

THE EXERCISE OF THE PUBLIC INTEREST POWER BY THE OSC – A NEW STANDARD IS NEEDED

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The ability of the State or any agency thereof to mete out sanctions in circumstances where there has not been a contravention of a clearly delineated statutory provision has generally been the purview of dictators or absolute monarchs. However, there is no doubt that under section 127 of the Ontario *Securities Act* (the "Act"),¹ the Ontario Securities Commission (the "**Commission**") has the power to exercise its public interest jurisdiction to sanction persons, absent a breach of the Act, regulations thereunder or policy statements.² It is therefore not surprising that the public interest power has been the subject of much controversy, and increasingly so with its more frequent use by the Commission.³ More recently, there has been debate as to whether the Commission's public interest power should be exercised, absent a breach of securities laws, only in circumstances where the conduct or transaction is clearly "abusive" of shareholders and the capital markets, or whether it may also be exercised "where the conduct engages the animating principles of the Act."⁴ We have issued a paper that can be found [here](#), which suggests that neither position provides a cogent or transparent basis for the exercise of the public interest power.⁵ Rather, we suggest that the appropriate standard is whether the conduct in question confounds the justifiable expectations of shareholders and the capital markets.

In this bulletin, we also provide a brief commentary on the recent decision of the Commission *In the Matter of Jowdat Waheed and Bruce Walter*,⁶ which was released following the completion of our paper.

Our Paper

We begin by reviewing the legislative history of the public interest power in the Act. This is followed by an in-depth analysis of the jurisprudence pertaining to the use of section 127 and its predecessor provisions, absent a breach of securities laws. We then examine the guiding principles that can be gleaned from the jurisprudence. In reviewing prior jurisprudence, it appears to us that one standard should be used to determine if the public interest power should be exercised. In *Canadian Tire Corp v CTC Dealer Holdings Ltd*,⁷ the Ontario Divisional

Court noted that the impugned conduct confounded the "justifiable expectations" of shareholders and the capital markets in general. We suggest that this standard would be more appropriate and would allow the Commission and practitioners to move away from labels, such as "abusive," which are difficult to define and may be simply unhelpful. The application of the justifiable expectations standard moves away from labels and focuses on preventing future conduct⁸ in order to protect investors, enhance market efficiency and promote confidence in the capital markets.

The application of the justifiable expectations standard starts with a fairly straightforward question: Would a reasonable investor lose confidence in the capital markets and be less willing to invest if the Commission did not take action to deter a repetition of the conduct in question? If the answer is clearly yes, then the "expectations" aspect of this standard has been met. In terms of "justifiable," we suggest that there are various policy reasons why the reasonable expectations of investors may not be supported under the Act. Limitations to the exercise of the public interest power include: (i) those imposed by the objects and purposes of the Act;⁹ (ii) the fact that the power may not be exercised to punish, but only to be preventive and prospective;¹⁰ (iii) the fact that the power may not be exercised to provide a private remedy, which would include redress for breach of fiduciary duty;¹¹ and (iv) the fact that a transactional nexus to Ontario is important in considering whether to exercise the power.¹²

In considering whether a transaction or conduct defeats the justifiable expectations of shareholders and the capital markets in general, prior jurisprudence has provided the following guidelines:

1. As a threshold issue, the conduct or transaction must contravene or be inconsistent with the policy and animating principles underlying securities laws and must have an impact on the capital markets.
2. The more the conduct or transaction is not specifically regulated under the securities laws, the more outrageous or egregious (or outside acceptable business conduct) the conduct or transaction must be. If the conduct or transaction is regulated under a statute not assigned to the Commission (for example, the *Canada Business Corporations Act*¹³), the term "flagrant" may be more appropriate.
3. If the conduct or transaction has been addressed by the Legislature without being made subject to regulation, then the exercise of the public interest power is highly unlikely.
4. The following conduct or transactions are more likely to be sanctioned: (i) artificial transactions; (ii) transactions structured intentionally to "end run the statutory scheme or exploit a loophole";¹⁴ and (iii) conduct or transactions which would otherwise be illegal, but are not caught by provisions in the securities regulations based on a technical matter, and are clearly (and intentionally enacted) contrary to the underlying principles of the statutory provision in question.

5. Conduct or transactions which run contrary to the "fundamental principles" under the Act, particularly those set out in section 2.1(2) of the Act including the "requirements for timely, accurate and efficient disclosure of information" and "requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants,"¹⁵ are more likely to be subject to the exercise of the public interest power.

While the justifiable expectations standard does not allow for simple answers, we believe it sets a relatively high threshold and affords market participants with more transparency and predictability regarding the exercise by the Commission of the public interest power than the standards currently being used. We ask you to review our paper, which provides greater insight into our analysis, including an application of the justifiable expectations standard to the facts of the key Commission decisions in *Re Biovail Corp.*,¹⁶ *Re Donald*¹⁷ and *Re VenGrowth Funds (Special Committee of Directors)*.¹⁸

Finally, our hope is that our paper serves as a catalyst for an ongoing debate regarding the standards and principles that should be used to determine when the public interest power will be exercised. The public interest power is a powerful, necessary and important tool that has been given to the Commission. In light of the fact that "[e]ffective and responsive securities regulation requires timely, open and efficient administration and enforcement of"¹⁹ the Act, it is incumbent on the Commission to exercise the public interest power in a manner that is transparent and cogent, where the results are predictable and easily understood by securities law practitioners and market participants alike.

Waheed decision

The Commission's decision in *Waheed* was released following the completion of our paper, and is therefore not discussed therein. However, the decision confirms key principles established in prior Commission decisions and provides further evidence of the concern expressed in our paper regarding the standard outlined in *Biovail*. This standard, which permits the public interest power to be exercised absent a finding of abuse where market conduct engages the animating principles of the Act, may allow the Commission to exercise the public interest power beyond its constitutional limit and contrary to the proper administration of the Act.

In *Waheed*, Staff of the Commission asserted that the respondents used confidential information, in breach of a consulting agreement with Baffinland Iron Mines Corporation ("**Baffinland**"), to acquire shares of Baffinland and to subsequently launch a hostile take-over bid for Baffinland. They argued that this created an unfair advantage over Baffinland's shareholders and potential investors. In addition, the confidential information was used to advise Baffinland's largest shareholder to initiate a dissident proxy fight, purportedly in breach of

fiduciary duties and obligations owed to Baffinland. Staff argued that this conduct should be subject to sanction through the exercise of the public interest power.

The respondents submitted that the information they used was not material and that the Act does not regulate the use or disclosure of non-material confidential information. Further, the allegations relate to a private law dispute between Baffinland and the respondents, which Baffinland chose not to pursue for its own strategic reasons. The Commission rightfully concurred with the respondents in holding that "the Act does not prohibit trading on the basis of non-material confidential information."²⁰ The Commission also held that "it is beyond the scope of the Commission's jurisdiction to make findings against Waheed with respect to allegations that he did not always act in Baffinland's best interest while a consultant."²¹

Staff's arguments in favour of the exercise of the public interest power were fundamentally contrary to the decisions of the Commission in *Lindzon* and *Canadian Tire*, each of which having held that the Commission should not provide a remedy for breaches of fiduciary duty or matters that are the basis of a private law dispute. This is particularly so when the allegedly wronged parties have the opportunity to seek redress from the courts. However, Staff's arguments in *Waheed* were consistent with the standard set out in *Biovail*, which we believe is too broad to provide any real guidance as to when the public interest power should be exercised.

For this and other reasons set out in our paper, we believe it is important for the Commission to clearly set out a cogent and transparent standard for the exercise of its public interest power that leaves no doubt as to the basis on which the power may be exercised.

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Download a copy of Paul Davis' paper titled [Justifiable Expectations Standard: The Basis for the Exercise of the Public Interest Power of the Ontario Securities Commission](#)

¹ RSO 1990, c S 5. In this bulletin, we will refer to the exercise of the Commission's jurisdiction under section 127 of the Act and its predecessor provisions as the "**public interest power**".

² For ease of reference, we will use the term "**securities laws**" to refer to the Act, regulations thereunder (including applicable multilateral, and national instruments) and policy statements.

³ Nigel Campbell, Erin Hault & David Badham, "Lesser Included Non-Offences?: The Use of the Public Interest Power in *Re Donald*" (2014) 27 Can J Admin L & Prac 161; "A Fine Balance Being Tipped – A Review of the Ontario Securities Commission's Public Interest Jurisdiction" (2014) 18 Corporate Liability 3 at 1090, 1096, 1098 [Leon & Carlo].

⁴ Leon & Carlo, *ibid*; Tom Atkinson & Cullen Price, "The Ontario Securities Commission's Public Interest Power: The Primacy of Principles" (2014) 27 Can J Admin L & Prac 205 at 212.

⁵ Paul Davis, "Justifiable Expectations Standard: The Basis for the Exercise of the Public Interest Power of the Ontario Securities Commission" (August 22, 2014). This paper was prepared with the assistance of Sandy Andreou (an associate at McMillan LLP); and Allison Vale, David Zhou, Jennifer Allman and Matthew Burns, each of whom is a summer student.

⁶ (26 August 2014), online: Ontario Securities Commission <<http://www.osc.gov.on.ca/>> [*Waheed*].

⁷ (1987), 59 OR (2d) 79 at para 78.

⁸ *Re Mithras Management*, (1990), 13 OSCB 1600 at 1610-11; *Committee for Equal Treatment of Asbestos Minority Shareholders v Ontario* (Securities Commission), 2001 SCC 37 at para 43 [*Asbestos SCC*].

⁹ *Asbestos SCC*, *ibid* at 41.

¹⁰ *Ibid* at para 43; *Re Cartaway Resource Corp*, 2004 SCC 26 at para 58.

¹¹ *Re Canadian Tire Corp* (1987), 10 OSCB 857 [*Canadian Tire*]; *Re Lindzon*, [1982] 42 OSCB 43C at 59C-60C [*Lindzon*].

¹² *Re HERO Industries Ltd* (1990), 13 OSCB 3775 at para 19; *Asbestos SCC*, *supra* note 8 at para 50-62.

¹³ RSC 1985, c C-44.

¹⁴ Cristian Blidariu & Rene Sorell, "Can the OSC's Public Interest Power Be Used to Expand Insider Trading Liability?," *Canadian Securities Regulatory Monitor* (28 May 2014).

¹⁵ *Securities Act*, RSO 1990, c S 5, s 2.1(2).

¹⁶ (2010), 33 OSCB 8914 [*Biovail*].

¹⁷ (2012), 35 OSCB 7383.

¹⁸ (2011), 34 OSCB 6755.

¹⁹ *Securities Act*, RSO 1990, c S 5, s 2.1(3).

²⁰ *Waheed*, *supra* note 6 at para 484.

²¹ *Ibid* at para 489.

a cautionary note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.