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via email and courier

Five Year Review Committee
c/o Purdy Crawford, Chair
Osler, Hoskin & Harcourt LLP
Barristers & Solicitors
Box 50, First Canadian Place
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Dear Sirs/Mesdames:

We wish to recognize the Committee for its dedication, hard work and perseverance in completing its Draft Report. We support most of the recommendations contained in the Draft Report. However, we have concerns about certain of the proposals put forward by the Committee. We are pleased to have the opportunity to provide you with our comments which reflect those concerns. Our comments focus on three areas:

1) constitutional issues regarding delegation of authority,
2) self-regulation, and
3) enforcement

1. Constitutional Issues Affecting Delegation of Authority

Chapter 1 – The Need for a Single Regulator
Recommendation 1:

The Draft Report calls for a single national securities regulator, but makes no recommendation about how a single Canadian securities regulator should be constituted. It suggests a national regulator or a supra-provincial body to which the provinces and territories delegate their authority.

While these issues have undoubtedly been canvassed in detail by the Committee, the establishment of a supra-provincial body may be preferred because of the numerous judicial precedents in its favour. The creation of a national regulator, while appealing on a number of grounds, is problematic because of the likely challenges that would be made to its authority to regulate property and civil rights in the provinces, matters which fall under section 92 of the Constitution Act, 1867. These challenges will create

uncertainty and indeed have an excellent prospect of being successful, because of the limits on federal constitutional power in this regard.

On the other hand, a supra-provincial body to which the provinces and territories delegate their authority, rests on solid constitutional ground, with many Supreme Court of Canada and other judicial pronouncements and scholarly writing supporting such inter-delegation going back more than fifty years. As examples, much of Canada's agricultural commodity marketing board legislation is based on this model in which the provinces delegate their authority over property and civil rights in the province to an agency that also receives federal delegated authority over inter-provincial trade and commerce, as well as imports and exports.

There may also be a concern if the proposed body receives power only from the provinces and territories, as suggested. The new body should have delegated authority from Parliament as well. Otherwise, there is a risk that the new body will lack certain necessary powers because it has not received authority over inter-provincial trade and commerce which only Parliament may confer. In addition, the new body should be able to regulate all activities of non-Canadian entities in Canada, and to enter into fully enforceable agreements with foreign regulators and entities which it may not be able to do without delegation to it by Canada. Without federally delegated authority these objectives may not be achievable.

Authority conferred by the federal, provincial and territorial governments would best secure the regulations of intra-provincial, inter-provincial and international trade in securities. On the policy side, it would show federalism at work.

Recommendation 2:

In the interim, the Draft Report calls for harmonization, together with legislation in two additional areas: delegation and mutual recognition.

In our view, it would not be advisable for the various regulators to seek to "be empowered to delegate authority to a securities regulator in another Canadian jurisdiction - moving from our current system of voluntary mutual reliance to a system of true reliance."

While delegation is obviously desirable, there are at least two methods by which it may be achieved. In the first, the legislature itself delegates its authority to a regulator in another jurisdiction. The second method, proposed by the Draft Report, and possibly objectionable on constitutional grounds if not policy grounds, involves the legislature delegating to the regulator the authority to sub-delegate authority to a regulator in another jurisdiction.

As noted above, there is ample legal precedent upholding inter-delegation by one legislature to a body created by another. We would be concerned that an attempt to

authorize such a sub-delegation would offend the "delegatus non potest delegare" doctrine (a delegate may not further delegate). Even if sub-delegation is constitutionally permissible, it removes an important law-making function from the legislatures and therefore may not be sound.

2. Self-Regulation

(a) Chapter 9.6 – Enforcing Their Own Rules

We believe that SRO's should be given the authority to conduct investigations and obtain evidence from non-members, provided that this authority is made subject to the Commission's review.

(b) Chapter 9.7 – Enforcing Compliance With Securities Laws

We agree in principle with the recommendation that SRO's be required to report to the Commission any breaches or possible breaches of securities laws. We are concerned, however, how this reporting obligation will be administered and whether the Commission will find this volume of information useful.

IDA Policy 8 was passed to compel full reporting of all complaints to the IDA. We respectfully question whether the IDA can be expected to deal effectively with the burden of significantly more information without additional resources. Care will have to be taken by the Commission in the organization and cataloguing of this information in a meaningful way, otherwise the system will be very difficult to manage. Perhaps the Commission could monitor the application of Policy 8 at the IDA before deciding how or to what extent it should implement this recommendation.

3. Enforcement

(a) Chapter 19.1 – Administrative Fine

This part deals with an "administrative fine" as one of the options available to the Commission in imposing penalties. Sub-sections (c) and (d) deal with two important aspects of the issue and highlight what we believe is a short-coming in the proposal. In 19.1(c), in the last sentence, the Draft Report urges the Commission to set out the factors it considers in the imposition of a fine, and make clear in the reasons in each case where the imposition of a fine is an issue the reasons for the decision. It would be of more assistance to the Commission and those counsel advising clients about sanctions, including fines, to have the principles set out in the Act, or at least in the Regulations. For example, sections 718, 718.1, 718.2, and 718.3 of the Criminal Code deal with principles of sentencing setting out factors that the Courts must consider in crafting an appropriate penalty. How those principles are applied in each case is left to the Courts. That may well have an impact on the scope for challenge of the power, and for the scope of appellate review. There is a concern whether the Commission has the

power to determine what factors should be considered in imposing an administrative fine, absent some specific authority in its enabling legislation.

The phrase "and it is in the public interest to impose such a fine" found in 19.1(d) begs the question whether a fine is a first resort or a last resort. Absent any specific wording, it is unclear where a corporate person has breached the statute, whether the fine applies to the corporation, or to officers and directors as well.

(b) Chapter 19.3 – Application of Money Paid as Administrative Fine or Disgorged Profits
Recommendation 1:

We respectfully submit that it is important that the fine and disgorgement of profits be limited to those situations where there has been a direct contravention of Ontario securities law. The current section 127 is broad and discretionary. There is a concern that the Commission has used this provision in the past to penalize conduct for which there has been no direct prohibition in either the Rules, Regulations or the Act. In other words, the Commission has used section 127 to set a precedent to establish conduct that is contrary to the public interest. While the precedent is of use for the industry in general on a go forward basis, the individuals who are found to have been in contravention have had no direct notice that their conduct was contrary to the public interest.

To extend an administrative fine and a requirement to disgorge profits as well to such a breach could be seen as overreaching. Such a penalty ought not to be imposed without prior warning, as this would offend the rules of natural justice.

In this regard, we suggest that the recommendation should be tailored to ensure that a breach of the other provisions of section 127 will not be deemed to be a breach of "Ontario securities law" within the meaning of this section. In other words, the Commission should not be able to use section 127 circularly, finding conduct which it deems to be contrary to the public interest and therefore, since such conduct breaches subsection 127(1), impose a penalty under the proposed new recommended subsection.

Recommendation 2:

This recommendation is of more concern, particularly the proposal that the administrative fine or disgorgement of profit may be used to or for the benefit of third parties. It will allow third parties to use the Commission to pursue recovery as opposed to litigation.

Using the proceeds of a fine to benefit third parties raises issues that are different than those that would arise where the Commission orders a disgorgement of profits. If a fine is in the nature of a penalty, and the proceeds are to be used to benefit third parties,

that is a significant departure from established practice. To the extent that the imposition of a fine is done in furtherance of the Commission's public interest objectives, allowing any private interests to benefit directly seems to be a contradictory proposition, and may well leave the Commission vulnerable to a successful challenge of the administrative fine power. One difficulty with using either an administrative fine or a disgorgement of profits order to benefit third parties that is common to either situation is that there is no mechanism for the third party to establish entitlement to any of the monies generated by either process. For example, if there were 10 victims, each with different values of claims, and the money available was not sufficient to satisfy the claims in full, the claimants would have an interest in attacking the claims of the other 9. Even if the available fund was sufficient to satisfy all the claims, the Commission would still have a responsibility to ensure that each claim was a bona fide one. In going through that exercise, some determination, at the very least, would have to be made as to the scope of the claim encompassed in determining the eligibility for a distribution. In addition, some of the eligible claimants may have other claims as well. The Commission would have to determine whether or not those claims would still be available. Using these mechanisms also seems to imply that all the potential claimants would agree to participate in sharing, which may not always be the case. There would also have to be some mechanism to encompass a situation where there was a legitimate right of set off between the entity subject to the fine or disgorgement order and one or more claimants. All of these issues may well be beyond the scope of the Commission's mandate. It may be that the Commission could be given the power to hold the proceeds of a fine or disgorgement order until all the potential claimants have agreed on the scope of the distribution or the potential claimants have had their entitlement determined either in a separate administrative proceeding or in the Courts.

One can understand the use of the money obtained in the settlement to be directed to third parties, since the settlement is an agreement between the parties. As such, the parties can agree that some of the money can be allocated to the benefit of third persons. However, in the absence of such a consensual decision, there are serious concerns raised, particularly as the sums involved are likely to be significant. We respectfully submit that the rules of evidence are significantly more lax at a Commission hearing than in Court. Hearsay evidence is allowed, and the requirements of proof are not as stringent.

There are also limited rights of disclosure. While we will comment further on this aspect in dealing with section 17 of the Act, an argument can be made that the parties who are subject to the hearing do not have the full opportunity to explore the allegations raised by the individual investors. As such, there is serious curtailment to fully defend the allegations.

Furthermore, allowing the disgorgement to third parties of these significant sums of money will effectively result in combining two proceedings into one. The individual facing the charges will not only be defending the allegations raised in the Notice of Hearing, but will also be forced to attempt to establish the personal interests which the

individual investors will have in a successful outcome of the hearing. This would sidetrack the purpose of the hearing. The Commission will have to address the claims of the investors or suggestions that their testimony is skewed by the potential for personal recovery. Furthermore, the individual investors may also seek to have their counsel present to protect their interests.

Finally, the Commission and the Courts would have to address the issue of the implied undertaking Rule. The recent decision of the Superior Court of Justice in A Co. v. Naster has refused to allow evidence produced at a Commission hearing to be used in a civil proceeding. The Court stated that: "…the law of Ontario hat "use of information obtained through the discovery process in an action for any purpose collateral or ulterior to the resolution of the issues in that action, **without leave of the court** (*emphasis added)*, is a contempt of the court"…

The implied undertaking rule is a principle of law recognized in Ontario. As such, it applies as well to proceedings before administrative tribunals as to the courts." However, creating the nexus between personal recovery and a Commission decision could result in the revisiting of this decision.

(c) Chapter 19.4 – Breach of Undertaking
Recommendation 1:

This recommendation is laudable, particularly as undertakings are entered into voluntarily. However, the recommendation should be extended to include the defence of reasonable diligence currently found in subsection 122(2) of the Act. This would avoid a conviction, with a fine and possible imprisonment, on the strict liability basis when the undertaking may not have been complied with or provided to the Commission due to an administrative error.

(d) Chapter 19.6 – Complaint-Handling and Dispute Resolution
Recommendations 1 and 2:

These are valid objectives. Our only concern is with respect to the compiling and reporting of statistics. In particular, consideration should be given to whether these statistics are kept on an individual basis, or are simply general statistics with respect to how many complaints were received and their ultimate resolution.

In the event that statistics are kept with respect to each industry service provider and are available to the public, then we are concerned that these statistics could be used to the detriment of those parties. The mere fact that a complaint has been made against a service provider will tend to raise concerns, even though the majority of the complaints may be without merit, withdrawn or disposed of without any culpability being attributed to such party.

This concern may be addressed by a recommendation that these statistics are not admissible either in court or at a hearing. In this respect, these statistics might be available to the general public if it is deemed necessary to ensure the transparency of the system. However, you would avoid the potential misuse of the statistics in situations where fines or imprisonment may arise.

(e) Chapter 20.2
Recommendation 1:

The concern raised above with respect to 19.3, Recommendation 1, applies equally to this recommendation. In particular, the Act should specify that a breach of this new recommendation would not be considered a breach which could have resulted in a $1,000,000.00 fine or disgorgement of profits.

We believe it may be viewed as overreaching for a breach of a policy or rule of a SRO or exchange to result in such a significant penalty. Such a penalty should be restricted to breaches of the Act or Regulations made thereunder, or a directed decision which applies as against that specific individual. The first two are laws which come from the Legislature directly, and as such the breach of same should attract these significant penalties. A breach of a direct decision is also tantamount to a contempt of the decision, which should attract penalties.

However, the same considerations do not apply with respect to a breach of a policy or rule, particularly one which is made by a SRO or exchange. Again, this can be ameliorated by simply excluding this new section from the penalties.

(f) Chapter 21.1
Recommendation 1:

We are unclear as to the significance of 5 years “less one day”. A sentence of 5 years means that the accused would be imprisoned in a federal penitentiary. Any sentence in excess of 2 years results in penitentiary time. It is for this reason that the current phrase of 2 years less one day is in the Act.

More importantly, increasing the sentence to 5 years presumably means that the offence is now an indictable offence. This should be specified in the recommendation as that allows for a variety of criminal procedures which will benefit the accused. As just one example, there is a right to a preliminary hearing, as well as a right to trial by a judge and a jury.

Furthermore, consideration should be given to amending subsection 127(8) and similar sections which would require the Superior Court of Justice, as opposed to the Ontario Court of Justice, to hear such a proceeding.

We are concerned, from a constitutional law standpoint, about having an indictable offence added to a provincial statute. However, assuming, for purposes of this particular recommendation, that such an indictable offence can be placed into a provincial statute, one would normally have the option of proceeding summarily (i.e., less than 2 years) or by way of indictment (seeking a sentence of up to 5 years). The Commission would have the election of proceeding under either option, which would necessarily entail which Court and which procedural defences are available to the accused.

(g) Section 21.2
Recommendation 1:

A similar issue is raised for this recommendation with respect to which Court (Ontario or Superior) is appropriate. Furthermore, allowing the Court to order that the defendant compensate or make restitution to persons who have suffered a loss raises issues.

As outlined earlier, such an approach would have the effect of combining two proceedings into one. The accused would not only be seeking to avoid jail time on a quasi-criminal conviction, but would also be forced to battle a civil proceeding within that proceeding to limit the compensation or restitution.

This proposal gives rise to a number of procedural concerns, including the normal discovery rights which the defendant would usually have in a civil proceeding. In a quasi-criminal proceeding, no such discovery rights are available. In a quasi-criminal proceeding, the accusers are only witnesses. They are not obliged to disclose all relevant documents, nor can they be forced to attend for pre-trial examinations for discovery. It is assumed that the primary issue in this regard would be the quantum of compensation, since the issue only arises once there has been a finding of guilt. However, the issue of causal connection between the infraction and the alleged damages will have to be fully explored.

We respectfully submit that an order for compensation or restitution is best left for a subsequent civil proceeding. The only manner in which such an order could arise in a criminal proceeding would be to have a bifurcation of the criminal proceeding. The first part would deal with the specific charges and whether the accused is guilty. If there is a finding of guilt, then there could be a secondary hearing with respect to the restitution. Prior to this second hearing, the accused should be provided with full discovery rights with respect to any individual who seeks restitution or compensation through this quasi-criminal proceeding.

(h) Section 22.1
Recommendation 1:

While we understand the rationale behind the confidentiality provisions in section 16, we suggest that changes be made to section 17.

While it is understood that the Commission and staff require confidentiality in their investigatory process, such requirements are no longer necessary once a decision is made to issue a Notice of Hearing. When the Notice of Hearing has been issued, the Commission ought to be required to produce all relevant information to the accused. This would include not only the witness statements upon which the Commission is going to rely, but all notes or earlier drafts of those statements, as well as notes and statements of all witnesses interviewed by the Commission, even if the Commission is not going to call or rely upon such information.

The Court of Appeal recently made some comments in this regard in the Marchment & Mackay v. Ontario Securities Commission and Deloitte & Touche LLP v. Ontario Securities Commission decisions. In Deloitte & Touche, the Court stated that:

"Relevant material in the Stinchcombe, supra, sense includes material in the prossession or control of Staff and intended for use by Staff in making its case against the Philip respondents. Relevant material also includes material in Staff's possession which has a reasonable possibility of being relevant to the ability of the Philip respondents to make full answer and defence to the Staff allegations. This latter category includes material that the Philip respondents could use to rebut the case presented by Staff; material they could use to advance a defence; and material that may assist them in making tactical decisions....

In deciding whether material in its possession could reasonably be relevant to the Philip respondents, Staff was obliged to take a generous view of relevance. Staff was not privy to defence strategies or tactics, or to material in the possession of the Philip respondents, which could alter the significance of documents in Staff's possession.

As Cory J. said in Dixon, supra, at p. 258:

"The right to disclosure of all relevant material has a broad scope and includes material which may have only marginal value to the ultimate issues at trial".

We respectfully suggest that section 17 be amended to delete the discretion for disclosure, and require disclosure when a Notice of Hearing has been commenced, or charges have been laid pursuant to sections 122 or 128.

(i) Section 22.2
Recommendation 2:

This recommendation is appropriate. We would simply suggest that the recommendation be expanded to include the omission of material facts which a person knows or ought reasonably to know would be relied upon by an investor in making a decision.

We extend our compliments to the Committee for a comprehensive and truly relevant Draft Report. As participants in the securities industry we welcome the opportunity to discuss this submission at your convenience. The comments set forth in this letter reflect the views of the individuals involved in the preparation of this submission, namely Henry S. Brown and Martin Mason (constitutional law), Michael Harpur, Charles Beall, Ellen Bessner, Duncan Boswell and Benjamin Na (advocacy), John S. Grant Jr., Constance Sugiyama and Guy David (corporate/securities), and not necessarily the views of the firm.

Please direct your enquiries to the undersigned as the contact person on this matter.

Yours very truly,
GOWLING LAFLEUR HENDERSON LLP

John S. Grant Jr.

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