Court File No. 33718

IN THE SUPREME COURT OF CANADA

IN THE MATTER OF Section 53 of the *Supreme Court Act,* R.S.C. 1985, c. S-26

AND IN THE MATTER OF a Reference by the Governor in Council concerning the proposed Canadian *Securities Act,* as set out in Order in Council P.C. 2010-667, dated May 26, 2010

FACTUM OF THE INTERVENER, CANADIAN FOUNDATION FOR ADVANCEMENT OF INVESTOR RIGHTS ("FAIR CANADA")

PART I – OVERVIEW

1. Canada, alone among advanced industrialized economies, does not have a national securities regulator.[1] In an age when capital markets are national or international, when capital flows freely across borders, and when public companies operate in multiple jurisdictions, this anomaly can present hardships for retail investors whom securities regulation is meant to protect.

2. FAIR Canada is a national non-profit agency, independent of government, regulators and the financial industry. Its purpose is to advocate in the area of securities regulation on behalf of Canadian retail investors.[2] FAIR Canada's position is that the proposed Canadian *Securities Act* is within the legislative authority of Parliament. The proposed *Securities Act* exhibits the traditional indicia established by this Court, which indicate that the proposed federal legislation is directed at the general regulation of trade affecting the entire country. Indeed, in this day and age, it is difficult to imagine an activity that is more truly of national economic concern than the regulation of Canada's capital markets. It touches on all Canadians. It impacts all industries. The federal government has demonstrated a rational basis to support the proposed *Act* pursuant to its power over trade and commerce. The proposed *Act* is constitutionally valid.

3. The fact that securities regulation has been largely local to date does not preclude the federal government from enacting laws to regulate the national economy when what were once local economic concerns develop into national and international ones. In fact, this Court has expressly acknowledged that a general scheme of securities regulation may well be within the legislative authority of Parliament, given the interprovincial and international character of

[1] Reference Record, Volume XXXII, Affidavit of Ermanno Pascutto, sworn October 28, 2010, p. 6, para. 14 ("Pascutto Affidavit").
[2] I*bid.* at p. 3, para. 7.

Canadian capital markets.[3] Local regulation of securities is a matter of historic, economic and political happenstance, not constitutional doctrine. As this Court has acknowledged many times, our Constitution must be read in light of changing contemporary realities, which include the development of Canada's capital markets into an important national economic concern, and not merely a collection of local ones.

4. The current patchwork model of securities regulation is inadequate and demonstrates the inability of the provinces and territories (alone or together) to regulate Canada's capital markets in as comprehensive a manner as the proposed *Act*. The current substitute for a true national regulator, created under this patchwork model, is accountable only to its member regulators, not the executive, Parliament or another legislature. It is a voluntary umbrella organization of regulators that operates on the basis of consensus among its members. In practice, this consensus-based model has led to important reforms intended to protect Canadian investors going unimplemented or being diluted and delayed, and has allowed individual provinces or territories to have a *de facto* "veto" over regulatory reform. Regulatory balkanization also inhibits the effective enforcement of securities laws across jurisdictions.[4] Taken together, the current consensus-based model has a negative impact on investors in Canada's capital markets. Those markets, being national and international in scope, would be better addressed by a comprehensive federal legislative scheme, such as the proposed *Act*.

PART II – QUESTION IN ISSUE

5. The Governor-in-Council has asked this Court whether the proposed Canadian *Securities Act* is within the legislative authority of Parliament.

PART III – ARGUMENT

The General Trade and Commerce Power

6. The classic articulation of the scope of Parliament's power over trade and commerce is from the Privy Council's decision in *Citizens Insurance Co. of Canada v. Parsons*; namely, Parliament may validly legislate for "the general regulation of trade affecting the whole dominion".[5] The "limits of s. 91(2) are not fixed and … questions of constitutional balance play

[3] *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161 at pp. 173-74 ("*Multiple Access*").
[4] Pascutto Affidavit, *supra* note 1 at pp. 3-5, paras. 9-11.
[5] *Citizens Insurance Co. v. Parsons* (1881), 7 A.C. 96 (P.C.) ("*Parsons*").

a crucial role in determining its extent in any given case at any given time."[6] As Dickson J. (as he then was) acknowledged in *Canadian National Transportation Ltd. v. Canada*, the economic concerns that will fall within the scope of Parliament's power over trade and commerce will change as the national economy itself develops,[7] consistent with the well-established doctrine that Canada's constitution is a "living tree", to be interpreted in light of contemporary realities. The only repeatedly acknowledged limit on s. 91(2) is that it could not grant Parliament "the power to regulate by legislation the contracts of a particular business or trade",[8] which the proposed *Securities Act* does not purport to do. This is because, to do so, would be a "nullification of a jurisdiction conceded to the provinces by the Constitution", as distinct from federal legislation "aimed at the economy as a single integrated national unit".[9]

7. The ultimate issue when assessing the validity of federal legislation enacted pursuant to the trade and commerce power is whether the legislation is "directed at a general regulation of the national economy" and is not "merely aimed at centralized control over a large number of local economic entities."[10] As LeBel J. recently held on behalf of this Court, determining whether a law is validly enacted by Parliament under the trade and commerce power "requires an assessment of the relative importance of an activity to the national economy as well as an inquiry into whether an activity should be regulated by Parliament as opposed to the provinces."[11]

8. Since *Parsons*, *supra*, courts have developed five "indicia" for determining whether "it is more probable that what is being addressed by a federal enactment is genuinely a national economic concern and not just a collection of local ones":[12] (1) the impugned legislation must be part of a regulatory scheme; (2) the scheme must be monitored by the continuing oversight of a regulatory agency; (3) the legislation must be concerned with trade as a whole rather than a particular industry; (4) the legislation should be of a nature that provinces jointly or severally would be constitutionally incapable of enacting; and (5) the failure to include one or more provinces or localities in a legislative scheme would jeopardize the successful operation of the

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[6] *Canadian National Transportation Ltd. v. Canada (Attorney-General)*, [1983] 2 S.C.R. 206, 1983 CarswellAlta 167 at para. 92 (*per* Dickson J.) ("*CN*").
[7] *Ibid.* at para. 105.
[8] *Parsons*, *supra* note 5.
[9] *CN*, *supra* note 6 at para. 105.
[10] *Ibid.*
[11] *Kirkbi AG v. Ritvik Holdings Inc./Gestions Ritvik Inc.*, 2005 SCC 65 at para. 16 ("*Kirkbi*").
[12] *CN*, *supra* note 6 at p. 268 [emphasis added].

scheme in other parts of the country.[13]

9. "These indicia do not, however, represent an exhaustive list of traits that will tend to characterize general trade and commerce legislation. Nor is the presence or absence of any of these five criteria necessarily determinative." Rather, these indicia are a "preliminary checklist of characteristics, the presence of which in legislation is an indication of validity under the trade and commerce power." They "merely represent a principled way to begin the difficult task of distinguishing between matters relating to trade and commerce and those of a more local nature."[14] The central issue for this Court's division of powers analysis is whether the proposed *Act* is directed at the general regulation of trade across the entire country, which it is.

The Proposed Canadian *Securities Act* is Constitutionally Valid

10. There are two steps to determining whether the proposed Canadian *Securities Act* is valid: characterization and classification. First, this Court must determine the dominant "matter" or "pith and substance" of the law.[15] Second, this Court must determine whether that "matter" falls under, in this case, the trade and commerce power, assigned to Parliament.[16] If the legislation falls within s. 91(2), which the proposed *Act* does, then it is valid.[17]

11. In order to conclude that the proposed *Securities Act* is constitutionally valid, this Court need only be persuaded that, in addition to the facts of which it is permitted to take notice, the extrinsic evidence relied upon by the federal government demonstrates that "there is a rational basis for the legislation", which the federal government wishes to enact pursuant to s. 91(2).[18] In division of powers cases, there is a presumption that the impugned legislation is constitutionally valid.[19] Moreover, this Court should defer to legislative judgment in matters of social and economic policy, especially where the government is mediating between competing interests, as long as the government has shown that its purpose is not colourable and that it has a reasonable basis for acting.[20] The federal government has met that threshold in the present reference.

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[13] See, e.g., *Kirkbi*, *supra* note 11 at para. 17.
[14] *City National Leasing Ltd. v. General Motors of Canada Ltd.*, [1989] 1 S.C.R. 641, 1989 CarswellOnt 125 at para. 36 ("*General Motors*").
[15] *Canadian Western Bank v. Alberta*, 2007 SCC 22 at para. 25.
[16] *Kitkatla Band v. British Columbia (Minister of Small Business, Tourism and Culture)*, [2002] 2 S.C.R. 146 at para. 52.
[17] *Reference re Anti-Inflation Act*, [1976] 2 S.C.R. 373 at p. 450 ("*Anti-Inflation Reference*").
[18] *Ibid.* at para. 67. See also *R. v. Malmo-Levine*, [2003] 3 S.C.R. 571 at para. 78 and *Reference re Remuneration of Provincial Court Judges*, [1997] 3 S.C.R. 3 at para. 183.
[19] *Re Firearms Act (Can.)*, [2000] 1 S.C.R. 783 at para. 25.
[20] *Anti-Inflation Reference*, *supra* note 17.

12. The fact that securities regulation has to date been local is a feature of historical, economic and political happenstance, rather than constitutional doctrine. While certain aspects of provincial regulation over the trade in securities are supportable under provincial authority over property and civil rights, no case has ever held that such jurisdiction was exclusive. Moreover, what may at one time have been a feature of a local economy can become a national economic concern, as did competition law.[21] Although the history of securities regulation in Canada has to date largely been a local affair, like other forms of consumer protection legislation, the Constitution does not assign securities regulation exclusively to either level of government. In fact, this Court has expressly acknowledged (as early as 1982) that it may well be within the legislative authority of Parliament to enact a general scheme of securities regulation, given the interprovincial and international character of Canada's capital markets.[22]

13. It is therefore necessary to consider the proposed *Securities Act* carefully, with a view to whether it could be validly enacted pursuant to a federal head of power, and not from the perspective that it is an impermissible encroachment on ordained provincial power. In other words, this is not a case like *General Motors*, *supra*, where a provision embedded in federal legislation *prima facie* runs afoul of a provincial head of power, but is saved by virtue of its inclusion in a scheme that is, as a whole, valid. Rather, the issue in this reference is whether Canada's capital markets are a national economic concern and whether Parliament's response to this concern is within its legislative authority.

(a) The Proposed Canadian Securities Act*'s Pith and Substance*

14. Parliament has directed the proposed *Securities Act* at the comprehensive regulation of Canada's capital markets,[23] not a single industry. The *Act* is a complete regulatory scheme for Canada's capital markets, overseen by a regulatory agency (the Canadian Securities Regulatory Authority),[24] and includes an independent adjudicative arm (the Canadian Securities Tribunal).[25]

15. For retail investors, the most important aspect of the proposed Canadian *Securities Act* is that the *Act* will replace the current provincial/territorial consensus-based model with a legislated national regulator, which (1) is accountable to the Governor-in-Council and, by extension, all

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[21] *CN*, *supra* note 7.
[22] *Multiple Access*, *supra* note 3 at pp. 173-174.
[23] Reference Record, Proposed Canadian *Securities Act*, Volume I, Tab 4, Preamble, p. 17 ("Proposed *Securities Act*").
[24] *Ibid*., Part 2, Division 2, ss. 22 *ff*, pp. 38 *ff*.
[25] *Ibid*., Part 2, Division 3, ss. 28 *ff*., pp. 43 *ff*.

Canadians; (2) is capable of imposing regulatory initiatives that are in the interest of Canadian investors;[26] and (3) is able to pool enforcement resources, develop expertise in the area of enforcement and enforce harmonized laws across the country to protect investors, as well as the integrity of Canada's capital markets.[27]

16. A closer examination of the current provincial/territorial consensus-based model of securities regulation in light of these improvements demonstrates not only why national regulation will likely be an improvement that will benefit all Canadians from a policy perspective, but, more fundamentally, why securities regulation is an important national economic concern, and not merely a collection of local ones. While provincial and territorial regulators may purport to act in the best interests of all Canadian investors, the experience of retail investors has not borne that promise out. No provincial or territorial government acting alone or together could enact comprehensive legislation of the type proposed in the *Act*.

17. At present, securities regulation in Canada is a patchwork of separate provincial and territorial regimes. The current model is comprised of provincial and territorial securities regulators, each of which has a mandate to regulate securities, but only within a particular province or territory. Similarly, each of these regulators has a mandate to protect investors, but only investors within each regulator's geographically limited jurisdiction.[28]

18. This regulatory approach does not reflect the needs of Canadian investors or the reality of Canada's capital markets. It is unlikely that all aspects of the issuance of securities, their sale and re-sale, and the enforcement of securities laws would occur within a single province as Canada's capital markets are now (and have for decades been)[29] more properly characterized as national and even international in scope. In an age exemplified by global communication and information systems, it is possible, for example, for an issuer to be headquartered in Saskatchewan, regulated by the Ontario Securities Commission, traded on the TSX Venture Exchange in British Columbia (which itself is headquartered in Alberta) and issuing securities that are available for purchase across Canada and internationally, and which securities are in fact purchased by a retail investor in New Brunswick through a discount brokerage that is a subsidiary of his or her federally

[26] See, e.g., Proposed *Securities Act*, *supra* note 23, Part 14, Division 2, ss. 227 *ff*., pp. 148 *ff*.
[27] See, e.g., Proposed *Securities Act*, *ibid.*, Part 11, ss. 131 *ff*., pp. 81 *ff*.
[28] Pascutto Affidavit, *supra* note 1, pp. 5-10, paras. 12-22.
[29] *Multiple Access*, *supra* note 3.

regulated bank.[30] However, even in these circumstances current regulation would be local,[31] despite the national scope of the transactions.

19. Collectively, and as a means of overcoming to some extent the current regulatory balkanization, the provincial and territorial regulators have attempted to achieve a national consensus on important issues through a voluntary umbrella organization (the Canadian Securities Administrators or "CSA"). The CSA is not accountable to either the federal or provincial executive, or to Parliament or another legislature. It is only accountable to its member regulators, which, because of the consensus-based approach required by an organization operating without the force of law, in practice means that individual provinces and territories can and do simply "veto" policy change to reflect local interests. This would be less likely in a national regime mandated to protect investors across the country. Even where no *de facto* veto occurs, other regulators may simply acquiesce to another regulator's demands, in the interests of maintaining harmony amongst regulators, but at the expense of Canadian investors.[32]

20. An example of local interests trumping other regulatory considerations is "spin off" companies (e.g. junior companies created through the transfer of capital from one or more senior companies). These spin offs were particularly popular in the oil and gas sector in Alberta. The junior company created through this transfer of capital would normally feature a slimmed down version of the existing management team from the senior company. From the perspective of investors, these spin off companies shared a number of problems, most notably they would typically involve initial, private offerings of securities to directors and senior officers of the senior company who are also directors and senior officers of the spin off company. At these private offerings, the junior company's securities would typically be sold for discounts of as much as 40-80%, representing a substantial transfer of wealth from public shareholders in the senior company to the officers and directors of the junior company. Although investors, the media and interested third parties raised these corporate governance and shareholder rights' issues publicly, as well as privately with the CSA and its member regulators, the CSA has declined to debate (let alone address) investors' legitimate concerns because of the influence of

[30] Pascutto Affidavit, *supra* note 1, p. 5, para. 13.
[31] Indeed, given the current model of securities regulation in which provincial and territorial regulators assume jurisdiction based on connecting factors between a transaction and a jurisdiction, there could be multiple local regulators assuming jurisdiction over this transaction, but no central regulation.
[32] Pascutto Affidavit, *supra* note 1, pp. 6-7, paras. 14-16.

the Alberta Securities Commission and (in turn) local industry interests within Alberta.[33]

21. Moreover, because of the consensus-based model, when provincial or territorial regulators propose initiatives (often designed to protect the most vulnerable investors), it can often take years to implement these initiatives and, even when they are implemented, these initiatives are often substantially diluted. While the proposed *Act* involves consultation with stakeholders prior to regulatory change (including, critically, an Investor Advisory Panel),[34] the Canadian Securities Regulatory Authority will have the authority to develop regulations for carrying out the purposes and provisions of the proposed *Act*. Unlike the current model, while input is encouraged, the Regulatory Authority (and, ultimately, the Minister) will have the legislative authority to promulgate regulations, for instance, to protect investors, without needing to dilute those regulations to achieve consensus among provincial and territorial regulators, each mandated to protect local interests even at the expense of investors in a national marketplace.

22. An example of the problems with the current regulatory environment is the CSA's point of sale initiative, which aims to provide retail investors in mutual funds with plain language disclosure of meaningful information about their investment by way of a fact sheet, at or before the time of purchase. Unfortunately, because of the need for consensus across the panoply of regulators, it has been more than a decade since the CSA and another financial regulator proposed this simple, but important initiative, and it has not yet been implemented. Moreover, in its current version, the initiative is arguably no better (and potentially worse) than the disclosure requirements already imposed on the sale of mutual funds,[35] since, as a concession to the industry, the initiative would eliminate the disclosure that is currently provided to mutual fund investors by way of a simplified prospectus in favour of the fact sheet. In other words, retail investors would receive less disclosure, not more, which undermines the benefit of the initiative.[36]

23. Proponents of provincial regulation claim the passport system as a success of the existing scheme. This model allows market participants (such as issuers) access to all participating jurisdictions by complying with a set of harmonized policies agreed to among the different

[33] Pascutto Affidavit, *supra* note 1, pp. 28-30, paras. 54-57.
[34] Proposed *Securities Act*, *supra* note 23, s. 51, p. 50.
[35] See, e.g., Small Investor Protection Association, "A National Regulator for Canada: The Perspective of the Small Investor", available at: <http://www.sipa.ca/library/830-SIPA-PaperNationalRegulator-20100909.pdf>.
[36] Pascutto Affidavit, *supra* note 1, pp. 10-17, paras. 23-32.

jurisdictions. However, although the issuer gains access to a broader market, the issuer continues to be regulated only by its own principal regulator. This state of affairs allows issuers to market securities widely, but may leave an individual investor who is located in a separate jurisdiction with only limited access to remedies when problems arise. Moreover, there is no government actor responsible to protect the investor's interests when investing in the securities of an issuer whose principal regulator is in another jurisdiction.[37]

24. Conversely, a provincial or territorial regulator cannot enforce its laws in another Canadian province or territory so as to protect investors located within its own jurisdiction. Although it may be possible for provincial and territorial regulators to cooperate on enforcement issues, the current patchwork enforcement scheme can create delays or even fail to enforce securities laws against offenders. For example, a "confidence man" who breaches securities laws in one province or territory may be able to avoid prosecution and perpetuate his practices simply by relocating his operations to another jurisdiction. Even if he is prosecuted in one jurisdiction, he may still be able to continue his operations in another jurisdiction, despite sanctions. Moreover, the current model could result in an accused unfairly facing multiple proceedings in separate jurisdictions leading to the possibility of conflicting judgments in distinct jurisdictions, which will tend to bring the administration of justice into disrepute.[38]

25. These enforcement issues, which are inherent to the local enforcement of provincial and territorial securities laws in a federal state with national capital markets, may have a significant negative impact on Canadian investors, and, in turn, on the proper functioning of Canada's capital markets. Under the proposed *Act*, on the other hand, enforcement will be harmonized across the country, allowing for resources to be pooled and expertise to be developed nationally, as well as limiting the ability of offenders to evade prosecution within Canada, and eliminating the possibility for conflicting judgments in separate jurisdictions.[39]

26. In summary, the pith and substance of the proposed *Act* is comprehensive national securities regulation. The proposed *Act* regulates Canada's capital markets for the benefit of all Canadians, in a manner that is beyond the ability of any province or territory, acting alone or

[37] Pascutto Affidavit, *supra* note 1, p. 5, 7-8, paras. 12, 17-20.
[38] Pascutto Affidavit, supra note 1, pp. 17-18, para. 33.
[39] See, e.g., Proposed *Securities Act*, *supra* note 23, Part 11, ss. 131 *ff*., pp. 81 *ff*.

together (through the CSA or other organization). Capital markets may once have respected a provincial or territorial boundary, but this has not been the case for decades. It is now difficult to imagine a more important national economic concern than Canada's capital markets or an activity that has greater importance to Canada's national economy than securities regulation, including the protection of investors. These issues touch all Canadians and, indeed, all industries.

(b) The Proposed Canadian Securities Act is a Valid Exercise of the Trade and Commerce Power

27. The pith and substance of the proposed Canadian *Securities Act* is comprehensive national securities regulation, which is a matter that comes within the general branch of the trade and commerce power, as it is an attempt to regulate trade generally, across the country. Specifically, when viewed through the lens of the five indicia, adopted by this Court:

a. the proposed *Act* adopts a regulatory scheme which is more comprehensive than current provincial and territorial schemes;

b. the scheme is monitored by the continuing oversight of a regulatory agency, namely the Canadian Securities Regulatory Authority;

c. the proposed *Act* is concerned with trade as a whole, rather than a particular industry, and is indeed aimed at the regulation of a national aspect of trade which affects all industries and all Canadians;

d. the scheme is of a nature that the provinces jointly or severally would be incapable of enacting because the limitations on their powers preclude them from establishing a comprehensive regime of securities regulation; and

e. the scheme has to be, and is intended to be, national in scope to ensure it is fully successful.

PART IV – COSTS

28. FAIR Canada does not seek costs, and asks that no costs be awarded against it.

PART V – DISPOSITION OF THE ISSUES AND ORAL ARGUMENT

29. The question referred to this Court by the Governor-in-Council should be answered in the affirmative.FAIR Canada asks leave to present 15 minutes of oral argument at the hearing of this reference.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

January 10, 2011

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Andrew Lokan/Massimo Starnino/Michael Fenrick

PART VI – TABLE OF AUTHORITIES

PART VI – STATUTES

Constitution Act, 1867 (U.K.), 30 & 31 Victoria, c. 3, s. 91(2)