

Enron, Fear and Loathing on Bay Street

**The 9th Queen's Annual Business Law Symposium
November 8-9, 2002**

**JOSEPH GROIA
KELLIE SEAMAN**

**GROIA & COMPANY
LAWYERS
THE STERLING TOWER
372 BAY STREET
TORONTO, ONTARIO
M5H 2W9**

**TELEPHONE: (416) 203-2115
FAX: (416) 203-9231**

“Power (*n*): The only narcotic regulated by the SEC instead of the FDA.”

Anonymous

The comment, made nearly a decade ago, that “it is not at all clear that the current popular interest in corporate governance is in fact more than a passing fad”¹ provides as good a starting point as any for addressing the current renewed interest in enhancing corporate accountability. On the one hand such a remark betrays the innocence of the pre-Bre-X, pre-Enron era; on the other it accentuates the fact that the current concerns are, if anything, an old recycled debate. That is not to say, however, that nothing has changed in the interim. A multitude of committees and task forces have spent the better part of a decade identifying a variety of possible villains and trying to protect their chosen victims from objectionable corporate conduct, punishing those who offend. In the process, the role of every imaginable government, regulator and market participant has been assessed. These have included Parliament in the discharge of the legislative function in both the corporate and securities fields, regulators in their policy and enforcement capacities, directors in their position as fiduciaries, lawyers, accountants and other professionals as gatekeepers, and even shareholders themselves for their considerable power to influence the markets.

That each of these forces plays an integral role in encouraging corporate accountability goes without saying. The hard part has always been drawing and defining the boundaries. To this end, there has been a shift in the demands for corporate accountability from a consideration of the integrity of market participants to a

¹ Jeffrey G. MacIntosh, “Corporate Governance in Canada: A Broad-Brush Assessment,” in *Securities Regulation: Issues and Perspectives – Papers Presented at the Queen’s Annual Business Law Symposium 1994* (Toronto: Carswell, 1995) at 321.

consideration of the integrity of the market itself. By questioning the honesty of the market, the role of the regulator becomes suspect; and the need to ascertain the proper parameters of that role becomes paramount. In Ontario this role is, of course, primarily played by the Ontario Securities Commission (OSC) and thus the proper scope of their duties, responsibilities and liabilities will be the focus of this little and, we hope, respectful paper.

Take a Seat, and Fasten Your Seatbelts.

Brown and Holmes once described the issue of regulating financial institutions as an empty seat at the boardroom table.² In the context of corporate governance, we begin by suggesting that if there ever was an empty seat at the boardroom table the OSC would like to be sitting in it. This is due, in large part, to the dominating and somewhat daunting position of the OSC in Canada's securities market. There is no doubt that this position renders the OSC a formidable force in effecting change in the corporate community through its policy/rulemaking functions and under its enforcement arm. The Commission's activities have long been directed towards encouraging better corporate governance as they see it – and as they punish corporate misconduct. There is, however, another side to this control. With great power comes great responsibility. Some commentators have now begun to critically reassess many of the actions currently being undertaken by the Commission. They ask, as do we, whether these new initiatives are punitive in effect and as such are not entirely appropriate given the OSC's role. As a regulatory body and a creature of statute, the Commission is subject to the confines of its legislation. These objects are prescribed by legal restraints under administrative law and

² David A. Brown, Q.C. and Janet A. Holmes, "The Regulation of Financial Institutions: The Empty Seat at the Boardroom Table," in *Securities Regulation: Issues and Perspectives – Papers presented at the Queen's Annual Business Law Symposium 1994* (Toronto: Carswell, 1995) at 341.

under the Ontario Securities Act (OSA). Although an in-depth analysis of the limits on the jurisdiction of the OSC is beyond the scope of this paper a quick glance should suffice for our purposes.

Defining the Role of the OSC in Corporate Governance.

When the statutory interpretations and judicial decisions are reduced to their simplest, what remains is that the OSC is a regulatory body, subject to the limits of administrative law (designed to keep such bodies in check) and the Act which has as its goals the protection of ‘investors from unfair, improper or fraudulent practices’ and the fostering of ‘fair and efficient capital markets and confidence in capital markets’.³ In respect of regulatory bodies in general, the Supreme Court of Canada has held that the focus of regulatory law should be the protection of societal interests, not the punishment of an individual’s moral fault.⁴ This leaves the punishment of moral fault, be it that of an individual or a corporation, to be meted out by the courts. The significance of this distinction cannot be stressed enough, especially given the variety of tools available to the Commission. In exercising their quasi-criminal enforcement powers in the civil courts, or the Provincial Courts, the OSC need not be concerned with the distinction between remedial and punitive power because the adjudication of those matters lie with the Courts. At the other end of the spectrum, the OSC has often explained its adjudicative role under the public interest provisions as purely protective insisting that they “are not here to punish past conduct; that is the role of the courts.”⁵

³ *Securities Act* (Ontario), s. 1.1.

⁴ *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154.

⁵ *Re Mithras Management Ltd.*, (1990), 13 O.S.C.B. 1600; *Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132.

Despite such clear expressions of restraint on the respective roles of the OSC, the goals as set out in the OSA provide ample opportunity for encroachment, for blurring, and if we are not careful, for dysfunction. According to the Act, the purposes of the Commission are twofold: to provide protection to investors from unfair, improper or fraudulent practices, and to foster fair and efficient capital markets and confidence in capital markets.⁶ This begs the question ‘what is required to foster fair and efficient capital markets and confidence in those markets?’ The difficulty in providing a concise answer has bestowed great flexibility on the Commission in addressing concerns about the market and the participants therein. So much flexibility, in fact, that the role of the Commission has blossomed into legislator/rule-maker, educator, clearing house, registrar, investigator, public relations office, prosecutor, party to proceedings, and ultimately adjudicator. This is not, of course, entirely the doing of the Commission. The courts and the legislature have also played a part in the expanded authority of the Commission to regulate corporate behavior and to punish corporate misconduct.

The suggestion here is not that a more active role for the Commission is objectionable per se. Rather, our concern lies in a process that has emerged whereby the Commission exercises a greatly expanded public interest discretion, the court endorses that expansion, and Parliament ultimately legalizes it. The 1994 amendments to the OSA provide an excellent example. For now it is sufficient that we simply acknowledge post-*Pezim*⁷, the willingness of our courts and our legislature to empower and defer to securities commissions like the OSC.

The Rule-Maker.

⁶ *Securities Act* (Ontario), R.S.O. 1990, c. S.5 [OSA], s. 1.1.

⁷ *Pezim v. British Columbia (Superintendent of Brokers)* [1994] 2 S.C.R. 557.

The power of the Commission to create the very rules by which the capital markets in Ontario operate is, perhaps, its most important introduction into the boardroom and the rules of corporate governance. It may also, arguably, be the OSC's most effective means of enhancing corporate accountability. Nevertheless such a role was not an obvious goal until the 1994 amendments to the Act which themselves came from a growing concern within the securities industry. This concern culminated in the well known *Ainsley*⁸ decision whereby the Ontario Court of Appeal affirmed the Superior Court's finding that the Commission did not have the power to impose a "de facto legislative scheme complete with detailed substantive requirements".⁹ With the days of ad hoc policy making by the Commission over, concerns were raised about the ability of the Commission to adequately protect investors without substantial legislative involvement.

The response was rapid and complete: by January of 1995 the process of legislative change, often characterized as tediously slow at the best of times, had churned out a task force,¹⁰ assessed their recommendations, presented a bill¹¹, and made the requisite amendments to the OSA. The revamped OSA not only provided the Commission with the authority to make the rules, it also contained an extensive list of matters about which the Commission could do so.¹² And while this might appear at first glance to be a limit on the powers of the OSC, the provision stipulates no less than 56 matters within the Commission's rulemaking direction.

⁸ *Ainsley Financial Corp. v. Ontario (Securities Commission)* (1994) 6 C.C.L.S. 241 (Ont. C.A.).

⁹ *Ibid.*, at 248.

¹⁰ Ontario Task Force on Securities Regulation, *Responsibility and Responsiveness – Final Report of the Ontario Task Force on Securities Regulation* (1994) 17 OSCB 3208. (The Daniels Task Force).

¹¹ Bill 190, introduced by the Ontario Government in November 1994.

¹² *Securities Act* (Ontario), R.S.O. 1990, c. S.5 [OSA], s.143 (1).

Another overriding reason for the amendments was the purported inability of the Commission to respond quickly to changes in the securities markets, in particular, the time consuming process of implementing the new and doing away with the old was seen as a stumbling block. Accordingly, the amendments provided, for the Commission, with Minister approval, to concurrently make a rule and amend a regulation where the new rule conflicts with a regulation.¹³

For our purposes, how the OSC has chosen to exercise its rule-making authority is not as important as how the activities of the Commission have had an impact on corporate accountability generally. This is especially so in light of the fact that the rules are but one small part of the regulatory framework; rounded out as they are by regulations, instruments and policy statements. How then does the OSC use the resources at its disposal to affect the corporate governance practices of market participants at a policy level? The answer lies in a few basic rules derived from the very nature of securities regulation: control everything the players do (who can issue, who can sell), everything they say (and can't say) and what happens if they make a mistake. Everything else will fall into place. When viewed in this way the differences between regulating the entity (registration requirements; financial disclosure obligations) and regulating the individuals within that entity (insider trading; personal liability) seem obvious. While the former provisions find the OSC supervising the market, the latter finds the OSC supervising the boardroom. Or, put into a different construct – these distinctions raise important issues of what differences should exist when the OSC is focused on a transaction, as opposed to a corporation, as ultimately opposed to a man or a woman. Nevertheless, the Commission arguably requires regulation on each of these levels and

¹³ Ibid, s.143 (3).

this helps to explain why it is only when we consider the punishment of people that issues of fairness and responsibility become most acute.

The Investigator.

The potential impact of the Commission's role as an investigator and examiner on enhancing corporate accountability is fairly obvious. Under the provisions in the Act the OSC has extensive powers to order investigations of persons and companies and to examine the "documents or other things" of those entities.¹⁴ The OSA also specifically provides investigators with "the same power to summon and enforce the attendance of any person and to compel him or her to testify on oath or otherwise ... as is vested in the Ontario Court (General Division) for the trial of civil actions."¹⁵ Naturally, investigatory powers as broad as these have not been without their own controversy. Suggested violations of common law rights and Charter protections run the gamut from procedural protections such as those provided by s.10 of the Canadian Charter of Rights and Freedoms¹⁶ to the pre-trial disclosure obligations on defence (there are none: *Stinchcombe*¹⁷).

The manner in which the courts have dealt with these powers suggests an eagerness to treat regulatory bodies generously in the name of administrative efficiency. The decision of the Supreme Court of Canada in *British Columbia Securities Commission v. Branch*¹⁸ is a case in point. *Branch* involved the issuance of subpoenas by the British Columbia Commission requiring senior officers of a company to testify and produce documents. The authority of the Commission to make such orders was contested on the

¹⁴ Ibid, s. 11.

¹⁵ Ibid, s. 13 (1).

¹⁶ Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982*, (U.K.), 1982 c. 11.

¹⁷ *R. v. Stinchcombe* (1991) 3 S.C.R. 328.

¹⁸ *British Columbia Securities Commission v. Branch* [1995] 2 S.C.R. 3.

basis that the information obtained in the hearings would be made publicly available. The Supreme Court of Canada rejected this proposition relying on the decision of La Forest J. in *Thomson Newspapers* that “the degree of privacy the citizen can reasonably expect may vary significantly depending upon the activity that brings him or her into contact with the state.”¹⁹

In respect of the regulation of securities specifically, Iacobucci J. said that “persons involved in the business of trading securities do not have a high expectation of privacy with respect to regulatory needs that have been expressed in securities legislation.”²⁰ So long as the ‘predominant purpose’ of the Commission is purely regulatory – that is for the purpose of regulating the securities market – Charter protections will be subordinated to this purpose. However, as David Stratus has suggested, the concerns change where the “predominant purpose is the investigation of suspected offences and the building of a case for prosecution.”²¹ In other words once the OSC begins to exercise authority, be it punitive or otherwise, which is traditionally outside that of regulatory bodies, something has to give: either its investigatory powers must be restricted accordingly or the appropriate procedural protections must be implemented.

The Public Relations Office.

At first glance, the Commission’s role in communicating the details of alleged misconduct might appear to be non-controversial. We all know that general deterrence

¹⁹ *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)* [1990] 1 S.C.R. 425 at 506.

²⁰ *Branch*, above note 14, at 39.

²¹ David Stratus, “Charter Protections in Regulatory Proceedings: Do They Exist,” in *Selected Topics in Corporate Litigation – Papers presented at the 7th Queen’s Annual Business Law Symposium 2000* (Conference materials provided by Queen’s University), Tab 8 at 24.

and judicial openness is an admirable goal of our legal system. What better way to deter future objectionable conduct than to publicize the cases of those who have done it and the price they may pay for doing so. The difficulty with this in the regulatory context lies in the multi-dimensional authority of the Commission and the potential injustice that can arise “where the investigative, prosecutorial and adjudicative functions are all under the same roof.”²² This is particularly the case where the distinctions between the various entities within the Commission are not clear in the minds of the readers of the *Globe and Mail*.

Admittedly the Commission has taken some small steps to try to separate these functions. Once an investigatory order is made and “if a Commission hearing ensues, it is now Commission policy that the Commissioners who authorized the order do not participate in the hearing.”²³ However, this neat separation between the Commission staff, who investigate and prosecute, and the Commission tribunal which adjudicates, is arguably not enough any longer to dispel the public confusion between allegations made by the OSC and findings of proven misconduct by the OSC. As Jeffrey Leon lamented “[t]he public doesn’t understand the nice distinction between Staff and the tribunal.”²⁴ The truth in this leaves the Commission open to criticism based on its potential to use the media as an enforcement mechanism instead of a means of deterrence.

The Enforcer.

The investigatory and rule-making powers of the Commission can be seen as defensive mechanisms, a shield if you will, created to enable the Commission to fulfill

²² Jeffrey S. Leon, “Administrative Justice and the Ontario Securities Commission: Balancing Fairness with the Fifth Estate,” in *The Advocates Brief*, Vol. 12 No. 2, September 2000.

²³ *Re Malartic Hygrade Gold Mines (Canada) Ltd.* (1985) 8 O.S.C.B 1557, at 1562.

²⁴ Leon, above note 22.

their mandate of investor protection and market integrity. Accordingly, advances into the area of corporate governance are reluctantly acknowledged as a necessary means to a meritorious end. These comparatively non-contentious roles stand, however, in stark contrast to the enforcement role now played by the Commission. Generally speaking, in our view, the contentiousness of these means arise more from who decides than it does upon the goals themselves. In our view, the administrative remedies available to the Commission generate more noise than any other and consequently get more attention (and are used more frequently than any other). Nevertheless, the Commission has other effective means of bringing enforcement proceedings: quasi-criminal, civil applications and uncharted waters in the oppression remedy in the Ontario Business Corporations Act (OBCA). A cursory review of these other mechanisms also helps provide a background for many of the current concerns over the Commission's increased use of its administrative and public interest authority.

The Commission as Complainant: The Oppression Remedy.

Under Canadian corporate law majority shareholders do not ordinarily find themselves owing fiduciary obligations to minority shareholders: *Brant Investments*.²⁵ This gap was one of the reasons for the creation of a statutory mechanism for aggrieved shareholders and hence the oppression remedy under the OBCA. Interestingly, this provision specifically extends these rights and remedies to the Commission in the case of an offering corporation. This allows the Commission to apply to the court for an order in respect of acts or omissions of a corporation or its directors that are exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interest of any

²⁵ *Brant Investments Ltd. v. Keeprite Inc.* (1991), 80 D.L.R. (4th) 161 (Ont. C.A.).

security holder, creditor, director or officer.²⁶ To our knowledge, this is almost never done by the Commission.

This self-imposed restraint can be seen in various ways. One could argue that the Commission is exercising its discretion to limit its role in enhancing corporate governance by leaving it to the shareholders to seek redress for oppression. However, this is doubtful. What seems more likely is that the Commission simply believes it is unnecessary to resort to OBCA remedies in light of the variety of enforcement mechanisms available to it under the OSA, especially those in the hearing room.

The Commission as Prosecutor: Quasi-Criminal Actions and Corporate Governance.

The prosecutorial role of the OSC is found in s.122 of the OSA. This is the primary enforcement mechanism in the Act and it contains the most severe of punishments for the most serious injuries to the market and its participants.²⁷ Accordingly, much of the conduct that gives rise to demands for more effective corporate governance measures can be addressed under s.122. Particularly given that under this provision the adjudicative function is exercised by a Court,²⁸ not the Commission, as one might argue should be the case. Even so, the OSC's power to prosecute has not escaped controversy.

For example, some of the specific securities law offences under this section relate to disclosure in various documents or in submissions to the Commission and they apply equally to omissions and commissions. In addition, there is a catch-all provision for

²⁶ *Business Corporations Act* (Ontario), R.S.O. 1990, c. B16, s.248 (1).

²⁷ The maximum penalty available to the court under s.122 (1) is a fine of not more than \$1,000,000 and/or imprisonment for a term of not more than two years, per count in the information. However, subsection 122 (4) increases the fine for contraventions of s.76 (Insider Trading) to a fine of not less than the profit made or loss avoided up to an amount that is triple the profit made or loss avoided.

²⁸ The Ontario Court (General Division).

any contravention of Ontario securities law.²⁹ Presumably these rules should be taken as an indication of the importance of making full, true and informed disclosure to the public and the Commission at all times.

The significance of this provision in the corporate governance context is further enhanced by the singling out of directors and officers for special (and unwanted) attention. While the general provision would appear to capture the directors and officers of a corporation (that is assuming they are persons within the meaning of ‘every person’) the Act does not take any chances – specific provision is made for every director or officer who authorizes, permits or acquiesces in the commission of such an offence.³⁰ We can say from our defense experience that these provisions are too broad, too vague, too troublesome, and arguably not Charter-proof.

The contentiousness surrounding this enforcement mechanism arises from the Commission’s sole discretion in commencing proceedings by way of a prosecution under this section. This raises two issues: Firstly, an aggrieved party has no means of redress without Commission consent. This strikes us as odd. Secondly, it allows the Commission to decide the procedural protections available to an accused by their apparently unfettered choice of proceeding. This second issue requires special consideration.

Because of the criminal nature of the proceedings under this section, the procedural protections are the same as those available to those accused of criminal offences. Likewise, the higher, beyond a reasonable doubt, standard of proof is also required. These distinctions among the enforcement options are important and every

²⁹ *Securities Act* (Ontario), R.S.O. 1990, c. S.5, s.122 (1)(c).

³⁰ *Ibid*, s.122 (3) provides for the same penalties as those in subsection 122 (1). Interestingly, no charge needs to have been laid and no finding of guilt needs to be made against the company or person in respect of the offence under subsection (1).

decision to proceed by way of one option as opposed to another must be viewed with this in mind. In *Wilder* Sharpe J. had the following to say about the Commission's discretion as to the manner of proceedings:

In some cases, the OSC may determine that *quasi*-criminal prosecution leading to fine or imprisonment is the most effective and appropriate means to ensure compliance with the Act and to ensure public confidence in the capital markets. In other cases, the OSC may prefer the more flexible and less drastic administrative sanctions available pursuant to s.127 as the best way to achieve the objectives of the legislation.³¹

This assessment of the options open to the OSC emphasizes that the Commission can choose to match the proceeding to the nature of the alleged conduct. However, it does not address the possibility that the Commission may choose to select the manner of proceeding that it considers based on arbitrary exigencies rather than the merits and the objective needs of the market. Is it possible that this discretion allows the Commission to only select quasi-judicial proceedings when they have an ironclad case and to choose administrative proceedings in all others? Whether or not this is fair or appropriate is a question best left for another day.

The Commission as Civil Plaintiff: Remedial Provisions.

The adjudication of Commission activity under s.128 is similar to that under s.122 in that the result rests with a Court. The Commission alone, however, has the discretion to decide whether or not to proceed in this manner. In contradistinction to the quasi-judicial provision, here, the court is empowered to make declarations³² and orders³³ instead of imposing fines and sentences. However, the available orders are wide in scope and the provision is not exhaustive. Many of the orders specifically set out in the section

³¹ *Wilder v. OSC* (2001) 53 O.R. 519 at 530.

³² *Securities Act* (Ontario), R.S.O. 1990, c. S.5, s.128 (1).

³³ *Ibid*, s.128 (3).

directly impact on corporate accountability and on controlling the actions of directors and officers. For example, the court may make an order prohibiting a person from acting as an officer or director.³⁴ Other orders provide for the payment of compensation, restitution and damages.³⁵

The inability of the Commission to make many of the orders currently available to the court under this provision is a topical issue in Ontario and we will revisit it in the context of reform. For now, the significance of this enforcement option lies in its breadth and the ample opportunities it provides for enhancing corporate accountability. As with s.122, this provision includes a catch-all phrase allowing the court to ‘make any order the court considers appropriate.’

More importantly, the orders available under this section are in addition to any penalty imposed by the court under s.122 or order made by the Commission under s.127. In light of the extensive application of these court-adjudicated enforcement mechanisms we ask parenthetically why the Commission needs to be buttressed with additional administrative sanctions?

The Commission as Adjudicator: Public Interest Discretion.

The powers afforded the Commission under s.127 are, in our view, the most controversial enforcement mechanisms under the OSA. Not surprisingly, this is also the option under which the Commission exercises the most discretion and the mechanism most preferred by the Commission in fulfilling its mandate. It is to this section that reformers most often turn when seeking to enhance corporate accountability, to heighten investor protection, and boost investor confidence. It is also here that the ultimate

³⁴ Ibid, s.128 (3) 7.

³⁵ Ibid, s.128 (3) 13 & 14.

protection of the market is frequently sought. Consequently this is also where we believe the regulatory-judicial dichotomy is most vulnerable to unwarranted integration. In assessing the validity and desirability of Commission action under this provision the distinction, made earlier, between the ostensible purposes of a regulatory body and those of the judiciary must be kept in mind.

The most important distinction between this enforcement option and those we have already looked at is that proceedings commenced under this provision are brought before the Commission. Thus, to some extent, the very existence of this authority is problematic because by the time the hearing is commenced before the Commission, the Commission has already performed every other significant role in the development of the case.

A second distinction is the broad discretion given the OSC in the name of 'the public interest' and the impact this discretion has on the appropriateness of the Commission making certain orders. When you move from prospective and protective decisions to remedial or punitive decisions, there must be serious consideration of whether distinction one suggests that distinction two should be limited to the future and not the past.

The orders available to the OSC under s.127 are inclusive. They are also quite serious in effect, including the livelihood and the reputation of market participants and professionals. Granted the Commission currently does not have the power to imprison, impose fines (administrative or otherwise), order one party to pay monies to another,

order rescission of a transaction, or require compliance with Ontario securities law.³⁶ The Commission does, however, have the power to suspend registration, make cease trade orders, order directors and officers to resign their positions, and prohibit persons from becoming directors and officers. In addition the Commission also has the express authority to order parties subject to investigation and/or Commission hearings, to pay both the investigation and the hearing costs of the Commission, whether or not they are subsequently found to be in breach of securities law.³⁷ Astonishingly, the Commission is not obliged, at least statutorily, to pay costs when it loses.

It goes without saying that such orders entail serious infringements on the rights of the accused to participate in the capital market. Accordingly, additional but limited constraints have been imposed. The Commission cannot make an order under this section without holding a hearing except where ‘the public interest’ requires a temporary order.³⁸ Furthermore, not all orders can be made on a temporary basis, most notably those requiring the resignation of directors and those prohibiting persons from accepting such positions. Even so, the threshold created by requiring a hearing is somewhat illusory given that the Commission need not find a breach of securities law in order to make an order under s.127.³⁹

The justification for this lies in the status of the OSC as a regulatory body and the apparently prospective nature of its jurisdiction. Yet this in no way addresses the

³⁶ Tim Moseley, ‘The Jurisdiction of the Ontario Securities Commission: Recent and Anticipated Developments,’ in *Selected Topics in Corporate Litigation – Papers presented at the 7th Annual Queen’s Business Law Symposium 2000*. See note 17, Tab 9 at 6.

³⁷ *Securities Act* (Ontario), R.S.O. 1990, c. S.5, s.127.1 (1) & (2).

³⁸ *Ibid.*, s.127 (5). A temporary order expires on the 15th day after its making; s.127 (6) with extension available only when a hearing has been commenced within the 15 day period: s.127 (7).

³⁹ *Re Cablecasting* [1978] OSCB 37; *Re Canadian Tire Corp.* (1987) 10 O.S.C.B 857; *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132. [*Asbestos*].

concerns surrounding the Commission's imposition of very serious restrictions on persons and companies that have not been found to be in violation of any laws. Admittedly, in theoretical terms a balance has to be struck between preventing market abuse and abusing market participants. This in turn requires some limitation on the Commission's public interest discretion. As Jeffrey MacIntosh aptly stated:

“the public interest power was never intended to be, nor could it logically be construed to be, unlimited in nature. Had the legislature intended it to be unlimited, then it needn't have troubled itself with the task of devising a securities act.”⁴⁰

That such limitations do exist has recently been confirmed by the Supreme Court of Canada in *Asbestos*.⁴¹ Unfortunately, the court's expression of these limits in terms of the broad purpose provisions of the Act are not very helpful in determining on a practical day to day basis, where Commission discretion should end. Accordingly, the public interest discretion of the Commission remains largely unclarified, and the Staff would argue, largely unfettered.

Judicial Review of Commission Decisions.

While there are more than a few good reasons to limit the public interest discretion of the Commission⁴² one of the most important is certainly the high threshold to get over before Canadian courts will interfere. Blair J. put it as follows:

“The exercise of [OSC] discretionary authority will not be interfered with unless it has been wielded in a fashion which fetters the application of the discretion, and provided it has been exercised in good faith, with an obvious and honest concern for the public interest and with evidence to support its opinion.”⁴³

⁴⁰ J.G. MacIntosh, “The Excessive Use of Policy Statements by Canadian Securities Regulators,” (1993) 1 Corporate Financing 19 at 20.

⁴¹ *Asbestos*, see note 36, at para. 41.

⁴² Not the least of which is the need for certainty. As James E.A. Turner expressed in his article “Comments On ‘Gatekeeping and the Commission: The Role of Professionals in the Regulatory System,’” ‘lawyers should not be giving advice based on what they *think* a regulator *thinks* the law should be’. See note 1, at 270.

Shortly after this decision the Supreme Court of Canada had an opportunity to address the standard of judicial review, this time in *Pezim*, in respect of the British Columbia Securities Commission. Speaking for the court Iacobucci J. held that their refusal to interfere with the decision of the Commission arose, at least in part, from the fact that they were “dealing with an appeal from a highly specialized tribunal on an issue which arguably goes to the core of its regulatory mandate and expertise.”⁴⁴

Most would agree with this portrayal of the Commission as particularly well prepared to deal with issues affecting the operation of the securities industry. Many would also agree that this expertise extends to dealing with issues of corporate accountability. And perhaps they would be right. This does not, however, suggest that the regulatory nature of the Commission can, or should, be extended to allow the Commission to make decisions that go beyond this somewhat narrow scope. More importantly, we argue that it should not be extended to allow for punitive sanctions. The desirability of confining such penalties to the courts becomes even more so when the threshold of judicial review is so high. It is within this context that we turn to the latest round of recommendations for reform.

The Five Year Review Committee Draft Report.⁴⁵

Following the 1994 amendments to the Ontario Securities Act a Committee must now be appointed every five years “to review the legislation, regulations and rules relating to matters dealt with by the Commission and the legislative needs of the

⁴³ *Ainsley Financial Corporation v. OSC* (1993), 14 O.R. (2d) 280, at 289-290.

⁴⁴ *Pezim v. British Columbia (Superintendent of Brokers)* [1994] 2 S.C.R. 557.

⁴⁵ May 31, 2002. Volume 25, Issue 22 (Supp.) O.S.C.B.

Commission.”⁴⁶ Not surprisingly, with such a broad mandate, this first 5 year review Committee examined a wide range of issues including the role of the Commission in regulating the capital markets and the participants therein, shareholder rights, and enforcement. The review process continues with a period for public comment to be followed up by a final report to be submitted to the Minister of Finance. It is worth noting that before the Minister makes any recommendations to the legislature another opportunity for public comment is contemplated. This emphasis on public involvement suggests that the Committee was likely well aware of the acute public concerns about the integrity of the capital markets and the proper role of the OSC therein.

In considering the need for reform of the Commission’s enforcement powers, the Committee began by ‘considering whether the Commission should have any enforcement powers in addition to those currently in the Act.’ In particular, they considered whether the Commission should have the power to levy administrative fines and whether the range of public interest orders that the Commission can make should be expanded to include some of the orders currently available to the court under s.128. Thus, while the recommendations encompass changes to all of the enforcement mechanisms under the OSA the most significant proposals are in respect of the Commission’s public interest power under s.127.

It is the current opinion of the Committee that “with the enforcement powers presently available to it under subsection 127(1) of the Act, the Commission is constrained in its ability to fashion an appropriate remedy in all situations.”⁴⁷ Another concern expressed by the Committee is the lack of consistency with other jurisdictions

⁴⁶ *Securities Act* (Ontario), R.S.O. 1990, c. S.5, s.143.12 (1).

⁴⁷ *Five Year Review Committee Draft Report*, see note 42, at 122.

and the desirability of moving towards a uniform system of securities regulation. In light of these concerns the Committee proposes the Commission be empowered to order the payment of administrative fines up to \$1,000,000. This is in keeping with the power currently held by the Quebec Securities Commission but substantially greater than that of other provincial Commissions and the Securities and Exchange Commission (SEC).⁴⁸

The ability of the SEC to impose administrative fines raises an important distinction between the enforcement powers of the OSC and the SEC. Under the Securities Exchange Act the SEC's public interest discretion to make orders akin to those available to the OSC is largely nonexistent. In the rare circumstances where such discretion is available it can only be exercised when 'needed for the protection of investors.'⁴⁹ Furthermore, that power is not wielded by the SEC but rather by an independent administrative law judge (ALJ). The many real problems arising from giving a Commission with wide public interest discretion the power to also order administrative fines was acknowledged by the Committee. Accordingly, the Committee recommended tying the administrative fine provisions only to those cases where a demonstrated breach of securities law has occurred. How is this a specialized tribunal issue? It seems to us to be a court/judge issue.

Another recommendation of the Committee is with respect to the power to order a disgorgement of profits. Once again the Committee looked to the SEC and the ability of an ALJ to make such orders and decided the OSC too should have this power. Their motivation for such reform seems to be the 'strong deterrent message' that can be sent by making a wrongdoer disgorge his profit. Are we to believe that this message is stronger

⁴⁸ For a summary of the administration fines currently available throughout Canada and elsewhere see footnote 286 at page 122 of the *Five Year Review Committee Draft Report*, note 42.

⁴⁹ *Securities Exchange Act of 1934*, 15 U.S.C. 78a (1995), s. 12 (k).

simply because the order is made by the Commission instead of the court? It seems to us to be the opposite; that investors and targets are both more likely to have trust and confidence in the decision of a judge than they are in the decision of a regulator who, in many cases, has had some prior role in the case. *YBM*⁵⁰ is an excellent example of this concern. In our view these proposals are neither a desirable, nor a necessary, response to the current calls for increased vigilance in maintaining the integrity of the capital markets.

The Immediacy of Reform: Playing the Enron Card.

At the eleventh hour of our preparing this paper, another small step in the process of reform got underway. In a securities industry speech, Ontario's Minister of Finance, Janet Ecker, said legislation will be introduced and hopefully passed this fall in an effort to "crack down on white-collar crime." Interestingly, the crimes to which the Minister seems to be referring are not ours but those of the United States. Specifically, Ms. Ecker had this to say about the current state of the Canadian capital markets: "To sit back and pat ourselves on the shoulder and say we haven't had Enron here, that's just asking for trouble ... We need to take steps to protect investors."

Ms. Ecker's proposals include a number of new enforcement options for both the Courts and the Commission. In particular, it is proposed that judicial enforcement powers be increased with jail terms of up to five years less a day and fines of up to \$5 million. The new administrative fines (up to \$1 million), administrative disgorgement orders, and, most importantly from the corporate governance context, personal liability for company executives in certifying the financial statements of their companies, are much more troublesome. There are a number of legal, political, and constitutional issues

⁵⁰ *Re: YBM Magnex International Inc.*, 2001 December 14 O.S.C.D.

that become engaged when the Government proposes to move the OSC out of its traditional regulatory role and into the uncharted waters of acting as a super-collection agency for investors, and as a quasi-quasi-criminal court through a new power to punish and to fine. We can only hope that these issues will be carefully considered before, rather than after, this legislation is passed.

The recommendations made by the Committee, and echoed by the Minister of Finance, are extensive and a brief review, as is required by the limits of this paper, really does not do justice to their work. There is, nevertheless, a point to be gleaned from even this brief discussion of the current recommendations for reform the name that we give a penalty does not change its character. If a market participant is found in breach of Ontario securities laws, and an administrative fine is imposed by the Commission this feels like punishment as surely as if it were ordered by a Court.

In their ‘Letter from the Committee’ the Five Year Review Committee made reference to the collapse of Enron and the fact “that Enron has changed the way we look at the integrity of our capital markets.”⁵¹ While it is not clear to us why we need to be looking at the integrity of our capital markets in a different way, one thing that is certain is that we are looking at them more often. On any given day one might easily confuse the front page of most newspapers with the business section. Ed Waitzer expressed his concern about the clamor for reform of corporate governance in terms of pressure on the government and the “risk that governments will respond to perceived crisis in precipitate ways simply to satisfy pressures ‘to do something.’”⁵²

⁵¹ *Letter from the Committee*, see note 42, at 6.

⁵² Edward Waitzer, “What’s Right About Corporate Governance,” (1993) 15 O.S.C.B. 5575, at 5576.

Interestingly, former OSC Chairman Waitzer, expressed this concern nearly a decade ago. The calls for corporate governance reform are louder than ever. This might suggest that the methods used thus far to police the boardrooms have been largely unsuccessful. We do not agree. We have seen that many of these new methods have involved increasing the role of the OSC and we have seen how the Commission uses its increased authority to govern the market and its participants. Perhaps the Committee on Corporate Disclosure was right, however, when they proposed in their Interim Report that the difficulty in regulating the capital markets is that it is “largely an attempt to modify human nature.”⁵³ No one has told us how giving the OSC even more power will accomplish this. Perhaps we are looking to the wrong solution. Perhaps we need *less* rather than more government intervention.

The idea that securities regulators may be engaged in an impossible task, akin to cleaning out the Augean stable, has been gaining momentum as the fallout from Enron begins to settle. It has even been suggested that over-regulating actually diminishes the integrity of the market “since no set of regulations, no matter how detailed, can outmaneuver a really determined manipulator, the rules provide, in effect, a road map for abuse.”⁵⁴ Our humble solution is this. Lets get back to basics. The OSC sets policy, regulates transactions and market participants, and when there is a need for remedial or enforcement measures to be taken, let that job fall to the Courts and to the Judges – as it has for hundreds of years. After all, what can the OSC and the Canadian capital markets lose except cases that should not be won anyways.

⁵³ *Toward Improved Disclosure, A Search for Balance in Corporate Disclosure*, Interim Report of the Toronto Stock Exchange Committee on Corporate Disclosure, December 7, 1995 at 23.

⁵⁴ *After Enron – Agenda for reform 2002, Reforms to Restore Confidence in Business*, taken from FT.com, Financial Times Website, September 9, 2002.

Most importantly, let's talk about the role and value of integrity and honesty in the marketplace and how we all have a role to play in lowering investor expectations, increasing their education, and restoring real values to Bay Street. At a time when our business leaders should be standing up to be counted they remain strangely silent – or committed to letting the Government do the job. Ultimately good corporate governance requires a consideration of Lord Chancellor Thurlow's question: "Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?"⁵⁵ To this end we must seek new and effective ways to find both a soul to damn and a body to kick. At the moment it seems that all we are doing is polishing our boots.

⁵⁵ As cited by J.C. Coffee Jr., "No Soul to Damn, No Body to Kick: An Unscandalized Inquiry into the Problem of Corporate Punishment" (1981) 79 *Michigan L. Rev.* 386 at 386.