

What's Next For Canada?

SECURITIES REGULATION
AFTER THE REFERENCE

Edited by Anita Anand



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for optimism that such efforts are likely to prove more productive in the future. In this respect, efforts at achieving intergovernmental cooperation in harmonizing laws and rationalizing their administration and enforcement can be likened to the problems confronting participants in economic markets who see private advantages to cartelizing the market: experience shows that cartels, amongst very different kinds of actors, are hard to form and are even harder to sustain where frequent renegotiation of the terms of the cartel is required in the light of changing external circumstances. While critics of the federal legislation in this case offer as an alternative some form of multijurisdictional commission (although sometimes mischaracterizing this as a model of regulatory competition),³³ an inter-governmental cartel of regulators is likely to be much less effective in regulating Canadian securities markets than a “benign” monopolist in the form of a single federal regulator. I say “benign” because the realities are that Canada is competing for capital in global capital markets and that national regulators are constrained by this imperative and will increasingly need to cooperate with other national regulators in establishing some basic ground rules for this competitive process and, in particular, in containing the transmission of systemic risks across national capital markets — a role that Canada’s system of decentralized securities regulation largely disqualifies us from playing.

33 See Chapter 12.

CHAPTER 3

Competition Policy, Efficacy, and the National Securities Reference

Edward M. Iacobucci

A. Introduction

In this brief comment on the Supreme Court of Canada’s decision in the *Reference Re Securities Act*,¹ I will expand and elaborate on a point raised by Michael Trebilcock in his excellent critique of the Court’s approach in Chapter 2.² Trebilcock concludes that the Court inappropriately distinguished competition policy from securities regulation. The Court contended that competition policy is an intrinsically national matter, while securities regulation is not. It engaged in this exercise in order to determine the applicability to the reference of the *General Motors of Canada v City National Leasing* case, which upheld a civil remedy in a federal competition policy statute as within the federal government’s general trade and commerce authority.³

I agree with Trebilcock that the Supreme Court failed to distinguish competition policy from securities regulation in a meaningful way, but would go further. In my view, as I explain below, securities regulation is of *greater* national significance than competition policy, and thus is even more suitably covered by the general trade and commerce power. Trebilcock also describes what

1 *Reference Re Securities Act*, 2011 SCC 66 [*Securities Reference*].

2 See Chapter 2.

3 *General Motors of Canada Ltd v City National Leasing*, [1989] 1 SCR 641 [*General Motors*].

the competition policy regime would look like if jurisdiction were provincial. His point is to demonstrate the absurdity of provincial jurisdiction over securities regulation; in addition I suggest that the example helps illustrate the confusion that the Court suffered in attempting to set aside considerations of efficacy in determining jurisdiction. I consider each point in turn.

B. Competition Policy and Local Jurisdiction

Trebilcock takes the Court to task for its approach to competition policy — rightly, in my view — for two important reasons. First, he points out that “[c]apital is an input or factor of production in all industries across Canada, and the effective functioning of capital markets is as important to the Canadian economy as the regulation of anti-competitive practices; indeed, the impact of capital markets on the efficient functioning of the Canadian economy may be more pervasive than the impact of competition laws.”⁴

I agree with Trebilcock’s observation, but would add to the latter point. Given capital’s mobility, securities markets are not inherently local in today’s world, though legal regulation might encourage certain transactions to take place within certain geographic bounds. Buyers and sellers of securities may be located anywhere in the world, and in fact, for diversification reasons, it makes sense for buyers in one region to look to acquire securities from businesses located in another region.⁵ And, of course, there are no transportation costs to undermine far-flung sales of securities.

In contrast, competition policy often concerns markets that are inherently very localized. A leading mergers case, for example, involved print advertising in community newspapers in the north shore area of Vancouver.⁶ It turns out that, for demand-side reasons, community newspapers sell in local markets: people in one small area do not want to read about local news from another small area. The outcome in this case would have had only

4 See Chapter 2, Section B(3)(c).

5 To elaborate, if performance in two geographic areas is not perfectly correlated, someone owning shares that derive value from economic activities in both areas will face lower risk in her portfolio than someone who owns shares in only one region, all other things equal.

6 *Canada (Director of Investigation and Research) v Southam Inc*, [1997] 1 SCR 748.

a focused impact in one neighbourhood of Vancouver and was hardly a matter of national significance. This is not an isolated example. Many cases in competition policy involve price-fixing in local markets, such as cement (which tends to be a local market because of supply-side considerations, specifically high shipping costs) or gasoline. A conviction of two neighbouring gasoline retailers does not come anywhere close to affecting national markets. Trebilcock is correct to point out that securities markets are at least national in scope, if not international, and there is no reason for *General Motors* not to apply. But it would be fair to go further and conclude that as between the two forms of economic regulation, competition policy is in fact much more likely than securities regulation to involve intrinsically local matters. The Court’s analysis of the national significance of competition policy is naïve.

C. Efficacy and Jurisdiction

Trebilcock’s second point on competition policy concerns the institutional implications of provincial jurisdiction. He asks what mergers policy would look like if it took the same approach as the *status quo* in securities regulation. Rather than pre-notifying a merger to one competition authority, merging parties would have to prepare thirteen different notifications to send to thirteen different regulators, and then contend with the decisions of thirteen different agencies. Trebilcock relies on this example to provide perspective on the absurdity of the *status quo* in securities regulation.

While I wholeheartedly agree that thirteen pre-notifications would be absurd, I would also rely on Trebilcock’s example for a different reason. In my view, the Supreme Court is terribly muddled in its treatment of the distinction between the optimality of institutional arrangements as a matter of policy, and the question of legislative competence and jurisdiction. As I find it difficult to know precisely what the Court meant to say on this matter, rather than paraphrase, I reproduce paragraph 90 of the decision in its entirety:

We would add that, in applying the *General Motors* test, one should not confuse what is optimum as a matter of policy and what is constitutionally permissible. The fifth *General Motors* criterion, it is true, asks whether failure of one or more provinces

to participate in the regulatory scheme would “jeopardize the successful operation of the scheme in other parts of the country”. However, the reference to “successful operation” should not be read as introducing an inquiry into what would be the best resolution in terms of policy. Efficaciousness is not a relevant consideration in a division of powers analysis (see *Reference re Firearms Act (Can.)*, at par. 18). Similarly, references in past cases to promoting fair and effective commerce should be understood as referring to constitutional powers that, because they are essential in the national interest, transcend provincial interests and are truly national in importance and scope. Canada must identify a federal aspect distinct from that on which the provincial legislation is grounded. The courts do not have the power to declare legislation constitutional simply because they conclude that it may be the best option from the point of view of policy. The test is not which jurisdiction — federal or provincial — is thought to be best placed to legislate regarding the matter in question. The inquiry into constitutional powers under ss. 91 and 92 of the *Constitution Act, 1867* focuses on legislative competence, not policy.⁷

Thus, according to the Court, optimal policy is irrelevant in determining what is constitutionally permissible. The reference to “successful operation” in *General Motors* is not about efficacy. Promoting “fair and effective commerce” should be understood to be about powers that are national in importance and scope. Canada must identify a distinct federal aspect. There is a question of legislative competence, not policy.

These observations by the Court do not make sense. For example, how can “successful operation” not have anything to do with efficacy? The Court appears to treat jurisdiction under *General Motors* as a kind of light switch: only if the light does not come on at all when the provincial jurisdiction switch is thrown would the federal government assume jurisdiction over a given matter; the fact that the light may be very dim with provincial jurisdiction, while it would be bright with federal authority, is irrelevant.

The obvious difficulty with such an approach to *General Motors* is that it would be a rare case in which the provinces could not assume jurisdiction over a matter and establish some kind of workable regime. To use the above metaphor, provinces will

almost always generate some kind of dim light when assuming jurisdiction over a matter.

To illustrate, consider a matter that the Court identified in the *Securities Reference* as within federal jurisdiction: securities regulation aimed at systemic risk. It is difficult to know exactly what regulating systemic risk with securities regulation would entail, but let us accept for the sake of argument the Court’s approach to the question. The Court observed at paragraph 103:

Systemic risks have been defined as “risks that occasion a ‘domino effect’ whereby the risk of default by one market participant will impact the ability of others to fulfill their legal obligations, setting off a chain of negative economic consequences that pervade an entire financial system” (M. J. Trebilcock, National Securities Regulator Report (2010), at para. 26). By definition, such risks can be evasive of provincial boundaries and usual methods of control. The proposed legislation is aimed in part at responding to systemic risks threatening the Canadian market viewed as a whole. Without attempting an exhaustive enumeration, the following provisions of the proposed Act would appear to address or authorize the adoption of regulations directed at systemic risk: ss. 89 and 90 relating to derivatives, s. 126(1) on short-selling, s. 73 on credit rating, s. 228(4)(c) relating to urgent regulations and ss. 109 and 224 on data collection and sharing.⁸

A key sentence in this passage is that systemic risks, “[b]y definition, . . . can be evasive of provincial boundaries and usual methods of control.” Federal jurisdiction follows. But the Court’s analysis of systemic risk is not consistent with its rejection of efficacy as a criterion for determining jurisdiction. The key differences between federal and provincial jurisdiction over matters concerning systemic risk turn on efficacy. There is no reason, for example, that provinces could not regulate short-selling. Indeed, as MacIntosh points out in his comment on the case, provinces do regulate short-selling.⁹ What MacIntosh does not acknowledge, however, is that there is a difference in the predictable efficacy of provincial and federal regulatory schemes aimed at systemic risk. For example, a provincial government whose objective is to maximize well-being in the province will have a bias against close regulation (including enforcement) of a practice that may create

7 *Securities Reference*, above note 1 at para 90.

8 *Ibid* at para 103.

9 See Chapter 12.

systemic risks across the country but is nevertheless good for the province. Even absent such a bias, a failure to regulate in one province for whatever reason could affect systemic risk elsewhere. This is the Court's implicit point in observing that systemic risks are "evasive of provincial boundaries."

But this analysis of the efficacy of provincial regulation says nothing about whether the provinces could put in place some kind of regime that addresses systemic risk. Of course they could: nothing prevents provinces from regulating securities with an eye to systemic risk. To be sure, given the localized nature of provincial jurisdiction and the associated spillovers, provinces may regulate suboptimally. But suboptimality, the factor that invites federal jurisdiction over systemic risk, is elsewhere in the *Securities Reference* decision characterized as irrelevant. Thus, the Court's acceptance of federal jurisdiction in the systemic risk context, based as it must be on efficacy, is not consistent with the Court's rejection of optimality as a criterion for deciding jurisdiction.

The other example of legitimate federal jurisdiction invoked by the Court is national data collection. There are two ways of thinking about what drives federal jurisdiction with respect to this kind of regulation. First, federal jurisdiction could follow because provinces can mandate the production of data only within their own borders, while the federal government may mandate data production across the country. Federal jurisdiction is thus superior to provincial jurisdiction if the objective is to gather comprehensive data. But, again, the functional superiority of a regime is not supposed to be a criterion in determining jurisdiction according to the Court elsewhere in its decision. Provinces obviously have the power to create a data collection regime within their borders; the fact that such regimes will be operationally inferior to a federal scheme should, the Court tells us, be irrelevant to the question of jurisdiction.

The other possible way of looking at the authority to establish a national data collection regime is that it is the "national" aspect that creates federal jurisdiction. It is tautological that a province (at least on its own) cannot create a national data collection regime. If, however, the label "national" is what drives jurisdiction here, then why does it not drive jurisdiction generally? That is, the federal government wants to establish a "national" securities regulator, something that no province has the power to do. Why not take the label "national" seriously in this context if one takes

it so seriously in the data collection context? The difference in contexts turns on efficacy: a national data collection regime is obviously superior to a provincial regime in achieving the goal of gathering data, while a national securities regulator, according to some (though not me), is not obviously superior. But efficacy, according to the Court, is an irrelevant criterion, and the Court's willingness to confer jurisdiction on the federal government to establish a national data collection regime is therefore puzzling.

Given the availability of some kind of provincial regulatory regime in almost any context, the test for jurisdiction that the Supreme Court set out in the *Securities Reference* under the general trade and commerce clause is unsatisfactory. The Court's distinction between whether the switch turns on a light and whether the light is bright is not helpful: provinces generally can establish some sort of regulatory regime over a matter, and thus the federal government will generally fail to meet the fifth *General Motors* criterion. This could not be what *General Motors* intended. Rather, *General Motors* meant what it said: whether the failure of a province to regulate a matter jeopardizes the successful operation of a scheme is relevant both to the efficacy of a provincial regime and to jurisdiction.

Let me return to Trebilcock's analysis of competition policy to illustrate this point still further. *General Motors* concluded that competition policy was vital to the national interest, and given the wide range of activities that would be affected by it, could be implemented effectively only by the federal government. The idea that federal jurisdiction is *necessary* for competition policy is simply wrong, however: competition policy could be implemented at the provincial level. Trebilcock's analysis of pre-notification of mergers in a provincial scheme is useful in responding to the Court's unsuccessful attempt in the *Securities Reference* to draw a distinction between good policy and constitutional authority. If competition policy were provincial and territorial rather than federal, two merging parties would have to notify thirteen authorities and satisfy all thirteen that the merger does not pose a competitive threat. This is an unwieldy and undesirable institutional arrangement, but it is entirely conceivable. And this would be true of all areas of competition policy, not just mergers: there is no reason that there could not exist thirteen authorities charged with investigating price-fixing or other market abuses in their territories. Indeed, there was, and remains, a common

law of restraint of trade that, by its common law nature, is under provincial authority, and thus some aspects of competition policy are in fact provincial.¹⁰

The fact that provincial jurisdiction over competition policy would produce a patchwork of inefficient overseers of potentially anticompetitive activities such as mergers does not undermine the proposition that provinces can establish competition policy regulation. Trebilcock's example of merger pre-notification is intended to illustrate the peculiar nature of the *status quo* in securities regulation, but it also points out the inconsistency of the *Securities Reference* with the *General Motors* approach to jurisdiction. When the Court in *General Motors* speaks of the necessity of federal jurisdiction, it is implicitly taking efficacy seriously. The Court in the *Securities Reference*, on the other hand, rejects efficacy as a relevant consideration, but is internally inconsistent on the question. When considering systemic risk and national data collection, the Court implicitly must have relied on efficacy as a significant factor in deciding jurisdiction. It is a pity that the Court did not go further and consider the efficacy of a national securities regulator in a more robust way.

D. Conclusion

Michael Trebilcock was correct, in my view, to claim that the Court's invocation of competition policy in the Reference as a comparison to securities regulation is flawed. I would add two further points. First, competition policy is in fact more local than securities regulation. Second, the acceptance of federal jurisdiction over competition policy in *General Motors* (and the acceptance of federal jurisdiction over systemic risk and information collection in the *Securities Reference*) must turn on efficacy. Efficacy is a key criterion in determining jurisdiction under the *General Motors* test: the Court in the *Securities Reference* was incorrect to reject it.

10 See Michael J Trebilcock, *The Common Law of Restraint of Trade: A Legal and Economic Analysis* (Toronto: Carswell, 1986).

~ PART 2 ~ Constitutional Considerations