra* note 100, § 102(2), ¶ 450-928, at 55,209. § 101(2)(b), *supra* ¶ 450-926, at 55,209, deems the acquisition or disposition of a put, call, or other transferable option to be a change in the beneficial ownership of the capital security to which it relates, thereby requiring a report to be filed.

315. *Id.* § 102(1), ¶ 450-927, at 55,209.

316. Insider Trading, *supra* note 100, § 148, ¶ 452-862, at 55,347; Form 36 Securities Act, CAN. SEC. L. REP. (CCH) ¶ 454-036, at 55,888 (1987).

317. Form 36 Securities Act, *supra* note 317, ¶ 450-927, at 55,209.

318. Uniform Policy 2-09, Insider Trading Reports - Loan and Trust Companies, CAN. SEC. L. REP. ¶ 470-209, at 57,779 (1987); Uniform Policy 2-10, Insider Trading - Persons Required to Report in More Than One Capacity, *id.* ¶ 470-210, at 57,779.

319. Insider Trading and Self-Dealing - Report of transfer by insider, *supra* note 100, § 104, ¶ 450-933, at 55,210; Insider Trading, *supra* note 314, § 148, ¶ 452-862 at 55,347; *Id.* § 150, ¶ 452-864, at 55,347; Form 36, *supra* note 317, ¶ 454-036, at 55,888.

320. Insider Trading and Self-Dealing - Report of transfer by insider, *supra* note 100, § 105, ¶ 450-933, at 55,210; Insider Trading, *supra* note 314, ¶ 452-868, at 55,348; Form 36, *supra* note 317, ¶ 454-038, at 55,903.

321. Insider Trading, *supra* note 314, § 155, ¶ 452-870, at 55,348.

322. Insider Trading and Self-Dealing - Filing in other jurisdiction, § 117(2), CAN. SEC. L. REP. (CCH) ¶ 450-977, at 55,213 (1988). *See* Ontario Policy 7.1, Application of Requirements of the Securities Act to Certain Reporting Issuers, CAN. SEC. L. REP. (CCH) ¶ 471-701, at 58,141 - 58,161 (1987).

323. *Id.* § 117(1), ¶ 450-976, at 55,213.

every report filed are published weekly by the Commission.[324]

CHAPTER XII - MERGERS AND ACQUISITIONS

12.01 *Introduction*

Corporate combinations can be effectuated in Canada by one of three basic methods: (1) an acquisition of the shares or assets of a business enterprise; (2) the take-over of publicly traded shares in accordance with the applicable legislation; or (3) the statutory amalgamation of two or more corporations. These are sometimes lumped under the heading of "mergers" in business discussions, but it is important to note that the term has no formal or statutory status in Canada. A decision as to the appropriate method to use depends upon the business purposes to be achieved and the income tax consequences which will flow therefrom, especially in light of tax provisions relating to capital gains.

Statutory amalgamations are provided for in the provincial and federal companies legislation.[325] Basically, these provisions permit two or more companies of the same jurisdiction to combine their assets and liabilities into one continuing corporation. The legislation requires the amalgamating corporations to enter into an amalgamation agreement prescribing the terms and conditions of the amalgamation, the means of carrying it into effect, and the means to obtain the necessary shareholder approval.

The impact of securities legislation upon these forms of acquisition or combination is minimized by the exemptions from the prospectus and dealer registrations requirements that are provided. As noted earlier,[326] issuance of securities in connection with statutory amalgamations or similar merger-type combinations are exempt from these obligations, as are those that relate to asset purchases with a fair value of at least $150,000. To the extent that shareholder approval is required, the proxy solicitation rules must be complied with and the necessary material filed.[327] In that insider trading may be involved, the liability provisions may be applicable as a basis for the assertion of a private claim.[328] Finally, if the acquisition involves a purchase of a significant block of the outstanding securities of a corporation, the take-over bid provisions of the securities legislation are applicable.[329]

12.02 *Merger of Subsidiary and Parent*

Both the federal legislation and provincial legislation permit short-

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324. 325*Id.* § 116, ¶ 450-975, at 55,213.

325. *See, e.g.*, OBCA, *supra* note 14, at §§ 173-178; CBCA, *supra* note 14, at §§ 181-186.

326. See Sections 5.04[c] and 8.01, *supra*.

327. *See* Section 14.02 *supra*.

328. *See* Section 10.05 *supra*.

329. *See* Chapter 13 Take-Over Bid Legislation in Canada, *infra* note 346.

form vertical and horizontal amalgamations of wholly-owned subsidiaries with the approval of the directors of each of the amalgamating companies. The general amalgamation agreement details the capital structure of the continuing corporation, as well as setting out the manner in which the shares of the predecessor securities will be converted into shares of the successor. Provided the companies are solvent, the continuing entity will come into force once articles of amalgamation are issued. Dissenting shareholders are permitted to require the amalgamated corporation to purchase their shares at values determined in accordance with the relevant legislation.[330]

12.03 *Issuer Bids and Going Private Transactions*

For an offer by an issuer to acquire or redeem its own securities, other than debt securities that are not convertible into equity securities, the amount of disclosure to be made by the issuer to its security holders and approval by the minority security holders is governed by legislation in Ontario relating to "issuer bids."[331] If such an offer is not an exempt one, various disclosure requirements must be met. Exemptions[332] are available if the acquisition: (1) is permitted in accordance with the terms and conditions of the securities without the prior agreement of the securities holders; (2) is required by the instrument creating or governing the class of securities or by the statute under which the issuer was incorporated or organized; (3) is pursuant to pre-existing rights known to security holders at the time of purchase and exercised by the security holder; (4) is made to meet sinking fund or purchase fund requirements; (5) is acquired from a current or former employee of the issuer or an affiliate, provided that where a published market for the securities exists, the acquisition cost does not exceed the market price of the securities and not greater than five percent of a class of securities are acquired under the exemption;[333] (6) is made in accordance with the requirements of a recognized stock exchange; (7) is one in which no more than five percent of the issuer's securities are purchased within a twelve-month period, if disclosure is made to the Commission and the financial press, by means of a notice of intention, at least five days prior to the proposed issuer bid;[334] (8) is of securities of a private company with no published market for the securities which are being acquired; or (9) is to securities holders which number fewer than fifty in Ontario, and the securities held by the Ontario holders represent less than two percent of the class of securities, provided the bid is in compliance with the laws of a jurisdiction recognized by the

330. OBCA, *supra* note 14, at § 184; CBCA, *supra* note 14, at § 190.

331. Take-Over Bids and Issuer Bids - Definitions, *supra* note 176, § 88(1), ¶ 450-821, at 55,181 (1987), defines "issuer bid."

332. *Id.* § 92(3), ¶ 450-842, at 55, 185.

333. *Id.* § 92(3)(a)-(d), ¶ 450-842, at 55,185.

334. *Id.* § 92(3)(f), ¶ 450-842, at 55,185; Take-Over Bids and Issuer Bids, *supra* note 176, § 168; ¶ 452-991, at 55,354; Form 36, *supra* note 317, ¶ 454-031, at 55,587.

Commission, and materials are forwarded to the Ontario security holders and filed with the Commission.[335]

Where the issuer bid is not exempt, as a matter of timely and adequate disclosure, prior to making an issuer bid, the issuer must deliver to existing security holders and the Commission[336] an issuer bid circular containing prescribed information similar to that for take-over bids. It is also subject to the procedural rules regarding time limits and pro rata acceptance of tenders that relate to take-over bids, except that disclosure of intent to purchase in the market is not required.[337] Federally incorporated companies are exempt from these requirements, in that their own legislation has disclosure requirements that apply to issuer acquisitions.[338]

In addition, protection of the rights of minority shareholders in going private situations is also legislated. The basic thrust of the legislation is to ensure that these transactions are implemented on a basis that is not unfair to the minority in terms of the price received, while avoiding rules that might be so restrictive as to preclude desirable transactions. "Going private transactions" are defined to include amalgamations, arrangements, consolidations, or other transactions proposed by an insider of an issuer in which the interest of a holder of a participating security is terminated without the holder's permission and without the substitution thereof of an interest of equivalent value in a participating security of the issuer or its successor or another issuer that controls the issuer.[339] Thus, where it is anticipated in a take-over bid or an issuer bid circular that a going private transaction will follow, the circular must contain a summary of a valuation of the offeree company or issuer, plus a statement that a copy of the valuation will be sent upon request to registered security holders.[340] Although matters of a sensitive nature, the disclosure of which would be adverse to the interests of the corporation and would outweigh the benefit of the information to prospective recipients, may be omitted by permission of the Director, the valuation must arrive at an opinion as to a value or range of values for the participating securities without any downward adjustments to reflect the fact that the participating securities do not form part of a controlling interest.[341] The valuation will be at a date not more than 120 days prior to the date of the bid, unless a prior valuation exists and has been updated, there has been no intervening event that has materially affected the value, or the intervening event is described and the change in value is stated.[342]

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335. Take-Over Bids and Issuer Bids, *supra* note 176, § 92(3)(h), ¶ 450-842, at 55,185.

336. *Id.* § 97, ¶ 450-868, at 55, 189; *Id.*, § 171, ¶ 453-006, at 55,355; Form 33, *supra* note 317, ¶ 454-033, at 55,862.

337. *Id.*, § 93(3) & (4), ¶ 450-847, at 55,186.

338. CBCA, *supra* note 14, at §§ 194-206.

339. Take-Over Bids and Issuer Bids, *supra* note 176, § 163(1), ¶ 452-961, at 55,351 - 55,352.

340. *Id.* § 163(2), ¶ 452-962, at 55,353.

341. *Id.* § 163(1)(6).

342. *Id.* § 163(4) & (5), ¶ 452-965, at 55,352.

Another requirement is that the squeeze-out element of the going private transaction should not be carried out without the approval of a majority of the minority shareholders affected. Two-thirds of the minority must approve where the consideration offered is other than cash or a security providing an immediate right to cash, or is less than the share price indicated by the valuation.[343] The requirement for minority approval does not apply if the controllers already hold ninety percent of the participating securities of the issuer at the time the transaction is initiated, provided a statutory appraisal remedy is available to the minority or a substantially equivalent enforceable right is made available.[344] The provisions for enhanced disclosure, valuation, and minority approval reflect the concern of the Commission to protect minority security holders and to ensure they are treated consistently in a fair and even-handed manner.

CHAPTER XIII - TAKE-OVER BIDS

13.01 *Introduction*

Together with insider trading, proxy solicitation, and regular financial disclosure, the substantive regulation of take-over bids in Canada did not occur until the enactment of the Ontario Uniform Act in 1966.[345] Readers should be aware that such forms of corporate acquisitions, insofar as they relate to questions of competition policy or foreign ownership of Canadian corporations are also regulated by relevant federal legislation.[346]

A take-over bid is defined as an offer to security holders in the relevant jurisdiction to purchase such a number of voting securities that the offeror will end up with an aggregate total exceeding twenty percent of the outstanding voting securities of the target company.[347] The fixed percentage figure is an attempt to establish an objective standard of the amount of shareholding necessary to exercise effective control of a company. Included in the definition of a take-over bid are acceptances by an offeror of an offer to sell and a combination of an offer to purchase and acceptance of offer to sell so that "puts" and "buy-sell" arrangements will be subject to regulation as well.[348]

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343. *See generally* Ontario Policy 9.1, Disclosure, Valuation, Review and Approval Requirements and Recommendations for Insider Bids, Going Private Transactions and Related Party Transactions, CAN. SEC. L. REP. (CCH) ¶ 470-901, at 58,217 (1991); Compulsory Acquisitions, § 182, CAN. SEC. L. REP. (CCH) ¶ 460-704, at 57,089.

344. Ontario Policy 9.1, *supra* note 344, ¶ 470-901, at 58,217. Part VIII - Minority Approval, § 2.

345. A comprehensive treatment of this subject is found in Anisman, Take-Over Bid Legislation in Canada (Toronto, C.C.H. Can. Ltd. 1974).

346. *E.g.*, Competition Act, R.S.C. ch. C-34 (1985)(as amended); Investment Canada Act, S.C. ch. C-20 (1985)(as amended).

347. Take-Over Bids and Issuer Bids - Definitions, *supra* note 176, § 88(1), ¶ 450-821, at 55,182.

348. *Id.* at 55,182, "offer to acquire."

13.02 *Provincial Regulation of Take-over Bid Offers*

[a] Procedural and Disclosure Requirements

The legislation details various provisions applicable to all take-over bids,[349] including: delivery of the bid; the minimum time for which a bid can be open (twenty-one days); restrictions on taking up the securities; rights of withdrawal (before twenty-one days and after forty-five days and an additional ten days whenever the terms of the bid are varied); pro rata take-up in the event of over-tendering; effect of market purchases on the bid; take-up provisions and timing of payment; restrictions on extensions of the bid; and required press release where all terms and conditions of the bid are complied with or waived.

The bid must be sent to all holders of the class of securities sought and of securities convertible into, or carrying the rights to purchase such securities, and adequate arrangements must be made to ensure that cash is available to effect payment in full if the take-over bid is made in cash.[350] Where the terms of the bid are changed by increasing the consideration to be paid, this must be paid to all offerees, regardless of when the shares are taken up.[351]

A take-over bid circular must form part of or accompany a take-over bid, and must contain information specified in the legislation and regulations.[352] This material includes: inter alia, beneficial ownership of the offeree company securities held by the offeror, its associates, directors, and senior officers, and insiders; the terms and conditions of the offer; the method and time of payments and rights of withdrawal; whether the offeror is aware of any material change in the financial position or prospects of the target company since its last filed financial statement; valuations if required or included; rights of appraisal and acquisition; market purchases of the securities sought; and a statement of the right to rescission or damages for misrepresentations contained in the circular.[353]

Contents of the circular must be approved by the directors of an offeror, and no experts' reports may be used therein without their written consent.[354] In addition, the chief officers and two directors must sign a certificate to the effect that full, true, and plain disclosure of all material facts relating to the take-over bid has been made, which must be included in the circular.[355] Where the consideration involved consists, in whole or in part, of securities, additional material is required, namely, the information prescribed in the appropriate form of prospectus for the company

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349. *Id.* § 94, ¶ 450-863, at 55,187.

350. *Id.* § 95, ¶ 450-864, at 55,188.

351. *Id.* § 96(3), ¶ 450-867, at 55,189.

352. *Id.* § 97(1), ¶ 450-868, at 55,189.

353. *See also*, Take-Over Bids and Issuer Bids, *supra* note 176, § 175(f), ¶ 454-032, at 55,357.

354. Form 32, item 24, CAN. SEC. L. REP. (CCH) ¶ 454-032, at 55,861 (1987).

355. *Id.*

whose securities are being offered in exchange, as well as that company's financial statements.[356]

An offeror cannot sell any of his shares which are the subject of the bid during the period of the bid, and if it offers to pay a price that exceeds the offer, the bid is deemed to be varied by increasing the consideration to the higher price.[357] Where a significant change has occurred in the information contained in the circular, or where the terms of the bid are varied, a notice of the change is to be sent to all offerees whose shares have not been taken up.[358] In such a case the period during which securities may be deposited shall not expire before ten days after the notice of variation has been delivered.[359]

[b] Directors' Circulars

Regardless of whether the board of directors of the target company recommends to its shareholders acceptance or rejection of a take-over bid, disclosure in the form of a directors' circular must be sent to each offeree within ten days of the bid.[360] The contents of the circular, which are prescribed in the regulations,[361] must be approved and the delivery thereof authorized by the directors, and the document must contain a certificate of full, true, and plain disclosure similar to the certificate required in the take-over bid circular,[362] as well as a statement of the right to rescission or damages for misrepresentation.

Within the circular, the directors must disclose their direct and indirect beneficial ownership in the offeror and offeree companies, whether any director, senior officer (or their associates), or insiders of the offeree company has accepted or intends to accept the offer and the number of securities involved, the existence of remuneration or compensation agreements to be entered into as a result of a successful bid, details of trading by directors and officers in securities of the offeree company, and particulars of any material changes in the financial prospects or operations of the target company since the last published interim or annual financial statements. Consideration must be given to the making of a recommendation to accept or reject a take-over bid, and the reasons for the recommendation must be disclosed, even where the directors cannot make a recommendation.[363] If the offerees are advised not to tender until further communication is received, then that communication must be made at least

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356. *Id.* at 55,860, item 15.

357. Take-Over Bids and Issuer Bids - Sales during bid prohibited, *supra* note 332, § 93(8), ¶ 450-851, at 55,187; *Id.* § 96(3), ¶ 450-867, at 55,189.

358. *Id.* § 97(2) & (4), ¶ 450-869 & 450-871, at 55,189.

359. *Id.* § 97(5), ¶ 450-872, at 55,189.

360. *Id.* § 98(1), ¶ 450-884, at 55,189.

361. Take-Over Bids and Issuer Bids, *supra* note 176, § 172, ¶ 453-007, at 55,355; Form 34, *supra* ntoe 317, ¶ 454-034, at 55,876.

362. Form 36, item 18 *supra* note 317, ¶ 454-034, at 55,880.

363. Take-Over Bids and Issuer Bids, *supra* note 176, § 98(2), ¶ 450-885, at 55,190.

seven days before the expiration of the bid.[364] In addition, an individual director or officer may recommend to the offerees acceptance or rejection of the take-over bid if a circular similar to the directors' circular is delivered.[365]

[c] Exempt Offers

Six categories of take-over bids are exempt from the rules outlined above. These include:[366]

(1)An offer effected through the facilities of a recognized stock exchange;

(2)The acquisition by an offeror and its associates or affiliates of not more than five percent of the voting securities of the target company in the twelve-month period, provided that if there is a published market price for the securities, the purchase is not made at a price above the market price;

(3)Purchases made by way of private agreement with not more than five shareholders, not made to shareholders generally, and for consideration which does not exceed 115 percent of the market price of the securities;

(4)An offer to purchase shares in a private company that is not a reporting issuer and where there is not a published market in respect of the securities bid for;

(5)An offer where the number of securities holders in Ontario is fewer than fifty who hold in the aggregate less than two percent of the outstanding securities of that class, made in accordance with the laws of a recognized jurisdiction, and all materials are sent to the Ontario securities holders; and

(6)Purchases of securities with no published market from not more than five persons where the bid is not made to shareholders generally.

With respect to calculation of shareholders for the private agreement exemptions, if the offeror knows or ought to know after reasonable inquiry that the offeree acts as trustee or other legal representative for others with direct beneficial interest in the securities, or that the offeree acquired the securities with the intent to sell under a private agreement, those people with a direct beneficial interest or from whom the securities were purchased are to be included in the calculation of the maximum number of shareholders.[367]

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364. *Id.* §§ 98(4) & (5), ¶¶ 450-887 & 450-888, at 55,190.

365. *Id.* §§ 98(3) & (7), ¶¶ 450-886 & 4550-890, at 55,190.

366. *Id.* § 92(1), ¶ 450-840, at 55,184; Take-Over Bids and Issuer Bids, *supra* note 337, § 165, ¶ 452-986, at 55,354.

367. Take-Over Bids and Issuer Bids - Determination of number of security holders, *supra* note 176, § 92(2), ¶ 450-841, at 55,184.

13.03 *Defensive Tactics*

To a greater extent than is evident in the United States, Canadian public companies often have a control block holder, rendering most public companies in Canada more or less immune from hostile take-over bids. The bidders are instead compelled to reach an agreement with the control block holder to purchase his shares. However, where a hostile take-over bid is made, strategies may be employed by the target company where the board of directors wish to thwart the action by the proposed acquiror.

The directors of a take-over target are subject to a duty at law in carrying out their responsibilities. The directors of the target company may employ various methods of making a hostile takeover so difficult that it will be unattractive and be withdrawn. These may be taken in good faith to protect the corporation and its shareholders from an inadequate offer. The defensive tactics available to the directors and management of a target corporation are numerous, and include actions such as providing themselves with golden parachutes, seeking white knights or white squires, issuing warrants as a dividend to shareholders giving them the right to buy additional shares at a bargain price in certain circumstances (poison pills), issuing shares with multiple voting, subordinate voting or no voting rights, providing staggered terms for directors, issuing shares or options (the "lock up" arrangement), divest in corporate assets (the "scorched earth" or "crown jewel" defences), or taking similar defence of action commonly known as "shark repellant" tactics. The issue is whether the use of such tactics by directors and management of a target corporation is in the best interests of the corporation and of the shareholders.

The Canadian securities administrators have enacted a policy which deals with take-over bids and defensive tactics.[368] The policy reiterates that the primary objective of take-over bid legislation is the protection of the bona fide interest of the shareholders in the target company. The secondary objective is to provide a regulatory framework within which take-over bids may proceed in an open and even-handed environment. The policy confirms the fiduciary standard required of directors of a target company by corporate law. In addition, the policy identifies the inappropriateness of developing a specified code of conduct in take-over bid situations for directors of the target company.[369]

However, the administrators identify specific defensive tactics which will be scrutinized in a take-over bid situation, which include: the issuance, or the granting of an option on, or the purchase of, securities representing a significant percentage of the outstanding securities of the target company; sale or acquisition, or granting of an option on, or agreeing to sell or acquire, assets of a material amount; and, entering into a contract other than in the normal course of business or taking corporation action

368. National Policy 38, Take-Over Bids - Reciprocal Cases Trading Orders, CAN. SEC. L. REP. (CCH) ¶ 470-038, at 57,670 - 57,671 (1990).

369. *Id.* § 2, at 57,671.

other than in the normal course of business.[370]

The policy concludes by stating that administrators realize defensive tactics, including those that are specifically subject to scrutiny, may be legitimately taken by a board of directors in genuine search of a better offer. It is only those tactics that are likely to deny or severally limit the ability of the shareholders to respond to a take-over bid or competing bid, that may result in action by the administrators, according to the policy.

CHAPTER XIV - PROXY REQUIREMENTS

14.01 *Introduction*

Since the mid-1960's, substantial proxy regulation has been an important element in the provisions for continuous disclosure contained in Canadian companies and securities legislation. Current securities legislation applies proxy requirements to those companies subject to the financial disclosure rules discussed above, and in Ontario the requirement applies to all reporting issuers.[371] Equivalent exemptions from the rules are provided in the case of conflicting legislative requirements, or if the Commission is satisfied adequate justification exists.[372] Provincial companies legislation generally exempts private companies from proxy rules, and provision is made for any interested person to apply to the Commission for an exemption.[373]

14.02 *Proxy Solicitation*

Mandatory solicitation of proxies is required of the management of all companies, concurrently with or prior to the giving of notice of a meeting of shareholders, by sending to each shareholder entitled to vote a form of proxy that complies with the provisions of the regulations.[374] The form of proxy must (1) indicate in boldface type whether it is solicited by management, (2) provide space for dating, and (3) provide means whereby the shareholder can specify the manner in which his shares are to be voted with respect to each matter identified in the proxy or information circular, or confer discretionary authority upon a nominee to so vote, provided that the proxy or information circular indicates in boldface type how the nominee intends to vote. No proxy can confer authority to vote (1) for the election of directors unless bona fide nominees for those elections are named in it or (2) at any meeting other than that specified in the notice. It must also indicate in boldface type that the shareholders have a right to appoint a person other than the person designated as

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370. *Id.* § 3, at 57,671.

371. Proxies and Proxy Solicitation - Mandatory solicitation of proxies, § 84, CAN. SEC. L. REP. (CCH) ¶ 450-802, at 55,173 (1988).

372. *Id.* § 87(2), ¶ 450-809, at 55,181.

373. *See, e.g.*, OBCA, *supra* note 14, § 113, ¶ 460-445, at 57,061 (1986).

374. Proxies and Proxy Solicitation - Mandatory solicitation of proxies, *supra* note 372, § 84, ¶ 450-802, at 55,173.

nominee and contain instructions as to the manner in which this right can be exercised.[375] A proxy can confer discretionary authority with respect to amendments or variations to matters identified in the notice and other matters which may properly come before the meeting, if the solicitor of the proxy is not aware, within a reasonable time prior to the solicitation, of the new matters and a specific statement is made in the proxy or information circular that accompanies it that the proxy is conferring that discretionary authority.[376]

No solicitations of proxies, whether by management or otherwise, can be made unless an information circular is sent to each shareholder whose proxy is solicited. Exemptions from this requirement are provided for the nonmanagement solicitation of less than fifteen shareholders,[377] solicitations by registrants or custodians of a mutual fund reporting issuer voting securities held by them in street name, provided that certain conditions are met,[378] or the solicitation by a person of shares of which he is the beneficial owner.[379] The form and content of this document are governed by regulations, and must contain information that is not obtained more than thirty days prior to the date of first distribution of the circular.[380] The stipulated form details items of information which must be clearly presented according to instructions contained therein. These include: revocability of proxies; persons making the solicitation; interest of directors, officers, nominees, and companies in matters to be acted upon; voting shares and principal holdings thereof; election of directors; remuneration and indebtedness of management and others; interest of management and others in material transactions; appointment of auditors; and management contracts.

The substance of each matter to be submitted to the shareholder, apart from the approval of financial statements, should be briefly described in sufficient detail to permit the shareholders to form a reasonable judgment concerning any of the matters.[381] These include matters such as alteration of share capital, charter amendments, property acquisitions or dispositions, amalgamations, mergers, or reorganizations. Where a reorganization or restructuring is involved, reference should be made to prospectus form or issuer bid form for guidance as to what is material.

While fines may be imposed, a greater importance is the effect of procedural irregularity or the provision of inadequate information in

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375. Proxies and Proxy Solicitation, *supra* note 101, § 158, ¶ 452-921, at 55,350; Proxies and Proxy Solicitation, *supra* note 101, § 160, ¶ 452-929, at 55,351.

376. *Id.* § 159, ¶ 452-929, at 55,351.

377. *Id.*, § 85(2)(A), ¶ 450-804, at 55,174.

378. *Id.* § 85(2)(b); Trading in Securities Generally, *supra* note 36, § 48, ¶ 450-490, at 55,145 (1986).

379. Proxies and Proxy Solicitation - Information circular, *supra* note 372, § 85(2)(c), ¶ 450-804, at 55,174.

380. Proxies and Proxy Solicitation, *supra* note 101, § 157, ¶ 452-902, at 55,350; Form 30, *supra* note 317, ¶ 454-030, at 55,838.

381. Form 30, *supra* note 317, ¶ 454-030, at 55,838.

these documents. If sufficient information upon which a reasonable judgment can be made is not provided, and if the provision of that information is material to the person entitled thereto, then it appears likely that action taken at the shareholders' meeting will be subject to invalidation.[382]

14.03 *Role of the Intermediaries*

In 1987, the Joint Regulatory Task Force to the Canadian Securities Administrators (the "CSA") recommended the adoption by the CSA of a National Policy Statement with respect to shareholder communications. The problem addressed by the task force was the disenfranchisement of beneficial non-registered shareholders of securities, being held in the names of market nominees (clearing agencies or financial intermediaries), due to certain deficiencies in legislation governing shareholder communications. As required by Ontario securities legislation[383] and by similar legislation within other Canadian jurisdictions, registrants and custodians are required to deliver proxy related material to non-registered shareholders where the issuer has paid "reasonable fees". These provisions contain deficiencies in that no specific fee scheduled is regulated, the issuer is not obligated to deliver information or proxy related material to the underlying owners, there are no specific time periods for such delivery, obligations are not clearly placed on banks or trust companies in their roles as intermediaries, and the role of clearing agencies in the capital market is not contemplated. As a result of these deficiencies, and based upon the task force's recommendations, National Policy No. 41 was approved by the CSA on October 28, 1987.[384]

The policy is designed to ensure that non-registered shareholders have the same access to corporate information and voting rights as registered holders, to ensure that the obligations of each participant and the communication chain are equitable and clearly defined, and to ensure that regulation and procedures are uniform within Canada. The policy imposes three basic requirements on issuers: to set a record date for the meeting; to undertake a search for non-registered holders pursuant to the methods described in the policy, and to send proxy related material on a timely basis to each security holder who is entitled to the receipt.

The process utilizes an early search, in which clearing agencies, namely Canadian Depository for Securities and West Canada Depository Trust Company, are utilized to determine intermediaries from other registered holders contained on the shareholders' list. Each of these clearing agencies must then provide the transfer agent of the issuer with an ex-

382. *See Garvie v. Axmith*, 1962 O.R. 65. *See also* the discussion of caselaw in Johnston at 267-68.

383. Trading in Securities Generally, §§ 48 Can. Sec. L. Rep. (CCH) ¶ 450-477 at 55,149 (1992).

384. National Policy 41, III Can. Sec. L. Rep. ¶ 470-041.

haustive nominee register to which the issuer must deliver a search card so that the determination of the number of sets of proxy related materials to be sent to each participant and intermediary can be determined.

Under the current regime, the time frames within which the various searches and materials must be forward are specifically set out. These include a minimum period of time which must elapse between notification of the record date, the record date, the mail date, and the meeting date.

CHAPTER XV - INVESTMENT COMPANIES

15.01 *Mutual Funds*

The regulation of mutual funds has been a subject of much discussion and controversy in Canada, but it was not until the enactment of the predecessor to the current Ontario Securities Act that any province established a statutory framework that compares with that provided under the Investment Companies Act in the United States. At the present time, unless the sale of securities of a mutual fund issuer is otherwise exempted, a prospectus must be filed in accordance with a special form prescribed by the regulations.[385]

Provision is made for the registration of a class of dealer known as a mutual fund dealer, meaning a person or company registration exclusively for trading in securities of mutual funds.[386] All such registrants are subject to the basic conditions of registration considered earlier concerning minimum net free capital, bonding, compensation funds, business records and procedures, financial statements, proficiency standards, and statements of account and portfolio.[387] A number of national and local policy statements regulate such matters as sales charges, management fees, forward pricing, conditions of redemption, ascertaining the net asset value of units or shares, financial statements, and changes in management or investment policies.[388]

The Ontario legislation recognizes the basic functional divisions of the mutual fund industry, insofar as it provides definitions for mutual fund management and distribution companies, management and distribution contracts, and contractual plans.[389] Earlier, draft legislation specifically required registration of these entities, as well as of contractual plan service companies. These proposals were derived from the 1969 Mutual

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385. Prospectus Requirements, *supra* note 194, § 32(1), ¶ 452-210 at 55,276 (1987).

386. Registration Requirements, *supra* note 37, § 86, ¶ 452-506 at 55,328 (1987).

387. *Id.*, §§ 84-140, ¶¶ 452-501 - 452-787 at 55,325 - 55,344 (1987). See Chapter 5, *supra*.

388. See National Policies 36, 39 III Can. Sec. L. Rep. ¶¶470-036, 470-039, Ontario Policies 1.9, 11.1, 11.2, 11.4, 11.5 III Can. Sec. L. Rep. ¶¶471-109, 472-101, 472-102, 472-104, 472-105.

389. Interpretation, *supra* note 27, § 1(1), ¶ 450-001 at 55,101 (1992). "Mutual Fund" is defined to include an issue of Securities that entitles the holder to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in a part of the net assets, including a separate fund or trust account of the issuer of the securities. *Id.*

Fund Report[390] which was concerned with abuses, both actual and potential, in the then expanding mutual fund industry. Since then, the industry has grown smaller in size, and it is felt that it is less able to withstand unnecessary administrative costs. In that provision is made for effective control of mutual funds by means of prospectus filings and the requirements discussed below, the proposals for registration were dropped from the legislation.[391]

At present, there is also provision for a class of advisers known as portfolio managers which are investment counsel registered for the purpose of managing investment portfolios for clients with discretionary authority granted by the clients.[392] They are subject to self-dealing restrictions imposed by legislation. A portfolio manager must not knowingly cause any investment portfolio managed by it to (1) invest in any issuer in which a "responsible person" or his associate is an officer or director, unless this is specifically disclosed to the client and written consent from the client is obtained, (2) purchase or sell the securities from or to the account of a responsible person or his associate, or the portfolio manager, and (3) make a loan to the same persons.[393] "Responsible persons" are defined to include the portfolio manager, its partners, directors, officers, and employees, together with affiliates and their directors, officers, and employees, but only if the latter group participates in the formulation of, or has access prior to implementation of, investment decisions made on behalf of the clients.[394]

In addition to these conditions of registration for portfolio managers, registered dealers managing mutual finds are subject to a National policy directive.[395] This makes provision for: (1) qualifications of dealer managers; (2) prior shareholder approval of dismissal of auditors; (3) material changes in the investment objective, policies, practices, or management company of the fund; (4) disclosure of aggregate brokerage commissions paid to related dealers and yearly management fees; and (5) prohibiting certain investments.

The Ontario legislation imposes similar self-dealing restrictions on all mutual funds, in which loans to or investments with "related" persons or companies will be prohibited unless exempted. Thus, mutual funds will be unable to make loans to an officer or a director, or their associates, of the fund, the management company or distribution company, or to a sub-

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390. Report of the Canadian Committee on Mutual Funds and Investment Contract (1960).

391. For a discussion of proposals in earlier drafts of the legislation, see Johnston at 129-34.

392. Registration Requirements, *supra* note 37, § 87, ¶ 452-507 at 55,328 (1987).

393. Insider Trading and Self-Dealing, *supra* note 100, § 118(2), ¶ 450-972 at 55,208 (1992).

394. *Id.*, § 118(1), ¶ 450-971 at 55,208 (1992).

395. National Policy 39, III Can. Sec. L. Rep. ¶470-039.

stantial security holder of one of the latter three entities.[396] A substantial security holder is a person or company, or a group of persons or companies, that holds more than twenty percent of the voting securities of a company.[397] Nor can a management or distribution company of a mutual fund make loans to the officers or directors, or their associates, of the fund or to a substantial security holder of the fund, so that indirect investments by way of loan are also prohibited.[398]

A fund cannot make an investment (1) in any substantial security holder of the fund, or its management or distribution company, (2) in any person or company of which the fund, or related funds, is a substantial security holder, or (3) in an issuer in which an officer or a director, or their associates, or a substantial security holder, of the fund or its management or distribution companies has a significant interest.[399] A significant interest is defined to include a more than ten percent interest by any one person or company, or a more than fifty percent interest by a group.[400]

The Commission will have the power to order that these restrictions do not apply, provided that the proposed investment "represents the business judgment of responsible persons uninfluenced by considerations other than the best interests of the fund" or is in fact in the best interests of the fund.[401] No investment which will result in the payment of a fee or other consideration to a related person or company will be permitted, unless (1) it is paid pursuant to a contract disclosed in a prospectus, or (2) the Commission grants an exemption.[402]

Every management company must also file reports of (1) transactions between the mutual fund and any related persons or company, (2) loans made from or to the mutual fund to or from any of the related persons or companies, (3) purchases or sales effected by the mutual fund through any related person or company for a fee, (4) any transaction in which the mutual fund is a joint participant with one or more of its related persons or company, in respect of each mutual fund to which it provides services or advice, within thirty days after the end of the month in which it occurs.[403] On the application of a management company, the Commissioner will have the discretion to order that these requirements do not apply to any transaction or class of transaction upon terms and conditions, if nec-

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396. *Id.*, § 111, ¶ 450-936 at 55,206 (1992).

397. *Id.*, § 110(2)(b), ¶ 450-933 at 55,205 (1992). Note that an investment of one issue in another deems the shareholders of the first to have proportionate interest for the purpose of this definition. *Id.*, § 110(2)(c), ¶ 450-933 at 55,205 (1992). Relief from this is found in Section 114 which will not permit imposition of the investment restriction if only because of this deeming effect.

398. *Id.*, § 112, ¶ 450-951 at 55,206 (1992).

399. *Id.*, § 11(2), ¶ 450-937 at 55,206 (1992).

400. *Id.*, § 110(2)(a), ¶ 450-933 at 55,205 (1992).

401. *Id.*, § 113, ¶ 450-952 at 55,206 (1992).

402. *Id.*, § 115, ¶ 450-954 at 55,207 (1992).

403. *Id.*, § 117(1), ¶ 450-958 at 55,207 (1992).

essary, if to do so would not be prejudicial to the public interest.[404] The legislation also imposes a standard of care on those responsible for the management of mutual funds, requiring them to "exercise the powers and discharge the duties of [their] office honestly, with good faith and in the best interests of the mutual fund, and in the connection therewith shall exercise the degree of care, diligence, and skill that a reasonably prudent person would exercise in the circumstances."[405] A person or company is responsible for the management of the fund if it has the legal power or right to control the fund or if, in fact, it is able to do so.[406]

Finally, a wide provision for insider liability governs mutual funds. No person or company who has access to information regarding the investment program of a fund or the investment portfolio managed for a client by a portfolio manager will purchase or sell securities of an issuer where the portfolio of the fund or that managed by a portfolio manager includes securities of that issuer and where the information is used for their direct benefit or advantage.[407]

CHAPTER XVI - ENFORCEMENT

16.01 *Introduction*

The enforcement of securities legislation by provincial regulatory authorities is an important element in attaining the objective of effective and consistent protection of the investing public. The division of legislative jurisdiction between federal and provincial governments in Canada and the central authority's control of the criminal law power could create constitutional conflicts resulting from the concurrent enforcement of different legislations. However, the conflict has been more potential than real to date,[408] although this may change in the future as Canadian capital markets become more integrated.[409]

The enforcement mechanisms available to provincial administrators can be grouped in three categories: (1) administrative and civil sanctions; (2) violations of provincial securities legislation; and (3) breaches of the

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404. *Id.*, § 117(2), ¶ 450-959 at 55,207 (1992).

405. *Id.*, § 116(1), ¶ 450-956 at 55,207 (1992).

406. *Id.*, § 116(2), ¶ 450-957 at 55,207 (1992).

407. *Id.*, § 119, ¶ 450-974 at 55,208 (1992).

408. *See Smith v. Queen*, 1960 S.C.R. 776, for permissive treatment of provincial assumption of criminal type sanctions in the field of securities law enforcement.

409. See Multiple Access Ltd. v. McCutcheon, 16 O.R.2d 593 (D.C. 1977), where it was held that an order granting leave to the plaintiff to commence an action against its corporate insiders, made pursuant to provisions in the Ontario Securities Act, was invalid in that these provisions were rendered inoperative by virtue of similar sections of the Canada Corporations Act. This was affirmed by the Ontario Court of Appeal, 19 O.R.2d 516 (1978), but on appeal to the Supreme Court of Canada the decisions of the Ontario Divisional Court and the Ontario Court of Appeal were set aside. The majority of the Supreme Court of Canada held that the provisions were within the legislative authority of both the provincial and federal governments, and that the otherwise valid provincial legislation was not rendered inoperative due to duplicity with valid federal law, 2 S.C.R. 161 [1982].

federal Criminal Code.

16.02 *Administrative Sanctions*

The range and applicability of the sanctions available to provincial securities authorities are very much a function of the discretion conferred upon them by the relevant legislation. Prime among the remedies utilized is the power to suspend, cancel, or revoke the licenses of registrants, provided that a hearing has been held.[410] Violation of the securities laws of any jurisdiction or of the rules of recognized self-regulatory organizations that are adopted for the protection of investors is considered in principle to be prejudicial to the public interest, and may affect a registrant's fitness for continued registration.[411]

Where it is appropriate, registration can be suspended without a hearing for an interim period of fifteen days.[412] Provision is made for voluntary surrender of registration, if the Commission is satisfied that financial obligations to clients have been discharged and surrender of the registration would not be prejudicial to the public interest.[413] The Commission also possesses a general power to order that trading in securities cease where, in its opinion, that action would be in the public interest.[414] This must be made after a hearing, unless the length of the hearing would be prejudicial to the public interest, in which case a temporary cease trading order may issue for a period of fifteen days, or longer if insufficient information is provided within that period.[415] Cease trading orders are most usually imposed in cases of default in financial reporting and provision is made for partially lifting a cease trade order to permit a shareholder to establish a tax loss for income tax purposes.[416]

An equally effective means of stopping trading is the denial of exemptions from the registration and/or prospectus and take-over bid requirements for certain trades or securities.[417] Such orders apply only to named persons or companies, a requirement which is strictly construed by the courts.[418] This technique is frequently utilized for chronic violation of insider reporting rules and in situations where prosecution is not feasible or is inconvenient.[419] Again, a hearing is required prior to such an order unless a temporary order is made for an interim period of no longer than fifteen days. Provided the hearing is commenced by the end of fifteen days, the temporary order can be extended until the hearing is

410. Registration, *supra* note 32, § 27(1), ¶ 450-357 at 55,128 (1992).
411. Enforcement, *supra* note 219, § 27(1), ¶ 451-024 at 55,214 (1988).
412. Registration, *supra* note 32, § 27(2), ¶ 450-358 at 55,128 (1992).
413. *Id.*, § 27(3), ¶ 450-359 at 55,128 (1992).
414. Enforcement, *supra* note 219, § 127(1), ¶ 451-021 at 55,212 (1992).
415. *Id.*, § 127(3), ¶ 451-023 at 55,212 (1992).
416. Ontario Policy 2.9, III Can. Sec. L. Rep. ¶471-209.
417. Enforecement, *supra* note 219, § 128, ¶ 451-024 at 55,213 (1992).
418. *See in re Clark*, O.S.C., 2 O.R.2d 277 (1976).
419. See JOHNSTON, *supra* note 21, at 362-63.

conducted.[420]

The Commission can order that the distribution of securities to which a prospectus relates must cease if it appears that after the acceptance of a prospectus there exist circumstances which would justify the refusal of a prospectus.[421] A hearing is required unless circumstances exist warranting a temporary fifteen-day order.[422]

Finally, the Commission can apply to the courts for an order directing compliance with the Act, restraining violations and directing the directors and senior officers of a person or company to cause the person or company to comply with or cease violating a decision or provision.[423] Although this is a distinct and independent remedy in addition to those discussed above, it is not frequently utilized, presumably because application to the courts is required.

16.03 *Offenses Against the Ontario Securities Act*

Securities legislation generally makes provision for penalties to attach to specific violations of its requirements. Breaches of the provincial statutes are punishable by way of summary conviction only, with varying levels of fines and imprisonment being applicable.

In Ontario, every person or company who makes a statement in any material, evidence, information, or document submitted, filed or furnished under the Act or regulations, or who makes a statement in any application, release, report, preliminary prospectus, prospecting return, financial statement, information circular, take-over bid circular, issuer bid circular or other document required to be filed or furnished under the Act or regulations, that, at the time and in light of the circumstances under which it is made, is a misrepresentation is guilty of an offense, unless they did not know and in the exercise of reasonable diligence could not have known that the statement was a misrepresentation.[424] Anyone who contravenes the Act or regulations or fails to observe or comply with any direction, decision, ruling, order, or other requirement made under the legislation is also guilty of an offence.[425] If convicted, persons or companies are liable to a maximum fine of $1,000,000 or imprisonment for a maximum of two years, or both. Every director or officer of a company or person, other than an individual, who authorized, permitted, or acquiesced in such an offense is also guilty of an offense and is liable to a fine of up to $1,000,000 or imprisonment for up to two years, or both.[426]

The enforcement sanctions also provide that where a person or com-

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420. Enforcement, *supra* note 219, § 124(2), ¶ 451-025, at 55,215 (1988).
421. Distribution - Generally, *supra* note 112, § 69(1), ¶ 450-667, at 55,163 (1986).
422. *Id.* § 69(2), ¶ 450-668, at 55,163.
423. Enforcement, *supra* note 219, § 122(1), ¶ 451-008, at 55,215.
424. 425*Id.* §§ 118(1)(a),(b) & (2), ¶¶ 450-999 & 451-000, at 55,213 & 55,214.
425. *Id.* §§ 118(1)(c) & (d), ¶ 450-999, at 55,214.
426. *Id.* § 118(3), ¶ 451-001, at 55,214.

pany contravenes the continuous disclosure requirements by trading based upon undisclosed material information and has made a profit, that person or company shall be liable on conviction to a fine of not less than the profit, and not more than the greater of $1,000,000 and triple the profit.[427]

The consent of the Minister is required before proceedings for such offenses can be instituted.[428] No court proceedings and no administrative proceedings can be commenced more than one year and two years, respectively, after the facts upon which the proceedings are based first came to the knowledge of the Commission.[429] Extensive powers of investigation are given to the Commission to assist in its regulatory and enforcement functions. These include appointment of persons to investigate and report upon the affairs and assets of the persons or companies subject to investigation, the summoning of witnesses and production of documents, and the seizure of documents, records, securities, or other property of those whose affairs are being investigated.[430] Additional powers include the discretion to issue orders freezing property or application to the court for the appointment of receivers, managers, trustees, or liquidators.[431]

16.04 *Criminal Offenses*

Various provisions of the federal Criminal Code are applicable to the field of securities regulation, but any detailed discussion of their technical application is beyond the scope of this section.[432] General offenses of conspiracy, fraud, and false pretenses are of potential widespread application.[433] Knowingly making false statements in writing, with the intent that they be relied upon, respecting the financial condition or means or ability to pay of any person, firm, or company in which the accused is interested or for whom he acts, for the purpose of procuring financial benefits, is an offence.[434] Specific offenses relating to the securities industry include knowingly making or publishing a false prospectus, fraudulent manipulation of stock exchange transaction, i.e., wash trading, and short sales against margin accounts.[435]

CHAPTER XVII - INTERNATIONAL ASPECTS

17.01 *Introduction*

In general, issuers of foreign jurisdictions involved in an offering in

427. *Id.* § 118(4), ¶ 451-002, at 55,214.
428. *Id.* § 119, ¶ 451-004, at 55,214.
429. *Id.* §§ 125(1) & (2), ¶ 451-027, at 55,216.
430. Investigations, § 11(1), CAN. SEC. L. REP. (CCH) ¶ 450-201, at 55,110 (1988).
431. *Id.* §§ 16 & 17, ¶¶ 450-224 - 228, at 55,122.
432. See Johnston, *supra* note 21, at 373-85.
433. Criminal Code, Can. Rev. Stat. 1985, c.C-46, as amended §§ 463, 380, 362.
434. *Id.* at § 362.
435. *Id.* at §§ 382, 400. Note that the Ontario Securities Act requires a declaration by any person or company of a short position.

which a portion of the securities are being sold in Canada are required to fully comply with the requirements within the jurisdiction of Canada in which the securities are to be offered. It is important to note that in the Canadian context, as the securities legislation is administered by each of the provincial securities regulators and there is no federal system, co-ordination of issuances in Canada may require different disclosures and filing requirements.[436]

Given the close proximity to the United States capital markets, and the extent to which security holders of various companies incorporated in Canada and the United States are held by residents of each of the two countries, the Securities Exchange Commission ("SEC") and the Canadian Securities Administrators ("CSA") recently completed a joint initiative to reduce duplication of regulation in cross-border offerings, issuer bids, take-over bids, business combinations and continuous disclosure and other filings. The purpose of the multi-jurisdictional disclosure system (the "MJDS") is intended to remove unnecessary obstacles to certain offerings of securities of U.S. issuers in Canada and to facilitate take-over and issuer bids and business combinations involving securities of U.S. issuers having less than a specified percentage of Canadian security holders, while ensuring that Canadian investors remain adequately protected.[437]

The MJDS applies to the public offering of securities of a U.S. issuer in Canada and the United States, or in Canada only. The intent of the MJDS is to reduce disincentives to extending to Canadian security holders of U.S. issuers take-over bid, issuer bid and business combination disclosure and opportunities generally in the same manner as in the United States, and on the basis of the U.S. disclosure documents.

17.02 *Multijurisdictional Disclosure System*

The basic approach of the MJDS is to allow regulatory review of disclosure documents for offerings made by a U.S. issuer in Canada and the United States by both the SEC and the Canadian securities regulatory authorities. The SEC will be responsible for carrying out the review in respect of the United States securities requirements, while the Canadian securities regulatory authorities will monitor compliance with the MJDS policy statement. The MJDS specifically confirms that the liability provisions of the securities laws of any province or territory or the discretionary authority of Canadian securities regulatory authority to implement remedies or important provisions contained therein may apply.

The MJDS system utilizes an approved rating system, in which ma-

436. However, uniform treatment of specific securities issues has been implemented. *See e.g.*, Policy 1, Clearance of National Issues, CAN. SEC. L. REP. (CCH) ¶ 470-001, at 57,525 (1971).

437. Policy 45, Multijurisdictional Disclosure System, CAN. SEC. L. REP. (CCH) ¶ 470-045, at 57,743-2 (1991).

ture issuers which have acquired a significant market following, and about which information is publicly disseminated, will be eligible under the system. The MJDS system encompasses prospectus offerings, offerings of debt or preferred shares, offerings of other securities, and rights offerings. Where the U.S. issuer meets the various requirements, and fully complies with the MJDS policy statement, offerings may be made concurrently in Canada and the United States with substantially similar disclosure documents.

The MJDS system also provides regulation with respect to the requirements for a bid made to security holders in Canada where the offeree issuer is a U.S. issuer, the offeree issuer meets certain requirements,[438] and where less than fourty percent of each class of securities which are subject to the bid are held by persons or companies whose last address as shown on the books of the issuer is in Canada. Where each of the requirements are met, the bid made under the MJDS system shall be exempt from compliance with the provision of applicable Canadian securities legislation governing the conduct of bids, except for the requirement to file the applicable disclosure documents. The MJDS policy statement contains specific provisions concerning securities exchange bids and the mechanics of making a bid.[439]

The MJDS permits securities of a U.S. issuer to be distributed by prospectus in Canada on the basis of documentation prepared in accordance with U.S. requirements (with certain additional Canadian disclosure) in connection with a business combination where less than fourty percent of the securities to be distributed by the successor issuer would be held by Canadian residents. The rationale for the availability of the MJDS in these circumstances is primarily to encourage fair treatment of Canadian investors.[440]

Finally, where an issuer becomes a reporting issuer in a province in Canada, and subject to, among other things, certain continuous disclosure, proxy and proxy solicitation, and shareholder communication requirements, and with its insiders being subject to certain insider reporting requirements, MJDS allows the U.S. requirements in these areas to satisfy the requirements of the Canadian provinces and territories.[441]

17.03 *Extraterritoriality*

In order to distribute securities within a jurisdiction in Canada, subject to various agreements and discretionary matters to be determined by the relevant regulatory authority, compliance must exist with the securities legislation in the jurisdiction which the securities are to be offered. Generally speaking, grounds available to an investor throughout Canada

438. *Id.* § 4.2, ¶ 470-045, at 57,743-19.
439. *Id.* §§ 4.4 & 4.5, ¶ 470-045, at 57,743-21.
440. *Id.* § 5.1, ¶ 470-045, at 57,743-25.
441. *Id.* § 6, ¶ 470-045, at 57,743-27.

to sue a foreign issuer in respect of a misrepresentation in offering documents, or other securities related offences, do not differ from remedies generally available where a foreign issuer is not involved. A foreign issuer wishing to offer securities in Canada will be subject to compliance with the applicable disclosure and filing provisions. As such, compliance with such measures will bring a foreign issuer within the scope of the remedies available under the applicable statute or common law (see Section 10 INFRA.).

Where a person or company from Canada has made an offering outside of Canada, the ability of an investor from a country other than Canada to bring an action against the issuing Canadian person or company is not subject to any particular provisions under Canadian securities regulation. Instead, where the issuer is subject to the applicable securities legislation in the jurisdiction in which the securities are issued, a foreign investor would have any rights accorded under the law of that particular jurisdiction in Canada. Essentially, the issue becomes whether the relevant provincial securities administrators in Canada, based on the underlying policy, will assume jurisdiction in the situation where a Canadian issuer has issued securities in a foreign market.

Where the jurisdiction is assumed, and where disciplinary or other proceedings under applicable regulation, or court proceedings are initiated, the issue of enforcement of such orders or judgments becomes one of conflict of laws. Any detailed discussion of conflict of laws rules is beyond the scope of these materials.

CHAPTER XVIII - SECURITIES COMMISSIONS AND THE PROFESSIONAL

18.01 *Accounting and Accountants*

The accountants role in the securities industry is to act as professionals in examining the financial statements of an issuer. The issuer's financial results, as reflected in the financial statements, form an integral part of the basis of most decisions to buy or sell a security. Accountants are trained to provide an independent expert opinion on the accuracy and method of preparation of the financial statements.

Accountants, in their roles both as accountants and as auditors have come under intense scrutiny and been subject to increased criticism in Canada recently, according to some authors.[442] These authors comment that the Ontario securities regulators have continually supported self regulation of accountants and auditors. However, one criticism of self regulation by accountants and auditors has been the delay in dealing with disciplinary action. The utility of the financial information prepared by accountants and verified through the auditing process will depend in large part upon whether users of the financial information believe the

442. Stanley M. Beck and Paul G. Cherry, *How the Regulators See Us* C.A. MAG., at 40-44 (Oct. 1987).

data. This, in turn, depends on users faith in the system of financial reporting and the confidence in the integrity of the auditor of a particular set of financial statements.[443]

18.02 *Lawyers*

The role of lawyers in the securities industry and in the capital markets can be generally outlined as three-fold. Lawyers, in a primary role, ensure that the intent of buyers and sellers of securities is reflected in the documents which evidence the transaction. The lawyer in performing this role is often acting as a corporate or contract law specialist, but also must be acutely aware of securities law implications.

The second role of securities lawyers is to monitor compliance with applicable laws by buyers and sellers. This role requires a lawyer with a comprehensive knowledge of securities law, so that buyers and sellers may be properly advised of their responsibilities under the applicable securities legislation. In that the securities legislation in Canada is prefaced upon the participants ensuring compliance, this role of a lawyer in advising the proper method of compliance is extremely crucial.

Finally, lawyers have a responsibility to ensure that a transaction does not violate the public interest in efficient capital markets. Similar to the second role outlined above, lawyers in performing this task must be securities law specialists. The necessity for professionalism is apparent, as often this responsibility opposes directly the needs of a client in completing a transaction.

443. *Id.*, at 44.