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SECURITIES LITIGATION AND ENFORCEMENT: THE CANADIAN PERSPECTIVE

Poonam Puri

INTRODUCTION

Achieving the proper balance between public and private securities enforcement is critical for promoting investor confidence and robust capital markets. There has been extensive research to determine whether public or private enforcement provides more effective market discipline and investor protection. These studies generally approach the question in terms of efficiency, accountability, ability to provide comprehensive market discipline, deterrence, and the best interests of the public. As a result, the traditional debate pits public and private enforcement against each other in an attempt to suggest that one offers an all-around superior approach.¹ This Article suggests that public and private enforcement each serve important and complimentary roles in protecting the interests of the investing public. Thus, it cannot be said that one is necessarily more important or capable than the other, rather that they should be understood as part of a unitary regime.

Although a comparative approach is used, the primary focus of this article is how recent legislative changes and market events have influenced the Canadian securities landscape. In doing so, this Article contributes to the ongoing debate on public and private enforcement by evaluating securities enforcement from a systemic perspective, focusing on the relationship between public and private enforcement and synergies that exist in the Canadian environment. This analysis of recent trends and literature on securities enforcement in Canada highlights the interrelationship between public and private enforcement in Canada and supports the con-

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1. See Rafael La Porta et al., *Investor Protection: Origins, Consequences, Reform* 5–6 (World Bank Fin. Sector, Discussion Paper No. 1, 1999), available at http://www1.worldbank.org/finance/assets/images/Fs01_web1.pdf; Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 207, 207–08 (2009).

clusion that any legislative changes must consider the securities regulatory framework as a whole as opposed to affecting changes on a piecemeal basis.

Part I of this Article begins with an overview of Canadian capital markets in comparison to those in the United States. This Part highlights the disproportionately high number of reporting issuers in Canada given the size of Canadian capital markets, the difficulties inherent in Canada's provincially regulated securities environment, and the traditionally more conservative behavior of Canadian regulators in respect of enforcement.

Part II discusses public enforcement in Canada and the traditional criticism that Canadian regulators are less aggressive than their American counterparts. However, examination of this claim suggests that these distinctions are primarily due to Canada's differing philosophical approach to securities regulation relative to the United States, rather than a reduced capacity. Also considered in Part II are three recent developments in Canadian securities regulation. First, there is the introduction of no-contest settlements in Ontario. Unlike securities regulators in the United States, Canadian regulators historically do not allow no-contest settlements. However, in late 2011, the Ontario Securities Commission ("OSC") began public consultations to allow this form of settlement.² Second, is the public regulators' initiative to provide compensation to investors. The OSC decided to provide investors with the proceeds from large public settlements following the asset-backed commercial paper ("ABCP") crisis in 2007³ as well as settlements from the 1999–2003 Canadian mutual funds market timing scandal.⁴ Although these changes are positive developments for Canadian securities regulation and provide a dynamic balance between public and private enforcement, regulators should establish clear policies to ensure that investors' expectations are protected. This Part of the Article concludes with a discussion of Canada's effort to introduce a national securities regulator and the options available follow-

2. *OSC Staff Notice 15-704 Request For Comments on Proposed Enforcement Initiatives*, 34 O.S.C. BULL. 10720, 10720–26 (2011) [hereinafter *OSC Staff Notice 15-704*], available at http://www.osc.gov.on.ca/documents/en/Securities-OSCB/oscb_20111021_3442.pdf.

3. Notice of Application, *In re Ont. Sec. Comm'n & Inv. Indus. Regulatory Ass'n of Can. & In re Declaration Concerning the Interpretation of the Order of June 5, 2008* by the Honourable C. Campbell J. Approving the Plan of Compromise and Arrangement Involving Metcalfe & Mansfield Alternative Investments Corp et al., Toronto CV 12-9606-OOCL (Ont. Sup. Ct., Feb. 15, 2012) (Can.), available at http://www.osc.gov.on.ca/documents/en/News/nr_20120216_osc-irroc-notice-application.pdf.

4. Settlement Agreement, *In re Sec. Act R.S.O. 1990, c.S.5, as amended & AGF Funds Inc.*, OSC PROC. (Dec. 12, 2004).

ing a recent decision by the Supreme Court of Canada that the federal government lacks jurisdiction to establish a national securities regulator.

Finally, Part III reviews the development of private enforcement in Canada. Unlike private enforcement in the United States, Canada's private enforcement regime is a relatively recent development. Class action legislation was introduced in 1993 and secondary market statutory liability came into force in 2005.⁵ Another factor distinguishing Canada from the United States is the Canadian cap on secondary market statutory liability. Canada's private enforcement regime is less developed than the United States. The reduced amount of litigation in Canada is partially attributable to the balance between public regulation and private enforcement, as demonstrated by the court's sanctioned release from private liability in the ABCP crisis in 2007.⁶ Part III concludes with a review of Canada's class action regime and the growing number of global class actions certified in Canada. Although Canada's private enforcement regime is less litigious than the U.S. regime, this appears to be changing now that Canadian securities legislation makes it easier for plaintiffs to bring private actions and the securities class action bar is becoming more developed.

I. CANADIAN CONTEXT

Canadian capital markets are closely integrated with the United States and have generally followed its lead on major legislative reforms. This Part provides a brief context on the structure of and development of Canadian capital markets, reviews the tendency for Canadian regulators to follow the lead of the United States, and finally, introduces challenges that exist in Canada's provincially regulated securities environment.

A. The Nature of Canadian Capital Markets

First, Canadian capital markets are relatively small in relation to international equity markets. As of 2004, the size of Canadian markets was approximately CAD \$1.178 trillion, comprising about 3.2% of worldwide market capitalization.⁷ In stark comparison, the combined market

5. Class Proceedings Act, S.O. 1992, c. 6 (Can.); Ont. Bill 198, An Act to implement Budget measures and other initiatives of the Government, 4th Sess., 37th Parl., § 185 (2005) (Can.).

6. Pan-Canadian Investors Comm. for Third-Party Structured Asset-Backed Commercial Paper v. Metcalfe & Mansfield Alternative Investments II Corp., 2008 CanLII 23497 (Can. Ont. Sup. Ct. J.) [hereinafter Metcalfe & Mansfield].

7. Christopher Nicholls, *The Characteristics of Canada's Capital Markets and the Illustrative Case of Canada's Legislative Regulatory Response to Sarbanes-Oxley*, in 4

capitalization of the New York Stock Exchange (“NYSE”), the American Stock Exchange, and the NASDAQ Stock Market was approximately 43.9%.⁸ While Canada’s total market capitalization is not very large, it hosts a disproportionately large number of public companies, meaning there are a high number of smaller companies. In 2004, there were approximately 3,500–4,000 public companies,⁹ a large number when compared to the 9,400 public companies in the United States at that time.¹⁰ In fact, at this time, Canada appeared to have more public companies per capita.¹¹ Another important feature of the Canadian public company landscape is that it has a relatively small number of very large issuers. For example, the 100 largest companies on the Toronto Stock Exchange (“TSX”) account for over 70% of the market capitalization of all TSX-listed companies.¹² By contrast, the 1,000 smallest issuers on the TSX account for less than 5% of its total market capitalization.¹³ There is a disparity between the United States and Canada’s perspectives as to what characteristics define a “small” or “large” company, with Canada’s small issuers being significantly smaller than those in the United States.¹⁴ This results in a bifurcation in Canada’s issuer base, which might suggest that Canada needs, in some instances, different policies and enforcement strategies to accommodate for the unique range of issuers.¹⁵ Also, this data suggests that some Canadian public companies go public too early, that the venture capital market is underdeveloped, and that there are opportunities for consolidation.¹⁶

Another important feature of Canada’s capital market landscape is that many of the largest issuers, representing over 50% of the TSX’s market capitalization, are cross-listed on American exchanges.¹⁷ Data shows that

CANADA STEPS UP 129, 149 (June 15, 2006), *available at* <http://www.tfmsl.ca/docs/V4%283A%29%20Nicholls.pdf>.

8. *Id.* at 149.

9. *Id.*

10. *Id.* at 153.

11. *Id.*

12. *Id.* at 154.

13. *Id.*

14. *Id.* at 162.

15. *See generally id.* (suggesting that the “lighter” regulations set up for small-cap companies in the U.S. could still “prove overly burdensome” for the even smaller small-cap companies in Canada).

16. *See id.* at 157. Nicholls suggests that this information is at least evident of the fact that less consolidation of firms occurs in Canada than in the United States and that companies in Canada are going public at an earlier stage—from 1995–2005, over half of the companies that made initial public offerings in Canada had market caps of less than \$100 million and less than 5% had market caps of over \$500 million.

17. *Id.* at 158.

eighty-six issuers on the TSX were also listed on the New York Stock Exchange (“NYSE”), with fifty-one of the largest issuers falling into this category.¹⁸ NASDAQ’s exchanges feature fifty-one TSX-listed issuers.¹⁹ Practically speaking, cross-listed companies are subject to the rules and regulations of both Canada and the United States, with possible enforcement oversight by both the U.S. Securities and Exchange Commission (“SEC”) and Canadian securities regulators.²⁰ This “double oversight” causes concerns about the potential confusion in accountability between Canadian and U.S. regulators and duplication of regulatory actions, and raises the broader question of whether both jurisdictions should be involved in enforcement activities. Indeed, some suggest that Canada should maintain its focus on Canadian-only companies and leave the oversight of enforcement activities for cross-listed issuers to the SEC.²¹ If this suggestion were followed however, many of the larger issuers in Canada would be excluded from Canadian oversight, even though a significant number of their investors would likely be Canadian. From a policy perspective, the independence and autonomy of Canadian regulators would also be greatly undermined.

The Canadian exchanges are often associated with various categories of listed public companies including the natural resource industry. In 2004, Canadian exchanges were most active in mining, oil and gas, manufacturing, technology, and financial services.²² Today, the TMX Group, which is the umbrella organization for the TSX and the Toronto Stock Venture Exchange, notes that these two exchanges list the highest number of oil and gas companies than any other exchange in the world.²³

An important feature of the Canadian corporate governance landscape is that Canadian public companies are allowed to maintain a dual-class share structure. This structure enables companies to issue multiple classes of shares with differential voting rights attached to the shares and

18. *Id.*

19. *Id.*

20. ONT. SEC. COMM’N [O.S.C.], NATIONAL INSTRUMENT 71-101 TRANSACTIONS OUTSIDE THE JURISDICTION (1999).

21. Warren Grover, Q.C., Blake, Cassels & Graydon LLP, Falconbridge Lecture in Commercial Law at Osgoode Hall Law School: Corporate Governance of Greed 18 (Oct. 7, 2004), *transcript available at* <http://osgoode.yorku.ca/media2.nsf/events/612468A480B1787885256F2C006DEAAB>.

22. Nicholls, *supra* note 7, at 164.

23. *See Energy, Oil & Gas*, TMXMONEY, http://www.tmxmoney.com/en/sector_profiles/energy.html (last updated Feb. 24, 2012).

often rests significant control in the hands of few people.²⁴ In these situations, minority (by votes) shareholders may be less able to exercise influence, and thus, shareholder approval may not always be demonstrative of appropriate governance practices.²⁵ Dual-class share structures are more common in Canada than in the United States.²⁶ Any discussion of corporate governance must proceed with the understanding that the challenge is not only to ensure that professional managers act in the best interests of the organization, its shareholders, and stakeholders, but also to implement practices that minimize the ability of controlling shareholders to extract private benefits for their advantage and to the detriment of public shareholders.²⁷

B. Geographic and Other Proximities to the United States

The United States has an undeniable influence on Canadian capital markets and securities regulation. While the Canadian and U.S. regimes are quite different, there is no doubt that geographical proximity and cultural, political, economic, and legal developments in the United States impact Canadian practices. First and most obviously, the geographic proximity of the United States and the size of its markets make American legislation relevant to Canadian companies that are cross-listed on U.S. exchanges and to companies that plan to be in the future.²⁸ Second, the proximity and resulting similarities in terms of cultural, political, and economic norms have created interdependencies between the two jurisdictions with regard to trading and many other facets of business. While Canadian autonomy will always be a concern, the reality in the securities industry is that the relative sizes of the Canadian and U.S. markets alone will significantly influence how autonomous Canada can truly be.²⁹

24. Anita Anand, Frank Milne & Lynnette Purda, *Voluntary Adoption of Corporate Governance Mechanisms* 13 (Queen's Univ. Econs. Dept., Working Paper No. 1112, 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=921450.

25. Anita Anand, *Towards Effective Balance Between Investors and Issuers in Securities Regulation*, in 3 CANADA STEPS UP 25 (Aug. 1, 2006), available at <http://www.tfmsl.ca/docs/v3%281%29%20anand.pdf>.

26. Houlihan Lokey, *Dual Class Stock Structures*, AM. BAR ASSOC. 1 (Aug. 2011), <http://www2.americanbar.org/calendar/2011-aba-annual-meeting-business-law/Meeting%20Materials/1986.pdf>. Companies are not allowed to adopt dual-class structures once they have been registered on the NYSE. *Id.*

27. Stephanie Ben-Ishai & Poonam Puri, *Dual Class Shares in Canada: An Historical Analysis*, 29 DALHOUSIE L.J. 117, 126–32 (2006).

28. Anand, *supra* note 25, at 42.

29. See Nicholls, *supra* note 7, at 149 (Canada has approximately 3.2% of worldwide market capitalization).

An example of the convergence to U.S. policies and practices is Canada's adoption of new, stricter corporate governance rules following the enactment of the Sarbanes-Oxley Act of 2002 ("SOX").³⁰ In response to the various corporate scandals making their way through North America, the United States enacted the SOX legislation to tighten up their corporate governance rules and address issues such as accounting fraud and top-level mismanagement.³¹ Following this development, Canada faced pressure to adopt similar changes and in 2004 implemented National Instrument 58-101,³² National Policy 58-201,³³ and National Instrument 52-110,³⁴ all of which addressed the need for stricter corporate governance guidelines.³⁵ Regardless of whether this new legislation in the United States was adopted by Canadian regulators, many Canadian companies were forced to comply with the SOX requirements given the high proportion of companies cross-listed on U.S. exchanges. From this perspective, U.S. rules and legislation became just as relevant as Canadian laws.³⁶ Additionally, Canadian corporate governance policy may converge with U.S. rules and regulations even when they are only listed in Canada because of global competition. Specifically, Canadian companies may feel pressure to adopt U.S. guidelines to match what many of their competitors have already done.³⁷

30. See generally Tara Gray, Econ. Div., Canadian Response to the U.S. Sarbanes-Oxley Act of 2002: New Directions for Corporate Governance, PRB 05-37E (2005) (Can.).

31. Erinn B. Broshko & Kai Li, *Corporate Governance Requirements in Canada and the United States: A Legal Empirical Comparison of the Principles-Based and Rules-Based Approaches* 1 (Sauder Sch. of Bus. Working Paper, 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=892708##; see also Poonam Puri & Anindya Sen, *A Cost Benefit Analysis of the Multi-Jurisdictional Disclosure System*, OSGOOD HALL L. SCH. 19-20 (June 10, 2003), [http://osgoode.yorku.ca/osgmedia.nsf/0/1D216EBEABA2FCFA852571CC00596068/\\$FILE/Cost_Benefit_MJDS.pdf](http://osgoode.yorku.ca/osgmedia.nsf/0/1D216EBEABA2FCFA852571CC00596068/$FILE/Cost_Benefit_MJDS.pdf).

32. O.S.C., NATIONAL INSTRUMENT 58-201 DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES (2008).

33. O.S.C., NATIONAL INSTRUMENT 58-201 CORPORATE GOVERNANCE GUIDELINES (2005), available at http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20050617_58-201_corp-gov-guidelines.pdf.

34. O.S.C., MULTILATERAL INSTRUMENT 52-110 AUDIT COMMITTEES (2011).

35. Broshko & Li, *supra* note 31, at 1; see also POONAM PURI, CAPITAL MARKETS INSTITUTE, ENFORCEMENT EFFECTIVENESS IN CANADIAN CAPITAL MARKETS 6-7 (Dec. 1, 2005) [hereinafter PURI, ENFORCEMENT EFFECTIVENESS], available at http://www.investorvoice.ca/Research/Puri_Enforcement_Effectiveness_01Dec05.pdf.

36. Anand, *supra* note 25, at 44.

37. *Id.*

Most importantly, the proximity and similarity to the larger, and arguably more sophisticated, U.S. market has prompted criticism of Canada's comparatively lax securities enforcement efforts.³⁸ While there are many factors to consider when evaluating the comparative effectiveness of the two regimes, including the types of remedies available to regulators and the timing of the development of each regime, many assert the relative effectiveness of the U.S. regime over the Canadian one.³⁹ One reason for this perception that the United States is a more effective enforcer is the SEC's aggressive pursuit of high-profile cases. The Hollinger scandal provides a good example. Conrad Black was removed as the Chairman of Hollinger in January 2004 and was aggressively investigated by the SEC thereafter, resulting in a civil fraud lawsuit in November of that year.⁴⁰ It was not until March of 2005 that the OSC launched proceedings against Black and Hollinger Inc.⁴¹ In 2004, after mounting pressure in the face of the SEC's swift pursuit, the OSC was forced to depart from standard practice and announced that an investigation into the activities surrounding the alleged fraud was, in fact, under way.⁴² Addressing the difference between the OSC and SEC pursuit of the matter, former Premier of Ontario Bob Rae stated, "For me, the hardest part about the Conrad Black trial has been explaining why it happened in Chicago and not Toronto."⁴³

As mentioned above, the convergence toward U.S. policies is a discernable trend, and will be further discussed below in the context of a

38. See, e.g., Peder de Carteret Cory & Marilyn L. Pilkington, *Critical Issues in Enforcement*, in 6 CANADA STEPS UP 167, 196-97 (Sept. 2006), available at http://www.investorvoice.ca/Research/CanadaStepsUp_Critical_Issues_Sept06.pdf; PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 4.

39. A more in depth discussion takes place in the following section on Public Enforcement in Canada. See *infra* Part II.

40. Press Release, U.S. Sec. & Exch. Comm. [S.E.C.], SEC Files Fraud Charges against Conrad Black, F. David Radler and Hollinger Inc. (Nov. 15, 2004) [hereinafter SEC Press Release], available at <http://www.sec.gov/news/press/2004-155.htm>; see also *OSC Launches Proceedings Against Black, Hollinger Inc.*, CBC NEWS (Mar. 18, 2005, 8:56 PM), <http://www.cbc.ca/news/canada/story/2005/03/18/osblack-050318.html> [hereinafter CBC NEWS].

41. Statement of Allegations of Staff of the O.S.C. at 1, *In re* Sec. Act R.S.O. 1990, c. S.5, & Hollinger Inc., OSC PROC. (Mar. 18, 2005) (Can.) [hereinafter *Hollinger*], available at http://www.osc.gov.on.ca/documents/en/Proceedings-SOA/soa_20050318_hollinger-inc.pdf.

42. *OSC Says Hollinger Investigation Underway*, OTTAWA BUS. J. (Jan. 22, 2004), <http://www.obj.ca/Other/Archives/2004-01-22/article-2129056/OSC-says-Hollinger-investigation-underway/1>.

43. Tyler Hamilton, *Why the OSC so rarely gets its man*, TORONTO STAR (Dec. 1, 2007), <http://www.thestar.com/printArticle/281645>.

very recent proposal by the OSC, which, if implemented, will have a considerable impact on the ease and frequency with which settlements can be reached in Canada.

C. Provincial and Territorial System of Securities Regulation

As alluded to earlier, the structures of the Canadian and U.S. regulatory regimes are quite different. To start, while the United States has one national regulator governing the activities of capital markets and state regulators addressing local needs, Canada employs regulators only at the provincial and territorial level.⁴⁴ As a result, the securities regulation landscape is divided into thirteen jurisdictions. Many commentators have suggested that the current regulatory structure in Canada may increase noncompliance and impose unnecessary costs on investors and market participants. The number of regulators combined with criminal enforcement efforts and self-regulatory organizations (“SROs”) increases the need for coordination and cooperation, and may cause jurisdictional overlap and accountability issues.⁴⁵

Variations in remedies and underlying policies across regulators also raise the question of whether a more centralized body is needed to regulate Canada’s capital markets.⁴⁶ Currently, the Canadian Securities Administrators (“CSA”) undertakes coordination efforts across provinces and territories, and aligns policy goals across jurisdictions.⁴⁷ The CSA is also tasked with releasing annual reports to communicate relevant information regarding enforcement and sanctions to the public.⁴⁸

Securities experts in Canada have been deliberating over the transition to a national regulator for approximately forty years, with no success to date.⁴⁹ Various expert panels and task forces have been established to explore the issue and what such a shift would mean for the future of securities regulation in Canada.⁵⁰ Indeed, the move towards a national

44. Constitution Act, 1867, 30 & 31 Vict., c. 3, § 92(13) (U.K.), *reprinted in* R.S.C. 1985, app. II, no. 5 (Can.).

45. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 9.

46. *Id.* at 21–22.

47. See generally CANADIAN SEC. ADM’RS, <http://www.securities-administrators.ca/aboutcsa.aspx?id=77> (last visited Apr. 9, 2012) (the Canadian Securities Administrators are comprised of regulators from each province and territory in Canada and are “primarily responsible for developing a harmonized approach to securities regulation across [Canada]”).

48. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 23.

49. Poonam Puri, *Legal Origins, Investor Protection, and Canada*, 2009 BYU L. REV. 1671, 1688 [hereinafter Puri, *Legal Origins*].

50. For example, the Task Force to Modernize Securities Legislation was established in 2005 in order to make recommendations for modernizing Canadian legislation to in-

regulator may be seen as another choice by Canada to converge to the U.S. approach. Some would argue that Canada is closer than ever to making this proposition a reality.

The latest attempt to establish a national regulator resulted in the creation of the Canadian Securities Transition Office as of June 2009, as per the report and recommendations of the Expert Panel on Securities Regulation.⁵¹ Further, a proposed federal securities act was tabled in the House of Commons on May 26, 2010 and referred to the Supreme Court of Canada for a reference decision on whether the federal government had jurisdiction to introduce this legislation.⁵² The initiative has received pushback from some Canadian provinces, notably Quebec and Alberta, which have questioned the constitutionality of the proposed legislation, citing an infringement of the federal government on provincial powers.⁵³ Reference hearings took place in April 2011, and the Supreme Court rendered its decision in December 2011, holding that the federal government lacks the jurisdiction to unilaterally create a national securities regulator.⁵⁴ Accordingly, a deeper look at the current structure of the Canadian capital market regime and some of the proposed changes to it are discussed in Part II below.

D. Canada Comes Out of the Global Financial Crisis Unscathed, or Not?

Amidst the economic turbulence that the world has experienced since 2008, Canada is perceived to have a safe and stable regulatory system and a conservative banking industry.⁵⁵ Indeed, the *Washington Post* writes that, "While the United States reels from the global financial crisis, with credit markets still frozen and stock prices careening from highs

crease Canada's competitiveness and maintain investor protection. See Paul Halpern & Poonam Puri, "Canada Steps Up"—Task Force to Modernize Securities Legislation in Canada: Recommendations and Discussion, 2 CAPITAL MARKETS L.J. 191 (2007).

51. Puri, *Legal Origins*, supra note 49, at 1693; see CAN. SEC. TRANSITION OFF., <http://csto.ca> (last visited Apr. 9, 2012).

52. Reference re Securities Act, 2011 SCC 66, ¶ 134 (Can.), available at <http://scc.lexum.org/en/2011/2011scc66/2011scc66.pdf>.

53. Nigel Campbell & Doug McLeod, *Supreme Court Hears Arguments on National Securities Regulator*, BLAKES BULL. (Apr. 20, 2011), http://www.blakes.com/english/view_bulletin.asp?ID=4714.

54. *Re Securities Act*, 2011 SCC 66, ¶ 134 (Can.).

55. Caroline Hepker, *G20: Why we all want to be Canadian now*, BBC NEWS (June 25, 2010), <http://www.bbc.co.uk/news/10409354>.

to lows, Canada has remained relatively insulated.”⁵⁶ In 2010, the World Economic Forum touted Canada as having the soundest banking system in the world for the third consecutive year.⁵⁷ On this achievement, Finance Minister Jim Flaherty commented that the stability of Canada’s financial sector “is the result of a sound regulatory regime, including capital requirements for financial institutions that are well above minimum international standards and higher than in many other jurisdictions, and a more conservative risk appetite among financial institutions.”⁵⁸ He also emphasized, however, that regulation is not enough to maintain a safe financial environment—effective supervision is also essential.⁵⁹ The Canadian market is seen to be so stable that Mark Carney, Governor of the Bank of Canada, was appointed chairman of the Financial Stability Board on November 4, 2011, most likely due to “Canada’s global reputation for strong financial services regulation, and the strength of Canada’s banks.”⁶⁰

This perception that Canada’s stable regulatory environment allowed it to escape the catastrophic effects of the credit crisis serves as a direct contradiction to the criticism that Canada’s fragmented regulatory regime is inadequate for the challenges faced by financial markets. The fact remains that Canada *did* face a crisis, albeit smaller in scale than the rest of the world. Following the subprime crisis in the United States, Canadian holders of commercial paper questioned the value of the assets behind their paper and, to protect themselves, discontinued investing in the ABCP market; the result being that conduits were not able to pay out maturing ABCP.⁶¹

56. Keith B. Richburg, *Worldwide Financial Crisis Largely Bypasses Canada*, WASH. POST (Oct. 16, 2008), <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/15/AR2008101503321.html>.

57. Press Release, Dep’t Fin. Can., World Economic Forum Ranks Canadian Banks Soundest in the World for the Third Consecutive Year (Sept. 9, 2010), *available at* <http://www.fin.gc.ca/n10/10-078-eng.asp>.

58. *Id.*

59. *Id.* Although a full discussion of this issue is beyond the scope of this Article, it should be noted that Canada’s ability to escape relatively unscathed can be attributed to Canada’s use of a non-risk adjusted leverage ratio in addition to the Basel II’s requirements on Tier I capital, the high degree of concentration in Canada’s financial system, and the risk-averse culture in the Canadian banking industry. For more information see Puri, *Legal Origins*, *supra* note 49.

60. Eric Reguly, *Carney Takes Reins of Global Banking Watchdog*, GLOBE & MAIL, Nov. 3, 2011, at B1, *available at* <http://www.ctv.ca/generic/generated/static/business/article2225184.html>.

61. Leanne Williams, *ABCP Crisis: The Canadian Solution*, 5 ECONOMISTS’ OUTLOOK 370, 370 (2008), *available at* http://www.tgf.ca/Libraries/Publications/ABCP_Crisis_The_Canadian_Solution.sflb.ashx.

In 2007, \$32 billion of third-party sponsored ABCP was frozen because of the inability of the issuers to rollover maturing notes.⁶² After meeting in August 2007, key market players entered what has become known as the “Montreal Accord.” The agreement froze the market while a long-term solution was developed.⁶³ A successful restructuring of the markets followed, using the Companies’ Creditors Arrangement Act.⁶⁴ Third party releases were also included in the restructuring plan, which largely eliminated private litigation, though actions for fraud could still be pursued.⁶⁵ The solution reached had implications for both public and private enforcement. As will be explored in both Part II and III, compared to the United States, Canada saw very few securities class action cases related to the credit crisis. The implementation of a plan that addressed issues in both the public and private realms allowed for the building of a long-term plan, the avoidance of frivolous litigation, and for the focus to be placed on the recovery of the financial markets, rather than individual claims.

II. PUBLIC ENFORCEMENT

Public enforcement in the Canadian securities markets is the primary responsibility of provincial regulators, with the federal government’s involvement limited to investigating and prosecuting criminal offenses. This disjointed approach to securities regulation in Canada offers a stark contrast to the United States, which nationally administers securities regulation through the SEC. Unlike the United States, which has pursued numerous, highly publicized securities enforcement cases, Canadian regulators are frequently criticized for being too passive in their enforcement activities.⁶⁶ However, this Article contends that public enforcement in Canada is robust and provides effective protection for participants in Canadian capital markets even though its capacity is limited by the fragmentation and duplication of enforcement resources across thirteen independent securities regulators.

62. John Chant, *The ABCP Crisis in Canada: The Implications for the Regulation of Financial Markets*, EXPERT PANEL ON SEC. REG. 18–24, <http://www.expertpanel.ca/documents/research-studies/The%20ABCP%20Crisis%20in%20Canada%20-%20Chant.English.pdf> (last visited Apr. 9, 2012).

63. Williams, *supra* note 61, at 371.

64. Companies’ Creditors Arrangement Act, R.S.C. 1985, c. C-36 (Can.). The Act is structured similar to Chapter 11 in the United States.

65. Williams, *supra* note 61.

66. Cory & Pilkington, *supra* note 38, at 186–88, 201.

This Part examines the effectiveness of public securities regulation in Canada by evaluating the regulatory framework and recent enforcement data from the CSA, and comparing the funding for securities enforcement in Canada and the United States. This Part will also consider the OSC's recent decision to introduce no-contest settlement funds in Ontario and distribute public settlements to investors for their losses in the 2007 ABCP crisis, as well as the market timing scandal in the Canadian mutual funds industry from 1999–2003.⁶⁷ These decisions are evaluated to assess how they impact the balance between public and private enforcement in Ontario. Finally, the Part concludes with a discussion of Canada's recent attempt to create a national securities regulator and identifies options following the Supreme Court's ruling that the federal government lacks jurisdiction to create a national regulator without the consent of the provinces. The options to be discussed given this ruling, are to continue with provincially regulated securities markets; to introduce a national regulator that focuses on systemic risk; or to encourage the provincial and federal cooperation in the development of a single securities regulator.

A. The Effectiveness of Public Securities Regulation in Canada

1. The Effectiveness of Canadian Securities Regulation

Canadian securities regulators conventionally assume a low profile in their securities enforcement activities and emphasize deterrence over punitive sanctions. This has fostered a belief that “enforcement in Canada is lax in comparison to the United States,”⁶⁸ and consequently is less effective.⁶⁹ Specifically, provincial regulators have been unwilling or unable to optimally exercise the quasi-criminal powers available to them, possibly because of institutional and financial constraints. Fines and other civil sanctions are used infrequently and tend to be far less than the damages sustained by investors.⁷⁰ However, regulators have recently begun exploring alternative approaches, such as no-contest settlements as well as regulatory fines, to provide partial compensation for losses suffered by investors.⁷¹ Although these strategies will certainly assist regulators in maximizing the utility of their scarce resources, more effective

67. Settlement Agreement, *In re* Sec. Act R.S.O. 1990, c.S.5, as amended & AGF Funds Inc., OSC PROC. (Dec. 12, 2004).

68. MICHAEL E.J. PHELPS ET AL., DEP'T FIN. CAN., IT'S TIME 7 (Dec. 2003) [hereinafter *IT'S TIME*], available at <http://www.wise-averties.ca/reports/WPC%20Final.pdf>.

69. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 24.

70. Cory & Pilkington, *supra* note 38, at 228.

71. OSC Staff Notice 15-704, *supra* note 2.

cooperation between federal and provincial regulators would help reduce duplicative costs. Further, the continued development of private enforcement mechanisms would help ensure that investors are adequately protected and compensated for losses.

Securities regulation in Canada is modeled on a regulatory pyramid that places significant resources on proactive compliance and strategically allocates resources in areas, such as enforcement, to deter improper conduct. A primary challenge for regulators is the large number of public companies per capita in Canada. Canada has almost half as many publicly traded companies as the United States, but a market capitalization ten times smaller than the United States.⁷² The difficulties inherent in effectively monitoring and sanctioning smaller issuers perpetuate the tendency of securities regulators to focus on proactive regulation to the detriment of their public enforcement mandate. However, the effective use of a pyramid approach to regulate still requires the use of fines and other more aggressive penalties, like quasi-criminal sanctions, in order to provide effective deterrence.⁷³

Canadian securities regulators are not as aggressive as their American counterparts in enforcing violations against high profile individuals or seeking highly punitive penalties to deter to illegal conduct.⁷⁴ However, as noted by Justice Peter de Cory and Professor Marilyn Pilkington, focusing narrowly on the number or value of penalties does not disclose whether the right matters are being prosecuted, nor will it identify institutional barriers to effective securities enforcement.⁷⁵ Under this pyramid approach to securities regulation, fines and other administrative sanctions should provide the basis for the securities commission's enforcement activities. Jurisdictional barriers and the large number of public issuers in Canada present challenges for administrative enforcement. In their report to the Task Force to Modernize Securities Legislation in Canada, Cory and Pilkington found that the fines levied by the securities commissions were minimal and only accounted for a small portion of the investors' total losses.⁷⁶

Unlike other regulatory contexts where regulators often have comparable or greater resources than the parties being regulated, provincial securities commissions usually have far smaller annual budgets than the par-

72. Nicholls, *supra* note 7, at 149.

73. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 9.

74. See, e.g., SEC Press Release, *supra* note 40; CBC NEWS, *supra* note 40.

75. Cory & Pilkington, *supra* note 38, at 188.

76. *Id.* at 228.

ties they regulate.⁷⁷ In part to maximize the securities commissions' limited resources, securities commissions recognized SROs to provide an additional layer of regulatory oversight. In Canada, the three most important SROs are the Investment Industry Regulatory Organization of Canada ("IIROC"),⁷⁸ the Mutual Fund Dealers Association of Canada,⁷⁹ and the Chambre de la Sécurité Financière,⁸⁰ IIROC resulted from the consolidation of the Investment Dealers Association of Canada ("IDA") and Market Regulation Services Inc., which occurred in 2008.

Again differing from the United States, Canadian securities regulators and SROs conventionally insist that parties accept liability as a condition of settlement.⁸¹ This principle greatly increases the time, human resources, and amount of money that regulators must devote to a particular file. Consequently, regulators resort to risk-based enforcement. In determining whether to pursue a matter, the OSC considers the degree of harm to the integrity of capital markets and the amount of resources required to pursue the case to a successful resolution.⁸² Therefore, to maximize the impact of their enforcement activities and provide the greatest deterrent effect, regulators may be inclined to pursue higher profile targets to the exclusion of smaller issuers.⁸³

Over the past ten years, there has been a move to strengthen criminal and quasi-criminal legislation governing capital market offenses by increasing maximum sentences and adding a list of aggravating factors

77. O.S.C., 2011 OSC ANNUAL REPORT 37 (2011), available at http://www.osc.gov.on.ca/static/_/AnnualReports/2011/pdf/OSC_AR2011_Full_ENG.pdf. The Ontario Securities Commission had an operating budget of \$84 million in 2011. *Id.* at 47.

78. See INV. INDUS. REG. ORG. OF CAN., <http://www.iroc.ca> (last visited Apr. 10, 2012).

79. See MUT. FUND DEALERS ASS'N OF CAN., <http://www.mfda.ca> (last visited Apr. 10, 2012).

80. See CHAMBRE DE LA SÉCURITÉ FINANCIÈRE, <http://www.chambresf.com/en/> (last updated Apr. 10, 2012) (Can.).

81. OSC Staff Notice 15-704, *supra* note 2.

82. OSC Staff Notice 11-719 *A Risk Based Approach for More Effective Regulation*, 25 O.S.C. BULL. 8410, 8410 (2002) (Can.) [hereinafter *OSC Staff Notice 11-719*], available at http://www.osc.gov.on.ca/documents/en/Securities-OSCB/oscb_20021220_2551.pdf.

83. See Susan Wolburgh Jenah, Acting Chair, O.S.C., Presentation at the Council of Securities Regulators of the Americas (COSRA) Meeting: A Risk-Based Approach to Securities Regulation 9–11 (Aug. 31–Sept. 2, 2005), available at <http://www.superfinanciera.gov.co/seminarios/RISK%20BASED%20APPROACH%20OSC.pdf>.

under the criminal code.⁸⁴ However, judges are often reluctant to pursue maximum sentences and, as a result, this greatly diminishes the impact of these reforms. The limited use of criminal and quasi-criminal sanctions by federal and provincial regulators is partially attributable to the overlap in jurisdiction and complexities of seeking a conviction through the courts, as opposed to a regulatory sanction imposed by an administrative body. Judicial proceedings tend to be more resource intensive than regulatory proceedings because of delays, constitutional protections, an elevated burden of proof, and time spent educating judges who may not have capital markets expertise.⁸⁵ Although criminal and quasi-criminal sanctions should be reserved for the most egregious cases and as a last resort, when a case involves criminal or quasi-criminal sanctions, the court should be open to imposing the maximum sentence, where appropriate, in order to send a clear signal that white collar crimes will be treated similarly to other criminal offenses.⁸⁶

The allocation of police resources also presents a major barrier to investigating capital market offenses. White collar crime has traditionally been a low priority for law enforcement and, given the highly technical and specialized nature of capital market offenses, generally perceived not to be career building for law enforcement officials.⁸⁷ In response, the federal government established Integrated Market Enforcement Teams (“IMET”) in 2003 to investigate high-profile criminal capital markets offenses.⁸⁸ Some issues however, still persist, such as the problem of attracting and retaining expert investigators.⁸⁹

Additionally, the original mandate of IMET was to tackle “high-profile” criminal cases, but it has been argued that this mandate does not necessarily align with the issues or enforcement objectives in each provincial jurisdiction.⁹⁰ Thus, some recommend that either the IMET’s mandate be expanded or the capacity of other police forces be enhanced

84. See An Act to Amend the Criminal Code (Capital Markets Fraud and Evidence-Gathering), Bill C-13, 37th Parl., 3d Sess. (2004) (Can.); An Act to Amend the Criminal Code (Sentencing for Fraud), Bill C-52, 40th Parl., 2d Sess. (2009) (Can.).

85. Cory & Pilkington, *supra* note 38, at 228. See PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 14, where I suggest the development of specialized courts to deal with white collar capital market offenses.

86. See PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 12–14.

87. Cory & Pilkington, *supra* note 38, at 228.

88. *Background: Integrated Market Enforcement Team Program*, ROYAL CAN. MOUNTED POLICE (Oct. 21, 2011), <http://www.rcmp-grc.gc.ca/imet-eipmf/background-information-eng.htm>.

89. Cory & Pilkington, *supra* note 38, at 204.

90. *Id.* at 204–05.

to tackle those cases that do not fit into the definition of “high-profile.”⁹¹ In response to these difficulties, the federal government has committed to aggressively pursue white collar crime and has worked to integrate securities enforcement among provincial and territorial regulators.⁹² Moreover, criminal enforcement would be within the authority of the proposed national securities regulator. However, the Supreme Court’s recent decision that the federal government lacks jurisdiction to unilaterally create a national regulator means that the jurisdictional divide between federal and provincial enforcement will continue.

2. Data on Securities Enforcement in Canada

This section provides an overview of enforcement activities and sanctions issued by Canadian securities commissions from 2006 to 2011. Consistent with the increased emphasis on prosecuting capital market offenses, the number of proceedings commenced has increased, along with the total value of fines and administrative penalties, and the number of cases concluded outside of the tribunal and the court processes.⁹³ However, the length of jail sentences has not significantly changed,⁹⁴ which demonstrates a continued reluctance by the courts to treat white-collar crime as seriously as other criminal and quasi-criminal offenses.

As previously indicated, quantitative data on securities enforcement provides a limited picture of the effectiveness of capital markets regulation in Canada. Although useful for identifying general trends, this data provides limited insight into which cases are being chosen for prosecution and why.

91. *Id.* at 208; Poonam Puri, Assoc. Dean, Osgood Hall Law Sch., Research Study prepared for the Expert Panel on Securities Regulation: Of Regulatory Reform and Enforcement Effectiveness: Models for a Common Enforcement Agency for Canada (June 30, 2008) (Can.), available at www.rotman.utoronto.ca.

92. Press Release, Pub. Safety Can., Integrated Market Enforcement Teams (IMETs) (Dec. 5, 2008) [hereinafter IMET Press Release], available at <http://www.publicsafety.gc.ca/media/nr/2007/nr20070514-1-eng.aspx>.

93. CAN. SEC. ADM’RS, 2008 ENFORCEMENT REPORT 6 (2008), available at http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSA_Enforcement_Report_English_2008.pdf [hereinafter 2008 ENFORCEMENT REPORT]; CAN. SEC. ADM’RS, 2009 ENFORCEMENT REPORT 4–8 (2009), available at [http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSARreportENG09\[FA\].pdf](http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSARreportENG09[FA].pdf) [hereinafter 2009 ENFORCEMENT REPORT]; CAN. SEC. ADM’RS, 2010 ENFORCEMENT REPORT 8 (2010), available at <http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSA2010EnforcementReportEng.pdf> [hereinafter 2010 ENFORCEMENT REPORT].

94. 2008 ENFORCEMENT REPORT, *supra* note 93; 2009 ENFORCEMENT REPORT, *supra* note 93; 2010 ENFORCEMENT REPORT, *supra* note 93.

The general data on enforcement cases from 2006 to 2010 is considered in Table 1:

Year	Proceedings Commenced	Reciprocal Orders	Total Cases Concluded	Cases Concluded Via...		
				Court Proceedings	Tribunal Hearings	Settlement Agreements
2006	118	7	95	18	28	49
2007	104	18	130	31	54	45
2008	171	90	123	28	55	40
2009	124	77	141	35	37	69
2010	178	74	174	64	39	71

Table 1: General Enforcement Data⁹⁵

Three observations are apparent from the data above. First, and perhaps most noteworthy, is the demonstrated commitment to coordination among provinces evidenced by the number of reciprocal orders issued. In 2008, amendments were passed by provincial legislatures to expand the use of reciprocal orders, which are used to prevent individuals or companies sanctioned by one jurisdiction, such as a cease trade order, from engaging in the prohibited conduct in the reciprocating jurisdiction.⁹⁶ The high number of reciprocal orders also illustrates the patchwork approach to securities regulation that exists among the Canadian provinces.

Second, although the raw number of settlement agreements has increased significantly in recent years, the percentage of cases concluded varies greatly from a high of 52% in 2006 to a low of 33% in 2008. As the OSC contemplates a move towards the no-contest settlement program, it will be interesting to observe whether the number and percentage of actions resolved through settlement agreements increases over the coming years.

Third, while the number of court proceedings is rising, the number of tribunal hearings has decreased by approximately 30% from 2008 to 2010. Although the change is not drastic, it is significant and could be indicative of a shift in case management strategy, kind of allegations, and the parties targeted by the securities commissions.

The most common types of violations have remained fairly consistent over the last few years. From 2008 to 2010, illegal distributions—that is, distributing securities without registration or a prospectus—formed the

95. 2008 ENFORCEMENT REPORT, *supra* note 93; 2009 ENFORCEMENT REPORT, *supra* note 93; 2010 ENFORCEMENT REPORT, *supra* note 93.

96. O.S.C., 2009 OSC ANNUAL REPORT 49–50 (2009), available at http://www.osc.gov.on.ca/static/_/AnnualReports/2009/enf.html.

largest category of violations.⁹⁷ The next most prominent category was misconduct by registrants,⁹⁸ and illegal insider trading was consistently present over the years as well.

The total fines and administrative penalties levied against market participants from 2008 to 2010 are illustrated in Table 2.

Year	Total Fines and Administrative Penalties
2008	\$12,469,117
2009	\$153,673,008
2010	\$63,827,006

Table 2: Fines and Administrative Penalties⁹⁹

Although the extremely large amount in 2009 was caused by settlements related to the ABCP crisis,¹⁰⁰ the increase between 2008 and 2010 is significant and may indicate a change in the enforcement priorities of public regulators.¹⁰¹

The statistics found in Table 3 below represent the number and term of prison sentences issued by courts in Alberta, British Columbia, Ontario, Quebec, and Manitoba.

97. In the Canadian Securities Administrators' 2010 Enforcement Report, illegal distributions are defined as: "a sale of securities to investors that does not comply with securities law registration, trading and disclosure requirements." 2010 ENFORCEMENT REPORT, *supra* note 93, at 10.

98. The Canadian Securities Administrators' 2010 Enforcement Report explains that "misconduct by registrants occurs when a person or company violates securities laws [.] fail[s] to register when required to do so, or . . . fail[s] to adhere[] to the conditions of a registration exemption." *Id.* at 13.

99. 2008 ENFORCEMENT REPORT, *supra* note 93, at 6; 2009 ENFORCEMENT REPORT, *supra* note 93, at 6; 2010 ENFORCEMENT REPORT, *supra* note 93, at 10.

100. The Canadian Securities Administrators' 2009 Enforcement Report lists the institutions that paid out settlements related to the ABCP crisis: National Bank Financial Inc., Scotia Capital Inc., Canadian Imperial Bank of Commerce and CIBC World Markets Inc., HSBC Bank Canada, Laurentian Bank Securities Inc., Canaccord Financial Ltd., and Credential Services Inc. 2009 ENFORCEMENT REPORT, *supra* note 93, at 11.

101. Enforcement activities related to the 2007 ABCP crisis were still ongoing when these figures were calculated, thus the figures for 2010 may also reflect this fact.

Year	Number of Jail Sentences	Minimum Sentence	Maximum Sentence
2008	6	6 months	8.5 years
2009	4	3 months	2.5 years
2010	15	3 months	3 years

Table 3: Jail Sentences Issued by Courts¹⁰²

Despite amendments increasing the maximum jail sentence for capital market offenses, courts appear hesitant to issue long sentences for securities law violations. At this point, it is difficult to determine whether the dramatic increase in the number of prison sentences in 2010 was either a statistical anomaly or the start of a trend. Moreover, the wide variation in the range and number of sentences each year reflects the disjointed approach to criminal and quasi-criminal enforcement in Canada. This is particularly pronounced given that only two of the fifteen sentences issued in 2010 were from Ontario.¹⁰³ As Canada's largest capital market, it is surprising that Ontario did not issue more jail sentences and this gap may reflect the differing priorities in securities enforcement across Canada.

3. Comparison of the Canadian and American Enforcement Regimes

Canadian and American securities regulators approach compliance and enforcement from different philosophical underpinnings. Canada's preference for compliance based strategies and a provincially regulated securities environment has resulted in fewer high profile public securities cases in Canada. In the past ten years, various studies attempt to understand how Canadian and American regimes compare with one another. Despite the common perception that Canadian securities enforcement is less robust than that of the United States, funding and staffing for enforcement activities appears to be comparable. Thus many of the differences apparent between the two systems may be rooted in different enforcement priorities.

Statistics on enforcement activity generally provide a limited picture of the capacity and effectiveness of securities regulation in a particular jurisdiction. Every year, securities regulators are confronted with hundreds of potential enforcement matters, yet only have sufficient resources to examine and commence an investigation of a very small number of these

102. 2008 ENFORCEMENT REPORT, *supra* note 93, at 6; 2009 ENFORCEMENT REPORT, *supra* note 93, at 6; 2010 ENFORCEMENT REPORT, *supra* note 93, at 8.

103. 2011 OSC ANNUAL REPORT, *supra* note 77, at 10.

claims.¹⁰⁴ Consequently, there is little information available to identify those matters which are not being pursued by regulators or have evaded any type of review. In addition, the high number of small public issuers in Canada significantly complicates enforcement in Canada relative to the United States.

Howell Jackson's 2005 study on regulatory intensity for the Task Force to Modernize Securities Legislation suggested that although budgets may not be the perfect proxy, "a reasonable level of regulatory staffing is perhaps a necessary condition for effective enforcement in financial markets."¹⁰⁵ Overall, Jackson concluded that when economic deflators were taken into consideration, Canada and the United States were very similar in enforcement intensity, and found Canada to have a more intense staffing budget as a percentage of GDP and market capitalization.¹⁰⁶ Although the gap between the number of enforcement actions in Canada and the United States was once significant, it has become progressively narrower in recent years.¹⁰⁷ Jackson concludes that from a structural perspective, Canadian and American securities enforcement efforts tend to be largely similar.¹⁰⁸

Jackson's conclusions challenge the traditional assumption that American enforcement is more intense than in Canada. However, since his study does not control for differences in capital market activity, it is not possible to evaluate whether the discrepancy in enforcement activity is the product of the regulatory environment or a different propensity for capital market offenses in the two jurisdictions.¹⁰⁹ Given that staffing budgets are similar, the differences in enforcement activity could be the product of systemic inefficiencies or unique regulatory priorities and challenges.

The primary difference between Canadian and American enforcement activity appears to be the differing philosophical approaches to securities regulation. Canadian securities regulators spent between 13% and 19% of their total operating budget on enforcement, whereas the SEC spent

104. *Id.* at 15. In the 2010–2011 fiscal year, the Ontario Securities Commission assessed 348 matters and brought a total of 32 actions before the Commission and 2 before the Ontario Court of Justice. *Id.* at 15–16.

105. Howell E. Jackson, *Regulatory Intensity in the Regulation of Capital Markets: A Preliminary Comparison of Canadian and U.S. Approaches*, 6 CANADA STEPS UP 77, 87 (July 30, 2006), available at [http://www.tfmsl.ca/docs/V6\(2\)%20Jackson.pdf](http://www.tfmsl.ca/docs/V6(2)%20Jackson.pdf).

106. *Id.* at 81.

107. *Id.* at 111–12.

108. *Id.* at 98. Jackson cautions that the limited time frame and lack of precise enforcement data limits the robustness of any conclusions drawn from this data. *Id.* at 85–86.

109. *Id.* at 84.

29% of its budget on enforcement during the same period.¹¹⁰ There were also significant staffing increases in the enforcement branches of the Ontario and Quebec securities commissions from 1998 to 2005 without a corresponding increase in the number of cases brought.¹¹¹ This may suggest a decrease in the efficiency of Canadian securities enforcement activity, or that the same number of cases are being pursued but are more complex and greater resources are being devoted to them.

While not a perfect comparison, the SEC data for 2010 and 2011, as well as projections for 2012, demonstrate the gradual growth in the SEC's enforcement budget. In 2010, enforcement comprised 33% of the SEC's total budget, and was expected to remain between 32% and 34% for 2011 and 2012.¹¹² With regard to staffing, the SEC dedicated 32% of its staff to enforcement in 2010. This number was expected to remain constant through 2011 and drop slightly to 30% through 2012.¹¹³ The up-to-date data for budget and resource allocation for the OSC was not readily available as the Ontario Securities Commission's has changed its annual reporting format since 2005. This highlights a gap in information disclosure; this information should be more easily available to the public.

While these indices do not provide a precise measure of Canadian enforcement intensity, they do suggest that the mechanisms in place provide Canada with a relatively robust regulatory environment. However, quantitative data on enforcement only allows for prospective analysis—it is not capable of monitoring changes in the actual behavior of market participants to evaluate the deterrent effect of enforcement activities.¹¹⁴ Although more difficult to measure, securities commissions and the CSA would benefit from undertaking a qualitative analysis of this nature.

B. New Public Enforcement Strategies

Although Canadian securities regulators are conventionally regarded as more reserved than their American counterparts, recent experience demonstrates their clear willingness to adopt new enforcement and investor protection strategies. In October 2011 the Ontario Securities Commission released Staff Notice 15-704, which proposes to allow regulators to offer no-contest settlements without requiring respondents to make an admis-

110. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 25. This study examined the total operating budgets of Canadian and American securities regulators in relation to the percentage dedicated to enforcement activities.

111. *Id.* at 23.

112. S.E.C., IN BRIEF FY 2012 CONGRESSIONAL JUSTIFICATION 11 (Feb. 2011), *available at* <http://www.sec.gov/about/secfy12congbudgjust.pdf>.

113. *Id.* at 9.

114. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 24.

sion of liability.¹¹⁵ No-contest settlements will help strengthen securities enforcement in Ontario and will enable regulators to pursue a greater number of claims. However, no-contest settlements must be properly managed to avoid commoditizing damages and discounting the role of public regulators in ensuring accountability.

As part of its enforcement activities, the OSC entered into substantial settlements following the ABCP crisis in 2007 and the investigation into market timing in Canadian mutual funds in 2005.¹¹⁶ The OSC is now attempting to return the ABCP funds to investors to help offset their losses. These developments suggest a shift in the role and objectives of the OSC to the use of public penalties and fines to compensate investors. This shift demonstrates recognition of the diverse nature of Canadian public markets. It also provides enhanced investor protection by enabling securities regulators to provide restitution for investors on losses sustained from smaller issuers against whom it may not be economical or feasible to pursue a private remedy. However, for this strategy to be effective, greater clarification is required from the OSC and it must detail how, and under what circumstances, a public settlement will be distributed to investors.

1. No-Contest Settlements

On October 21, 2011 the OSC released Staff Notice 15-704 and requested comments from participants in Canadian capital markets, as required under the OSC's notice and request for comment procedure for rule making.¹¹⁷ This proposal stems from the OSC's broader "credit for cooperation" program, which seeks to reward market participants who self-report regarding their roles in illegal activities.¹¹⁸ Two of the most noteworthy elements of Staff Notice 15-704 are (1) No-Enforcement Action Agreements, which protect self-reporters from liability; and (2) the No-Contest Settlement Program that eliminates the existing requirement for a person or company to admit guilt before a settlement can be reached.¹¹⁹ Elimination of the long-standing requirement that parties admit liability is controversial and considered by some to represent the "Americanization" of Canadian securities enforcement.¹²⁰

115. *OSC Staff Notice 15-704*, *supra* note 2, at 10720–21.

116. *Metcalfe & Mansfield*, 2008 CanLII 23497 (Can. Ont. Sup. Ct. J.).

117. *OSC Staff Notice 15-704* *supra* note 2, at 10720; Ontario Securities Act, R.S.O. 1990, c. S-5, § 143.2 (Can.).

118. *OSC Staff Notice 15-704*, *supra* note 2, at 10720–21.

119. *Id.* at 10721–24.

120. Barbara Shecter, *New Rules Urged for Rise in Class Actions*, FIN. POST, Oct. 25, 2011, at FP4.

The primary impetus for introducing no-contest settlements is to facilitate the efficient resolution of public enforcement proceedings while striking a proper balance with concurrent private litigation. In the background to the staff notice, the OSC notes that issuers are often concerned about the implications of an admission of public liability for ongoing private liability.¹²¹

Recognizing the controversy and potential for abuse surrounding no-contest settlements, the current proposal from the OSC is cautious and tightly circumscribed. To be eligible for a no-contest settlement, Staff Notice 15-704 would require the participant to have fully complied with the OSC's investigation.¹²² This may include self-reporting and remedial steps to address non-compliance including, where appropriate, provision of compensation to affected third parties. The no contest settlement must also be deemed to be in the public interest pursuant to *Ontario Securities Act* §127 and will only be available if the respondent has not been the subject of previous enforcement activities.¹²³

The use of no-contest settlements draws heavily on the U.S. approach to securities enforcement, which traditionally did not require regulators to obtain an admission of liability as part of a settlement agreement. However, the more guarded approach taken by the OSC reflects Canada's traditional preference for compliance based strategies and its contemporary shift to incorporate more aggressive enforcement activities.¹²⁴ The discretion to offer no-contest settlements in appropriate circumstances will provide regulators with a more tailored range of enforcement options. In a submission to the OSC on Staff Notice 15-704, two lawyers from a firm experienced in class actions contend that no-contest settlements diminish the role of public regulators in ensuring accountability and providing the basic evidence of corporate wrongdoing necessary to predicate a private action.¹²⁵ However, forcing public regulators to impose a finding of liability limits regulators' ability to develop proportionate penalties tailored to the circumstances.

Securities regulators already exercise a degree of selectivity in deciding which cases to pursue.¹²⁶ Settlement agreements reached with a re-

121. *OSC Staff Notice 15-704*, *supra* note 2, at 10721.

122. *Id.*

123. *Id.*; R.S.O. 1990, c. S-5, § 143.2 (Can.).

124. Mary Condon & Poonam Puri, *The Role of Compliance in Securities Regulatory Enforcement*, 6 CANADA STEPS UP 3, 14 (June 28, 2006).

125. Response to Request for Comments on Proposed Enforcement Initiatives from Douglas M. Worndl & A. Dimitri Lascaris, Siskinds LLP, to John Stevenson, O.S.C. 2-3 (Dec. 6, 2011).

126. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 15.

spondent commonly negotiate the amount of the fine, terms of the agreement, and the manner in which the admission of liability is framed.¹²⁷ Allowing regulators to offer no-contest settlements for less significant offenses represents sound regulatory policy and will enable regulators to conserve their limited enforcement resources. Contrary to the suggestion that no-contest settlements will undermine public securities enforcement, the wider range of settlement options could expand the number and range of cases that regulators are prepared to pursue. Given the finite financial resources of public regulators, it is not practical to seek full public vindication in every case. However, the ability to obtain a no-contest settlement agreement may still offer a significant deterrent effect as regulators can resolve a greater number of cases.

Therefore, provided no-contest settlements are used in a tailored and proportionate manner to complement the existing enforcement activities, their introduction will provide a net benefit for investors and the Canadian capital markets.

2. Using Public Settlements to Compensate Investors

Following an extensive investigation into market timing in Canadian mutual funds, the OSC entered into settlements with five Canadian mutual funds, where they agreed to pay \$205.6 million to their investors.¹²⁸ This public settlement agreement was deemed to be without prejudice to any other private right of action held by investors.¹²⁹ However, the decision of public regulators to recover damages on behalf of private investors marks a major shift in the role and mindset of the public regulators, whose primary mandate has traditionally been one of compliance and deterrence.¹³⁰

One of the principal challenges for effective securities regulation is determining the proper approach to assure investor protection. Public regulators traditionally perceive their role as protecting the integrity of capital markets through deterrence and compliance initiatives. By contrast, private investors are chiefly concerned with being compensated for their losses. Public regulators should also “assist investors in receiving compensation for harms suffered in the capital markets.”¹³¹ In particular, se-

127. James Langton, *Taking aim at “no contest” settlements*, INV. EXEC. (Jan. 2012), <http://www.investmentexecutive.com/-/taking-aim-at-no-contest-settlements>.

128. *Metcalfe & Mansfield*, 2008 CanLII 23497 (Can. Ont. Sup. Ct. J.).

129. *Fischer v. IG Inv. Mgmt. Ltd.*, 2012 ONCA 47, ¶ 2 (Can.). A more detailed discussion of the private market dimensions of these settlement agreements for private investors takes place in Part III of this Article.

130. O.S.C., STATEMENT OF PRIORITIES FOR FISCAL 2011–12, at 6 (2012).

131. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 3.

curities regulators should seek restitution for investors where it is more efficient to do so, provided that investors are given adequate opportunity to participate in the enforcement process and have their positions heard. Such an approach may be particularly effective when pursuing claims against smaller issuers and where it is not economical for an individual or class given the statutory limits on private secondary market liability under section 138.1 of the Ontario Securities Act.¹³² However, such a shift may require an amendment to the Ontario Securities Act. The OSC has jurisdiction under the Ontario Securities Act to apply to the Ontario Superior Court for an order compelling respondents to make restitution or compensation directly to an aggrieved party, but the Commission appears to lack jurisdiction to distribute directly the proceeds of a public settlement to investors.

The OSC's decision to require parties involved in the OSC's market timing settlement to compensate investors was relatively uncontroversial.¹³³ However, more significant policy concerns were raised by the OSC's initiative to distribute \$60 million to investors using public settlement funds received following the ABCP crisis in 2007.¹³⁴ As part of the court supervised ABCP restructuring, the Pan Canadian Investor Committee agreed to provide investors who had less than \$1 million invested in the ABCP market with a full return on their investment, in exchange for a full release from private liability with the exception of claims for fraud.¹³⁵ This agreement stipulated that the OSC would "not make any order or award to compensate or make restitution to an aggrieved person or company or to pay general or punitive damages."¹³⁶ Further, it stated that the settlement would be used in a "fair and appropriate" manner to be "determined in accordance with applicable laws, court orders, and the public interest."¹³⁷ Since the majority of retail investors received a full return on their investments, the OSC's distribution

132. R.S.O. 1990, c. S-5, § 138.1 (Can.).

133. Following the public settlement with the O.S.C., investors launched a private class action to recover funds not accounted for in the public settlement. The courts decision to certify this class action is discussed in greater detail later in this Article. *See infra* Part III.C.

134. Applicants' Factum ¶ 2(a), *In re Ont. Sec. Comm'n & Inv. Indus. Regulatory Ass'n Can.*, CV-12-9606-00CL (Can. Ont. Sup. Ct. J. 2012) [hereinafter Applicant's Factum]; Barbara Shecter, *Watchdogs Push to Return \$60-Million to ABCP Investors*, FIN. POST (Feb. 16, 2012, 4:33 PM), <http://business.financialpost.com/2012/02/16/watchdogs-want-to-return-60-million-to-abcp-investors/>.

135. Applicants' Factum, *supra* note 134, ¶ 21.

136. *Id.* ¶ 5.

137. *Id.* ¶ 21; *Metcalfe & Mansfield*, 2008 CanLII 23497 (Can. Ont. Sup. Ct. J.).

of these settlement funds will likely go to institutional investors such as large pension funds and other sophisticated parties.

A second concern is whether the distribution of public settlement funds is commensurate with the reasonable expectations of the Canadian capital markets financial industry and the general public when the Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper entered a settlement with the IIROC and the OSC. Although debate surrounding the legitimacy of the OSC's move is beyond the scope of this paper, the Ontario Superior Court's recent decision upholding the OSC's use of the ABCP settlement funds may impact future negotiations on the use of a general release from private liability.¹³⁸

If the OSC's decision to compensate investors by using public settlements is part of a broader policy shift, the OSC should develop clear policies to help manage the expectations of investors and define which settlements would be distributed to investors. Although it may be politically uncomfortable for public regulators like the OSC to justify retaining multi-million dollar fines, regulators should be mindful of the positive role of private litigation in obtaining remuneration for investors. If the OSC is moving towards a policy of distributing settlements to investors, empirical research should be conducted to examine the capacity of private litigation to obtain comparable or superior settlements and efficiently distribute funds back to investors. Ultimately, any shift in enforcement activity of the OSC should be fully articulated and applied consistently to safeguard the expectations of market participants and the public.

3. Balancing Public Enforcement Strategies

The OSC's decision to distribute the ABCP settlement to investors and consider the use of no-contest settlements demonstrates alignment between public and private enforcement activities. Where investors are incapable of bringing a private action, distributing settlements to investors may offer a more efficient process and provide greater recognition of the rights of private investors in the public enforcement process. However, this approach must be carefully tailored so as not to create the expectation that the OSC will or should obtain compensation for private parties in all instances. No-contest settlements will also enhance the public en-

138. *OSC Proceedings: Proposed distribution of ABCP settlement funds permitted by Court Order*, O.S.C. (Mar. 13, 2012), http://www.osc.gov.on.ca/en/Proceedings_nr_20120313_osc-iiroc-abcp-settlement-funds.htm.

forcement process by allowing regulators to fashion a more proportionate sanction for each particular offence. Accordingly, no-contest settlements represent sound regulatory policy and offer a more balanced approach to public enforcement that views deterrence and market discipline as end goals of effective securities regulation, rather than high-profile findings of liability.

Both initiatives are positive developments for securities regulation in Ontario. Nevertheless, regulators must ensure that this expanded role for public enforcement does not usurp the rights of private litigants. It is important to allow private parties to manage their own claims and to have meaningful participation in the process.

B. Canada's Pursuit of a National Securities Regulator

In Canada, securities are regulated at the provincial and territorial level through thirteen independent regulatory bodies, each with their own capabilities and priorities. This fragmented regulatory framework causes significant concern for Canadian capital markets and prompted the Wise Persons' Committee's recommendation in 2003 that Canada harmonize its securities legislation and enforcement activities.¹³⁹ In 2004, twelve of the provinces and territories, Ontario the lone hold-out, introduced a passport system for securities regulation.¹⁴⁰ The system attempted to harmonize securities legislation and policies by providing for mutual recognition of reporting issuers in each of the passport jurisdictions. Each province, however, continues to retain its own, independent enforcement agencies.

Following a report of the Expert Panel on Securities Regulation in 2009, the Government of Canada drafted legislation to create a national securities regulator and referred the proposed bill to the Supreme Court for a reference decision on its constitutionality.¹⁴¹ In December 2011, the Supreme Court unanimously held that the federal government does not have jurisdiction to enact the legislation in its current form under the federal trade and commerce power of the Constitution.¹⁴² Rather, securities

139. MARY CONDON, ANITA ANAND, & JANIS SARRA, *SECURITIES LAW IN CANADA: CASES AND COMMENTARY* 589 (2005).

140. A Provincial/ Territorial Memorandum of Understanding Regarding Securities Regulation (2004) (Can.), available at http://www.securitiescanada.org/2004_0930_mou_english.pdf.

141. Reference re Securities Act, 2011 SCC 66, ¶ 134 (Can.); Order in Council P.C. 2010-0667 (Securities Act) (May 26, 2010) (Can.).

142. *Re Securities Act*, 2011 SCC 66, ¶ 8 (Can.).

regulation is provincial jurisdiction under provincial property and civil rights powers.¹⁴³

1. Structure of the Proposed National Securities Regulator & Supreme Court's Decision

Under the proposed securities act, the federal government sought to establish the Canadian Securities Regulatory Authority to advance the objectives of increased accountability and stability in Canadian capital markets.¹⁴⁴ Responsibility was to be divided between a regulatory division and securities tribunal. The Regulatory Division would promote increased accountability and stability in capital markets through increased communication with the Minister of Finance and establishment of an Investor Advisory Panel to represent the interests of both large and small investors at all stages of the regulation and enforcement process. Also, similar to the recent move by the OSC to distribute public settlements to investors, the Regulatory Division would have the capacity to provide restitution directly to investors. Enforcement proceedings would be carried out before an expert securities tribunal.

Under a nation-wide mandate, a national securities regulator would have the capacity to pool enforcement resources, coordinate enforcement efforts across multiple Canadian jurisdictions, and represent Canada in negotiations with regulators in international markets.¹⁴⁵ Opponents of a national securities regulator argue that similar coordination can be, and is, achieved through cooperation among the provinces and territories. However, even a highly integrated regulatory framework creates a degree of duplicative costs and inefficient allocation of resources. More importantly, a lack of centralized accountability in Canadian capital markets still remains.¹⁴⁶ Inevitably, thirteen separate regulators will pursue different types of capital market offenses with different intensities and varying degrees of effectiveness in each jurisdiction. As the system is presently constituted, there is considerable inconsistency in the nature of cases that get pursued and the factors deemed relevant in sanctioning.¹⁴⁷ Consequently, it is very difficult to identify and prioritize issues of national interest.

In ruling that the federal government lacked jurisdiction to enact the proposed securities act, the Supreme Court of Canada held that capital

143. *Id.* ¶ 116.

144. DOUGLAS M. HYNDMAN ET AL., CAN. SEC. TRANSITION OFF., TRANSITION PLAN FOR THE CANADIAN SECURITIES REGULATORY AUTHORITY 3 (July 12, 2010).

145. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 20.

146. Cory & Pilkington, *supra* note 38, at 247–48.

147. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 22.

markets in Canada developed at a local level and concluded that there was insufficient evidence to support the contention that they now operate at the national level.¹⁴⁸ By focusing narrowly on the federalist division of powers question, the Supreme Court did not acquire as clear an understanding of the evolution and present state of Canadian capital markets. As a result, the Court did not provide a clear path forward for the future development of Canadian capital markets.

The Court maintained that since specialized industries are geographically clustered within Canada, the securities markets for these industries will be similarly clustered along geographic lines.¹⁴⁹ However, although these companies are often headquartered in particular geographic markets, they frequently distribute their securities in national and international markets. Thus, the appropriate market for capital is at least nationwide. In Canada, over two-thirds of issuers are reporting in more than one jurisdiction.¹⁵⁰ Consequently, there is a high degree of inefficiency and duplication for both regulators and reporting issuers in Canadian capital markets.

2. Options Moving Forward

Following the Supreme Court of Canada's decision in *Reference re Securities Act*,¹⁵¹ public securities regulation is at a crossroads. Although the previous discussion of public regulation in Canada demonstrated that the provinces and territories have a relatively robust enforcement environment compared to the United States, the duplication and overlap in each of the jurisdictions greatly diminishes the ability of provincial and territorial regulators to develop nation-wide enforcement strategies. After the Supreme Court's decision, there are three options available to securities regulators: (1) continue with provincially regulated securities markets and encourage cooperation under the passport system, (2) introduce a national regulator to address systemic risk factors that arise at the national level, or (3) encourage the provinces to cooperate with the federal government in developing a single securities regulator.

First, although increased cooperation and integration is possible under the current model for securities regulation, inefficiencies and a lack of clear strategic direction continue to inhibit it. Under the passport system, Canadian securities regulators lack a unitary voice on the international stage. Further, it is not possible to effectively integrate securities regula-

148. *Reference re Securities Act*, 2011 SCC 66, ¶¶ 116–27 (Can.).

149. *Id.* ¶ 127.

150. IT'S TIME, *supra* note 68, at 5.

151. *Re Securities Act*, 2011 SCC 66, ¶ 149.

tion with macro-economic policies and the financial sector regulations made at the federal level. Thus, Canada will continue to be vulnerable to regulatory gaps, as evidenced in the regulation of ABCP during the 2007 financial crisis.

The Supreme Court indicated that a federal regulator focused on systemic risk factors is a constitutionally valid option.¹⁵² However, it is not clear how the federal government could identify what constitutes systemic risk and develop an appropriate regulatory framework without trenching upon provincial regulatory efforts. Would this regulator focus on companies with market capitalizations above a certain threshold or regulate particular financial instruments or products? The narrow mandate of such a regulator could further exacerbate our patchwork regulatory environment wherein the federal regulator simply becomes the fourteenth actor in Canada.

Finally, the preferred option is for the federal government to continue to work towards establishing a national regulator by exploring cooperative solutions such as an opt-in national regulator. For example, the provinces could independently create an agency or the federal government could continue to build upon the foundation laid by the Canadian Securities Transition Office. Although the latter solution might be restricted to those provinces willing to cede jurisdiction to a centralized body, such a solution will provide for more effective enforcement proceedings and greater efficiency for all market participants.

III. PRIVATE ENFORCEMENT

Unlike the United States, which instituted secondary market liability in the 1930s and implemented well-established class action legislation by the 1960s,¹⁵³ Canada's private enforcement regime is a relatively recent development. In the 1970s, Canadian securities laws were amended to incorporate a private statutory right of action for misrepresentations in an issuer's prospectus. The capacity of private parties to initiate civil actions was further enhanced by the adoption of class action legislation in Ontario in 1993, and later by all other provinces.¹⁵⁴ This made it easier and more cost-effective for investors to bring actions against issuers and market intermediaries. In 2005, Canada's private enforcement regime took its present form, when securities laws were amended to provide statutory liability for secondary market misrepresentations. The regime

152. *Id.* ¶ 104.

153. SEC Rules and Regulations under the Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (2009).

154. Class Proceedings Act, S.O. 1992, c. 6 (Can.).

was developed following the 1994 report of the Toronto Stock Exchange Committee on Corporate Disclosure (“Allen Committee”).¹⁵⁵ The Allen Committee recognized that deterrence would be a primary objective, as well as compensation of aggrieved investors. Secondary market investors were thereby enabled to bring actions for non-negligent breaches of the issuer’s continuous disclosure obligations.

Part III will review the literature and quantitative data on private enforcement in Canada and highlight three key observations. First, Canadian and American securities and class action laws are based on the same underlying principles and policies.¹⁵⁶ However, key differences emerge as a result of Canada’s jurisprudential approach to class action certification and its cap on secondary market statutory liability. These differences may be responsible for the recent divergence in Canadian and American jurisprudence on global class actions.

Second, even after accounting for Canada’s smaller capital markets, Canada has significantly fewer securities class actions than the United States each year. Interestingly, although initial claim values in Canada are significantly lower than those in the United States, median settlement values are similar. This statistic raises the question of what is causing such a convergence, but it is difficult to draw definitive conclusions. Before the factors responsible for these trends can be accurately evaluated, the Canadian class action environment must be allowed time to develop and yield more long term data.

Finally, there is a strong interplay between public and private enforcement in Canada. Both enforcement routes are often used simultaneously to promote stability and capacity in Canadian capital markets. The ABCP crisis in 2007 demonstrated the ability of public and private actors to work cooperatively to develop a court sanctioned restructuring and release from private liability. This enabled Canada to avoid most of the 255 new class actions initiated in the United States following the financial crisis.¹⁵⁷ The interplay between public and private enforcement was also evident when Canadian securities regulators sanctioned five mutual

155. TORONTO STOCK EXCH. COMM. ON CORPORATE DISCLOSURE, FINAL REPORT: RESPONSIBLE CORPORATE DISCLOSURE: A SEARCH FOR BALANCE (1997) (Can.).

156. See TARA GRAY & ANDREW KITCHING, PARL. INFO. & RES. SERVICE, PRB 05-28E, REFORMING CANADIAN SECURITIES REGULATION 14 (2005), available at <http://www.parl.gc.ca/Content/LOP/researchpublications/prb0528-e.htm>.

157. JORDAN MILEV ET AL., NERA ECON. CONSULTING, RECENT TRENDS IN CLASS ACTION LITIGATION: 2011 YEAR-END REVIEW 2 (Dec. 14, 2011), available at http://www.nera.com/nera-files/PUB_Trends_Year-End_1211_final.pdf; BRADLEY HEYS & MARK BERENBLUT, NERA ECON. CONSULTING, TRENDS IN CANADIAN SECURITIES CLASS ACTIONS: 2011 UPDATE 2 (2012), available at http://www.nera.com/nera-files/PUB_Recent_Trends_Canada_01.12.pdf.

funds for not having adequate safeguards in place to prevent market timing and the subsequent use of a private class action by investors to claim residual damages not captured in the public settlement.¹⁵⁸

A. Statutory Framework & Jurisprudence

1. Secondary Market Liability

Primary market statutory civil liability was incorporated into provincial securities legislation far earlier than secondary market statutory liability in Canada. As noted earlier, the United States has imposed statutory liability on secondary market transactions since the 1930s, which allows considerable analysis of the effectiveness of the United States' secondary enforcement regime.¹⁵⁹ In particular, observers are critical of the tendency for secondary market actions to result in pocket shifting from the corporation or its insurers to its shareholders.¹⁶⁰ Thus, Canadian legislation and jurisprudence has the opportunity to consider the American experience in developing its own private enforcement system.

In 2005, following decades of debate, part XXIII.1 of the Ontario Securities Act was introduced to provide statutory liability for secondary market disclosures.¹⁶¹ The change modernized Canadian securities legislation by providing investors with a strict liability, statutory right of action when an issuer breaches their continuous disclosure obligations.¹⁶² The reforms greatly simplify the secondary market liability framework, make secondary market liability more attainable than under the common law remedies of negligent misrepresentation and fraud, and provide a common legal issue for investors to rely upon in seeking certification in a class action.

158. *Fischer v. IG Inv. Mgmt. Ltd.*, 2012 ONCA 47 (Can.).

159. See, e.g., Ann Morales Olazábal, *Defining Recklessness: A Doctrinal Approach to Deterrence of Secondary Market Securities Fraud*, 2010 WIS. L. REV. 1415, 1415; Alicia Davis Evans, *The Investor Compensation Fund*, 33 J. CORP. L. 223, 237 (2007).

160. See Adam C. Pritchard & Janis P. Sarra, *Securities Class Actions Move North: A Doctrinal and Empirical Analysis of Securities Class Actions in Canada*, 47 ALTA. L. REV. 881, 882 (2009).

161. R.S.O. 1990, c. S-5, § 23.1 (Can.); see 3 PHILIP ANISMAN ET AL., PROPOSALS FOR A SECURITIES MARKET LAW FOR CANADA (Philip Anisman ed., 1979) (Volume 3 presents "papers prepared by the consultants to the Securities Market Study to provide an analytical and policy background for the development of the [proposals] as set out in the preceding two volumes." The studying and resulting proposals were meant "to facilitate the formulation by the [g]overnment of Canada of its policy on the regulation of the Canadian securities market.").

162. R.S.O. 1990, c. S-5, § 138.4(4) (Can.).

2. Standing, the Burden of Proof, and Statutory & Common Law Actions

Similar to the United States, Canada provides a right of action to any person or company who transacts in an issuer's securities where a misrepresentation is made in a document or statement.¹⁶³ The right of action extends from the time the misrepresentation is made until the time the statement is corrected.¹⁶⁴ Misrepresentations or omissions that give rise to liability can occur in any document released by the responsible issuer or in any public oral statement released by a person with actual or ostensible authority to speak on behalf of the responsible issuer. Persons deemed to have influence by virtue of their relationship to the issuer may also be liable for their conduct or misrepresentations. Civil actions may be brought against the reporting issuer and its directors, officers, and experts for their contributions to the disclosure, as well as control persons and other individuals deemed to have influence in the corporation.¹⁶⁵ Thus, in the Canadian context, the group of potential defendants is confined to persons who enter into a special relationship with the issuer rather than including any individual who makes a misstatement or commits a manipulative act.

To determine the appropriate burden for imposing liability for misrepresentation or omissions, Canadian securities legislation distinguishes between core and non-core documents. The distinction is based on whether the material is a constitutive part of the issuer's continuous disclosure obligations as opposed to other, non-core compulsory filings with securities regulators.¹⁶⁶ Issuers are subject to strict liability for any misrepresentations or omissions of material facts in their core documents. For non-core documents, the plaintiff's burden of proof is higher and requires that at the time the document or statement was issued, the defendant knew of the misrepresentation, deliberately avoided acquiring knowledge of the misrepresentation, or was guilty of gross misconduct in connection with the document or oral statement.¹⁶⁷ Thus, Canada's strict liability standard for core documents imposes greater liability on defendants than in the United States, where plaintiffs are generally required to demonstrate recklessness.¹⁶⁸

Although the Ontario Securities Act gives plaintiffs a statutory right of action for misrepresentations or omissions, the common law torts of neg-

163. *Id.* § 138.3 (Can.).

164. *Id.* § 138.3(1)–(3) (Can.); Securities Act of 1933, 15 U.S.C. § 77q (2006); 17 C.F.R. § 240.10b-5 (2012).

165. R.S.O. 1990, c. S-5, § 138.3(1)–(3) (Can.).

166. *Id.* § 138.1.

167. *Id.* § 138.4(1).

168. Pritchard & Sarra, *supra* note 160, at 893.

ligent misrepresentation and fraud remain available to investors in both the primary and secondary markets.¹⁶⁹ These common law remedies are preferable where the plaintiffs seek damages in excess of the statutory cap on secondary market liability or where the three-year limitation period under the Ontario Securities Act has elapsed.¹⁷⁰ Thus, it is common for plaintiffs to plead both a statutory claim under the Ontario Securities Act and a common law claim of negligent or fraudulent misrepresentation.

In pleading a common law cause of action, plaintiffs are required to demonstrate their reliance on the misrepresentation. Following the Supreme Court of Canada's decision in *Queen v. Cognos*,¹⁷¹ courts have vacillated on the proper approach to proving detrimental reliance in the context of class actions. In *McCann v. CP Ships*, the court refused to require every class member to show reliance in order for the claim to proceed as a class action.¹⁷² This approach was subsequently affirmed in *Silver v. Imax*,¹⁷³ where the court allowed questions of reliance to be considered at trial. However, the *Imax* and *McCann* decisions were challenged in *Dobbie v. Arctic Glacier Income Fund*, where the Court found that in certain circumstances the question of individual reliance may overwhelm the common issue and render the negligent misrepresentation claim inappropriate for a class action proceeding.¹⁷⁴ Without an appellate court's decision clarifying the proper approach to detrimental reliance in a securities class action, this area of the law remains uncertain.

169. R.S.O. 1990, c. S-5, §§ 130(10), 138.13.

170. *Id.* § 138.1 (Statutory Cap on Liability); *id.* § 138 (180 days from knowledge of misrepresentation or omission, or a three-year limitation period for primary market statutory liability); *id.* § 138.14 (six months from knowledge of misrepresentation or omission, or a three-year limitation from when the transaction giving rise to the cause of action occurred). The *Limitations Act*, § 15(2) provides for a fifteen year absolute limitation period and § 4 provides for a two-year limitation period from when the cause of action was discovered. *Limitations Act*, S.O. 2002, c. 24, §§ 4, 15(2). But see also, provisions which toll the limitation period in class actions legislation, for example, section 28(1) of the *Class Proceedings Act*. S.O. 1992, c. 6, § 28(1) (Can.).

171. *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87 (Can.).

172. *McCann v. CP Ships Ltd.*, [2009] O.J. No. 5182, ¶ 59 (Can. Ont. Sup. Ct. J.) (QL).

173. *Silver v. Imax Corp.*, [2009] O.J. No. 5585, ¶ 40 (Can. Ont. Sup. Ct. J.) (QL).

174. *Dobbie v. Arctic Glacier Income Fund*, 2011 ONSC 25, ¶ 227 (Can. Ont. Sup. Ct.).

3. Limits on Secondary Market Statutory Liability

The limit on secondary market statutory liability is a defining feature of Canada's securities regime. In Ontario, potential damages against issuers are capped at the greater of \$1 million or 5% of issuer's market capitalization. Influential persons within the corporation or officers or directors of the issuer are liable up to the greater of \$25,000 or 50% of their aggregate compensation from the issuer. Experts are liable for the greater of \$1 million or the revenue earned from the issuer and its affiliates in the twelve months prior. Finally persons making oral public statements are liable for the greater of \$25,000 or 50% of their aggregate compensation from the issuer.¹⁷⁵ Given these relatively low caps, the prospect of a high settlement under the Ontario Securities Act's secondary market statutory liability provisions is greatly diminished unless the plaintiff brings suit against a large issuer or is able to successfully advance a common law claim for negligent or fraudulent misrepresentation. Consequently, if it is indeed the case that private enforcement disproportionately targets large issuers, public regulators might consider work to restore balance by examining how they might best tailor their enforcement activities to fill this gap and ensure comprehensive market discipline.

4. The Class Actions Regime

This section discusses the development of Ontario's class action regime since its inception in 1993. Compared to the United States, the Canadian class action regime places the greatest procedural hurdle before the action commences, rather than assessing the claim during the pleadings process. Consequently, Canada has taken a relatively reserved approach to securities class actions, and has yet to develop a class action bar as large and highly specialized as that found in the United States.

Securities legislation provides investors with a broad right to bring civil actions against an issuer. However, the high cost of litigation relative to the quantum of damages often make these actions impractical for retail investors. The introduction of class action legislation helps to overcome these barriers and makes securities litigation financially viable for a far wider class of investors.¹⁷⁶ Thus, any discussion of the effectiveness of Canada's private securities enforcement regime must also consider the efficacy of the class action system.

Ontario's 1993 Class Proceedings Act was modeled on Rule 23 of the United States Rules of Civil Procedure. However, the 1982 Law Reform

175. R.S.O. 1990, c. S-5, § 138.1.

176. Pritchard & Sarra, *supra* note 160, at 882.

Commission of Ontario generated much of the policy used for interpreting the provisions of the Class Proceedings Act. These guiding principles are (1) the promotion of judicial economy and efficiency, (2) enhanced access to private litigation, and (3) the modification and deterrence of the wrongdoer's behavior.¹⁷⁷ Some argue that these principles render Canadian legislation "more liberal in facilitating class actions than its American counterpart,"¹⁷⁸ and the principles may also present a challenge to finding an effective balance between public and private securities enforcement. This contention is examined in greater detail in the discussion of the *Fischer v. IG Investment Management* class action certification, where a class of investors sought private redress for losses accruing from market timing in Canadian mutual funds, following a finding of public liability and an order that damages be paid back to the injured investors.¹⁷⁹

In addition to requiring plaintiffs to obtain leave from the court to bring a secondary market statutory liability claim, they must also seek certification under the Class Proceedings Act. "The certification motion is intended to screen claims . . . at least in part to protect the defendant from being unjustifiably embroiled in complex and costly litigation."¹⁸⁰ Canada and the United States have adopted similar approaches to certify classes by requiring individuals to have a common question of law or fact, and ensuring that the class action represents the preferable procedure.¹⁸¹ A significant difference between the two regimes, however, is that in Canada, the class proceedings framework requires prospective class counsel to produce a plan and workable method for structuring the proceedings.¹⁸² As a result, the certification process can be highly litigious and competing firms challenge each other's capacity to effectively manage the action.¹⁸³ Consequently, protracted contests for carriage of the class action can add significant delays to the early stages of the securities class action process in Canada. When carriage of the class action is not contested, the court will grant leave where it is satisfied the action is brought in good faith and there is a reasonable possibility of success.¹⁸⁴ Although the Court in *Silver v. Imax* appears to have established a low

177. Gary D. Watson, *Class Actions: The Canadian Experience*, 11 DUKE J. COMP. & INT'L L. 269, 269–71 (2001).

178. *Id.* at 272.

179. *Fischer v. IG Inv. Mgmt. Ltd.*, 2012 ONCA 47, ¶ 18 (Can.).

180. *Robertson v. Thomson Corp.*, [1999] O.R. 3d 389, ¶ 4 (Can. Ont. Gen. Div.).

181. Class Proceedings Act, S.O. 1992, c. 6, § 5(1) (Can.); FED. R. CIV. P. 23.

182. *Fischer*, 2012 ONCA 47.

183. *See, e.g.*, *Smith v. Sino Forest Corp.*, 2012 ONSC 24 (Can.).

184. R.S.O. 1990, c. S-5, § 138.8(1).

standard of “more than a *de minimis* possibility of success at trial” for obtaining leave,¹⁸⁵ the good faith requirement becomes relevant where sanctions are pursued by both public and private agents.

In contrast, U.S. reforms focus on reducing “abusive litigation,” by enacting legislation such as the Private Securities Litigation Reform Act of 1995.¹⁸⁶ These amendments created procedural safeguards to filter out frivolous and abusive litigation at the pleading process,¹⁸⁷ rather than examining the substance of a claim during the certification process. Similarly, the Securities Litigation Uniform Standards Act of 1998 extended the Private Securities Litigation Reform Act’s provisions from federal court securities fraud suits to include state court securities fraud suits.¹⁸⁸ As a result, American law and jurisprudence has evolved in a manner conducive to large and numerous securities class actions.

Comparison of class action legislation in Canada and the United States reveals that, on one hand, the legislators have adopted similar approaches to certification. As evident in the data on private enforcement (below), however, Canada has fewer securities class actions than the United States, even after appropriate deflators are taken into account. From a legislative perspective, this may be attributed to Canada’s emphasis on certification, which creates a barrier to entry before the class action can get under way and in some sense provides an incentive to litigate outside of Canada. In contrast, the U.S. focus on “abusive litigation” moves delays into the pleadings stage,¹⁸⁹ enabling U.S. courts to establish the class more expeditiously.

Unlike the United States, which has provided for class actions and secondary market liability since the 1930s, Canada’s legislation is quite young. As a result, Canada has not yet developed a large and highly specialized class action bar. Historically, Canada has not culturally recognized class actions as a fundamental element of Canada’s civil procedure regime, but that is changing. However, in recent years, Canada has experienced greater specialization and competition within the plaintiff’s class action bar. This maturation is particularly evident in the recent contest for carriage of the *Sino Forest* class action.¹⁹⁰ In their motion, four applicants vied for the right to lead this international class action which

185. *Silver v. Imax Corp.*, [2009] O.J. No. 5585, ¶ 324 (Can. Ont. Sup. Ct. J.) (QL).

186. JAMES M BARTOS, UNITED STATES SECURITIES LAW: A PRACTICAL GUIDE 265 (3d ed. 2006).

187. *Id.*

188. *Id.*

189. Pritchard & Sarra, *supra* note 160, at 913.

190. *Smith v. Sino Forest Corp.*, 2012 ONSC 24, ¶ 1 (Can.).

claimed damages of \$6.5 billion.¹⁹¹ In reaching his decision, Justice Perell of the Ontario Superior Court noted that all firms involved likely had the capacity and expertise to manage a class action of this magnitude.¹⁹² Eventually Justice Perell decided that the action proposed by two firms jointly should prevail because of the arm's-length relationship between the representative plaintiff and the defendant, the broader class definition, and their cautious pleadings.¹⁹³ The ability of four leading class action firms to contest carriage of the *Sino Forest* action evidences the growth of the Canadian class action bar and its increasing capacity to manage multiple large class actions simultaneously, while maintaining high settlement values.

B. An Overview of the Most Recent Empirical Data on Securities Class Action Litigation in Canada

Review of the empirical data on securities class action litigation highlights several distinct features in Canada's private enforcement regime. In particular, since the introduction of secondary market statutory liability in 2005, the number of new filings and ongoing cases has steadily increased.¹⁹⁴ However, the numbers of class action settlements in Canada continue to be far fewer than the United States, averaging approximately one-fifth the number of claims per issuer from 2008–2011.¹⁹⁵ Interestingly, median settlement values in Canada tend to be roughly comparable to those in the United States averaging between \$9 and \$11 million per action—notwithstanding the fact that Canada's market capitalization is approximately one-tenth that of the United States.¹⁹⁶

Given that over 88% of the TSX and TSX-Venture's market capitalization is held by the 200 largest issuers and over 40% of listed companies there have market capitalization below \$10 million,¹⁹⁷ statutory liability

191. Statement of Claim ¶ 2(f), *Trs. Labourer's Pension Fund Cent. & E. Can. v. Sino Forest Corp.*, 2012 ONSC 1924 (No. CV-11-431153-00CP), available at http://www.kmlaw.ca/site_documents/111100_SOC_6jan12.pdf.

192. *Sino Forest*, 2012 ONSC ¶ 234 (Can.). Motions for certification were made by Rochon Genova LLP, Kim Orr Barrister P.C., and jointly by Siskinds LLP and Koskie Minskie LLP. *Id.* ¶ 4. Carriage was ultimately awarded to Siskinds LLP and Koskie Minskie LLP. *Id.* ¶ 7.

193. *Id.* ¶¶ 277, 293, 308.

194. HEYS & BERENBLUT, *supra* note 157, at 4.

195. Pritchard & Sarra, *supra* note 160, at 881.

196. Nicholls, *supra* note 7, at 134, 149.

197. *Id.* at 133–34. These 40% of issuers with a market capitalization of less than \$10 million will have a maximum secondary market statutory liability of \$1 million, pursuant to Ontario Securities Act § 138.1. From 2008–2011, the smallest class action settlement was \$1.3 million in *Henault v. Bear Lake Gold Ltd.*, 2010 ONSC 4474 (Can.), which

in the secondary market regime may impose a limit on the ability of private enforcement to ensure comprehensive market discipline. Consequently, the high median settlement values in Canadian securities litigation relative to U.S. settlements suggests that litigation has focused on larger issuers who have the market capitalization to pay multi-million dollar settlements.

Year	Number of Claims Filed ¹⁹⁸	Number Secondary Market Liability Claims Filed ¹⁹⁹	Total Number of Claims Outstanding ²⁰⁰	Number of Claims Filed in the U.S. ²⁰¹
2008	12	8	26	245
2009	9	6	28	218
2010	10	8	33	241
2011	15	9	45	232

Table 4: Secondary Market Liability Claims, 2008–2011

1. 2008.

Buoyed by a sharp increase in the number of secondary market statutory liability claims, twelve new class actions were filed in 2008, representing a 240% increase from 2007. The steady growth in secondary market statutory liability claims and as a percentage of the total securities litigation in Canada demonstrates the suitability of the secondary market for class actions and the limited incentives for litigation in the primary market, when investors retain a statutory right of rescission.²⁰² However, despite the increase in the number of new claims, growth in the total number of ongoing class actions remained relatively modest—increasing from twenty-two active cases at the end of 2007 to twenty-six by the end of 2008.²⁰³

The United States also experienced a dramatic increase in class actions between 2007 and 2008, increasing from 198 to 245.²⁰⁴ This increase was largely driven by the 102 new class actions claiming damages after the

settled for 6.5% of its initial claim value. This indicates that there were no settlements against the smallest 40% of issuers in Canada over this period.

198. HEYS & BERENBLUT, *supra* note 157, at 2.

199. *Id.*

200. *Id.* at 11.

201. *Id.* at 16.

202. R.S.O. 1990, c. S-5, § 105.

203. HEYS & BERENBLUT, *supra* note 157, at 3.

204. *Id.* at 3.

2007 credit crisis.²⁰⁵ By contrast, proactive intervention by provincial securities regulators and private institutions during the ABCP crisis in 2007 enabled Canada to avoid much of this litigation. Because of the court-supervised restructuring of the ABCP market and release from private liability only three class actions related to the credit crisis were filed in Canada.²⁰⁶

2. 2009

Following the dramatic growth in the number of securities class actions in 2008, there was a moderate decrease of nine new securities class actions filed in 2009.²⁰⁷ This cooling is likely due to the more conservative investment climate following the recession and lack of readily attainable financing to support shareholder activism. Moreover, the lingering effects of the credit crisis made it difficult for prospective litigants to effectively pursue private actions. Although the conduct leading to the credit crisis provided prospective litigants with many viable causes of action, the defendants they sought to recover from may have lacked adequate resources to pay large settlements because of the effects of the crisis.

Despite the slight cooling in securities class actions in 2009, the number of new filings and ongoing actions remained above pre-recession levels. Moreover, median settlement values and the ratio of initial claim value to settlement value, or claim-to-settlement value, remained consistent with previous years, which were \$9.1 million and 15.3%, respectively. By contrast, the United States experienced a marked decrease in both the number of class action filings and settlement values in 2009.²⁰⁸ Although the smaller number of class action settlements in Canada limits the robustness of any conclusions, the steady increase in the number of ongoing securities class actions and constancy in claim-to-settlement ratios demonstrates the development of an increasingly capable class actions bar in Canada.²⁰⁹ These values indicate that Canadian firms are selective in the cases they pursue and have the skills necessary to obtain

205. MILEV ET AL., *supra* note 157, at 2.

206. A detailed discussion of Canada's management of the ABCP Crisis takes place *infra* Part III.C.

207. HEYS & BERENBLUT, *supra* note 157, at 2.

208. MILEV ET AL., *supra* note 157, at 17.

209. *See, e.g.*, *Monsanto v. TVI Pacific Inc.*, 2009 ONSC 43191 (Can.); *Pysznyj v. Orsu Metals Corp.*, 2010 ONSC 1151 (Can.); *Ainslie v Afexa Life Sciences Inc.*, 2010 ONSC 4294 (Can.); *McCann v. CP Ships Ltd.*, [2009] O.J. No. 5182 (Can. Ont. S.C.J.); *Yee v. Aurelian Resources Inc.*, [2009] 007 ABQB 68 (Can.); *O'Neil v. SunOpta Inc.*, [2010] O.J. No. 5251, 2010 ONSC 2735 (Can. Ont. S.C.J.).

consistent outcomes, especially when compared to the wide discrepancy in settlement values and claim-to-settlement ratios in the United States.²¹⁰

3. 2010

The number of securities class actions continued to increase steadily in 2010 with ten new filings, eight of which involved secondary market statutory liability claims.²¹¹ Overall, the number of active securities class action claims increased from twenty-eight to thirty-three. This continued growth in the number of secondary market statutory liability filings was likely fostered by the relatively liberal approach to certification adopted by the Ontario Superior Court in *Silver v Imax* in 2009,²¹² and the growing familiarity and experience with the secondary market statutory liability regime.

The settlement of \$28.5 million in *Elliott v. NovaGold*²¹³ represented Canada's largest securities class action settlement to date. However, this large settlement value was offset by a record low settlement of \$1.3 million in *Henault v. Bear Lake Gold*.²¹⁴ As a result, the average annual settlement value of \$13.5 million was slightly higher.²¹⁵ Record settlements in the United States, where the median settlement value was \$11 million and the mean average was \$42 million, likely contributed to the increase seen in Canada.²¹⁶ Although settlement values in Canada were, on average, higher than in previous years, the wider range indicates that securities class actions in Canada are expanding. Law firms are becoming increasingly entrepreneurial by searching for potential class actions with claims worth a variety of values.

4. 2011

In 2011, the number of securities class actions in Canada reached a record high. Fifteen new claims were brought and a total of forty-five ac-

210. MILEV ET AL., *supra* note 157, at 19–23.

211. HEYS & BERENBLUT, *supra* note 157, at 2.

212. *Silver v. Imax Corp.*, [2009] O.J. No. 5585 (Can. Ont. Sup. Ct. J.) (QL).

213. Judgment at ¶ 1(f), *Elliott v. NovaGold Resources Inc.* (Can. Ont. Sup. Ct. J.) (Aug. 4, 2010) [hereinafter *NovaGold Judgment*].

214. *Henault v. Bear Lake Gold Ltd.*, 2010 ONSC 4474, ¶ 18 (Can.).

215. See *NovaGold Judgment*, ¶ 1(f) (Can. Ont. Sup. Ct. J.) (2010); *Henault*, 2010 ONSC 4474, ¶ 18; *West Coast Soft Wear Ltd. v. 1000128 Alberta Ltd.* [2010] O.J. Nos. 5247, 5248 ¶ 45 (Can. Ont. S.C.J.); *Metzler Inv. v. Gildan Activewear*, 2011 ONSC 1146, ¶ 6 (Can.). The median value was \$10 million, and averaged 12.6% of the original claim value.

216. MILEV ET AL., *supra* note 157, at 18.

tive claims continued with initial claim values totaling \$24.5 billion.²¹⁷ This dramatic increase was driven in part by the large number of new claims initiated against foreign issuers. The 450% growth in the number of securities class actions over the past decade highlights the rapid development of Canada's private enforcement regime and demonstrates a strong trend towards continued growth in the coming years.²¹⁸

However, there was also a significant decrease in the number of class action settlements in 2011, with only two cases settling, compared to five in 2010.²¹⁹ Settlement values in these two cases continued to reflect a trend towards a broader range of settlement values, with Norbourg Asset Management settling with investors for \$55 million and Redline Communications Group for \$3.6 million, with an average claim-to-settlement ratio of 17.5%.²²⁰ Given the number of ongoing high-value claims, it is anticipated that this broader range of settlement values will become a permanent fixture of Canada's class actions environment over the coming years.

An emerging dynamic in Canadian and American securities class actions is the high number of claims against Chinese companies. This was most pronounced in the United States where the number of filings against Chinese-based issuers jumped from ten in 2010 to thirty-nine in 2011.²²¹ Although attention for the increase in the number of claims in Canada against Chinese issuers was muted by the smaller market, the three new Canadian claims against Sino Forest, Cathy Forest Products, and Zungi Haxi Corporation have garnered significant publicity in both Canada and the United States. These claims are raising concerns about the capacity of public and private regulators to secure judgments against these issuers.²²² The OSC has responded to these concerns by initiating a targeted review of foreign issuers to ensure that existing disclosure requirements provide investors with sufficient information.²²³ Further, the review is examining whether auditors, underwriters, and other market intermediaries supporting the issuer's distribution are providing an effective check on the issuer's regulatory compliance.²²⁴

217. HEYS & BERENBLUT, *supra* note 157, at 3.

218. *Id.* at 3.

219. *Id.* at 11–12.

220. *Id.* at 10.

221. *Id.* at 4.

222. *Id.*

223. Press Release, O.S.C., OSC Commences Emerging Market Issuers Regulatory Review (July 5, 2011), *available at* http://www.osc.gov.on.ca/en/NewsEvents_nr_20110705_osc-reg-review.htm.

224. *Id.*; *see also* R.S.O. 1990 c. S-5, §§ 37.3, 57.

5. Observations

The steady growth in securities class actions, in particular secondary market statutory liability claims, demonstrates the robust nature of Canada's private enforcement regime. High average settlement values as a percentage of the initial claim values supports the proposition that there is a strong balance between proactive public enforcement and, where necessary, private actions, to provide an effective mechanism for investors to recover a portion of their losses. However, the number of securities class action filings in Canada continues to be far fewer than the number of filings in the United States, even when accounting for deflators, such as population.²²⁵

Over the past three years, the range of settlement values in Canadian class actions has grown progressively wider as new record settlements are reached. Given the United States Supreme Court's decision in *Morrison v. National Australia Bank*,²²⁶ it is likely that the trend in large class actions favoring Canadian firms will continue. Thus, it is anticipated that the Canadian securities class action bar will remain under pressure to expand in coming years to meet this growing demand.

C. An Analysis of the Balance between Public and Private Enforcement

As Canada's securities regulatory regime continues to develop, the need for balance between public and private enforcement becomes increasingly critical. Unlike LLSV theories of securities enforcement,²²⁷ which emphasize the role of private enforcement as the most effective mechanism for balancing investor protection and economic growth,²²⁸ I see a system which balances public and private enforcement as most effective. The greatest value in such a system is that it allows public and private enforcement to work together to an ultimate common objective.²²⁹ It is not that either enforcement arm is inherently superior, rather the balance and the use of effective regulatory incentives can ensure that both public and private enforcement work together effectively to provide comprehensive investor protection and efficient capital markets.²³⁰

Recently, Canada experienced three critical securities enforcement events, which have shaped the present regulatory environment and pro-

225. HEYS & BERENBLUT, *supra* note 157, at 3, 16.

226. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2869 (2010).

227. LLSV refers broadly to the works of Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny.

228. Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1141-45 (1998).

229. Puri, *Legal Origins*, *supra* note 49, at 1671.

230. Jackson & Roe, *supra* note 1, at 208.

vided a strong foundation for future reforms. First, Canada's ABCP crisis in 2007 demonstrated the potential for public and private actors to cooperate in fashioning an appropriate remedy. However, the largely private nature of settlement negotiations and agreements leaves significant questions unanswered with respect to accountability and whether the agreement was truly in the best interests of investors. Second, the public and private response to market timing in Canadian mutual funds between 1999 and 2003 emphasized the similar, but jurisdictionally separate objectives of public and private enforcement regimes. Finally, the *Abdula v. Canadian Solar—Certification*²³¹ decision, recently affirmed by the Ontario Court of Appeal, demonstrates the nature of the challenges for Canadian securities regulation, as the nation becomes increasingly involved in global class actions.

The interplay between public and private enforcement raises questions about the proper balance between the deterrence and compensatory objectives of market regulation. Since the OSC appears to be taking a more proactive role in sanctioning violations and seeking compensation for harmed investors, regulators must be careful to ensure that public enforcement does not rob private litigants of their day in court. Public and private enforcement should not be viewed as mutually exclusive avenues for redress.²³²

Remedies provided by the OSC should not be regarded as complete substitutes for private settlements. But, if investors were to receive standing to participate in proceedings before the OSC and were provided sufficient compensation through a court-sanctioned restitution or compensation process, it is conceivable that their right to a private claim should be extinguished. This, of course, is subject to the implementation of appropriate legislation.

1. Canada's Asset Backed Commercial Paper Crisis in 2007

The lack of class actions resulting from the Canadian credit crisis was primarily due to the response of private institutions, which took quick action to freeze the ABCP market. At the start of the 2007 financial crisis, the Canadian ABCP market was composed of approximately \$32 billion in non-bank sponsored notes and \$85 billion in bank sponsored notes.²³³ Prior to the crisis, regulators had adopted a hands-off approach to ABCP regulation. Since issuers were not required to provide a long-

231. *Abdula v. Canadian Solar*, 2011 ONSC 5105, *leave to appeal granted* 2012 ONCA 211 (Can.).

232. See PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 8.

233. Chant, *supra* note 62, at 4.

form prospectus detailing the content and assets underlying the ABCP, they were able to market all ABCP products as homogeneous, low-risk investment products. When the credit crisis arrived, investors began to question the quality of the assets guaranteeing these products and, as a result, the turnover of maturing notes ground to a halt. Prompt intervention by private financial institutions prevented widespread defaults in the non-bank sponsored markets and ensured that the expectations of investors were protected.

Following the market freeze, the Pan-Canadian Investor Committee agreed to a court approved restructuring of the ABCP market. The restructuring included a full release from private liability with the exception of claims for fraud and provided a full return on the investments of investors with less than \$1 million in the ABCP market.²³⁴ As a result, the Canadian market avoided the dramatic increase in class actions seen in the United States. Therefore, comparisons of the number of class actions in the United States and Canada following the 2008 financial crisis may not provide a complete basis for analyzing the effectiveness of Canada's private enforcement regime.

In sharp contrast to the Canadian experience, 255 new securities class actions were filed in the United States in 2008, with the credit crisis driving these numbers to a ten-year high.²³⁵ One hundred and ten of these cases were a direct result of the credit crisis and approximately half of the new filings were against defendants in the financial sector.²³⁶ The types of cases brought were similar to those in Canada, with approximately 25% related to accounting, over 40% related to product and operational defects, and the remainder divided among company-specific earnings guidance, merger integration issues, customer and vendor issues, and other industry-related issues.²³⁷

The credit crisis generated an interesting dilemma for plaintiffs, since their losses were incredibly large, but the pockets from which they attempted to recover these losses were incredibly small due to the crisis.²³⁸ The disparity between the number of cases brought in Canada and the United States as a result of the credit crisis was significantly affected by Canada's resolution of the ABCP issue. Thus, the balance between public and private enforcement in Canada may have helped increase short-

234. *Metcalfe & Mansfield*, 2008 CanLII 23497, ¶ 39 (Can. Ont. Sup. Ct. J.).

235. STEPHANIE PLANCICH & SVETLANA STARYKH, NERA ECON. CONSULTING, 2008 TRENDS IN SECURITIES CLASS ACTIONS 1 (Dec. 2008), *available at* http://www.nera.com/extImage/PUB_Recent_Trends_Report_1208.pdf.

236. *Id.* at 1.

237. *Id.* at 6.

238. *Id.* at 17.

term investor confidence and provide greater certainty than would have been possible under a post facto, private enforcement system.

Although issuers were released from private liability, public discipline was still enforced through sanctions by provincial securities regulators. Most notably, fines were levied against the investment firm Coventree Inc. and two of its executives for misrepresentations prior to the ABCP crisis. Also, private settlements were entered wherein seven Canadian banks agreed to pay \$139 million in fines including \$75 million from National Bank and \$22 million from the Canadian Imperial Bank of Commerce.²³⁹ Thus, the Canadian approach may favor proactive, public regulation as a first line of defense and private enforcement as a secondary layer of protection.

2. The Public and Private Response to Market Timing in Canadian Mutual Funds

Public and private enforcement both serve important roles in Ontario's securities enforcement regime. As a public regulator, the OSC has broad public interest jurisdiction to impose market discipline and, where appropriate, seek leave from the court to direct compensation to investors.²⁴⁰ A number of private civil remedies are also available to investors to ensure they receive adequate compensation and a right to manage their own claims. Since public and private enforcement work towards the common goal of ensuring comprehensive market discipline, their enforcement activities may overlap and raise issues of certainty and finality for the parties involved. The Ontario Court of Appeal's recent decision in *Fischer* underscores the need for these two regimes to work cooperatively.²⁴¹ Further, a good balance between both systems ensures more effective use of scarce enforcement resources.²⁴²

In 2003, the OSC commenced an investigation into late trading and market timing in 105 Canadian mutual funds and ordered these funds to provide the OSC with an overview of the policies and procedures that they were using to combat market timing and late trading. Market timing occurs when investors take advantage of the "stale prices" of foreign securities used to calculate the Net Asset Value ("NAV") of an international mutual fund. A fund's NAV value is calculated daily at 4:00 pm EST, using the closing market values of all the fund's holdings. Because

239. Order, *In re Coventree Inc.*, Geoffrey Cornish & Dean Tai, OSC PROC. (Nov. 8, 2011).

240. See R.S.O. 1990, c. S-5, §§ 127, 128.

241. See *Fischer v. IG Inv. Mgmt. Ltd.*, 2012 ONCA 47 (Can.).

242. PURI, ENFORCEMENT EFFECTIVENESS, *supra* note 35, at 16; see, e.g., *OSC Staff Notice 11-719*, *supra* note 82, at 8410.

European and Asian markets close at 6:00 pm and fourteen hours prior to North American markets, the closing prices of these securities do not reflect developments in the North American market and may be undervalued. Market timers exploit upward trends in the North American market by recognizing that foreign equities in the fund are likely to gain when the market opens the next day, and as a result the NAV value of the fund will undervalue these foreign securities. In order to capitalize on this position, market timers make a short-term investment in the fund and then sell their investment once the foreign market appreciation is factored into the NAV and realize the arbitrage profit. Although not illegal, market timing reduces the profitability of the fund for long term investors and forces managers to hold large sums of money out of the market to pay for daily churn in the fund.

When investigating five mutual fund companies²⁴³ the OSC maintained that the failure of these funds to implement adequate safeguards against market timing constituted a breach of the manager's fiduciary duty to the fund.²⁴⁴ By 2005, the OSC had settled or rendered decisions against all five mutual funds, who agreed to pay a total \$205.6 million to their investors.²⁴⁵ Significantly, these settlements were deemed to be "without prejudice" to the parties in "any civil or other proceedings which may be brought by any other person or agency."²⁴⁶

In 2009, a class of investors applied to certify a class action against these five funds for residual damages not accounted for in the OSC's settlement. The motions judge refused their application, maintaining that a class action was not the preferable procedure since the policy objectives of compensation, judicial economy, access to justice, and behavior modification had been satisfied by the OSC settlement.²⁴⁷ This decision was subsequently overturned by the Divisional Court, which held that

243. The five funds include CI Mutual Funds, AIC Limited, Franklin Templeton Investments, IG Investment Management Ltd, and AGF Funds Inc. *Fischer*, 2012 ONCA 47, ¶ 1 n.1.

244. Settlement Agreement, *In re* Sec. Act R.S.O. 1990, c.S.5, as amended & AGF Funds Inc., OSC PROC. (Dec. 12, 2004); *In re* Sec. Act R.S.O. 1990, c.S.5, as amended & CI Mutual Funds Inc., OSC PROC. (Dec. 16, 2004); Settlement Agreement, *In re* Sec. Act R.S.O. 1990, c.S.5, as amended & Franklin Templeton Investments Inc., OSC PROC. (Dec. 28, 2005); Settlement Agreement, *In re* Sec. Act R.S.O. 1990, c.S.5, as amended & I.G. Investment Management Ltd., OSC PROC. (Dec. 16, 2004); Settlement Agreement, *In re* Sec. Act R.S.O. 1990, c.S.5, as amended & AIC Ltd., OSC PROC. (Dec. 16, 2004).

245. See, e.g., *supra* note 244.

246. *Fischer*, 2012 ONCA 47, ¶ 17.

247. *Id.* ¶ 80.

since investors were claiming monetary damages beyond those provided by the OSC, their claim could not have been fully satisfied.²⁴⁸

Chief Justice Winkler of the Ontario Court of Appeals upheld the Divisional Court's ruling and found that the OSC serves a public regulatory function, which is distinct from the private remedial goals of the proposed class action.²⁴⁹ Chief Justice Winkler ruled that the OSC "lacked the jurisdiction under its enabling provision of s. 127(1) of the *Securities Act* to decide the liability and damages issues raised in the private law action."²⁵⁰ Consequently, decisions of the OSC are not capable of extinguishing a private party's right of action.

The Ontario Court of Appeal's decision in *Fischer* is significant because it affirms the interrelationship between public and private enforcement in Canada and recognizes the purposes they serve. Although it is still premature to assess the full impact of this decision, the precedent it establishes provides greater certainty for prospective securities class actions where public enforcement activities have taken place. This distinction between public and private liability may ultimately expand the scope of compensation available to investors seeking redress for secondary market statutory liability since sanctions levied by the OSC are not prejudicial to the investor's private right of action and the cap on private, secondary market civil liability under §138.1 of the Ontario Securities Act. However, in order for the OSC to assume this role legitimately, the legislature would need to amend their enabling legislation.

3. Global Class Actions

In an increasingly integrated global economy, securities litigation frequently spans multiple jurisdictions. This is especially pronounced in Canadian markets, given the high percentage of companies cross-listed on domestic and foreign exchanges. A major challenge for regulators and courts is determining the proper role of international private enforcement and whether an active securities litigation system encourages a more effective regulatory environment.²⁵¹ Ontario courts appear willing to assume jurisdiction in cross-border proceedings without requiring the majority of investors to be Canadian residents. This approach stands in stark contrast to the U.S. Supreme Court's decision in *Morrison*, where for-

248. *Fischer v IG Inv. Mgmt. Ltd.*, 2011 ONSC 292, ¶¶ 235–65 (Can.).

249. *Fischer*, 2012 ONSC 47, ¶ 10.

250. *Id.* ¶ 80.

251. See generally La Porta, *supra* note 1 (discussing the various systems of protection for investors in legal systems all over the world); Jackson & Roe, *supra* note 1 (concluding that public enforcement is overall as important as private enforcement in explaining financial market outcomes around the world).

eign plaintiffs were denied jurisdiction to sue American defendants when the securities were purchased on foreign exchanges.²⁵² The divergent jurisprudence in Canada and the United States may significantly impact the development of Canada's class action system as foreign investors begin to regard Canada as a hospitable jurisdiction for global securities class actions.

Generally, where there is a real and substantial connection between the individual claim and the jurisdiction in which the claim is being brought, a Canadian court will exercise its inherent jurisdiction to certify national and global class actions.²⁵³ However, two recent decisions in Ontario conflict on whether foreign investors who purchased their securities abroad should be certified as members of an Ontario class action. In *McKenna v. Gammon Gold*, the court refused to include investors who purchased securities outside of Canada in the class.²⁵⁴ In a more recent certification decision in *Silver v. Imax*, the court defined the class to include both Canadian and U.S. investors who purchased their shares on the TSX and NASDAQ.²⁵⁵ The court accepted that since Imax was an Ontario based company, trading on the TSX, Ontario was the appropriate jurisdiction, even though only 10–15% of the investors were Canadian residents.²⁵⁶

Another example of Canadian courts' willingness to assume jurisdiction in global class actions was in *Mondor v. Fisherman*, where Canadian investors brought a class action against YBM for secondary market losses.²⁵⁷ Since YBM's headquarters were located in Pennsylvania, a class action was also filed by American shareholders in the U.S. District Court for the Eastern District of Pennsylvania.²⁵⁸ It was agreed by the judges in both jurisdictions, however, that Canada had a greater interest than the United States in the subject matter since YBM was incorporated in Canada.²⁵⁹ These cases demonstrate a general willingness by Canadian

252. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2869 (2010).

253. See, e.g., *Van Breda v. Village Resorts Ltd.*, 2012 SCC 17 (Can.); *Baxter v. Canada* (Att'y Gen.), [2005] O.J. No. 2165, ¶ 12 (Can. Ont. Sup. Ct. J.) (QL); *Nantais v. Teletronics Proprietary (Can.) Ltd.*, [1995] O.J. No. 2592, ¶ 98 (Can. Ont. Gen. Div.) (QL); *Carom v. Bre-X Minerals Ltd.*, [1999] O.J. No. 1662, ¶¶ 281–86 (Can. Ont. Sup. Ct. J.) (QL); *Wilson v. Servier Can. Inc.*, [2000] O.J. No. 3392, ¶ 28 (Can. Ont. Sup. Ct. J.) (QL).

254. *McKenna v. Gammon Gold Inc.*, 2010 ONSC 1591, ¶ 116 (Can.).

255. *Silver v. Imax Corp.*, [2009] O.J. No. 5585, ¶ 6 (Can. Ont. Sup. Ct. J.) (QL).

256. *Id.* ¶¶ 109–30.

257. *Mondor v. Fisherman*, [2002] O.J. No. 1855, ¶ 1 (Can. Ont. Sup. Ct. J.) (QL).

258. *Paraschos v. YBM Magnex Int'l Inc.*, 130 F. Supp. 2d 642, 642 (E.D. Pa. 2000).

259. *Mondor*, [2002] O.J. No. 1855, ¶¶ 11–12.

courts to assume jurisdiction for international class actions where a connection to Canada has been established.

The opportunity for Canadian courts to hear global class actions may be accentuated by the U.S. Supreme Court's decision in *Morrison*,²⁶⁰ where Justice Scalia held that there is no cause of action for a foreign plaintiff to sue foreign and American defendants for misconduct in connection with securities traded on foreign exchanges.²⁶¹ Since the United States appears to be adopting a more restrictive approach to international class action certification, *Morrison* may steer litigation to the jurisdiction where the company is incorporated or listed. This may, in turn, force the Canadian class action bar to develop increased autonomy and capacity.

Another indication of the willingness of Canadian courts to assume jurisdiction in international class actions was seen in the certification decision in *Abdula v. Canadian Solar*.²⁶² In approving the certification, the Ontario Superior Court held that Canada had jurisdiction because Canadian Solar is a company incorporated in Canada who sold securities to Canadian investors, notwithstanding that Canadian Solar's principal place of business is China, their securities are listed exclusively on the NASDAQ, and all regulatory filings and disclosures were made to the SEC.²⁶³ In his decision, Justice Taylor relied heavily upon the Ontario Superior Court's decision in *Silver v. Imax* to support his liberal approach to certifying this action.²⁶⁴ Since Canadian Solar's sole links to Canada's jurisdiction are its place of incorporation and investors, this decision appears to push the limits of the precedent from *Imax* and *Mondor*. Thus, the Ontario Court of Appeal's recent decision in *Canadian Solar* is very important to the evolution of Canada's global class action regime. The Court of Appeal's affirmation of Justice Taylor's decision, clearly signals Canada's willingness to allow actions against foreign issuers if a real and substantial connection to Canada is established, and may cause plaintiffs to regard Canada as a viable alternative to the United States following its decision in *Morrison*.

4. Private Enforcement Conclusions

The introduction of secondary market statutory liability and class action legislation created an opportunity for investors to pursue far more claims than would have been possible under the common law. Still, secu-

260. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2888 (2010).

261. *Id.*

262. *Abdula v. Canadian Solar*, 2011 ONSC 5105, *leave to appeal granted* 2012 ONCA 211 (Can.).

263. *Id.*

264. *Silver v. Imax Corp.*, [2009] O.J. Nos. 5573, 5585 (Can. Ont. Sup. Ct. J.) (QL).

urities class action litigation in Canada occurs far less frequently than in the United States. This appears to be the result of multiple factors. First, Canadian capital markets are approximately one-tenth the size of American markets. Second, secondary market statutory liability has been part of the U.S. securities landscape for over eighty years, whereas it has existed in Canada for only seven years and is still developing sufficient jurisprudence to guide its implementation. Also, elements of the Canadian regime may limit the number of cases pursued under the secondary market civil liability provision. The limits on statutory liability and the double leave requirement for certifying a secondary market statutory liability class action serve as procedural gatekeepers for private enforcement. Consequently, the frequency and range of defendants appearing in private securities actions appears to be limited.²⁶⁵

CONCLUSION

Securities enforcement in Canada has significant room for further development and harmonization between the public and private enforcement regimes. Overall, the future of securities regulation in Canada depends on the ability of legislators, courts, and regulators to strike an appropriate balance between public and private mechanisms. Despite the suggestion that investors should be allowed to seek redress through the civil liability system, a robust public regulatory system is essential for deterrence and compensation.

Review of Canada's public enforcement regime suggests that Canadian regulators are traditionally more reserved than their American counterparts. This difference appears to be due to the differing philosophical approaches to enforcement. Similarly, private enforcement in Canada also appears to be less active than in the United States. As a result, any reforms aimed at improving securities enforcement in Canada must not proceed with a view that one enforcement regime is dominant in Canada. Strengthening the capacity of one regime without due regard for the other may significantly limit the ability of the overall securities regime to achieve optimal deterrence and compensation.

Recent initiatives by the OSC to return the proceeds of public settlements to investors and the courts' willingness to grant broad standing to global securities class actions may demonstrate an effort to align the interests and objectives of public and private enforcement. Overall, these appear to be positive developments, and so long as they are properly managed, they will complement the recent growth in private enforcement

265. Mary Condon, *Rethinking Enforcement and Litigation in Ontario Securities Regulation*, 32 QUEEN'S L.J. 1, 43 (2006).

since the introduction of secondary market statutory liability in 2005. The number of private securities class actions has been increasing steadily and damages have remained comparatively high as a percentage of initial claim value. This demonstrates the strength of the plaintiff's bar in Canada. However, the number of claims filed in Canada continues to be far fewer than the United States (even after accounting for appropriate deflators), indicating that there continues to be significant room for further development.

Further development is also necessary for public and private enforcement regimes in Canada. The number of private actions initiated by investors continues to be far lower than the United States. Given the statutory cap on secondary market statutory damages, we must question whether private enforcement is capable of providing market discipline against smaller issuers. After the Supreme Court of Canada's recent reference decision on the constitutionality of a national securities regulator, public enforcement will continue to be challenged by a lack of coordinated, centralized enforcement and duplication of resources in each of the provinces and territories.