Securities Regulation and the Division of Powers

Introduction

On May 26, 2010, the Federal Minister of Finance tabled the *Canadian Securities Act* in the House of Commons and initiated a Supreme Court Reference[1]. The Reference question put to the Supreme Court was whether the proposed *Canadian Securities Act* was within the legislative authority of the Parliament of Canada[2].

Up to this point the regulation of securities has been performed at the provincial level. Each province has legislation similar to the proposed federal act regarding security regulation, and each has its own agency set up to enforce that legislation. In the past decade, provinces have worked to harmonize their efforts at securities regulation through the development of a "passport" system which has aimed to create unified standards and practices. However, there are still 13 regulators operating in separate jurisdictions. The*Canadian Securities Act* aims to replace them with one national regulator.

There have long been calls for the Federal Government to establish a single national securities regulator. Canada pointed out in their arguments that numerous commissions and panels dating from the 1930s have recommended that a national regulator be created[3]. The most recent recommendation for such reform came from the "Hockin Panel", commissioned by the Minister of Finance, which issued its report in 2009. The panel argued that a national regulator would "provide clear national accountability, reduce compliance burdens, reduce systemic risks, strengthen enforcement, and better serve the needs of investors".[4] Based mainly on this most recent report, the Federal Government moved to initiate legislation that would become the proposed *Canadian Securities Act*.

The principal opponents of the federal effort to create a national securities regulator are the provinces of Alberta and Quebec. Both these provinces initiated their own reference question with their respective Courts of Appeal. In March of 2011, the Alberta Court of Appeal ruled that the federal initiative was an unconstitutional intrusion into provincial jurisdiction[5]. In April of 2011, the Quebec Court of Appeal reached the same conclusion[6]. Although these decisions are no doubt influential, the decision of the Supreme Court will be the final and authoritative ruling.

This article will examine the major arguments that both sides presented to the Supreme Court in March of 2011, focussing on the arguments made by the Government of Canada and the Government of Alberta.

The Character of the *Securities Act*

The substantive portion of the arguments put forward by the Federal and Provincial Governments focus on differing interpretations of the trade and commerce clause of the

Constitution[7]. However, the arguments put forward by each side were heavily influenced by their differing interpretations of the essential character of the proposed *Canadian Securities Act* itself. The essential character of a piece of legislation is important because it represents the starting point for any further analysis regarding which level of government has authority to enact laws in that area according to the division of powers. Determining this essential character of the legislation is done through a pith and substance analysis. The contesting sides were at odds over how such an analysis should be conducted.

Canada argued that such an analysis should be done on a high level of generality focusing on the stated purposes laid out in the Act itself[8]. Not surprisingly, using this method of analysis, Canada argued that the Act aimed at comprehensive national securities regulation and as such was justified under the trade and commerce power in the Constitution Act, 1867.[9]

Alberta, on the other hand, argued that precision and specificity were needed in any pith and substance analysis of the Act[10]. This was because of the high level of intrusion by the Federal Government into traditional areas of provincial jurisdiction[11]. A general purpose laid out in the Act is simply not sufficient to determine its essential character. Based on this approach, Alberta argued that the essential character of the Act was regulation of the trading in securities and was an intrusion into the provincial power over property and civil rights[12].

The Nature and Limits of the Trade and Commerce Clause

In section 91(2) of the *Constitution Act of 1867*, the Federal Government was given jurisdiction over trade and commerce[13]. At the same time, the provinces were given jurisdiction over property and civil rights in section 92(13)[14]. These two similar powers inevitably came into conflict. In 1881, the Judicial Committee of the Privy Council, at that time the highest court in Canada, made its famous ruling in *Citizens Insurance v Parsons*[15]. Parsons would set the parameters for the use of the trade and commerce clause for the next century, adopting a very narrow interpretation of the powers that the clause gave to the Federal Government. The Privy Council ruled that the clause gave the Federal Government power over two branches of trade: interprovincial and international trade, and general regulation of trade affecting the dominion as a whole.[16] While the first branch, international and interprovincial trade, would be dealt with often by the courts, it would be nearly a century before the second branch, general regulation of trade affecting the whole dominion, would be seriously examined.

The "general branch" of the trade and commerce clause came into much wider use beginning in the 1970s and moving into the 1980s. In *General Motors of Canada v City National Leasing*[17], Justice Dickson set out the five criteria to be used in determining the validity of invoking the general branch of the trade and commerce clause:

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 with 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 scheme in other parts of the country[18]

The Court made it clear that this is not an exhaustive list and that the presence or absence of any of the criteria is not determinative. Rather, examining where the federal trade and commerce clause begins is a useful starting point[19]. Indeed, in this case it represented the crux of the argument for both sides.

Arguments of the parties.

On April 13th, 2011, the Supreme Court of Canada heard the arguments of Canada and Alberta over the constitutionality of the *Canadian Securities Act.* Both sides conceded that the first two *General Motors* criteria were met in the Act. The points of the contention revolved around the last three criteria.

The legislation must be concerned with trade as a whole rather than with a particular industry

Canada argued that securities law transcends any one particular industry[20]. Trading in securities is a tool used by every major industry to raise capital to invest in their business. As such, it must be recognized as something that has to be regulated on a national level. Canada compares securities laws to competition laws, which apply nationally. All industries compete so competition law affects trade as a whole. Similarly, all industries trade in securities, so regulation of that practice is also concerned with trade as whole[21].

To show that the *Canada Securities Act* is aimed at general regulation, Canada pointed to the preamble of the Act. The preamble makes broad references to the national importance of the securities market and the need for a national system of regulation to manage such things as risk to the entire securities system[22]. In addition, the recent economic crisis was cited as an instance in which a national regulator would be essential to systemic risk management[23].

Alberta countered that Canada weathered the economic crisis better than any other G8 country and did it with 13 provincial and territorial regulators instead of one national one. In contrast, the United States, which has a national regulator, fared the worst[24].

Alberta argued that what was truly important in considering the “trade as a whole” criteria was not what the proposed Act said but rather what Courts have ruled in the past regarding the securities industry[25]. Alberta pointed to numerous cases which referred to trading in securities as an industry in itself. While these past Court decisions were not directly aimed at securities regulation, they do illustrate a trend in Canadian jurisprudence to view the

trading in securities as a specific industry and not as a national trade[26].

Alberta compared the securities industry to the insurance industry. Just as all industries make heavy use of securities trading to raise capital, they also make heavy use of insurance to mitigate risk. The *Parsons* case specifically ruled that insurance could not be regulated by the Federal Government under the trade and commerce clause. Considering the similarity of insurance to securities, the same treatment should apply to both, and securities should be considered a separate industry and not part of trade as a whole[27].

The legislation should be of a nature that provinces jointly or severally would be constitutionally incapable of enacting.

Canada acknowledged that the provinces do work together and have created a somewhat consistent system of regulation through their passport system. However, just because the provinces can band together to act does not mean that the Federal Government lacks the authority to act as well[28]. The provinces simply cannot regulate the securities industry in the manner necessary in the modern age.[29] Canada argued that this failing stems from a number of constitutional limitations placed upon them:

· For starters, the provinces cannot apply their regulations extra-provincially. Orders and sanctions can only apply in the province that issues them. For example, a securities trader was forced to cease trading in BC due to fraudulent activities, but was still allowed to continue operating in New Brunswick. This is a glaring inefficiency that can only be countered by a national system of regulation[30].

· Furthermore, the securities industry has become primarily international in scope. There are numerous international organizations that work towards common standards in trading. Currently Canada has no voice at these organizations because provinces cannot sit as members. Only a national regulator could represent Canada at these vital organizations[31].

· There are two additional factors that impact on the provinces ability to regulate securities. First, provinces cannot regulate federally incorporated companies[32] and second, provinces lack the ability to include criminal sanctions with their regulations[33]. Both of these are constitutional limitations placed on the provinces.

Alberta countered that the passport system has been effective in creating consistent rules for those entering the securities market and that, presently, security traders often only need to be registered once to trade throughout Canada. Even if Canada is correct in pointing out the flaws in the passport system, the provinces still retain the constitutional ability to fix them[34].

Alberta pointed out that Canada has adopted regulations in their proposed Act that are nearly identical to those contained in the supposedly flawed *Alberta Securities Act.* It appears inconsistent for Canada to copy a regulatory scheme that it argues is deeply flawed. The only true difference is that Canada's scheme would apply nationally. Alberta argues this is simply not enough of a difference to make out a case that Alberta is incapable of

regulating in this area.[36]

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

In addressing this final criterion, Alberta pointed out that the proposed Act contains an opt-in clause. This clause obviously envisions that the system of national regulation will not apply in every province. On its very face, this shows that unanimous provincial involvement is not necessary[37].

The purpose of this criterion was discussed extensively in *General Motors*. When discussing it, Justice Dickson was clear that one of its main purposes was to protect the sphere of provincial powers by delineating specific criteria indicating that the Federal Government alone was capable of regulating effectively in a particular area[38]. If the proposed Act could end up not applying nationwide then is should be considered an area that the provinces are more than capable of regulating without the involvement of the Federal Government.

Canada argued that we now live in the modern era of co-operative federalism and that the opt-in clause contained in the proposed Act is a great example of that principle in action.[39] Ever since the agricultural cases of the 1970s that led to co-operative ventures between provinces, the Supreme Court has been ready to accept arrangements that are the product of co-operation between different jurisdictions even when that co-operation strains the limits imposed by the federal-provincial division of powers. It would be an odd situation for the Court to rule that the proposed Act would be constitutional only if participation were mandatory and forced on the provinces rather than voluntary. While unanimous provincial involvement is essential if the regulator is to be fully functional, Canada will accommodate provincial interests through the opt-in clause in the name of co-operative federalism. In so doing, they are still fulfilling the spirit of the fifth criterion of the general branch of the trade and commerce clause[40].

Conclusion

Both Canada and Alberta put forward compelling arguments in favour of their view on the constitutionality of a national securities regulator. While Canada focused much of their argument on the broad themes of effective economic management of what they see as a national issue, Alberta focused on the specific nature of the securities industry and argued that the provinces were best positioned to effectively regulate it. Alberta also relied on numerous prior cases in which the securities industry was acknowledged as an area of provincial concern. However, Canada is correct in responding that no Court has ever definitively ruled on a federal role in the regulation of securities trading[41].

The stakes are high. The Federal Government is seeking to dramatically expand its powers over the economic management of the country. Alberta, along with Quebec, is fiercely resisting this effort. What the Court will ultimately decide is hard to predict. Given the

strong arguments on either side, the case may well divide the court. Whatever the Court does end up ruling, this decision will add a critical chapter to the history of the general branch of the trade and commerce clause in our Constitution. A decision on this important case is expected in the fall of 2011.

In the news:

http://www.financialpost.com/news/Quebec+Court+Appeal+opposes+federal+securities+regulator/4541869/story.html

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[1] Both the Federal and Provincial governments have the ability to direct reference questions to their Courts of Appeal on questions of Constitutionality.

[2] Robert J Frater and Peter W Hogg QC, *In the Matter of a Reference by Governor in Council concerning the proposed Canadian Securities Act, as set out in Order in Council P.C. 2010-667, dated May 26, 2010*(Appellants Factum filed at the SCC, December 17, 2010) at para 44, (http://www.scc-csc.gc.ca/factums-memoires/33718/FM010_Attorney-General-of-Canada.pdf) - The question focussed on whether the proposed Act fell within the federal powers over Trade and Commerce which are contained in section 91(2) of the *Constitution Act, 1867 infra* note 13.

[3] *Canada* at para 33.

[4] *Canada* at para 40.

[5] *Reference re Securities Act (Canada),* 2011 ABCA 77, 41 Alta. L.R. (5th) 145 .

[6] *Québec (Procureur général) c. Canada (Procureur général),* 2011 QCCA 591, 2011 CarswellQue 2938 .

[7] Section 91(2) of the *Constitution Act, 1867, infra* note 13, grants the Federal Government power over Trade and Commerce.

[8] *Canada Supra* note 2 at para 47.

[9] *Ibid* at para 50.

[10] E David D Tavender Q.C, E Brian Foster Q.C, L Christian Enns and Jordan C Milne, *In the Matter of a Reference by Governor in Council concerning the proposed Canadian Securities Act, as set out in Order in Council P.C. 2010-667, dated May 26, 2010* (Interveners Factum filed at the SCC, February 10, 2011) at para

76, http://www.scc-csc.gc.ca/factums-memoires/33718/FM094_Intervener_Attorney-General-of-Alberta.pdf.

[11] *Ibid.*

[12] *Ibid* at para 57.

[13] *Constitution Act, 1867* (UK), 30 & 31 Vict, c 3, s 91(2), reprinted in RSC 1985, App 11, no 5.

[14] *Ibid* at s 92(13).

[15] *Parsons v. Citizens' Insurance Co. of Canada*, 1881 CarswellOnt 253, All ER Rep 1179 .

[16] *Parsons* at para 26.

[17] *City National Leasing Ltd. v. General Motors of Canada Ltd*, [1989] 1 SCR 641, 58 D.L.R. (4th) 255 .

[18] This list was summarized in this fashion in *01; 358211258Kirkbi AG v. Ritvik Holdings Inc. / Gestions Ritvik Inc.,* 2005 SCC 65 at para 17, [2005] 3 S.C.R. 302 .

[19] *General Motors Supra* note 17 at para 36.

[20] *Canada Supra* note 1 at para 90.

[21] *Ibid* at para 91.

[22] *Ibid* at para 49.

[23] *Ibid* at para 29.

[24] *Alberta Supra* note 10 at para 40.

[25] *Ibid* at para 94.

[26] *Ibid.*

[27] *Ibid.*

[28] *Canada* at para 107.

[29] *Ibid* at para 105.

[30] *Ibid* at para 109.

[31] *Ibid* at para 118.

[32] *Ibid* at para 116.

[33] *Ibid* at para 117.

[34] *Alberta Supra* note 10 at para 95.

[35] *Ibid* at para 51.

[36] *Ibid* at para 52.

[37] *Ibid* at para 96.

[38] *General Motors* supra note 17 at para 60.

[39] *Canada Supra* note 2 at para 132.

[40] *Ibid* at para 134.

[41] *Canada Supra* note at para 65.