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VIEW FROM THE WEST: THE ALBERTA COURT OF APPEAL HOLDS THE PROPOSED CANADIAN *SECURITIES ACT* TO BE UNCONSTITUTIONAL

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Background

On May 26, 2010, the Government of Canada officially released a proposed Canadian *Securities Act* (**Proposed Act**), which seeks to establish a national securities regulator as a voluntary regime that provinces and territories would be able to opt into.[1] Concurrent with its release, the Government of Canada referred the Proposed Act to the Supreme Court of Canada for its opinion as to the legislative authority of the Parliament of Canada to pass the Proposed Act.

The Proposed Act is now opposed by the provinces of Alberta, British Columbia, Manitoba, New Brunswick, Quebec, and Saskatchewan. Alberta and Quebec, both strongly opposed to a national regulator, referred the Proposed Act to their respective courts of appeal.

Inside

Opponents argue that local regulators, compared with a centralized regulator in Toronto, are more familiar with the nuances of local industries – for example, the energy industry in Alberta.

While the Supreme Court will not hear the matter until April 13 and 14, 2011, both the Alberta and Quebec Courts of Appeal have already heard arguments regarding the constitutionality of the Proposed Act. The Albert Court of Appeal was the first to release its decision on March 8, 2011.[2]

Decision

The *Securities Act Reference* was heard on January 24, 2011 by a five-member panel of the Alberta Court of Appeal. The Government of Alberta appeared as the appellant; while, the Government of Canada appeared as the respondent. The interveners were the Attorney General of Quebec, arguing against the Proposed Act, and the Canadian Bankers Association, arguing in favour of the Proposed Act.

Broadly, the Court was asked to consider whether Parliament, under the *Constitution Act, 1867*,[3] has the authority to: (1) pass legislation to regulate the securities industry in Canada; and (2) pass legislation to exclude the application of the *Securities Act* (Alberta).

In a unanimous decision, the Court held the Proposed Act to be contrary to the division of powers in the *Constitution At, 1867*, and therefore, unconstitutional. The Court concluded:

> [T]he proposed federal securities legislation would enter an area of regulation long occupied by the provinces, and long considered to be clearly within provincial jurisdiction. The proposed legislation does not meet the traditional tests for inclusion in the "trade and commerce" power, nor is it consistent with the guidelines that have been suggested from time to time for defining the scope of that power. It is inconsistent with numerous prior decisions of the highest courts delineating the division of power over specific industries. The proposed legislation would, if enacted, be unconstitutional.

Consequently, in response to one of the questions put to it,[4] the Court answered that Parliament does not have legislative authority to pass legislation identical to or similar to the Proposed Act.

Arguments and Analysis

The securities industry has historically been regulated by the provinces using their jurisdiction over "Property and Civil Rights within the Province", granted by s. 92(13) of the *Constitution Act, 1867*. Alberta conceded that small, isolated portions of the proposed legislation were a valid exercise of federal criminal power pursuant to s. 91(27) of the *Constitution Act, 1867*. However, central to the outcome of the appeal was whether Parliament could legislate with respect to the securities industry under the federal head of power over "The Regulation of Trade and Commerce", granted by s. 91(2) of the *Constitution Act, 1867*.

The Court found the Proposed Act to be in substance similar to provincial securities legislation in addressing the integrity of market participants, protecting the investing public, and ensuring ethical practices in the capital markets. While Canada asserted that the securities industry had changed with more varied, complex, and sophisticated products, the Court held that this does not change the nature of the division of powers under the *Constitution Act, 1867*, nor does it change the fundamental character of securities products as matters of property and contractual rights. The Court dismissed Canada's assertion that the proposed legislation would address systemic risk within the securities industry, on the basis that as with provincial legislation, the proposed federal legislation would do nothing to assess the merit of any particular investment. Moreover, the proposed legislation was found not to be "crisis legislation" bringing it within the scope of Parliament's legislative powers.

The Court held the regulation of the securities industry to be a matter falling under provincial power over property and civil rights for the following reasons:

(1) securities legislation licenses and regulates participants in the industry and is a form of professional regulation which has traditionally related to civil rights in the province;

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(2) securities are property that are traded according to contractual and property arrangements, which do not involve cross-border movement of property; and

(3) the regulation of the raising of capital, the requirements of continuous disclosure, and the regulation of extraordinary transactions by reporting issuers are matters of property and civil rights.

Canada did not dispute that the provinces have jurisdiction over the regulation of the security industry under the property and civil rights head of power, but argued that Parliament has concurrent jurisdiction to legislate with respect to securities regulation. Canada grounded the constitutionality of the Proposed Act on the "general" branch of the trade and commerce power. The trade and commerce power encompasses international or interprovincial trade, and also "general" legislative authority to legislate trade and commerce.

The indicia of legislation validly enacted under the general trade and commerce power, endorsed by the Supreme Court of Canada in *General Motors v. City National Leasing* ("*General Motors*"),[5] are that:

(a) the impugned legislation must be part of a general regulatory scheme;

(b) the scheme must be monitored by the continuing oversight of a regulatory agency;

(c) the legislation must be concerned with trade as a whole rather than with a particular industry;

(d) the legislation should be of a nature that the provinces jointly or severally would be constitutionally incapable of enacting; and

(e) the failure to include one or more provinces or localities in a legislative scheme would jeopardize the successful operation of the scheme in other parts of the country.

The Court concluded that the proposed securities legislation failed to meet the last three criteria having found that: (1) the Proposed Act concerned regulation of the securities industry rather than trade in general; (2) the provinces had been regulating the securities industry for decades already; and (3) a lack of participation by all provinces would not jeopardize the operation of the Proposed Act in other parts of the country (in fact, the opt-in nature of the Proposed Act contemplates that it would operate in only some parts of Canada).

Moreover, the Court could not ignore that the proposed legislation attempts to displace a whole body of existing valid provincial legislation, making a comparison with previous failed attempts by the federal government to assume the regulation of the insurance industry. In the Canadian tradition of constitutionalism, the federal trade and commerce power has not been allowed to subsume provincial power over property and civil rights. The Court strongly stated that "[t]he present Reference in reality involves an attempt to overturn all those earlier cases, and to rewrite Canadian constitutional history in a way that would disrupt the predictability required in constitutional law".

Looking Ahead

In mid-April, the Supreme Court will hear the Government of Canada's reference question – "Is the … proposed Canadian *Securities Act* within the legislative authority of the Parliament of Canada?". While the Alberta Court of Appeal's decision in the *Securities Act Reference* may be compelling (as may be the Quebec Court of Appeal's decision once released), it will not be binding on the Supreme Court, which is the ultimate judicial authority.

As in the *Securities Act Reference*, the Government of Canada is unlikely to argue that the Proposed Act is in pith and substance a matter distinct from the regulation of the security industry, which falls within provincial jurisdiction. Therefore, the federal government must continue to assert that the Proposed Act falls under the general arm of the federal power to regulate trade and commerce. Despite the decision in the *Securities Act Reference*, there is still room for such an argument. As the Supreme Court stated in *General Motors*, the five factors are only indicia and are not a test for the valid application of the general trade and commerce power, and the five factors "merely represent a principled way to begin the difficult task of distinguishing between matters relating to trade and commerce and those of a more local nature".

We will report to our readers on the outcome in the Quebec Court of Appeal and the Supreme Court when those decisions are released.

Notes:

[1] The proposed Canadian *Securities Act* is available on the Department of Finance Canada website: www.fin.gc.ca/drleg-apl/csa-lvm-eng.asp.

[2] *Reference Re Securities Act (Canada)*, 2011 ABCA 77.

[3] (U.K.), 30 & 31 Victoria, c. 3.

[4] The Court determined that it was inappropriate to attempt to answer the second question as there was no clear indication that the federal government proposed to enact legislation to exclude the application of the Alberta *Securities Act* (a) to market participants who elect to be regulation under a federal regime, (b) to market participants who have a substantial connection to a jurisdiction other than Alberta, or (c) by an express paramountcy clause or similar unilateral, each of which the Alberta government identified as recommendations in the *Final Report and Recommendations* of the Expert Panel on Securities Regulation, which is available at www.expertpanel.ca/eng/reports/index.html.

[5] *General Motors v. City National Leasing*, [1989] 1 S.C.R. 641.

FORM 41-101F2: INVESTMENT FUNDS REQUIRED TO PROVIDE BETTER DISCLOSURE

By Kathleen Jones-Lepidas. © CCH Canadian Limited.

The OSC recently issued Staff Notice 81-714 to summarize the views of OSC Staff ("Staff") on the disclosure required by Form 41-101F2, *Information Required in an Investment Fund Prospectus* (the "Form"), and the types of comments staff will usually raise when they are reviewing an investment fund prospectus required to be filed in the form of the Form.

Who Must Use the Form?

The Form must be used by all investment funds filing prospectuses other than mutual funds that file prospectuses under National Instrument 81-101, *Mutual Funds*.

It contains specific disclosure requirements for investment funds, in addition to the general requirement in securities legislation to provide full, true, and plain disclosure of all material facts in the prospectus relating to the securities to be issued.

Why is Compliance with the Form Important?

Compliance with the disclosure requirements of the Form is imperative because the Form is intended to provide clear and concise information about the investment fund to investors, which in turn will help them make informed investment decisions. Staff expect the disclosure to comply with the plain language principles listed in section 4.1 of Companion Policy 41-101CP to National Instrument 41-101; they also expect the disclosure to be presented in the order (and to use the headings) specified in the Form. This format allows the prospectus disclosure to be presented in an easy-to-read format and in a straightforward manner.

Cover Page and Prospectus Summary Disclosure Issues

- **Intention of the cover page and prospectus summary disclosure**: In reviewing the prospectus, Staff will consider the purpose of the Form and, specifically, the intention of the cover page and prospectus summary disclosure, which should ensure that investors are presented with information about the investment fund in a clear, concise, and comparable format that aids them in making informed investment decisions.

- **Cover page disclosure should be brief**: In Staff's view, the cover page disclosure should only provide a brief description of the investment fund and the securities to be distributed and should be limited to the disclosure specifically mandated by Item 1 of the Form. Accordingly, Staff may ask that cover page disclosure be reduced or that certain disclosure be removed.

- **Prospectus summary disclosure should also be brief**: Staff expect that the prospectus summary disclosure will only provide a brief summary of the information that appears elsewhere in the prospectus. For brevity's sake, Staff may request that certain disclosure in the summary prospectus be removed and be replaced with cross-references to the more detailed disclosure that appears elsewhere in the prospectus.

- **Chart and graphs should be removed**: Generally, Staff will request that charts and graphs not mandated by the Form be removed from the prospectus summary.

- **Other Material Facts**: Staff have reminded filers and their counsel that information not requested under any other section of the Form may be disclosed under "Other Material Facts".

- **When additional, tailored disclosure is needed**: If an investment fund has complex or unique risks, features, or costs, Staff have requested that additional, tailored disclosure that is specific to the securities to be distributed be added to the cover page or to the prospectus summary disclosure to ensure that investors are provided with full, true, and plain disclosure of all material facts.

Filers Must Provide Disclosure About Investment Objectives

- **What makes this fund different?**: Information describing the fundamental nature of the investment fund or the fundamental features of the investment fund that distinguish it from other investment funds is required by Item 5.1 of the Form. Specifically, the instructions to Item 5.1 require a statement of the type(s) of securities in which the investment fund will primarily invest under normal market conditions.

- **Investment strategies must be disclosed**: In their reviews, Staff have asked filers to disclose investment strategies that are an essential aspect of the investment fund as an investment objective of the investment fund.

- **Certain disclosure should be removed**: Staff may also ask filers to remove certain disclosure that does not form part of the investment objective, such as an investment fund's initial indicative yield.

Prospectuses for Multiple Investment Funds

- **Number of investment funds should be limited**: Staff's view is that the number of investment funds offered in a prospectus should be limited to investment funds with substantially similar investment objectives, strategies, and features.

- **Should multiple investment funds be combined?**: In reviewing multiple prospectuses of exchange traded mutual funds, Staff will determine whether the combination of multiple investment funds into one single prospectus has an impact on the fund's ability to provide investors with full, true, and plain disclosure. If the number of investment funds incorporated into one prospectus interferes with the presentation of key information in a clear, concise, and comparable format for investors, Staff will ask the filer to separate the investment funds into different prospectus documents.

For further information, please refer to OSC Staff Notice 81-714, which has been reproduced in Volume 3A of the CANADIAN SECURITIES LAW REPORTER at ¶490-690.

CANADIAN SECURITIES ADMINISTRATORS

IFRS Notice Revised

The CSA has revised Staff Notice 81-320, effective March 23, 2011. The notice updates investment funds and their advisers on the adoption of International Financial Reporting Standards ("IFRS") by investment funds in Canada. The notice has been reproduced in Volume 1 of the CANADIAN SECURITIES LAW REPORTER at ¶8150.

CSA Proposes to Update and Streamline Regulatory and Reporting Requirements

The CSA recently published proposed amendments to the following documents:

- National Instrument 21-101, *Marketplace Operation* ("NI 21-101"), and Companion Policy 21- 101CP ("21-101CP");

- National Instrument 23-101, *Trading Rules* ("NI 23-101"), and Companion Policy 23-101 CP ("23-101CP");

- Form 21-101F1, *Information Statement Exchange or Quotation and Trade Reporting System* ("Form 21-101F1");

- Form 21-101F2, *Initial Operation Report Alternative Trading System* ("Form 21-101F2");

- Form 21-101F3, *Quarterly Report of Marketplace Activities*; and

- Form 21-101F5, *Initial Operation Report for Information Processor* ("Form 21-101F5").

The main objective of the proposed amendments is to update and streamline the regulatory and reporting requirements in NI 21-101, NI 23-101, and the forms and to align, where appropriate, requirements that apply to all exchanges. In order to accomplish this objective, the CSA has proposed amendments in the following areas:

1. Regulatory and reporting requirements of marketplaces;

2. Transparency requirements applicable to marketplaces dealing in exchange-traded securities;

3. Transparency of marketplace operations;

4. Other requirements applicable to marketplaces;

5. Definition of a marketplace;

6. Transparency requirements applicable to marketplaces, interdealer bond brokers, and dealers dealing in government debt securities;

7. Locked and crossed markets; and

8. Information processors.

The CSA has requested written comments on the proposed amendments by June 16, 2011. For further information, please refer to the March 18, 2011 OSC Bulletin and to related OSC Staff Notice 21-705, *Process for Marketplace Filings and Proposed Rules of Exchanges*, which has been reproduced in Volume 3A of the CANADIAN SECURITIES LAW REPORTER at ¶490-235.

CSA Publishes Proposed Designated Rating Organization Instrument

Credit rating organizations ("CROs") are not currently subject to formal securities regulatory oversight in Canada, even though the conduct of their business may have a significant impact upon credit markets and ratings continue to be referred to within securities legislation. For both of these reasons, the CSA has proposed a securities regulatory regime for CROs that is consistent with international standards and developments. In order to implement an appropriate Canadian regulatory regime for SROs, the CSA has published for comment a revised version of National Instrument 25-101, *Designated Rating Organizations*, as well as revised versions of the following documents:

- Consequential amendments to National Instrument 41-101, *General Prospectus Requirements*;
- Consequential amendments to National Instrument 44-101, *Short Form Prospectus Distributions*;
- Consequential amendments to National Instrument 51-102, *Continuous Disclosure Obligations*; and
- National Policy 11-205, *Process for Designation of Credit Rating Organizations in Multiple Jurisdictions*.

The CSA has requested written comments on the proposed amendments on or before May 17, 2011. For further information, please refer to the March 18, 2011 OSC Bulletin.

CSA Proposes Securitized Products Rules

The CSA recently published for comment proposed rules and rule amendments relating to securitized products (the "Proposed Securitized Products Rules"). The Proposed Securitized Product Rules set out a new framework for the regulation of securitized products in Canada, which consist of two main features:

1. Enhanced disclosure requirements for securitized products issued by reporting issuers; and
2. New rules that narrow the class of investors who can buy securitized products on a prospectus-exempt basis (in the "exempt market"), and require that issuers of securitized products provide disclosure at the time of distribution, as well as on an ongoing basis.

The CSA has requested written comments by July 1, 2011. For further information, please refer to the April 1, 2011 OSC Bulletin.

MUTUAL FUND DEALERS ASSOCIATION

Rules 1, 2, and 5 Amended

The amendments to the MFDA Rules have been incorporated in Volume 1 of the CANADIAN STOCK EXCHANGES MANUAL, starting at ¶701-001.

Notices 78 and 79 Added

The Notices have been incorporated in Volume 1 of the CANADIAN STOCK EXCHANGES MANUAL, at ¶706-078 and ¶706-079.

CANADIAN NATIONAL STOCK EXCHANGE

Notice 2011-001 Added

The Notice has been incorporated in Volume 1 of the CANADIAN STOCK EXCHANGES MANUAL at ¶1102-045.

Form 3 Amended

The amendments to Form 3 have been incorporated in Volume 1 of the CANADIAN STOCK EXCHANGES MANUAL at ¶1103-006.

TSX RULE BOOK AND POLICIES

TSX Rule Book Amended

The amendments to the Rule Book have been incorporated in Volume 2 of the CANADIAN STOCK EXCHANGES MANUAL, starting at ¶1700-001.

TSX Policies Amended

The amendments to the Policies have been incorporated in Volume 2 of the CANADIAN STOCK EXCHANGES MANUAL, starting at ¶1701-901.

TSX VENTURE EXCHANGE

TSX Venture Exchange Rules Amended

The amendments to the Rules have been incorporated in Volume 2 of the CANADIAN STOCK EXCHANGES MANUAL, starting at ¶2000-101.

FEDERAL UPDATE

Criminal Code of Canada Amended

The *Standing up for Victims of White Collar Crime Act*, S.C. 2011, c. 6, which amended the *Criminal Code*, was assented to on March 23, 2011 but is not yet in force. The amendments will be incorporated into Volume 1 of the CANADIAN SECURITIES LAW REPORTER starting at ¶62-025 in a future report.

PROVINCIAL UPDATES

Alberta

Alberta Securities Commission Staff Notice 91-702, *Over-the-Counter Derivatives*, dated February 28, 2011, has been added to Volume 2 of the CANADIAN SECURITIES LAW REPORTER at ¶178-137.

New Brunswick

New Brunswick Securities Commission Staff Notice 21-702, *Business Continuity Planning – Industry Testing Exercise*, dated February 8, 2011, has been reproduced in Volume 3 of the CANADIAN SECURITIES LAW REPORTER at ¶21-702.

Nova Scotia

The Fees Schedules in the Securities Regulations have been amended by Rule 11-504, effective April 1, 2011. These amendments have been incorporated into Volume 3 of the CANADIAN SECURITIES LAW REPORTER, starting at ¶406-701.

Notice No. 11-708, *Rule 11-504 Amendments to the Fees Schedules in the General Securities Rules*, dated March 16, 2011, has been reproduced in Volume 3 of the CANADIAN SECURITIES LAW REPORTER at ¶429-907.

Rule 11-504, *Amendments to the Fees Schedules in the General Securities Rules*, dated February 16, 2011, has been reproduced in Volume 3 of the CANADIAN SECURITIES LAW REPORTER at ¶425-008.

Blanket Order 41-503, dated February 16, 2011, has been reproduced in Volume 3 of the CANADIAN SECURITIES LAW REPORTER at ¶429-383. This order revokes Blanket Orders 41-501 and 44-501.

Nunavut

Bill 4, *Miscellaneous Statutes Amendment Act, 2011*, which amends the *Trustee Act*, received Royal Assent on March 10, 2011.

The *Business Corporations Act* was amended by S.Nu. 2011, c. 6, s. 3(2), in force February 25, 2011. This amendment has been incorporated into Volume 1A of the CANADIAN SECURITIES LAW REPORTER at ¶118-586.

The *Securities Act* was amended by S.Nu. 2011, c. 6, s. 25(2), Sched. G, in force February 25, 2011. This amendment has been incorporated into Volume 1A of the CANADIAN SECURITIES LAW REPORTER at ¶119-615.

Ontario

The *Good Government Act, 2011*, S.O. 2011, c. 1, which received Royal Assent on March 30, 2011 but is not yet in force, made various amendments to the *Business Corporations Act*. The amendments will be incorporated into Volume 3A of the CANADIAN SECURITIES LAW REPORTER starting at ¶460-001 in a future report.

The OSC issued Staff Notice 81-713 summarizing its findings from a series of focused reviews of independent review committee related disclosure and informal discussions with IRC members. The notice has been reproduced in Volume 3A of the CANADIAN SECURITIES LAW REPORTER at ¶490-989a.

The OSC recently issued revisions to the Table of Concordance and List of New Instruments. The revisions, which appear in OSC Staff Notice 11-739, will be incorporated into Volume 3A of the CANADIAN SECURITIES LAW REPORTER at ¶490-128l in a future report.

The OSC recently issued a practice directive under Staff Notice 41-702 to alert issuers (including investment fund issuers) and their advisers of the following:

- procedural changes to facilitate the OSC's review of personal information forms filed by directors, executives, officers, and other individuals; and

- common deficiencies in preliminary prospectus filings.

The notice, which also reminds issuers and their advisers of the timing for filing preliminary prospectus materials and the issuance of receipts, will be reproduced in Volume 3A of the CANADIAN SECURITIES LAW REPORTER at ¶490-552 in a future report.

The OSC recently issued a practice directive to alert issuers (other than investment funds) and their advisers of the procedural steps an issuer should follow when making an application for an exemption from certain requirements, where the exemption will be evidenced by the issuance of a receipt for a final prospectus (or by an amendment to a final prospectus). The notice will be reproduced in Volume 3A of the CANADIAN SECURITIES LAW REPORTER at ¶490-553 in a future report.

Recent Cases

Plan of arrangement

• • • **Ontario Securities Commission** • • • In June 2010, Staff of the Ontario Securities Commission (the "Commission") issued a Notice of Hearing in connection with a Statement of Allegations which alleged, among other things, that in connection with a proposed arrangement to eliminate a multiple voting structure (the "Proposed Transaction"), Magna International Inc. ("Magna") had failed to provide adequate disclosure to shareholders, and the Proposed Transaction was abusive. Due to the upcoming shareholders' meeting scheduled for June 28, 2010 to vote on the Proposed Transaction, the Commission issued a decision without reasons on June 24, 2010 (the "Decision"; see 2010 CSLR 900-357). The facts briefly are that Magna is a reporting issuer incorporated under the Ontario *Business Corporations Act* whose authorized share capital consisted of an unlimited number of Subordinate Voting Shares, Class B Shares, and Preference Shares. The Subordinate Voting Shares were entitled to one vote per share and the Class B Shares were entitled to 300 votes per share. All of the outstanding Class B Shares were held by 447 Holdings Inc. ("447"), and 447 was solely held by 446 Holdings Inc. ("446"), which in turn was a subsidiary of the Stronach Trust. Accordingly, the Stronach Trust had legal and effective control of Magna via indirect holdings, with 66 per cent of Magna's voting rights. In March 2010, Magna's executive management had discussions with Frank Stronach ("Stronach"), who provided consulting services to Magna and its subsidiaries personally and through private entities, as to whether he would consider the elimination of Magna's multiple voting structure as part of an overall reorganization. Stronach indicated he would be willing to consider the transaction if there was shareholder support and the arrangement did not jeopardize Magna's key operating principles. In April 2010, the executive management of Magna proposed that Magna purchase all of the outstanding Class B Shares for US$300 million and nine million Subordinate Voting Shares, make amendments to the existing consulting agreements with Stronach, and reorganize Magna's vehicle electrification business. A Special Committee was struck, which in turn hired independent financial and legal advisers to assess the Proposed Transaction. The advisers reported to the Special Committee that the cancellation of the outstanding Class B Shares would create a significant dilution of the Subordinate Voting Shares and the overall impact could not be known, as it was an unprecedented transaction in the Ontario capital markets. The Special Committee's advisers further determined that if the Proposed Transaction was to be submitted to shareholders, it should be approved by a majority of the votes cast at a special meeting by disinterested shareholders and be carried out as a plan of arrangement. This would require the Proposed Transaction to be subject to a review by a court to consider fairness and reasonableness. Neither the Special Committee nor the Magna board (the "Board") made any recommendations as to how shareholders should vote in respect of the Proposed Transaction in the Management Information Circular/Proxy Statement that was issued in relation to the Proposed Transaction (the "Circular"). Prior to the June 28, 2010 shareholders' meeting, the Commission also granted Torstar standing to various groups, including institutional shareholders of Magna who were opposed to the Proposed Transaction, and shareholders who were in favour of the Proposed Transaction (see 2011 CSLR 900-384). Security analysts at various investment institutions and a third-party market analyst were generally supportive of the Proposed Transaction.

In its decision, the Commission concluded it was in the public interest to order that: (a) if Magna wished to proceed with shareholder approval of the Proposed Transaction, the Circular must be amended and resent to shareholders; (b) the Subordinate Voting Shares issued by Magna in connection with the Proposed Transaction were to be cease traded until Magna complied with the required amendments to the Circular; and (c) the exemption in paragraph 5.5(a) of MI 61-101, *Protection of Minority Security Holders in Special Transactions* ("61-101"), would not be available until the disclosure requirements of section 5.3 were complied with.

There were four issues before the Commission:

(a) Did the Circular provide sufficient disclosure to the Class A Shareholders to permit them to make an informed decision?;

(b) Was the Proposed Transaction abusive?;

(c) Did the Board comply with its fiduciary duties in submitting the Proposed Transaction to shareholders?; and

(d) Was the process followed by the Board and Special Committee in reviewing the Proposed Transaction inadequate?

The Commission ordered a cease trade of the Subordinate Voting Shares pending compliance with additional disclosure requirements.

To the first issue of the adequacy of the disclosure in the Circular, the Commission began by stating that the disclosure required was the same under securities, corporate, and common law; that is, the disclosure in a circular must have been in sufficient detail to enable a reasonable shareholder to make an informed decision on how to vote on a proposed transaction. Furthermore, the disclosure standard is contextual and varies with the circumstances. In this case, the Proposed Transaction was also a "related party transaction" within the meaning of 61-101, and while the Market Cap Exemption would have applied (and no party disputed the application), the Board chose to have the simple majority of the Class A Shareholders approve the Proposed Transaction. As a result of required approval, subsection 5.2(1) of 61-101 applied, which required more fulsome disclosure, including the Board's reasonable beliefs about the fairness of the Proposed Transaction, the Board's recommendations, the background of the Board's and Special Committee's deliberations, and an analysis of any expert opinions obtained by the Special Committee. In the Commission's view, the fact that neither the Board nor the Special Committee made any recommendations as to how shareholders should vote meant the shareholders were essentially "left to their own devices" as to how to vote, and this demanded a higher level of disclosure. The Commission held that the shareholders should have had the same information and analysis that the Special Committee had in order to make an informed vote, instead of the simple laundry list of considerations, factors, and information that the Special Committee reviewed. Other deficiencies in the Circular included the lack of the potential benefits of the Proposed Transaction to Class A Shareholders, alternatives to the Proposed Transaction, and why the financial advisers engaged by the Special Committee to review the Proposed Transaction refrained from providing any opinions or formal valuations.

To the second issue of whether the Proposed Transaction was abusive, the Commission turned to subsection 127(1) of the Act, which authorizes it to intervene where it is in the public interest to do so. However, this broad jurisdiction to act is constrained by the purposes of the Act and any order under section 127 is to "restrain future conduct that is likely to be prejudicial to the public interest in fair and efficient capital markets" (see *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132). Further, where there is no breach of Ontario securities law, this conduct must be proven to be abusive of investors or the capital markets, and be beyond a mere complaint of unfairness (see *Re Canadian Tire Corp.* (1987), 10 OSCB 857). In the case at bar, the holders of the Subordinate Voting shares knew, when they purchased their shares, that they had no right to participate in any such buyout as the one being proposed. The Stronach Trust, as the controlling shareholder, was legally entitled to sell its Class B Shares at any price it negotiated. In the Commission's view, it appeared that the primary complaint of the shareholders who opposed the Proposed Transaction was that they felt the price being paid for the Class B Shares was excessive. However, as the Commission noted, a transaction is not abusive simply because certain shareholders consider the price to be inappropriate. Further, the fact that the Class A shareholders were required to approve the Proposed Transaction also undermined the possibility that it was an abusive transaction. The Commission concluded that the Class A Shareholders were entitled to decide for themselves whether the Proposed Transaction would proceed via a vote, and the Commission had no jurisdiction to intervene with that entitlement.

The Commission declined to answer the third issue of whether the Board complied with its fiduciary duties in submitting the Proposed Transaction to the shareholders. In its view, it is not generally within the Commission's jurisdiction to address what is essentially a corporate law matter, although there may be instances where it is appropriate to consider the role and process followed by a board or special committee when it reviewed a transaction. In this case, the Committee saw no reason to believe there was impropriety in the Board's delegating the decision of how to vote for the Proposed Transaction to shareholders, as it was their right to do so.

Regarding the final issue of the adequacy of the Board and Special Committee in reviewing the Proposed Transaction, the Commission looked to 61-101, which imposes requirements on related party transactions. Under the Companion Policy to 61-101, a committee of independent directors should negotiate, or review and report on, a related party transaction to ensure that all shareholders are treated fairly. In the findings of the Commission, there were three major issues with respect to the actions of the Board and Special Committee. First, it was improper for executive management to have negotiated with the Stronach Trust after it was made clear that Stronach was willing to collapse the dual class share structure. This negotiation should have been conducted by the Special Committee, as by the time it came to the Special Committee it was a "take it or leave it" proposition. Second, the mandate of the Special Committee was, in the opinion of the Commission, too narrow. The Special Committee was limited to considering and reviewing a proposal developed by the executive management and reporting to the Board. This mandate did not authorize the Special Committee to address the key question of whether the Proposed Transaction was fair to the Class A Shareholders. It also seemed nonsensical to the Commission that the Special Committee brought its obser-

vations and commentary to executive management when it should have dealt with the Stronach Trust. Although this taint led the Commission to consider intervening in the Proposed Transaction, ultimately, the Commission found that there was insufficient evidence of the process and deliberations of the Special Committee for it to interfere.

Subsequent to the issuance of the decision, the special meeting of the shareholders was postponed until July 28, 2010, to allow for the issuance of a supplement to the Circular which was reviewed by the Staff of the Commission (who had no further comment). At the special meeting, the Proposed Transaction was approved, and in August 2010, the Ontario Superior Court of Justice approved the Proposed Transaction, as it had satisfied the "fair and balanced" test (see 2010 CLSR 900-364). An appeal by certain Magna shareholders was dismissed (see 2010 CSLR 900-370), and the Proposed Transaction was completed in accordance with its terms.

Re Magna International Inc., 2011 CSLR ¶900-391,
June 24, 2010 (Ontario Securities Commission)

Sanctions and costs

• • • **Ontario Securities Commission** • • • In a September 7, 2010 decision, an Ontario Securities Commission ("OSC") Panel (the "Panel") found that Lewis Taylor Sr., Lewis Taylor Jr., Jared Taylor, Colin Taylor, and 1248136 Ontario Limited (collectively, the "Taylor Respondents") and Rene Pardo ("Pardo") (collectively, the "Respondents") had violated the registration and prospectus requirements of the Ontario *Securities Act* (the "Act") and had made representations prohibited by the Act contrary to the public interest. The Panel's findings were made in connection with the sale of the shares of Mega-C Power Corporation ("Mega-C"). The Respondents all had various substantial involvements with Mega-C (and with a related corporation, Mega-C Technologies), either having made key decisions or having been in positions to make key decisions.

This was the second phase of the hearing, at which the Panel provided reasons and decisions as to the appropriate sanctions and costs that should be ordered against the Respondents. In determining the appropriate sanctions, the Panel considered the factors set out in *Re Belteco Holdings Inc.* (1998), 21 O.S.C.B. 7743, *Re M.C.J.C. Holdings and Cowpland* (2003), 26 O.S.C.B. 8206, and *Re Lamoureux*, [2002] A.B.S.C. No. 125. These factors included:

(a) the seriousness of the misconduct and the harm done;

(b) the respondents' characteristics, including their capital market experience;

(c) benefits received by the respondents;

(d) whether the seriousness of the improprieties and remorse have been recognized;

(e) the risk to investors if the respondents were allowed to continue to operate in the capital markets; and

(f) mitigating factors.

The Panel imposed sanctions (including disgorgement) against the Respondents. The Panel began by noting that Pardo's conduct was serious and had directly caused great harm to hundreds of investors. For example, Pardo had attended several meetings, where he made misrepresentations to potential investors that Mega-C had applied (or would apply) to be listed on a stock exchange. The Panel also found that Pardo had received benefits from Mega-C of approximately C$900,000, and was an experienced businessman with considerable capital market experience. In the Panel's opinion, Pardo appeared to understand the seriousness of his conduct, as there was evidence supporting his claim that when he saw the harm being done to investors, he made efforts to assist them. However, Pardo's conduct showed a lack of understanding of his responsibilities as an officer of an issuer.

Consequently, the Panel concluded that it would be in the public interest to make an order that would protect investors from similar conduct by Pardo in the future.

Turning to Lewis Taylor Sr., the Panel found that he had devised and led the common enterprise based on a promissory note scheme, and enlisted the help of his three sons. It also found that he was an experienced businessman, and had previously been found to have contravened Ontario securities law. In contrast, the Panel concluded that his sons, Lewis Taylor Jr., Jared Taylor, and Colin Taylor, had limited business experience and had no previous record of any kind with the OSC. According to the evidence, the three sons were influenced by their father, and would have been unable to assess the merits of the promissory note scheme and its compliance with the Act, since they were relatively young and inexperienced when the scheme began. Nevertheless, the Panel found that Lewis Taylor Jr. had employed his sales skills, in meeting with investors and in preparing written materials to persuade them to invest in Mega-C. Further, Jared Taylor issued the promissory notes to investors, collected the funds from them, and instructed Pardo to issue share certificates to them. Lastly, Colin Taylor had played a lesser role by directing Pardo (through his company) to transfer Mega-C shares into the names of several individuals who invested through the Taylor Respondents.

The Panel ultimately found that the Taylor Respondents did not recognize the seriousness of their misconduct and imposed sanctions on them to protect investors from similar conduct in the future, and to send a message of general deterrence to others considering similar contraventions under the Act. The Panel also imposed a disgorgement order on the Respondents to ensure that none of them benefited from their breaches of the Act, and to deter them (and others) from similar misconduct in the future. The orders included that:

(a) with certain exceptions, the Respondents were barred from trading in or purchasing securities and from using exemptions under Ontario securities law;

(b) the bans applied to each Respondent for various periods of time;

(c) the Respondents were reprimanded;

(d) the Respondents would resign as directors or officers of any issuer and were, for various periods of time, prohibited from acting as a director or officer of any issuer; and

(e) the Respondents would disgorge monies to the OSC in various amounts.

No costs were ordered.

Re Mega-C Power Corporation, 2011 CSLR ¶900-392, January 26, 2011 (Ontario Securities Commission)

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