**DETAILED REPLY TO JEFFREY MACINTOSH**
**by**
**Philip Anisman**

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This is a brief reply to Professor MacIntosh's detailed rejoinder on the Financial Post website.

## Overlapping and Excessive Insider Trading Liabilities and Penalties

Professor MacIntosh's response on the scope of exposure under the market liability provision for insider trading in the PCMA continues to ignore the provisions of the statute. He says, for example, that "the damages owing to *any single plaintiff* could be in the millions." The PCMA says that the amount of damages payable to a plaintiff "is the *lesser* of" the plaintiff's loss as a result of the contravention and an amount equal to triple the profit made or loss avoided by an insider and all tippees. In Professor MacIntosh's example, this amount would be $300, even if the single plaintiff were a large block trader whose damages were computed in the manner Professor MacIntosh describes. He also refers to the discretion given to a court not to apply this cap on liability, suggesting that damages could be greater. If PCMA, s. 129, were interpreted as he suggests, a court would be likely to exercise this discretion to reach a fair result on the facts of a given case.

More importantly, Professor MacIntosh's response reflects a desire to defeat, rather than improve the draft legislation. PCMA, s. 129, appears to be derived from the secondary market liability provisions in current provincial legislation. With a maximum potential recovery of

$300, no individual plaintiff would bring an action. The provision clearly contemplates the possibility of class actions. As there are ambiguities in the provision, Professor MacIntosh could have suggested clarifying them or limiting the provision's scope. Alternatively, he could have suggested that the PCMA adopt the liability provisions for insider trading in provincial securities acts other than British Columbia's. He chose to do neither, but to use his interpretation as a basis for rejecting the entire proposals.

Professor MacIntosh went on to summarize other potential liabilities, not mentioned in his earlier columns, that an improperly trading insider might incur under the draft legislation. Six of the seven of these liabilities exist under current law. His position on following the Ontario *Securities Act* ("OSA") suggests that he does not think these provisions should be changed or that they provide a basis for "chucking" the proposed legislation

**Inexplicable Differences in the Drafting of the PCMA and CMSA Insider Trading Liabilities**

Professor MacIntosh's statement in his second article, to which he refers, was that there are "in material respects, differences in the substantive triggers for liability, defences, onuses of proof and penalties." His attempted justification demonstrates the accuracy of the distinction between regulatory offences and the criminal offence in the CMSA, which explains the differences that he said were inexplicable.

He then goes on to object to other provisions that are either not related to his criticism or, he says, do not explain them. He refers, for example, to sentencing guidelines that are in the CMSA, but not in the PCMA. This difference also flows from the distinction between regulatory

and criminal legislation. The sentencing guidelines in CMSA, s. 75, are based on those in the Criminal Code, s. 380.1.

Professor MacIntosh objects to subsection 67(2) of the CMSA, which says a court may infer from the fact that a person traded with knowledge of material undisclosed information that the person used that knowledge to trade. A person's use of information is a mental element, which is necessarily a matter of inference that may be based on an accused's knowledge of the information at the time of trading. Unless there are facts that negate it, this inference should be drawn. Identifying this in the CMSA leaves it open to, and may encourage, a court to draw the inference in appropriate circumstances, but does not compel it to. The provision quoted by Professor MacIntosh says a court "may" infer that a person used such knowledge, not that it must do so. This is not an "abandonment" of the requirement to prove use, or *mens rea*, which "might render the provision unconstitutional." Nor does it negate the differences between the PCMA and CMSA provisions, let alone "annihilate any argument" that they exist. Professor MacIntosh is incorrect in substance and in his hyperbole. He apparently has less faith in our courts than the drafters of the legislation.

What is particularly troublesome about Professor MacIntosh's response on this issue is his willingness to attribute improper motivation to the drafters of the legislation. He declares that the provision relating to the permissibility of an inference is an expansion of securities law that the proponents of the legislation "no doubt hope will slip through the cracks without notice." There is no basis for this conclusion. It does not go to the merits of the provision, or to the merits of Professor MacIntosh's argument. In the context of a debate about appropriate public policy, it is simply inappropriate.

**Expansion of the Regulator's Licensing Powers**

Professor MacIntosh attempts to clarify his earlier statement about registration by treating as equivalent to registration recognition of stock exchanges, clearing agencies, auditors oversight organizations and self-regulatory organizations and designation of trade repositories, credit rating organizations, investor compensation funds, dispute resolution services, information processors and marketplaces. Although the substantive regulatory provisions relating to recognized and designated entities differ from those applicable to registrants, there are some similarities between these processes in that the regulator is responsible to consider an application from and regulate the activities of all such organizations under the relevant legislation. But this would not include all market participants or "anyone connected with capital markets", for example, directors and officers of an issuer.

Moreover, the legislation permits entities to apply to the regulator for recognition. These organizations currently may apply for recognition or designation or are otherwise recognized under the OSA and other provincial acts. Recognition is compulsory only with respect to stock exchanges and clearing agencies, as now. Other such organizations may, however, practically have to apply in order to perform the functions for which they have been established, like a self-regulatory organization.

Professor MacIntosh claims that a recognized auditor oversight organization will be "another new type of entity". The BC *Securities Act* ("BCSA") contains a definition of "auditor oversight body" and permits the commission to recognize such an organization as a self-

regulatory organization. The New Brunswick and Saskatchewan acts are much the same, although in the latter, the term used is "auditor oversight organization," as in the PCMA. Moreover, such an entity exists; it is the Canadian Public Accountability Board (CPAB) which, in effect, has been recognized by all of the Canadian securities regulators in *National Instrument 52-108 – Auditor Oversight*, initially proposed in 2002 and adopted in 2004.

One addition correctly identified by Professor MacIntosh is the ability of the Authority to make a regulation adding entities that provide investors or market participants with an identified type of service to the list of entities that may apply for designation. While it may be preferable to make such additions through amendment to the legislation, this rulemaking authority does not provide a basis for the conclusion that the regulators may "happily skip through the looking glass into a Wonderland of largely unrestrained regulation." A regulation intended to address new types of market organizations will have to be published for comment and will have to pass muster with the Council of Ministers who will likely address any demonstrated excess when they consider approving or rejecting a proposed regulation.

Professor MacIntosh is correct that there is no appeal to the Tribunal from a designation made by the Authority under the CMSA. But this deficiency in the legislation can easily be corrected by acknowledging that decisions concerning recognition and designation of entities will likely be made on behalf of the Authority by the Chief Regulator and providing a right of appeal to the Tribunal. This can be done by amending the PCMA to give the Chief Regulator such decisionmaking authority, as suggested in my formal submission on the legislation.

Professor MacIntosh's position on the scope of regulation making authority is also a reasonable one, which should be addressed. But correcting these issues does not require that the complete proposal be rejected and that the cooperating jurisdictions start from scratch.

As for the CMSA, most of the matters that the Authority is authorized to address under it relate to organizations, practices and products that the Authority will already have jurisdiction over under the PCMA. The difference is that the federal act addresses these organizations, products and practices from a systemic perspective that goes beyond the authority of any individual province. This should not create the difficulties that Professor MacIntosh hypothesizes.

**Administrative Fines under the CMSA**

Professor MacIntosh denies suggesting in his first column that there was an obligation to hold a hearing to determine whether to hold a hearing. He summarizes the provisions of the CMSA concerning the initiation of proceedings to impose an administrative fine and then repeats that a notice of violation "may be sent out *without any hearing, or even advance notice*", thus suggesting again that there should be a hearing before issuing a notice intended to lead to a fine after a hearing, or in terms of the CMSA an "opportunity to make representations." He thus denies the comment, and goes on to admit its accuracy, while stating that he "never made any such assertion."

This is not to say that the administrative fine provisions of the CMSA do not require amendment. As Professor MacIntosh correctly says, an opportunity to make representations

appears to be less than the type of hearing that would be required if a proceeding to impose a fine had to be brought before the Tribunal. Yet he fails to make the obvious suggestion that the CMSA should be amended to require that the Chief Regulator bring any such proceedings before the Tribunal by issuing a notice, as recommended in my formal submission.

If this recommendation is adopted, there would be nothing wrong with requiring the Chief Regulator to state in the notice the proposed sanction. This might apply to any proceedings brought before the Tribunal. In addition, a notice of proceedings to seek an administrative fine should not be treated like a traffic ticket with the result that a respondent who fails to respond is automatically guilty and obligated to pay the proposed fine. While it may be reasonable to permit the Tribunal to accept the allegations in a notice of hearing in these circumstances, as is the case with Investment Industry Regulatory Organization of Canada (IIROC) and Mutual Fund Dealers Association (MFDA) proceedings, the Tribunal should have no more than a discretion to do this and should have to determine the sanction to be imposed. The common practice of self-regulatory hearing panels in such circumstances is to require proof of the allegations.

**Novelties: The "Unfair Practice" Provision**

To start from the original comment, a prohibition against unfair practices is not new. Both the BCSA and the Saskatchewan act prohibit such practices (BCSA, ss. 50(3)-(4); Sask. SA, s. 44.1).

Professor MacIntosh is correct to say that the words "unfair practice" are not contained in the OSA's rulemaking provisions. As he states, the OSA authorizes rules "regulating trading and or advising about securities or derivatives to prevent trading or advising that is fraudulent, manipulative, deceptive or unfairly detrimental to investors." Professor MacIntosh engages in verbal hairsplitting about a purported difference between prohibiting an unfair practice and prohibiting a practice that is unfairly detrimental to investors; he also argues that the OSC's authority is restricted to trading or advising, while under the PCMA the regulator's is not. On this basis he alleges the PCMA has no corresponding restrictions and could define "anything at all" as an unfair practice.

This is not correct. Regulating trading or advising that is unfairly detrimental to investors covers rules prohibiting unfair practices in connection with trading. The PCMA prohibits a person from engaging in an unfair practice "in relation to a trade." Any practice that the regulator prescribes under the PCMA must, therefore, be in relation to a trade. A practice prescribed by the regulator relating to a trade would have to be designed to protect investors or the integrity of the securities or derivatives market. Section 70 of the PMCA does not significantly alter the rulemaking power that the OSC now has.

While Professor MacIntosh's position concerning the BCSA is arguable and may be correct, PCMA, s. 70 would prohibit a person from engaging, in relation to a trade, in an unfair practice, "including" putting unreasonable pressure on another person, entering into a transaction with a person who is unable to protect his or her own interest and engaging in any other practice prescribed by regulation. This specification of unfair practices is not exhaustive. The Commission or a court may find conduct that is not specified in the section to be an unfair

practice, and any conduct so found would be in violation of the PCMA. In the circumstances, if there are additional practices that the regulator considers "unfair," it would be desirable for it to address them by means of a regulation, which would require disclosure of and an opportunity to comment on a proposed regulation before proceedings are initiated against a person. Otherwise, the regulator would be limited to administrative and judicial prosecution for such practices or to a policy statement indicating how it interprets "unfair practice" and its intention to bring such proceedings when it occurs. Permitting rulemaking provides a greater opportunity to comment before a proceeding is brought and subjects the proposed regulation to review by the Council of Ministers.

In any event, PMCA, s. 70 authorizes rulemaking, following the example of the OSA. Professor MacIntosh's position is thus inconsistent with his advocacy of the OSA and arguably counterproductive in light of the advantages of the rulemaking process in this context.

**Novelties: The "Unjust Deprivation" Provision**

Professor MacIntosh appears not to understand the response to his criticism of prohibiting conduct that "results in an unjust deprivation or a risk of an unjust deprivation" of a person's money, property or property value because, he says, the words are either redundant or invoke civil law concepts like unjust enrichment and the corporate law oppression remedy. The quoted words, however, are derived from a line of case law interpreting the meaning of fraud under the Criminal Code. Briefly, the Supreme Court of Canada held over thirty-five years ago that two essential elements of fraud are dishonesty and deprivation and that the latter, deprivation, is

"satisfied on proof of detriment, prejudice or risk of prejudice", without there having to be an actual loss; see *R. v. Olan*, [1978] 2 SCR 1175.

As Professor MacIntosh acknowledges, the prohibition of conduct that a person knows or reasonably ought to know perpetrates a fraud on any other person, as interpreted by courts and commissions, requires subjective knowledge. The addition of the clause to which he objects would add to the prohibition conduct that results in an unjust deprivation or a risk of unjust deprivation, thus including in objective terms the essential elements of fraud. This addition appears to have been added to create a regulatory offence that does not require proof of knowledge or intention, thus furthering the regulator's ability to address fraudulent conduct. The result would be that in a proceeding for a violation of this provision, the regulator would have to prove that the conduct was unjust and that it deprived another or created a risk of depriving another of money, property or value, and an accused or respondent would bear the onus of demonstrating some form of due diligence or reasonable belief that it did not. To repeat, this is an incremental change that will assist the regulator in addressing conduct that is essentially fraudulent. It does not provide a basis for "chucking" the proposed legislation.

**Novelties: Changes in Wording**

Professor MacIntosh continues to play with words. He admits that there may be no difference between a commission's authority to make an order "if in its opinion" or "if it considers that" it is in the public interest, but goes on to argue that different wording invariably raises difficulties, unless there is case law showing otherwise. He does not, himself, suggest any

different meaning that a court might adopt. This is a formalistic argument, which given his admission, is less than persuasive.

The same is the case with respect to the purported difference between an "untrue statement" and a "false or misleading statement". While the same conceptual statute-interpretation arguments may be made about this change in wording from the OSA, they carry little weight unless a difference in meaning can be discerned. Without such an explanation, characterizing these differences as "wildcards" remains an overstatement.

Professor MacIntosh takes a similar approach to the use of "trade", rather than "sale", in the prohibition against insider trading because a trade, as defined in the legislation, includes an act in furtherance of a sale. In the context of insider trading, the obvious acts in furtherance of a sale would be tipping or encouraging or recommending a person to trade, which are specifically prohibited under the PCMA. It is difficult to conceive of any additional conduct that would directly result in a person "trading." Professor MacIntosh suggests that deliberately creating a situation that gives other persons "easy access to inside information" would be an act in furtherance of trading in violation of the law. This is a stretch. The jurisprudence interpreting the extended meaning of "trade" in securities laws would not go this far. (In addition, it is likely that deliberately creating a situation that gives a person access to information would be tipping.)

The point that Professor MacIntosh refuses to recognize is that the use of "trade" does not create any practical potential for an unforeseen extension of the prohibition against insider trading to persons who do not have a direct connection with the insider who provides the information or encouragement. Even if one disagrees, it is an overstatement to suggest that it

involves a "significant broadening of insider trading liability … that is fraught with uncertainty" and that provides a reason to reject, rather than fix, the proposed legislation.

**The Collection and Dissemination of Confidential and Privileged Information**

Both the PCMA and CMSA provide that all information obtained by the Authority under it is confidential, unless the information is publicly available (PCMA, s. 193(1); CMSA, s. 13(1)).

The PCMA does not refer to privileged information in the provisions authorizing the Chief Regulator or the Authority to require disclosure of information. As Canadian courts are very protective of solicitor-client privilege, there is no serious potential that these provisions of the PCMA will be interpreted or applied to require anyone to disclose information that is privileged. This conclusion is reinforced by the provisions to which Professor MacIntosh refers in his website response.

The confidential information obtained by the Authority under the provisions of both the PCMA and CMSA is thus not likely to include information that is privileged. Even if it did, section 195 of the PCMA prohibits the Authority and any person to whom the Chief Regulator or the Authority may disclose information from passing on information that is privileged, as Professor MacIntosh acknowledges.

(Section 195 appears to be missing a word; the prohibition appears to have been meant to apply to information *obtained* pursuant to the specified investigation and disclosure provisions.

In addition, this section requires further attention. It should, for example, also apply to information obtained on an investigation under Part 11 of the PCMA.)

Professor MacIntosh objects to disclosure by the regulator of information obtained in an investigation to other regulatory bodies, but fails to address the increasing globalization of securities markets, the frequent need for cooperation with regulators in and outside Canada or the fact that such cooperation exists now. While acknowledging that the PCMA precludes disclosure of privileged information, he does not mention that it limits disclosure of compelled testimony, without providing the witness an opportunity to make representations (s. 196). This limitation may diverge from Ontario's current provisions, but it is stricter than those in other provinces.

(Nevertheless, these disclosure provisions require tightening. PCMA, s. 196, would allow the Chief Regulator to disclose compelled testimony without a hearing, if the Tribunal authorizes the disclosure on an *ex parte* application. An application without notice to the witness who testified should not be permitted. A witness should have an opportunity to address release of the witness's compelled testimony in a hearing before the Tribunal.

In addition, Professor MacIntosh correctly argues that the discretion given the Authority and the Chief Regulator to disclose confidential information is too broad. If the discretion to disclose such information under PCMA, ss. 193(2)(d) and 193(3)(c) is necessary, such disclosure should require notice to the person who provided the information and an opportunity to be heard before the Tribunal.)

The privilege for information relating to settlement discussions, that is, settlement privilege, encompasses mediation privilege, as a mediation relates to a settlement. It does not relate to the "dispute resolution service" referred to in section 17 of the PCMA, which deals with designated entities. These entities would include an organization like the Ombudsman for Banking Services and Investments (OBSI), which effectively has been recognized under *National Instrument 31-103 – Registration Requirements, Exemptions and Ongoing Registrant Obligations*, s. 13.16, and which cannot itself compel disclosure of privileged information.

That being said, there should be no objection to the addition of a provision to the PCMA and CMSA that expressly protects privileged information and, possibly, also permits limited waivers of privilege. Of course, Professor MacIntosh does not recommend this.

**Economies of Scale not Important?**

Professor MacIntosh turns a statement about efficiencies from employee layoffs into an assertion about overcoming duplication and misallocation of regulatory resources. The comment in Professor MacIntosh's third column denied that there would be efficiencies from a reduction in the number of employees because there would not be many. This is different than regulatory efficiencies that are likely to result from the coordination of regulatory efforts and policy development that is likely to occur with a single cooperative regulator. Reduction of duplication of these efforts and employee time relating to them and a reduction in the time required to adopt regulatory instruments are likelier with a cooperative regulator than without one.

**Local Development Initiatives and the Fracturing of Uniformity**

Professor MacIntosh conflates governmental economic development initiatives that are limited to a single province with companies carrying on business in multiple jurisdictions. The purpose of permitting local development initiatives is to permit a province to create local incentive programs within its own boundaries. Companies participating in such incentive programs would not be entitled to different standards if they seek to raise capital outside of the province that creates the program. Accommodation of such initiatives would not implicate general rules and would not jeopardize the uniform regulation that is the goal of the proposed regulatory regime.

## Missing Sections and Missing Regulations

Admittedly, it would have been desirable to publish the complete proposed legislation and regulations at the same time. But the failure to do so does not provide a basis for rejecting the proposals before they can be evaluated in their entirety. Whether or not the governments involved should be criticized for publishing the proposed acts without the implementation and enabling legislation or the regulations, rather than releasing a substantial part of their work early to facilitate comment, is beside the point. Professor MacIntosh unfairly advocates rejection before he has had an opportunity to review the complete package.

## Accountability

Professor MacIntosh admits that there is minimal accountability through ministers in the current system. He then engages in hypotheticals and speculation about the manner in which the

Council of Ministers will review regulations acting as a body, rather than individually, suggesting that they might disregard their peers in non-participating provinces. These comments do not require a response.

## Other Expansions of Regulatory Authority

Professor MacIntosh is correct that section 95 of the PCMA authorizes the Authority, rather than the Chief Regulator, to make both class and individual orders, and that, as a result, there would be no appeal to the Tribunal. In his desire to reject the proposals, he fails to consider the manner in which this provision can be modified to address the legitimate concerns that he raises.

As recommended in my formal submission, the provision should be amended to preclude blanket orders by deleting the authority to make class orders. It should also authorize the Chief Regulator, rather than the Authority, to make individual orders in specific cases, after a hearing, which orders would then be appealable to the Tribunal. Again, even though his criticism in this instance is valid, it does not justify Professor MacIntosh's conclusion.

## Usurpation of the Role of the Civil Courts

Professor MacIntosh persists in his inaccuracy by conflating the Tribunal's authority to make an order in the public interest with its authority to compensate a person for harm incurred as a result of a violation of capital markets law. As he correctly states, a decision of the Tribunal is included in the definition of capital markets law with respect to a person who is subject to the

decision. But the Tribunal would not be authorized to make a public interest decision and in the same proceeding order compensation based on prior conduct that was contrary to the decision just made. To do so would involve unauthorized retroactivity. Rather, the Tribunal could only order compensation if a person fails to comply with an order made by the Tribunal previously, that is, an order to which the person was subject at the time of the conduct in question, and the failure causes harm to another person.

An example may be helpful. The Tribunal may make an order in the public interest imposing conditions on a registrant's conduct of business. The order imposing conditions would become capital markets law with respect to the registrant. If the registrant subsequently fails to comply with the condition in a manner that causes another person harm, the Tribunal would have authority under section 90 of the PCMA to order the registrant to compensate that person. While there is no express statement in the PCMA requiring a "previous order" of the Tribunal, a previous order would have to have been violated before the Tribunal could order compensation based on it.

**Changes and Precedents**

Professor MacIntosh refers to his asserted "extraordinarily long menu of fundamental changes to securities laws", but seeks to avoid the fact that the examples that currently exist in at least one participating province were his own examples. He argues that the cooperative scheme should follow the OSA and not accept provisions that exist in only one other province. As stated in my previous comment, this ignores the cooperative process reflected in the draft PCMA.

Professor MacIntosh seems to oppose cooperation that would involve a divergence from the OSA, when he disagrees with the substance of a change. While this may provide a reason for him to object to the change, it is not a basis for rejecting all of the proposed legislation. His recommendation reflects the position he started from, namely, that there should not be a national regulator.

He also seems to suggest that it is inappropriate to address the unfairness, lack of moderation and inaccuracies in his comments, rather than attempting to correct provisions in the legislation with respect to the criticisms made by him that happen to be valid. One can, of course, do both.

## A "Last-Ditch Attempt to Scuttle the Proposed Cooperative National Securities Regulator"?

Professor MacIntosh denies any intention to scuttle the proposed cooperative regulator. He now says the statement in his fourth column that the proposal "should be completely scrapped" meant only that the proposed legislation "should be chucked in the dustbin in favour of a fresh start" based on the current Ontario act. This is at best disingenuous. He must know that using the Ontario act as he wishes would likely destroy the cooperation shown to date and that withdrawing the proposed legislation would strain existing political support. Thus, while he denies the goal in the heading of his most recent column, his recommendation would terminate the initiative for a cooperative regulator. The proposed legislation can be improved in many respects, but Professor MacIntosh has chosen not to address this question. There is no reason to give any credence to his recommendation.

*Philip Anisman practises securities law in Toronto. He was the principal author of the 1979* Proposals for a Securities Market Law for Canada *and was a legal adviser to the Canadian Securities Transition Office.*