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Cooperative Capital Markets Participating Jurisdictions

**Re: Cooperative Capital Markets Regulatory System**

Dear Sirs:

We are pleased to respond to your request for consultation with respect to the proposed Capital Markets Stability Act (“**CMSA**”) and proposed model Provincial Capital Markets Act (“**PCMA**”).

Blake, Cassels & Graydon LLP is a national law firm with a very significant Canadian capital markets practice. We represent a large number of market participants, consisting of public company issuers, of varying size, and industry sector, and registrants, and investors. We represent clients in both participating provinces and non-participating provinces.

**Development of Co-Operative Markets Securities Legislation**

We are concerned that the 90 day comment period has been insufficient for many capital market participants to fully consider the legislation, and the implications thereof.

The absence of explanation for changes from what is common to the existing legislation of the major capital markets legislation has also detracted from obtaining the full benefit of the comment period.

We note that, for many significant national securities rules, the process involves a consultation paper or similar broad consultation process, before rules are prepared, which are then published for comment, republished for comment after an initial comment period, and occasionally re-published again. We believe that, in this case, in all the circumstances, both pieces of legislation would greatly benefit if further opportunities were provided for comment.

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An additional comment period would also allow market participants to benefit from a consideration of the comments of other participants. Given the scope of the two pieces of legislation, and number of changes, this would be particularly beneficial in this case.

We note that the current body of national rules has been a result of collaborative effort with notice and comment processes on a significant number of national rules on an individualized basis over many years, which has allowed for considered and detailed examination of the requirements and provisions, both on a policy basis, but also on a “drafting” basis to make sure the provisions are clear and “work”. The enactment of new uniform provincial securities legislation arguably should receive the same degree of consideration and comment.

The proposed federal Capital Markets Stability Act is an entirely new piece of legislation, to a large degree without precedent. We would expect it would be the subject of a broader consultation with participants in the financial markets and the public, before comments on a more detailed level as to the wording of specific provisions are solicited.

### **Principal Comment**

As a national law firm representing market participants who are based in, or who participate in the capital markets of, both participating and non-participating jurisdictions, our overriding concern is the harmonization nationally of clear requirements and the responsive administration of the requirements. Very substantial progress has been made by the Canadian securities administrators in achieving harmonization of requirements and responsive administration over the past two decades. The new legislation should be designed to further that achievement.

Accordingly, as an overriding comment, we are of the view that it is preferable that the uniform legislation reflect, so far as possible, what is currently common to the securities legislation provisions of major capital markets jurisdictions (participating and non-participating), without the introduction at this stage of new provisions and terminology, or provisions or drafting which is not common to the major capital markets jurisdictions.

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This would, in our view, continue the objective of harmonization of securities legislation and allow for the most seam-less administration of this new legislation by the new Authority.

We comment below on certain specific provisions, as examples of our view as to the preferred approach.

### **Misrepresentation Definition**

We note that the definition of misrepresentation, a core definition, has been changed in a number of respects from the current definition in Ontario securities legislation. No explanation or rationale has been provided for this change. The term is used in securities legislation the context of both civil and regulatory liability, including individual personal liability, for disclosure in both primary and second market contexts. The civil liability provisions themselves were adopted after considerable review, consideration and deliberation. A similar degree of deliberation and consideration should be followed with respect to any change in the definition of this term.

### **Capital Markets Participants Definition**

Likewise, although some of the major capital markets jurisdictions have a definition of market participant, not all do. Given the extensive powers provided to the Authority and requirements and provisions in respect of market participants, such as recordkeeping, regulatory access and inspections without judicial process, we suggest that this definition be pared down to the market participants which are common to the definition of this term in the legislation of major capital markets jurisdictions.

For example, “control persons” are not commonly found in the definition of market participants in the major capital markets jurisdictions, even for those that employ the concept of market participant. “Control persons” come into the market in a different way than “reporting issuers” (which raise capital in the markets) and registrants, who are in the business of trading, or advising on the trading of securities. “Control persons” are already indirectly regulated through existing legislation and rules (e.g. prospectus requirements) and it is not clear what the rationale is for adding them to the list of “market participants” at this stage, given the significant implications of that change.

If other participants are to be added, which has significant implications to them given the other provisions in the legislation, this should be subject to further consideration and deliberation.

We also note that the PCMA would apply to the new obligations and provisions to persons who are automatically exempted from the registration requirement or the prospectus requirement, who would also become market participants subject to the Authority's investigation and other powers.

Under the current Ontario securities legislation, clause (b) of the definition of "market participant" applies that definition to a person or company "exempted from the requirement to be registered under this Act by a ruling of the Commission".

In contrast, clause (a) of the same definition in the draft PCMA would apply to "a person exempted from the requirement to be registered under capital markets law".

Clause (r) of the same definition in the draft PCMA would apply to a person distributing securities in reliance on an exemption from the prospectus requirement in section 27 of the PCMA.

By dropping the limitations that apply only to persons who are exempted "by a ruling", it renders ambiguous the application of the definition.

It also makes more important having a clear distinction between the non-application of the registration or prospectus requirement, through lack of jurisdiction or otherwise, and an exemption from those requirements.

For example, section 3(a) of Multilateral Instrument 32-102 *Registration Exemptions for Non-Resident Investment Fund Managers* purports to "exempt" from the investment fund manager registration requirement if a person (i) acts as a manager of a fund, (ii) does not have a place of business in the local jurisdiction and (iii) none of the investment funds have security holders resident in the local jurisdiction. On those facts, what would be the basis for the jurisdiction of the securities regulator in the Canadian local jurisdiction? Yet MI 32-102 describes that as an exemption.

In a comment letter previously submitted in connection with the notice and request for comments for MI 32-102, we noted that activities which do not give rise to the jurisdiction of the securities regulator, in 12749113.2

that case for investment fund manager registration, should not be characterized as “exemptions”. The response to the comment was simply “Please refer to the chart provided in Appendix A to 32-102CP.”<sup>1</sup> This was not actually responsive to the comment, since a precondition to the section 3 exemption was not that the fund had distributed securities in the local jurisdiction.

This is not to debate the merits of that particular exemption, but to illustrate the uncertainties which arise in interpretation when regulatory obligations are imposed on persons based on language that says it applies not only to registrants, but also to those who are either required to register or are exempted from registration requirements, or applying to those who are exempted from prospectus requirements, without focusing upon how that “exemption” arises.

It is impossible to assess the full impact of this since the registration and prospectus exemptions in the regulations to the PCMA have not yet been published, but if we use the exemptions in the current securities laws as analogies, the following examples of currently exempted persons would, under the PCMA, become market participants and subject to the provisions in that legislation:

- Exemptions from the registration requirement:
  - o Canadian banks even if limiting their activities to only those activities not prohibited by its governing legislation (OSA, s. 35.1(1)1.);
  - o foreign dealers trading on a cross-border basis with dealers registered in Canada (NI 31-103, s. 8.5);
  - o persons who provide investment advice that is not purported to be tailored to the needs of anyone receiving the advice (OSA, s. 34(1)1.); and
  - o private investment clubs (NI 31-103, s. 8.10).
  
- Distributions made pursuant to exemptions from the prospectus requirement:
  - o all private issuers (NI 45-106, s. 2.4);

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<sup>1</sup> OSCB (2012) 35 OSCB 6308  
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- o issuers distributing their own securities to their employees, which would include every company, public and private, from whatever jurisdiction in which Canadian employees participating in a stock plan (NI 45-106, s. 2.24);
- o issuers distributing stock dividends to their shareholders (NI 45-106, s. 2.31);
- o bank deposits (NI 45-106, s. 2.41); and
- o the government of Canada and the governments of the provinces (NI 45-106, s. 2.34).

It seems inconsistent with the regulatory decision to provide an automatic registration exemption or automatic prospectus exemption to nevertheless include these persons in the category of "market participants".

We would recommend that those who are included in the scope of the definition of market participant through being subject to an exemption from capital markets law only be included if that exemption was made pursuant to a ruling of the Authority, consistent with common provincial legislation in major capital markets jurisdictions.

### **Section 129 and Potential Class Action Ramifications**

Section 129 of the PMSA provides for a civil cause of action against a person who contravenes insider trading prohibitions (including prohibitions on tipping and recommending). This constitutes a considerable expansion of the group of potential claimants to a civil claim for insider trading beyond what is provided for under existing section 134 of the OSA. Section 134 of the OSA only provides: i) a right of action for damages to the specific seller or purchaser who was on the other side of a contravening trade and ii) a right of action to the reporting issuer itself to seek an accounting for any benefit received as a result of such contravening trades.

Section 129 of the PMSA provides that any person who contravenes section 66 of the PMSA is liable for damages to a person who purchases or trades a security of the issuer referred to in that section, or enters into a transaction within the meaning of section 69 of the PMSA involving a related financial

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instrument, “during the period beginning at the time when the contravention occurred and ending at the time when the material change or material fact is disclosed.”

The amount of damages payable to the plaintiff, in accordance with proposed subsection 129(2), is the lesser of: a) “the ‘loss’ incurred by the plaintiff as a result of the contravention”; and b) “the amount equal to triple the profit made or the loss avoided by all persons a result of the contravention.”

However, subsection 129(2) is subject to a broad judicial discretion to consider “any other measure of damages that may be appropriate in the circumstances” that is provided under subsection 129(4).

The backgrounder to the PMSA indicates that proposed section 129 is based on section 136 of the British Columbia Securities Act. However, section 136 differs from section 129 in that it does not establish a judicial discretion to depart from the “amount of damages” payable to a plaintiff.

It is unclear whether it is the intention of the participating provinces that section 129 facilitate the prosecution of class proceedings against alleged insider traders (including “tippers or recommenders”). However, as there is no requirement for a direct nexus between the plaintiff and the defendant to a section 129 claim to the extent that the plaintiff must have either bought or sold the securities that were traded as a result of the alleged contravention, it may be inevitable that section 129 will have this result.

Assuming that, intentionally or unintentionally, section 129 will encourage the pursuit of class proceedings for insider trading, tipping and recommending, the lack of specificity regarding the basis for a damages claim raises uncertainties that will needlessly complicate, delay and increase the costs associated with such actions and potentially give rise to opportunistic proceedings. For example, where damages are to be measured in accordance with subsection 129(2)(b), would *each class member* be entitled to recover three times the profit or loss avoided as a result of the contravention or would this be the maximum amount available to the class as a whole?

Of greater concern is how is a plaintiffs’ “loss” is to be measured under section 129(2)(a). If this loss represents changes in share value that result from the improper trading activity itself, it will only be substantial in exceptional cases. However, if this “loss” is to be calculated as the difference between

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the market price at which a plaintiff actually purchased or sold securities and the price at which that the same securities would have traded if the material information or material change at issue had been generally disclosed, damages could be extremely significant, especially if the cause of action may be pursued on behalf of a class. Indeed, there would be no reason why damages would not be equivalent those that could be recovered under a Part XXIII.1 action, only without the liability limits. The wording of subsection 129(3) is consistent with the latter interpretation. Otherwise it should read "In determining the loss incurred by the plaintiff, the court must not include an amount that the defendant proves is attributable to a change in the market price of the securities that is unrelated to the *contravening transactions*" as opposed to being unrelated to "*the material change or material fact*".

Of even greater concern is the fact that the judicial discretion afforded under subsection 129(4) will make it difficult if not impossible for parties to reasonably quantify potential damages and reach negotiated solutions before trial.

If indeed section 129 is intended to facilitate class proceedings, the section contrasts sharply with secondary market liability provisions in existing Part XXIII.1 and in proposed Part 13 of the PMSA, which provide various protections to potential defendants including, amongst other things, a leave requirement, liability limits and a detailed formula for calculating damages. If section 129 has the potential to generate large damage awards in a class action context, there is good reason to be concerned about opportunistic proceedings that, without a leave requirement or any other preliminary merits test, may be easy for plaintiffs to certify and pursue irrespective of whether there is any merit to the allegations. The heightened exposure to civil liability for directors and officers will inevitably increase the cost of directors' and officers' liability insurance and heighten the challenges associated with attracting and retaining experienced and qualified directors and officers.

We urge the participating provinces to reconsider the expansion of the civil right of action for insider trading beyond its current form in the OSA. However, if the expanded right is to be maintained, careful consideration as to whether it can or should facilitate class actions and further delineation of both the basis for damages and the method for quantifying such damages is warranted.

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### **Takeover Bid and Issuer Bids**

We appreciate the rationale provided for the adoption of the "platform" approach. However, in certain cases, certain provisions and concepts contained in provincial securities legislation have been so well established, and are significant enough, that they should, in our view, be embodied in the legislation. For example, the current proposed provisions relating to take-over bids should in our view, at a minimum, contain the definition of take-over bid which references the thresholds and types of securities sought, and as well, certain well established exemptions, such as those for normal course issuer bids, should be retained.

### **Prospectus Requirements**

Consistent with the foregoing comment regarding the "platform" approach, we question the removal of the "2 day" cooling-off period from the prospectus requirements. This length of time has been a well-established matter of securities laws and we are not aware of a rationale as to why it would need to be removed from the legislation at this stage.

### **Transitional Issues**

We note that the draft legislation does not appear to address issues of transition of existing reporting issuers and registrants in the participating provinces to the jurisdiction of the Authority. As these entities will be joining a "new regime" which did not exist when they initially became reporting issuers and registrants (and reporting issuers for instance cannot easily relinquish that status) it would be of benefit to release for comment the proposed transitional provisions.

### **Regulation Making**

As the legislation adopts a "platform" approach, it would be beneficial to release for review and comment the sections of the PCMA which deal with regulation making authority, so these can be reviewed in the context of the legislation and the draft regulations.

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We thank the co-operative capital markets regulatory jurisdictions for this opportunity to provide our initial comments on the proposed draft initial legislation and look forward to having further opportunities to do so.

You may direct any further comments to our Mr. John Tuzyk ([john.tuzyk@blakes.com](mailto:john.tuzyk@blakes.com)).

Yours very truly,



Blake, Cassels & Graydon LLP