Reference re Securities Act (2011): Does Parliament Have the Power to Establish a Canada-wide Securities Regulator?

Introduction

In a decision released November 22, 2011, the Supreme Court of Canada provided its opinion on whether the government's proposed *Securities Act*[1] was within the constitutional authority of the federal Parliament.[2]

The decision in *Reference re Securities Act* is the result of a "reference" question posed to the Supreme Court. A reference asks the Court to give an advisory opinion on a particular question.[3] In this case, the question for the Supreme Court's consideration was whether the proposed *Securities Act*, as drafted, fell "within the legislative authority of the Parliament of Canada."[4] In other words, the question for the Supreme Court was whether the proposed *Securities Act* was within federal jurisdiction.

The proposed Act would create a Canada-wide securities regulator, and was described as a "comprehensive foray" by the federal government into the area of securities regulation.[5] A number of provinces argued that the regulation of securities is a provincial matter, and so the federal government did not have the legislative authority to pass the Act.

As noted by the Supreme Court, the word "securities" refers to a "class of assets that conventionally includes shares in corporations, interests in partnerships, debt instruments such as bonds and financial derivatives."[6] Currently, securities are regulated in each province by provincial laws and regulatory bodies.[7]

The Question for the Supreme Court

As noted above, the question for the Supreme Court's consideration in this reference case was whether the proposed federal *Securities Act* falls within the legislative authority of the federal government as outlined in the *Constitution Act, 1867*.

Sections 91 and 92 of the *Constitution Act, 1867* divide the power to legislate in specific areas between the federal and provincial governments. For example, the federal government has jurisdiction in areas such as banking and criminal law, while the provincial government has jurisdiction over other areas such as natural resources and hospitals. This separation is referred to as the "division of powers." For a federal system (such as Canada's) to function, some powers are allocated to the federal government and others to the provinces.

However, not all questions of jurisdiction are answered easily by the text of sections 91 and 92 of the *Constitution Act, 1867*. Questions frequently arise regarding how a particular subject or area should be classified. The task of interpreting the *Constitution Act, 1867* falls to the courts. In the *Securities Reference*, the conflict was between the federal power over "the regulation of trade and commerce" (section 91(2) of the *Constitution Act, 1867*) and the provincial power over "property and civil rights in the province" (section 92(13)). Specifically, the key question was whether the words "the regulation of trade and commerce" include the regulation of securities, or whether the regulation of securities is part of "property and civil rights in the province."

In a unanimous decision, the entire Supreme Court concluded that the proposed *Securities Act* was not part of the federal government's power to regulate trade and commerce. Accordingly, the proposed Act was outside the legislative authority of Parliament and thus deemed unconstitutional.[8]

The Two Sides of the Argument

The arguments of the federal and provincial governments were canvassed in an earlier article.

In short, the Government of Canada (along with the government of Ontario and several interveners) argued that the *Securities Act* is a constitutional exercise of the federal government's general power to regulate trade and commerce, pursuant to section 91(2) of the *Constitution Act, 1867*.[9] Canada did not dispute that some aspects of securities regulation are within the power of a province to regulate, including the regulation of contracts and property. Instead, Canada argued that the securities market has evolved such that it is now a matter affecting the country as a whole.[10] The "general" branch of the federal trade and commerce power gives the federal government the jurisdiction to legislate trade that affects the entire country, as opposed to a specific industry. Canada argued that without a national approach to the regulation of securities, the securities industry might not be adequately controlled, putting the entire country's financial system at risk.

The provincial governments of Alberta, Quebec, Manitoba, and New Brunswick - also supported by a number of interveners - argued that the proposed Act was unconstitutional. They contended that the legislation would be an intrusion into their exclusive constitutional authority over property and civil rights(pursuant to section 92(13) of the *Constitution Act, 1867*), which includes authority over the regulation of contracts, property, and professions.

The Provincial Reference Cases: The Opinions of Two Provincial Courts of Appeal

In earlier references brought by provincial governments, both the Alberta Court of Appeal and the Quebec Court of Appeal were asked to advise on the constitutionality of the proposed Act. Both courts concluded that the proposed Act was unconstitutional.[11]

The Alberta Court of Appeal, in a unanimous decision, concluded that the proposed Act was an unconstitutional intrusion into provincial power over property and civil rights, and that it

essentially “mirrors” existing provincial legislation dealing with securities regulation.[12]

In a split decision, a majority of the Quebec Court of Appeal came to the same conclusion. One judge, Justice Dalphond, disagreed. He concluded that the Canadian securities market is a “single, integrated, pan-Canadian market”, and so power to regulate it falls under the federal government’s power over trade and commerce.[13]

Overarching principles guiding the Supreme Court

Before embarking on its detailed analysis of whether the proposed Securities Act was, in essence, under federal or provincial jurisdiction, the Supreme Court canvassed general principles relating to Canadian federalism, the regulation of securities, and the proper role of the Court in this matter.

Canadian federalism: flexible cooperation, but no erosion of the division of powers

The Supreme Court noted that, since 1949, the trend has been to adopt a “flexible” view of federalism and the division of powers. Instead of emphasizing “watertight compartments” of jurisdictional control to ensure each level of government has exclusive control over a defined list of areas, the Supreme Court has accommodated overlaps in jurisdiction and encouraged “intergovernmental cooperation.” As former Chief Justice Dickson famously noted in *Ontario (Attorney General) v OPSEU*, Canadian constitutional law permits a significant amount of overlap in the division of powers between federal and provincial legislative authority.[14] Chief Justice Dickson described this overlap as the “dominant tide of constitutional doctrines.”[15]

But, the concepts of “overlap” and “flexible federalism” did not decide the matter for the Supreme Court. As the opinion in the *Securities Reference* shows, the Supreme Court is only willing to go so far in supporting overlap and flexibility. The Court said that this approach “cannot override or modify the separation of powers.”[16] With respect to the trend emphasizing a flexible approach to federalism, the Supreme Court stated:

Notwithstanding the Court’s promotion of cooperative and flexible federalism, the constitutional boundaries that underlie the division of powers must be respected. The “dominant tide” of flexible federalism, however strong its pull may be, cannot sweep designated powers out to sea, nor erode the constitutional balance inherent in the Canadian federal state.[17]

The concept of balance was central to the Supreme Court’s decision.[18] The Court emphasized that, while overlap is permitted and cooperation is to be encouraged, one power cannot be given an interpretation so broad that it would effectively “eviscerate” a power of another level of government.[19]

The regulation of securities and the role of the Supreme Court

In addition to emphasizing the concept of *balanced* federalism generally, the Supreme Court discussed the role of federalism in the context of securities regulation specifically. It

acknowledged that the regulation of securities has both provincial and federal aspects and that there have been several proposals over the years to institute a federal securities regulator, dating back as far as 1935.[20]

The most recent proposal (and the proposal that lead to the proposed *Securities Act* under consideration) was developed in 2009 by an expert panel on securities regulation - the "Hockin Panel."[21] The Hockin Panel recommended the creation of a "comprehensive national regime" to regulate Canadian securities, and provided for transitional measures as provinces opt-in to the proposed scheme.[22]

However advantageous a federal securities regulator may be to the Canadian securities market (as was suggested by the Hockin Panel), the Supreme Court declined to comment on the effectiveness of the regime. The Supreme Court was careful to note throughout the decision that its role was not to determine the "optimal model" for securities regulation because "the policy question of whether a single national securities scheme is preferable … is not one for the courts to decide."[23] And further: "our answer to the reference question is dictated solely by the text of the Constitution, fundamental constitutional principles and the relevant case law."[24] In other words, the Court's role was only to decide whether the proposed*Securities Act* was constitutional, and not whether it was good federal policy.

The classification exercise: does the proposed Act fall under federal or provincial jurisdiction?

As noted above, sections 91 and 92 of the *Constitution Act, 1867* divide legislative powers between the federal and provincial governments. Because these sections do not make it absolutely clear whether securities regulation should be under federal or provincial jurisdiction, the Supreme Court undertook a process that can be described as a "classification exercise."

The "pith and substance" of the proposed Act

The first step for the Court in the classification exercise is to determine the essence, "main thrust", or "pith and substance" of the legislation at issue. This involves a tool known as the pith and substance analysis. The analysis looks to both the purpose of the legislation and the legislation's effects to determine its main thrust.[25]

To determine the purpose of the proposed *Securities Act*, the Supreme Court looked both to the preamble of the Act and its specific provisions. According to the Act's preamble, its purpose is to create a single Canadian securities regulator. Section 9 of the Act states that the legislation's broader purposes are to "provide investor protection, to foster fair, efficient and competitive capital markets and to contribute to the integrity and stability of Canada's financial system."[26] As the Supreme Court noted, all of these broader purposes have both federal and provincial aspects.

The Supreme Court found that the direct effect of the proposed legislation is to establish a federal securities regulator, and in so doing to effectively displace any existing provincial

regulatory schemes dealing with securities.[27]

The Supreme Court concluded that the pith and substance of the proposed Act is "to regulate, on an exclusive basis, all aspects of securities trading in Canada, including the trades and occupations related to securities in each of the provinces."[28]

Does the Act fall within the federal power to regulate trade and commerce?

Having determined that the main thrust of the proposed Act is the exclusive regulation of securities at the federal level, the Supreme Court then turned to the next step in the classification exercise – whether the *Securities Act* fell within the federal government's power to regulate trade and commerce.

The federal government had to argue against decades of case law establishing that the regulation of securities was a matter of provincial jurisdiction under the province's authority over property and civil rights.[29] The federal government argued that the transformation of the securities market over recent years made securities regulation now a federal matter under the federal trade and commerce power.

But, what does "trade and commerce" really mean? In an early division of powers case, the Judicial Committee of the Privy Council determined that the words "the regulation of trade and commerce" should not be interpreted literally.[30] To do so would not achieve the balance that sections 91 and 92 aim to strike between the different levels of government. Instead, the federal trade and commerce power has two branches:

1. Power over interprovincial and international commerce; and

2. The "general" trade and commerce power – the power to regulate trade and commerce affecting the "whole dominion."[31]

As the Supreme Court noted multiple times in the *Securities Reference* opinion, the government of Canada sought to establish that the proposed *Securities Act* was valid legislation based only on this second branch of the trade and commerce power – the general power. Accordingly, the Supreme Court did not consider whether the legislation would be valid under other federal heads of power, nor did the Supreme Court consider whether provisions of the Act dealing with areas of provincial competence were valid as supporting the exercise of a federal power.[32]

A number of more recent division of powers cases have aimed to elaborate on the meaning of the general branch of the trade and commerce power. In *Attorney General of Canada v Canadian National Transportation Ltd*, Justice Dickson of the Supreme Court wrote that in order for legislation to fall under the general trade and commerce power, it must be "*qualitatively different* from anything that could practically or constitutionally be enacted by the individual provinces either separately or in combination."[33]

Later, in *General Motors of Canada Ltd v City National Leasing*, the Supreme Court developed a framework of questions to be used as a tool to help determine if legislation

meets this test of "qualitative difference."[34] The decision outlined five indicators that suggest the federal government has jurisdiction under the general trade and commerce power (the "General Motors" inquiry):

1. If the legislation is part of a general regulatory scheme;

2. If the scheme is under the oversight of a regulatory agency;

3. If the legislation is concerned with trade as a whole rather than with a particular industry;

4. If the legislation is such that individual provinces, acting alone or together, would be constitutionally incapable of enacting it; and

5. If the legislation is such that the failure to include one or more provinces would jeopardize its successful operation in other parts of the country.[35]

In the *Securities Reference* opinion, the Supreme Court had no difficulty concluding that the first two steps of the inquiry were satisfied: the proposed *Securities Act* was clearly part of a general regulatory scheme under the oversight of a regulatory agency.[36]

This left the final three questions of the *General Motors* inquiry.

The third question asks whether the proposed *Securities Act* is concerned with trade as a whole, or a particular industry. Here, the Supreme Court acknowledged that the maintenance of "Canada's financial stability" and the "preservation of capital markets" go beyond the regulation of a single industry and are concerned with trade as a whole.[37] However, the Supreme Court noted that the proposed Act is not merely concerned with these broader concerns, but also with the day-to-day, detailed regulation of all aspects of securities in the country. In doing so, the legislation overreaches areas of federal concern and descends into areas of provincial concern.[38] The government of Canada argued that the securities industry has been transformed in the modern era, and now must be regulated federally. However, the Supreme Court did not think that the federal government proved this claim.[39]

The fourth question asks - is the legislation such that individual provinces, acting alone or together, lack the constitutional capacity to enact it? The Supreme Court did not believe so. It emphasized that the legislation goes too far into the detailed, day-to-day regulation of provincial matters.[40]

Finally, is the scheme such that the failure to include one or more provinces would jeopardize its successful operation? In answering this question, the Supreme Court emphasized that this step should not involve an assessment of whether the legislation involves good policy.[41] Instead, the focus should be on what is "constitutionally permissible."[42] Under the proposed *Securities Act*, provinces have the choice to decide whether to opt-in to the federal scheme. The legislation itself contemplates the possibility that not all provinces will be involved. This feature undermines any argument that the

failure to include one or more of the provinces would jeopardize the scheme's successful operation, because even the legislation itself permits provinces to opt-out.[43]

Accordingly, the Supreme Court concluded that the proposed *Securities* Act was not a valid exercise of the federal government's general trade and commerce power. The Court determined that the Act's main focus was the regulation of contracts and property within each of the provinces, a matter of provincial legislative authority. As a result, the Act was found to be unconstitutional and beyond the federal government's legislative power.

What happens next: is the idea of a federal securities regulator dead?

The Supreme Court's opinion in the *Securities Reference* is interesting for a couple of reasons.

First, while the Supreme Court was asked to answer a reference question, it chose to answer the question in a limited way because of the arguments put before it by the federal government. As a result of the limited nature of the federal government's argument, the Supreme Court's opinion assessed the proposed *Securities Act*'s constitutionality based only on the second, general branch of the trade and commerce power. The decision does not go so far as to speculate whether the proposed *Securities Act* could be a justifiable exercise of federal government jurisdiction under another head of power, including the first branch of the trade and commerce power (the power to regulate interprovincial and international trade), or the federal power to make laws for the "peace, order, and good government of Canada."[44]

Second, the Supreme Court emphasized throughout the decision that its opinion on the constitutionality of the proposed legislation does not preclude the different levels of government from working together in a cooperative manner to come to an optimal solution for the good of all Canada:

It is open to the federal government and the provinces to exercise their respective power over securities harmoniously, in the spirit of cooperative federalism.[45]

The Supreme Court thus indicated that a national securities regulator is still constitutionally possible for Canada – it would just need to involve cooperation and collaboration between the provinces and the federal government. The Supreme Court suggests that there is some experience in other federal states suggesting that this kind of "power sharing" between different levels of government in the area of securities regulation can be successful.[46]

As a result, the idea of a federal securities regulator is not entirely dead. Such a body may still emerge in the future. It is clear, however, that the proposed *Securities Act*, as drafted, does not fall under the federal government's power to regulate general trade and commerce affecting the whole dominion.

Further Reading

James Raworth, "Securities Regulation and the Division of Powers", *Centre for Constitutional Studies*(2011).

Ken Dickerson, "Reference Case to Confirm Constitutionality of Federal Securities Regulation" (16 October 2009).

Maxime-Olivier Thibodeau, "Creating a Federal Securities Regulator – Has the Debate Been Settled?"*Library of Parliament* (20 June 2012).

Maxime-Olivier Thibodeau, "Proposed Federal Securities Regulator 2. Constitutional Aspects" *Library of Parliament* (17 May 2012).

Andrew Kitching, "Securities Regulation: Calls for a Single Regulator" *Library of Parliament* (16 February 2009).

Tara Grey and Andrew Kitching, "Reforming Canadian Securities Regulation" *Library of Parliament* (19 September 2005).

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[1] The proposed *Securities Act* was set out in Order in Council PC 2010-667.

[2] *Reference re Securities Act*, 2011 SCC 66, [2011] 3 SCR 837 .

[3] The reference question was brought under s 53 of the *Supreme Court Act*, RSC 1985, c S-26, which permits the Governor in Council to refer a question regarding the interpretation of any federal or provincial legislation to the Supreme Court for its consideration.

[4] *Securities Reference, supra* note 2 at para 1 .

[5] *Ibid* at para 2.

[6] *Ibid* at para 40.

[7] *Ibid* at para 41.

[8] *Ibid* at para 134.

[9] *Ibid* at para 32.

[10] *Ibid* at para 4.

[11] *Reference re Securities Act (Canada)*, 2011 ABCA 77; *Quebec (Procureure generale) c Canada (Procureure generale)*, 2011 QCCA 591.

[12] *Securities Reference, supra* note 2 at para 37.

[13] *Ibid* at para 39.

[14] *Ibid* at paras 57-58.

[15] *Ontario (Attorney General) v OPSEU,* [1987] 2 SCR 2 at para 27. Chief Justice Dickson's full description was: The history of Canadian constitutional law has been to allow for a fair amount of interplay and indeed overlap between federal and provincial powers. It is true that doctrines like interjurisdictional and Crown immunity and concepts like 'watertight compartments' qualify the extent of that interplay. But it must be recognized that these doctrines and concepts have not been the dominant tide of constitutional doctrines; rather they have been an undertow against the strong pull of pith and substance, the aspect doctrine and, in recent years, a very restrained approach to concurrency and paramountcy issues."

[16] *Securities Reference, supra* note 2 at para 61.

[17] *Ibid* at para 62.

[18] *Ibid*. The Court references the "balance" of Canadian federalism at least 15 times throughout the decision.

[19] *Ibid* at para 7.

[20] *Ibid* at para 12.

[21] *Ibid* at para 26.

[22] *Ibid* at para 27.

[23] *Ibid* at para 10.

[24] *Ibid*.

[25] *Ibid* at para 63.

[26] *Ibid* at para 95.

[27] *Ibid* at para 99. Specifically, the Act contains requirements dealing with registration of securities dealers, prospectus filing, and disclosure in addition to specific requirements for participants in the securities market. The Act also provides a framework for both civil remedies and regulatory/criminal offences for violations. See *ibid* at para 30.

[28] *Ibid* at para 106.

[29] *Ibid* at para 44. See *Multiple Access Ltd v McCutcheon*, [1982] 2 SCR 161 at 183.

[30] *Citizens Insurance Co of Canada v Parsons* (1881), 7 App Cas 96.

[31] *Securities Reference, supra* note 2 at para 46.

[32] *Ibid* at para 32.

[33] *Attorney General of Canada v Canadian National Transportation Ltd*, [1983] 2 SCR 206 at 267.

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

[35] *Securities Reference, supra* note 2 at para 80, citing *General Motors v City National, ibid* at 661-62.

[36] *Ibid* at para 110.

[37] *Ibid* at para 114.

[38] *Ibid*.

[39] *Ibid* at para 116.

[40] *Ibid* at para 122.

[41] *Ibid* at para 90.

[42] *Ibid*.

[43] *Ibid* at para 123.

[44] See *ibid* at para 132.

[45] *Ibid* at para 9.

[46] *Ibid* at para 48.