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

AFFIDAVIT OF ERMANNO PASCUTTO
(Sworn October 28, 2010)

I, Ermanno Pascutto, barrister and solicitor, of the Town of Oakville, in the Province of Ontario, MAKE OATH AND SAY:

1. I am the Executive Director of the Canadian Foundation for Advancement of Investor Rights / Fondation canadienne pour l'avancement des droits des investisseurs ("FAIR Canada"), and as such, I have knowledge of the matters set out below.

2. Before assuming my current position, I had a career spanning 30 years as a senior securities regulator and legal practitioner in the financial markets in Canada and Hong Kong. Among other things, I was Executive Director and head of staff of the Ontario Securities Commission in the 1980s. I was also a founding Director and Vice-Chairman of the Hong Kong Securities and Futures Commission. More recently, I was an independent director of Market Regulation Services Inc., as well as an Advisor to the Dubai Financial Services Authority. A copy of my *curriculum vitae* is appended hereto as **Exhibit "A"**.

3. I make this affidavit in support of FAIR Canada's position that the question referred to this Court by the Governor-in-Council should be answered in the affirmative and for no other purpose.

BACKGROUND

This Reference

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

5. The proposed legislation creates a single Canadian securities regulator, supported by a comprehensive statutory and regulatory regime that applies across Canada. Parliament proposes to do so through a regime that will apply to provinces and territories that opt-in.

6. Parliament proposed the legislation in part because it recognized the increasingly national and international dimension of capital markets in Canada, as well as the fact that financial products have evolved and increased in their complexity. The proposed legislation is intended, among other things, to increase the well-being of all Canadians and to ensure the integrity, fairness and stability of Canada's capital markets. Securities legislation achieves these

objectives by promoting efficiency in capital markets and by protecting investors from unfair practices.[1]

FAIR Canada

7. FAIR Canada is a national non-profit agency. Founded in 2008, FAIR Canada is independent of government, regulators and the financial industry. Its purpose is to advocate in the area of securities regulation on behalf of retail investors in Canada.

8. FAIR Canada was formed with a one-time grant of funding from Market Regulation Services Inc. ("RS") and the Investment Dealers Association (the "IDA")[2] using funds derived from fines levied against their member firms. RS and the IDA viewed the funding of FAIR Canada as a desirable use of money earmarked by those organizations for projects that benefit the public, recognizing that retail investors are differently situated from institutional market participants and lacked a voice in policy debates pertaining to securities regulation.

Overview of FAIR Canada's Position

9. FAIR Canada's position is that the question referred to this Court by the Governor-in-Council should be answered in the affirmative. The current patchwork model of securities regulation is inadequate. It has led to important reforms going unimplemented or being delayed, reforms which were intended to

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[1] Proposed Canadian *Securities Act*, Preamble, Reference Record (Attorney General of Canada Materials, Vol. 1, Tab 4, p. 17.

[2] These two entities have since combined to form the Investment Industry Regulatory Organization of Canada ("IIROC"), the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada.

protect Canadian investors. Even more fundamentally, when these reforms finally are adopted, they are often substantially diluted under the current model. The current system favours consensus amongst regulators at the expense of the protection of retail and other investors. In practice, individual provinces and territories (especially the larger provinces) can and do simply "veto" policy change. Moreover, the consensus model precludes serious discussion at the national level of issues that are particularly sensitive in some jurisdictions and instead sacrifices sound regulatory policy to benefit specific jurisdictions, which are ultimately protecting local interests.

10. Furthermore, under the current system, no individual province or territory can mandate that another jurisdiction comply with sound policy because each jurisdiction's authority is territorially bounded, even though the investors in the former jurisdiction may have a keen interest in the proper regulation of a market participant in the latter's jurisdiction by virtue of their investment. As a result, the current system can often produce results that, on a national level, actually undermine the goal of securities regulation, rather than further it.

11. Finally, the "substitute" for a national securities regulator in Canada is inadequate. Instead of a national securities regulator, acting with the force of law and accountable to Parliament or the executive, the current model is a voluntary umbrella organization of member regulators. While this organization solicits submissions from stakeholders, discussions take place and decisions are made without proper transparency or accountability in an environment where the

emphasis on harmony and consensus may result in decisions that are less than optimal. The public has no insight into the workings of this organization.

THE CURRENT REGULATORY INADEQUACIES

Background: The Passport Model

12. Securities regulation in Canada is currently a patchwork of separate provincial and territorial regimes. The present system is comprised of provincial and territorial securities regulators, each of which has a mandate to regulate the issuance and sale of securities, but only within a particular province or territory. Similarly, each of these regulators has a mandate to protect investors, but again, only investors within a particular jurisdiction. Collectively, the regulators under these regimes attempt to achieve a national consensus on important issues, which impact directly on retail investors and others in the securities market nationwide.

13. In the face of highly compartmentalized regulatory authority, the reality of the modern Canadian securities market is that market participants are not geographically bounded, nor have they been for some time now. The market for securities in Canada is truly national and international in its scope. It would now be routine, for example, for an issuer to be headquartered in Saskatchewan; regulated by the Ontario Securities Commission; traded on the TSX Venture Exchange; and issuing securities that are available for purchase by investors across Canada and internationally, securities which are in fact purchased by a

retail investor in New Brunswick through a discount brokerage owned by his or her bank.

14. Canada is the only G20 country that does not have a national securities regulator. In an effort to address (to some degree) the regulatory balkanization of the securities market in Canada, the provincial and territorial regulators have established a voluntary umbrella organization, called the Canadian Securities Administrators (the "CSA"). The CSA is not a national securities regulator, nor is it intended to be one. Instead, the CSA aims to achieve harmonization as between provincial and territorial regimes, through consensus. The CSA does not have the authority to impose a solution on participating regulators, even were a solution in the best interests of investors or other players in the securities market. As the CSA itself says of its purpose:

> The 10 provinces and 3 territories in Canada are responsible for securities regulations. Securities regulators from each province and territory have teamed up to form the Canadian Securities Administrators, or CSA for short. The CSA is primarily responsible for developing a harmonized approach to securities regulation across the country.
>
> The CSA brings provincial and territorial securities regulators together to share ideas and work at designing policies and regulations that are consistent across the country and ensure the smooth operation of Canada's securities industry. By collaborating on rules, regulations and other programs, the CSA helps avoid duplication of work and streamlines the regulatory process for companies seeking to raise investment capital and others working in the investment industry.
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> In recent years, the CSA has developed a the [*sic*] "passport system" through which a market participant has access to markets in all passport jurisdictions by dealing only with its principal regulator and complying with one set of harmonized laws. It is a major step forward in improving Canada's securities regulatory system by providing market participants with streamlined access to Canada's capital markets. [Emphasis added.]

15. The CSA has no authority to make laws or promulgate regulations, as this overview might suggest. It is not a governmental or quasi-governmental agency

with independent authority to impose rules or policies in the area of securities regulation. The CSA is an umbrella organization that brings together the thirteen securities regulators across Canada, which themselves establish applicable and enforceable regulatory rules and policies within their own jurisdiction. Of necessity, the CSA operates through consensus, in order to issue national, harmonized rules and policies, wherever possible. In this way, CSA plays a very significant role in securities regulation across Canada. However, because national policy is achieved through consensus, policy can become diluted to reflect the interests of the CSA's membership and, even then, an urgently needed policy may take years to develop and implement, even in a watered down form; that is, if consensus is ever achieved at all. A copy of the "Overview" and "Who We Are" pages from the CSA's website is attached hereto as **Exhibit "B"**.

16. Moreover, because the CSA is a voluntary organization of member regulators, there is no transparency into its processes and no accountability to either Parliament or the executive. The CSA is accountable only to its member regulators.

17. One of the features of the current model of securities regulation established by the majority of CSA members is the "passport" system, whereby a market participant (such as a securities issuer) gains access to all participating jurisdictions by complying with a set of harmonized policies, agreed to as between the different jurisdictions. However, while the issuer gains access to a

broader market, the issuer only reports to its own principal provincial or territorial regulator.

18. Far from being a model settled upon because it is the best one available from the perspective of market participants, the existence of the passport model is instead a function of necessity: there is at present no single national regulator responsible for the Canadian securities market, despite the fact that the securities market in Canada is national in scope. While some market participants may prefer it this way, this is not a good system for retail investors, who are among the most vulnerable stakeholders in Canada's securities market.

19. In fact, in my view (as I will elaborate on further below), the passport model is not intended to be of benefit to retail investors. It is mostly intended to make life easier for listed companies making offerings of securities.

20. In my view, the efforts of the CSA, together with its member regulators, while directed at establishing a more cohesive national framework for securities regulation in Canada, have, in some cases, merely exacerbated concerns for investors by providing wider market access to issuers and other participants, while at the same time providing for only provincial or territorial regulation. This state of affairs allows issuers to market securities widely, but may leave an individual investor with only limited access to remedies when problems arise and potentially with no government actor responsible for or willing to protect his or her interests when investing.

21. It is my view that the current system is inherently flawed, as it provides for provincial and territorial regulation of what is a truly national marketplace. The securities market is not a community of communities. Rather, as the proposed legislation intimates, "capital markets affect the well-being and prosperity of all Canadians",[3] regardless of provincial and territorial borders. In my view, some of the problems with the current regulatory model, which I address more fully with concrete examples below, include:

a. the manner in which the current "passport" system has failed to produce an effective national system of securities regulation;

b. the inadequacies of the current system of investor protection relative to the regime that would prevail under the proposed legislation; and

c. the inadequacies of the current system in enforcement and investor protection relative to the regime that would prevail under the proposed legislation.

22. In what follows, I will illustrate each of these problems through five examples:

a. the CSA's point of sale initiative (the "Point of Sale Initiative"), which aims to provide retail investors in mutual funds with plain language disclosure of meaningful information, at or before the time of purchase. Unfortunately, because of the need for consensus across the panoply of securities 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

[3] Proposed Canadian *Securities Act*, Preamble, Reference Record (Attorney General of Canada Materials, Vol. 1, Tab 4, p. 17..

implemented. Moreover, in its current version, it is arguably no better (and potentially worse) than the current disclosure requirements already imposed on the sale of mutual funds;

b. the well-known case of insider trading allegations made against former British Columbia Premier William Bennett, his brother Russell Bennett and Harbanse Doman in both British Columbia and Ontario. This case demonstrates the manner in which enforcement of securities laws in Canada can break down where multiple regulators try to take the lead when enforcing territorially-bounded securities laws;

c. the limitations of adopting provincial and territorial securities regulation in an era of increasingly international capital markets, from the perspective of Canada's role in policy formation and enforcement at an international level;

d. the recent initiative by only some of the provincial securities regulators, under the umbrella of the CSA, to make changes to the disclosure requirements of venture issuers, which may reflect an industry-friendly regulatory approach on behalf of certain provinces to the detriment of Canadian investors; and

e. the lack of a national regulatory response to specific corporate governance and shareholder rights issues, which were not addressed at the national level because (under the current consensus model of securities regulation) provincial interests opposed discussion of regulatory improvements.

The Point of Sale Initiative: Watered Down and Delayed

23. From a retail investor protection perspective, one of the most important initiatives in Canadian securities regulation that has emerged in the past decade

is the Point of Sale Initiative, which would (if implemented) provide retail investors purchasing mutual funds with disclosure of meaningful information in plain language at or before the time they decide to purchase units in a particular fund. The initiative is a joint one with the Canadian Council of Insurance Regulators ("CCIR"), who hoped to implement a similar disclosure requirement with respect to segregated funds.[4] Unfortunately, it has been more than a decade since (at the behest of the CSA and CCIR) the Joint Forum of Financial Market Regulators[5] (the "Joint Forum") first proposed the Point of Sale Initiative and it has yet to be implemented by securities regulators. Moreover, as it stands, the current plan has been significantly watered down; in my view, at least in part as a result of the consensus model of securities regulation.

24. The need for the Point of Sale Initiative is clear. Investors in Canada range widely in their level of sophistication. At one end of the spectrum are large institutional investors, such as pension funds and banks. These investors directly purchase securities and rely on teams of professionals when reaching investment decisions. At the other end of the spectrum, are retail investors, who are much more likely to purchase mutual funds, than to purchase securities directly, and who are generally not financially literate and who rely on their financial advisor and publicly available information when making investment

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[4] A Segregated Fund is a type of investment fund administered by Canadian insurance companies in the form of individual, variable life insurance contracts offering certain guarantees to the policyholder such as reimbursement of capital upon death.

[5] The Joint Forum was founded in 1999 by the Canadian Council of Insurance Regulators (CCIR), the Canadian Securities Administrators (CSA), and the Canadian Association of Pension Supervisory Authorities (CAPSA), and also includes representation from the Canadian Insurance Services Regulatory Organizations (CISRO) and the Bureau des services financiers in Québec.

decisions. Retail investors may even rely exclusively on the advice of an investment advisor who is in a conflict of interest, as that advisor is paid through financial incentives from the very mutual funds he or she is selling to the retail investor. For these reasons, the Point of Sale Initiative is almost exclusively of interest to retail investors.

25. The basic thrust of the Point of Sale Initiative (as it was initially framed) is that potential investors would be provided with a simple two-page form (called "Fund Facts") prior to or at the time of purchase of a mutual fund to make it easier for investors who are not financially literate to find and use key information when reaching investment decisions. The format provides investors with basic information about the mutual fund, followed by a concise explanation of mutual fund expenses and fees, advisor compensation and the investor's cancellation rights. An introductory heading would specify that more detailed information about the mutual fund would be available in a simplified prospectus.

26. Despite the straightforward nature of the Point of Sale Initiative, it has been more than a decade since the Joint Forum first proposed the initiative and it has still not been finalized. Instead, much ink has been spilled, in lieu of action. Since the Point of Sale Initiative was first proposed in 1999, it has been the subject of numerous reports, including:

a. on May 7, 1999, the Joint Forum released a *Comparative Study of Individual Variable Insurance Contracts (Segregated Funds) and Mutual Funds*;[6]

b. on December 15, 1999, following consultations with stakeholders, the Joint Forum published its *Recommendations for Changes in the Regulation of Mutual Funds and Individual Variable Insurance Contracts*;[7]

c. on February 13, 2003, the Joint Forum released a Background Paper on the Regulation of Point of Sale Disclosure for Segregated Funds and Mutual Funds and Consultation Document 81-403, Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds. In that paper, the Joint Forum stated that "[w]e believe this paper provides us with compelling evidence that regulatory reform is needed to clarify and harmonize the laws across Canada";

d. on April 30, 2003, after inviting submissions from stakeholders, the Joint Forum published the *Stakeholder submissions regarding Rethinking Point of Sale Disclosure 81-403*;

e. on August 1, 2003, after reviewing submissions from stakeholders, the Joint Forum announced in a press release that members of the Joint Forum will be studying these responses as they finalize the point of sale disclosure recommendations;

f. despite this confidence, it was not until June 15, 2007, that the Joint Forum released *Proposed Framework 81-406 Point of Sale Disclosure for Mutual Funds and Segregated Funds* and, again, invited input from stakeholders;

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[6] (1999) 22 OSCB 2761.
[7] (1999) 22 OSCB 8067.

g. the Joint Forum then published stakeholder responses on October 15, 2007;

h. in light of its consultation, on October 24, 2008, the Joint Forum released the *Final Framework 81-406 Point of Sale Disclosure for Mutual Funds and Segregated Funds*;

i. on June 19, 2009, the CSA then released its *Notice and Request for Comment on the Implementation of Point of Sale Disclosure for Mutual Funds*;

j. the CSA received feedback from stakeholders on October 17, 2009; and

k. finally, on June 16, 2010, the CSA published *CSA Staff Notice 81-319 Status Report on the Implementation of Point of Sale Disclosure for Mutual Funds*, which adopted a staged implementation of the point of sale initiative.

27. To date, the Point of Sale Initiative has not been implemented by any regulator in Canada. However, as noted, the CSA has adopted a plan to implement the proposal in stages. As currently anticipated, implementation will have three steps:

a. on October 8, 2010, the CSA published amendments to NI 81-101 and related instruments, with an effective date of January 1, 2011. After these amendments come into effect, mutual funds will be required to prepare a Fund Facts document, post it on their website and deliver it to investors, upon request. Delivery at point of sale will not be required;

b. importantly, in mid-2011, the CSA intends to publish a proposal (for comment from stakeholders) to allow delivery of the Fund Facts

document to satisfy the current simplified prospectus requirements, which would in fact reduce the amount of disclosure provide by funds to retail investors; and

c. once the CSA has completed its review and consulted with all stakeholders, the CSA intends to move forward with requirements for point of sale delivery of the Fund Facts document for mutual funds. The CSA also intends to publish, for further comment, any proposed requirements that would implement the agreed upon delivery requirements and will consider whether to extend the policy to include other investment vehicles, such as exchange traded funds.

28. In short, although conceived of in 1999, the simple requirement for point of sale delivery of this information will likely not come into effect until 2012, at the earliest, more than 13 years later.

29. In my view, even more fundamentally, the need to achieve consensus amongst 13 different regulators has compelled concessions relating to the final policy that have diluted its protections. For example, as I noted above, the plan, in its latest iteration, would eliminate the simplified prospectus, currently provided to investors in mutual funds. While the simplified prospectus alone is not enough to assist retail investors when making investment decisions, for many investors it can still be a valuable source of information, which it appears will be lost under the current plan. In other words, an initiative intended to protect investors through greater disclosure would in fact reduce the amount of information currently available to those investors, which in my view undermines the very

benefit the Point of Sale Initiative was intended to provide. I understand that the Small Investor Protection Association[8] has concluded (after careful consideration) that the proposal does not satisfactorily advance the current model from an investor perspective.

30. While all stakeholders should be consulted when regulators propose changes that could have an impact on them and their positions reflected in policies (where appropriate), it is my view that both the dilution of the Point of Sale Initiative and the lengthy delay in first settling on and then beginning the process of implementing the initiative is attributable at least in part to the consensus model of securities regulation mandated by the current passport model (and, prior to that, the Mutual Reliance Review System). On the other hand, centralizing securities regulation in a single national body, acting with the force of law and accountable to Parliament or the executive, would allow for consultation with stakeholders, but would provide for the development of sound regulatory policies that are in the national interest and would streamline a process that, as it currently stands, must see agreement between 13 provincial and territorial regulators, in addition to input from market participants, prior to even acting on a relatively straightforward initiative and despite "compelling evidence" that regulatory reform is necessary on a national scale.

31. Moreover, while consultation is present in the current model, transparency and accountability are not. Retail investors and other market participants may be

[8] The Small Investor Protection Association is a volunteer member organization committed to fair practice in the investment industry.

invited to contribute to the dialogue, but decisions are made without transparency and without accountability to Parliament or the executive, which would occur were the proposed Canadian *Securities Act* implemented.

32. As a point of comparison, Hong Kong, which has centralized regulation of its securities market, implemented its own similar initiative within 18 months of its publication of its public consultation document. Hong Kong's requirements apply not only to mutual funds, but also to segregated funds, exchange traded funds and other investment vehicles. The CSA, on the other hand, intends to consider whether its as-yet-unimplemented initiative may apply to these other vehicles at some point in the future.

Canada's Patchwork System Breaks Down: The Bennett-Doman Case

33. In my view, enforcement under the current patchwork model of securities regulation is also inadequate. Enforcement issues arise when a territorially-bounded regulator must determine who and what is subject to its jurisdiction in circumstances where that subject matter has an extra-territorial aspect. In many cases, there may be no principled reason why a particular actor or particular conduct does not fall within the bailiwick of multiple jurisdictions. As an example of these jurisdictional complexities, I have attached a copy of *O.S.C. Policy 1.5 – Distribution of Securities Outside Ontario* as **Exhibit "C"** to my affidavit. The problems created by the patchwork model of securities regulation can be seen in the problems this creates for enforcement. Specifically:

a. the potential for parallel proceedings to derail enforcement of securities regulation and therby jeopardize the public interest in the integrity of capital markets;

b. the fact that the voices of investors in one jurisdiction may not be heard because another prosecuting jurisdiction, with no statutory mandate to protect those interests, takes the lead in investigating and prosecuting securities offenses;

c. the added cost to the public of duplicative enforcement proceedings;

d. the inadequacies that the current model creates from the perspective of innocent defendants, who may have to defend against multiple proceedings; and

e. the added difficulties presented in terms of settlement, which is generally in the interests of all stakeholders.

34. A good example of the problems that may arise where two or more regulators have valid claims to jurisdiction over persons who have engaged in unlawful conduct is the Bennett-Doman insider trading case. The basic facts of the case are well-known to those involved in Canadian securities regulation and so I will not go into great detail. The allegations in the case produced decisions from British Columbia and Ontario courts, as well as the British Columbia Securities Commission ("BCSCn") and the O.S.C. In my view, the case demonstrates well the potential of the current patchwork system of securities regulation to break down when there are two (or even more) competing regulators with jurisdiction over the parties and the interests involved. While the

offenders ultimately did face administrative sanctions in British Columbia, the case shows how easily enforcement in the current model could have been derailed by parallel proceedings in a regulatory model where multiple regulators can claim jurisdiction over the same market players.

35. In summary, the case involved William Bennett, a former B.C. premier, his brother, Russell Bennett, and Harbanse Doman, a Vancouver businessman. Mr. Doman controlled and directed Doman Industries Ltd. ("DIL"). All three held shares in DIL. In 1988, a U.S. company, Louisiana Pacific Corporation ("LPC") expressed interest in an arrangement with or take-over of DIL. Russell Bennett was accused of purchasing shares with undisclosed material information of this potential transaction. All three were accused of selling shares with inside information when LPC terminated the transaction on November 4, 1988, by telephone call to the DIL office. Shortly after LPC's call, telephone records show that someone from DIL phoned the McIntosh Centre (where the Bennetts had their office). The phone records could not confirm the identity of the callers, but the suspicion was that LPC phoned Mr. Doman who in turn phoned one of the Bennetts. All three sold shares in DIL following LPC's termination of the transaction, but before that termination was public knowledge.

36. Pursuant to the B.C. *Securities Act*, the Crown brought quasi-criminal charges against all three. In B.C., the provincial court had jurisdiction over the quasi-criminal allegations, whereas the BCSCn had jurisdiction over the administrative sanctions that might be sought against them. The B.C. provincial

court rendered a decision in the quasi-criminal case in May 1989, less than six months after the alleged insider trading. The trial judge held that the Crown had not met its burden of proving beyond a reasonable doubt that Mr. Doman had made a phone call to the Bennetts in order to tip them off that the transaction between DIL and LPC had been terminated. The trial judge even went so far as to say that the Crown had not proved the allegations on a balance of probabilities.[9] The Crown did not appeal this ruling.

37. The administrative proceedings initiated by the BCSCn were much more involved and complicated. There were several appeals from different aspects of the BCSCn's decisions, which made their way to the B.C. Court of Appeal.[10] Leave in one of these cases was even sought to this Court.[11] Ultimately, the BCSCn held all three liable for insider trading and imposed administrative sanctions against them, for example, limiting their ability to act as directors of companies and holding them jointly and severally liable for the BCSCn's costs.[12]

38. Throughout the quasi-criminal and administrative proceedings in B.C., the O.S.C. also pursued quasi-criminal and administrative proceedings against all three, based on the same allegations. DIL was a reporting issuer in both B.C. and Ontario, and its shares traded on both the Toronto and Vancouver Stock Exchanges, as they then were. The O.S.C. (which, in Ontario, had jurisdiction

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[9] *R. v. Bennett*, [1989] B.C.J. No. 1884 (Prov. Ct.).
[10] See, e.g., *Bennett v, British Columbia (Securities Commission)*, [1992] B.C.J. No. 1655 (C.A.); *Bennett v, British Columbia (Superintendent of Brokers)*, [1993] B.C.J. No. 2519 (C.A.); and *Bennett v, British Columbia (Superintendent of Brokers)*, [1993] B.C.J. No. 2519.
[11] [1994] S.C.C.A. No. 52.
[12] *Re Bennett* (1999), 42 B.C.S.C.W.S. 7 (22 Ocotober 1999).

over both administrative and quasi-criminal sanctions) went so far as to lay quasi-criminal insider trading charges against all three[13] and issued a notice of hearing.[14] However, the O.S.C. ultimately did not pursue these allegations, over concerns of double jeopardy, in light of the proceedings in B.C. provincial court.[15]

39. Nonetheless, the O.S.C. did pursue administrative sanctions against all three offenders. The offenders refused to attorn to Ontario. They also refused to appear and testify before the O.S.C. at the administrative hearing. The High Court of Justice refused to order that the three offenders appear, holding that the OSC had no coercive power outside of the province, including no power to ask for a summons to be issued outside Ontario.[16] The OSC appealed, but the appeal was dismissed.[17] Ultimately, the OSC also discontinued its administrative proceedings against the offenders. In other words, because the offenders resided in B.C., they were able to avoid participating in administrative proceedings in Ontario, notwithstanding that DIL was a reporting issuer in Ontario, many of the investors who suffered losses as a result of the insider trading were based in Ontario, and its securities were traded in Ontario on the Toronto Stock Exchange.

40. As noted, the BCSCn had also initiated administrative proceedings against the offenders; however, because of the Ontario proceedings (which had since been discontinued) the offenders challenged the B.C. proceedings in part on the

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[13] (1989), 12 O.S.C.B. 600.
[14] (1989), 12 O.S.C.B. 2536.
[15] (1989) 12 O.S.C.B. 2546.
[16] (1990), 13 O.S.C.B. 505.
[17] *Ontario Securities Commission v. Bennett*, [1991] O.J. No. 253 (C.A.).

basis of the parallel proceedings in Ontario. The matter was brought before the B.C. Supreme Court, which rendered its decision in 1991. The court held on the facts of the case before it that there had been no abuse of process.[18] What is unclear from the judgment is whether the result would have been different had the Ontario proceedings still been ongoing. In those circumstances, it would have been more difficult, I believe, for the court to conclude that there was no abuse of process, when the offenders faced similar sanctions for the same conduct in two separate jurisdictions.

41. Had the O.S.C. proceedings still been ongoing, it is possible that a B.C. court would have found the B.C. proceedings to be an abuse of process, while at the same time the O.S.C. would have had no coercive powers available to it to compel the offenders' attendance to face sanctions within its jurisdiction. The problems with this result from the perspective of the market are palpable, but I believe they are inherent to the current regulatory model, which carves up responsibility for securities regulation into discrete geographical units. Were there instead a national regulator with the capacity to enforce securities laws nationally, it would, in my view, alleviate this risk considerably and provide better protections to investors and other market participants nationwide.

42. Given the national scope of Canada's capital markets, the current model also silences the voice of retail investors and other market participants, who happen to not be located within the jurisdiction prosecuting an offense. The

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[18] *Bennett v. British Columbia (Securities Commission)*, [1991] B.C.J. No. 1021 (S.C.).

prosecuting jurisdiction has no mandate to represent the interests of other participants located in other provinces and territories.

43. Further, the current patchwork model also necessitates duplicative investigations and enforcement proceedings, which merely add cost to securities regulation with no added benefit.

44. From the perspective of the innocent defendant, who may still be investigated by and have to defend against proceedings in multiple jurisdictions, the current patchwork model is clearly inadequate. The need to defend against (and bear the cost of) multiple proceedings is a fundamentally unfair result, but a possible (even a likely) one under the current model of decentralized regulation.

45. The problem for both the alleged offender and the public is compounded by the fact that many large Canadian issuers are also listed in the United States. This means that an alleged offender may be facing prosecution from the U.S. Securities and Exchange Commission (the "S.E.C."), in addition to prosecutions in one or more jurisdictions within Canada. Like most litigation, many prosecutions against alleged offenders end in settlement, which is normally to the advantage of all involved parties. However, by increasing the numbers of regulators with jurisdiction, the current model makes achieving settlement more onerous, which is to no one's advantage.

The Current Model is Inadequate from an International Perspective

46. As I noted above, many large Canadian issuers are listed both in the U.S, and in Canada. Increasingly, enforcement (like capital markets themselves) is international in scope. The decentralized model adopted in Canada may lead to difficulties when domestic and foreign securities regulators investigate abroad and require the cooperation of foreign jurisdictions. For example, if the S.E.C. requires the assistance of Canadian securities regulators in the course of an investigation, it must (potentially) conclude agreements with 13 distinct regulators. The S.E.C. currently does not have agreements in place with all jurisdictions in Canada. In other words, valuable information relating to the enforcement of securities laws may be lost if a foreign regulator has not and is unable to conclude an agreement with a provincial or territorial securities regulator (or conclude one in time). Given the increasing interdependence of international capital markets, far from being "someone else's problem", the inability of a foreign securities regulator to investigate properly in Canada may well have an adverse impact on Canadian investors, as well investors in other jurisdictions. It may also lead to unwillingness on the part of foreign jurisdictions to assist Canadian regulators in their investigations.

47. Moreover, the existence of 13 distinct regulators in Canada has arguably limited Canadians' ability to participate as fully as they otherwise could in policy formation and capital markets internationally. For example, the S.E.C. began in 2008 to establish mutual recognition arrangements with other jurisdictions. These arrangements allow U.S. stock exchanges and broker-dealers and those

in a reciprocating jurisdiction to operate within the other's respective jurisdiction, without the need for separate regulation of all aspects of these entities in both countries. As part of these arrangements, the reciprocating jurisdictions enter into Memorandums of Understanding, bolstering each jurisdictions' supervisory and enforcement obligations to the other. As part of the process, the S.E.C. and the reciprocating jurisdiction conduct extensive due diligence of the other's securities regulatory regime and markets.

48. In May 2008, the S.E.C. announced that it had agreed with Canada to a "schedule for the completion of a process arrangement that would open the way for discussions of a potential US-Canada mutual recognition arrangement." Attached hereto as **Exhibit "D"** to my affidavit is a copy of that press release. As this Court no doubt knows, Canada is the U.S.'s largest trading partner. However, despite only agreeing to a schedule for completing a mutual recognition process arrangement with Canada in the future, the S.E.C. actually concluded its first mutual recognition arrangement with Australia in August 2008. Unlike Canada, Australia has a centralized securities regulator. I surmise that some of the difficulty in concluding an agreement between Canada and the U.S. is attributable to the decentralized nature of Canadian securities regulation, which is more difficult to assess and creates added difficulties from both a supervisory and enforcement perspective than would the centralized regulatory framework in Australia.

The Proposed Changes to the Regulation of Venture Issuers: Provincial Interests and National Regulation

49. Like investors, securities issuers also have a range of interests, some of which can depend on the nature of the particular issuer. An important example are venture issuers, which are more "junior", less established companies that tend to list their securities on Canada's junior exchanges (e.g. the TSX Venture Exchange). Venture issuers are generally smaller than issuers listed on the Toronto Stock Exchange, and have less capital and fewer resources than more established issuers. However, they are also generally more speculative and riskier investments for retail investors. I agree that it is important that regulatory requirements are tailored to the venture issuer market. Yet, my view is that the current model properly strikes a balance between the interests of venture issuers and of other market participants.

50. Despite this, certain provinces, notably those with more junior issuers' resident within their jurisdiction, have recently moved to eliminate measures intended to protect retail and other investors from these riskier investments. On May 31, 2010, the CSA released its *Multilateral Consultation Paper 51-403 Tailoring Venture Issuer Regulation* and invited consultation. The paper proposes eliminating certain disclosure requirements for venture issuers, currently required for other issuers. Proposed changes include eliminating the need for disclosure of quarterly financial statements; reducing disclosure of director compensation; and relaxing conflict of interest rules. From the perspective of retail investors, material reduction to the amount of required disclosure would result in information gaps for investors, who have limited

additional sources of information about companies listed on the risky, prospective venture market.

51. As this Court may know, Canada experienced a period during which its venture market was viewed unfavourably by investors both domestically and internationally, particularly the former Vancouver Stock Exchange. This led to the need for robust, yet tailored, regulation, through which provincial and territorial regulators were able to restore confidence in venture markets. The continuing fear is that confidence in Canada's public venture market will be eroded once again if disclosure requirements in the industry are reduced further, as some provinces appear to desire.

52. Interestingly, while the paper was released under the mantle of the CSA (which, as noted above, is the umbrella organization for all provincial and territorial regulators), its position is only currently supported by regulators from Alberta, British Columbia, Manitoba, Nova Scotia, New Brunswick and Saskatchewan. The paper's position has not been adopted by Ontario or Quebec. In my view, this is telling, and demonstrates the role different provincial and territorial interests play in shaping securities policies in Canada through the CSA, notwithstanding whether these policies are in the best interests of all market participants. I say this because the provinces which have suggested changes to the compliance requirements for venture issuers are provinces that, in general, have a greater public venture market than the provinces that have so

far resisted these changes, whereas many of the investors are based in Ontario and Quebec.

53. While I am of the view that Ontario and Quebec are justified in their reluctance because of the impact the proposed changes could have on retail investors, the point I am making is a more fundamental one; namely, that policy (even consensus-driven national policy) may be adversely influenced by regional interests. While regional interests are important, a true national securities regulator (such as the one proposed in the draft legislation) would allow regional interests to be reflected, though not at the expense of the national marketplace. In light of the reality of the truly national marketplace for securities in Canada, a single regulator responsible for securities policy in Canada makes more sense than allowing a national debate to become derailed by regional interests.

Corporate Governance and Shareholder Rights Policy Issues Going Unaddressed by the CSA: The "Spin-Off" Companies Example

54. Institutional and retail investors (and groups acting on their behalf, such as FAIR Canada) have made numerous submissions on corporate governance, abuse of shareholders and shareholder rights over the years to securities regulators and, in particular, to the O.S.C. However, my understanding is that while the O.S.C. has at times agreed with the validity of these concerns and has advised that they would raise the issues at the CSA, the O.S.C. has at times not followed through and the CSA has not addressed these issues. My understanding is that the O.S.C. is generally reluctant to raise issues at the CSA level where it is clear that there will be significant opposition from a major

regulator, located in one of Canada's larger provinces. In essence, harmony among CSA members trumps investor protection and sound public policy for Canada's capital markets. While I believe this phenomenon is generally acknowledged by regulators and senior practitioners, it is not something that is ever discussed publicly.

55. An example of local interests trumping other regulatory considerations is "spin off" companies. Spin-off companies were particularly popular in the energy sector between 2003 and 2006,[19] where mergers between an oil and gas royalty trust and an oil and gas producer (collectively, an "E&P Company" or "Exploration and Production Company") featured what were known as "exploreco" spin-off listings ("Exploreco Spin-Offs"). In short, a portion of the assets of the E&P Company would be transferred to a new Exploreco Spin-Off, which would then be listed on the Toronto Stock Exchange or TSX Venture Exchange. A slimmed down version of the existing E&P Company's management team would manage the new Exploreco Spin-Off. Attached to my Affidavit as **Exhibit "E"** is a brief position paper I wrote on the issue in September 2008, which addresses the issues raised by Exploreco Spin-Offs in more detail.

56. From the perspective of investors, Exploreco Spin-Offs share a number of problematic features. Perhaps most problematically, the creation of Exploreco Spin-Offs generally involved private placements (or non-public offerings) of

[19] After which time, changes to the tax benefits of income trusts meant that these transactions were less desirable.

securities to directors and senior managers of the parent E&P Company (who were also directors or senior managers of the Exploreco Spin-Off). Public shareholders in the E&P Company were not invited to participate in these private placements, where securities of the Exploreco Spin-Off were often sold to insiders at discounts of as much as 40-80% of their fair market value. The result was a transfer of wealth from public shareholders to directors and senior management of the Exploreco Spin-Off. While the TSX rules generally prohibit private placements to insiders at discounts greater than 10% of the market price of the shares, I understand that Exploreco Spin-Offs avoided these rules by completing their private offering of securities immediately before the Exploreco Spin-Off's securities begin trading on the TSX or TSXV exchanges.

57. Institutional and retail investors complained about the corporate governance and shareholder rights abuses. The media wrote commentaries critical of the Exploreco Spin-Off transactions. I raised my concerns on this issue with the O.S.C., which I understood would address the issue with the CSA at the national level. However, to my knowledge, nothing has been done publicly to address the problem. I understand that the CSA has declined to debate (let alone address) the investors' legitimate concerns over these vehicles because of the influence of the Alberta Securities Commission and the influence of local interests. My understanding is that this policy initiative was simply not discussed between the members of the CSA, because the Alberta Securities Commission was opposed to discussing the issues, despite their importance to national securities policy.

The Future of Securities Regulation in Canada

58. As the question referred by the Governor-in-Council raises a constitutional issue, I feel compelled to note that the problems raised by the current regulatory balkanization of the Canadian securities market will continue to evolve. With the increasing complexity of financial products and the rapid pace of change in financial markets, new issues affecting retail investors are constantly coming to light in the area of securities regulation that have not previously been considered or addressed. In this environment, I believe that it is important that the Parliament of Canada (as well as the provinces and territories) should have the flexibility to address these emerging issues in a timely manner that is most advantageous for Canadian retail investors and other market participants.

CONCLUSIONS

59. Canada is the only G20 country that does not have a national securities regulator. However, the Canadian securities market is a truly national one, which requires a national regulator to direct policy and to enforce regulation which has an impact on all Canadians. The current model of securities regulation in Canada is inadequate. It reflects an outmoded view of Canada's capital markets as territorially bounded. The new reality is that capital moves across Canada (and around the world) with the touch of a computer. The creation of a national securities regulator (like the one proposed in the draft legislation) will provide greater protection for retail and other investors, while at the same time ensuring that a national securities market operates as efficiently as possible. For these

reasons, I believe this Court should answer the question posed by the Governor-in-Council in the affirmative.

Sworn before me)
in the City of Toronto,)
in the Province of Ontario)
this 29th day of October, 2010)

Ermanno Pascutto

Commissioner for Taking Affidavits
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This is Exhibit "A" to the
Affidavit of Ermanno Pascutto
Sworn this 29th day of October 2010

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A Commissioner for taking affidavits

Ermanno Pascutto

Ermanno Pascutto has had a 30-year career as a senior securities regulator and legal practitioner in the financial markets in Canada and Hong Kong. Ermanno is the founder and initial executive director of the non-profit Canadian Foundation for Advancement of Investor Rights ("FAIR Canada"). Prior to establishing FAIR Canada in mid-2008, Mr. Pascutto's practice was focused on the regulation of public companies and financial intermediaries, including advising with respect to governance, disciplinary and enforcement matters. He has also consulted to stock exchanges and securities commissions in Hong Kong, the Middle East and the Caribbean.

FAIR CANADA

Ermanno Pascutto is Executive Director of FAIR Canada, having launched this independent national non-profit agency in mid-2008. FAIR Canada seeks to be a national voice for investors in securities regulation and a catalyst for the enhancement of the rights of individual investors and shareholders. (See www.faircanada.ca for further information.)

Since its establishment, FAIR Canada has produced numerous submissions and reports on a diverse range of investor protection topics including:

- Risks to investors of leveraged and commodity ETFs,
- Money Market Funds, identifying problems for investors caused by low interest rate environment,
- Hazards of Contracts for Difference and the TSX's proposal for SPACs (blank cheque offerings),
- Know your Client, Suitability, the Client Relationship Model, and Arbitration programs,
- Submissions on the importance of retail investor input and representation on regulatory bodies,
- Submissions on Point of Sale for Mutual Funds, and
- Introducing a requirement for firms and advisors to put their clients' best interests first.

SECURITIES REGULATORY EXPERIENCE

Canada - Mr. Pascutto was **Executive Director** and head of staff of the **Ontario Securities Commission** from 1984 to 1989. At that time, the OSC was structured as a two tier organization with staff reporting to the Executive Director rather than the Chairman. In addition to management responsibilities for an agency with 150 professional and support staff, the Executive Director was involved in all key or contentious issues involving public financings, mergers and acquisitions, investigations and prosecutions, policy formulation and capital markets regulation. During his tenure, Mr. Pascutto worked with the Chairman of the OSC to transform the agency into a dynamic and respected organization and reformed key elements of securities laws. Working with the U.S. SEC, he conceived and developed the world's first

Memorandum of Understanding between the securities regulators of any two countries. He also led the OSC in numerous high profile and successful enforcement actions

Before being promoted to the position of Executive Director, Ermanno was **Legal and Policy Advisor to the Commission** (1983 – 1984). Prior to joining the OSC, Mr. Pascutto was **Director of Market Policy** at the **Toronto Stock Exchange** (1980- 1983) having joined the TSE on a secondment from Osler Hoskin & Harcourt.

Hong Kong - Mr. Pascutto left his position as Executive Director , OSC to play a critical role in the establishment of the **Securities and Futures Commission** ("SFC") in Hong Kong. In 1989, Mr. Pascutto was recruited to be a founding director of the SFC board, **Vice-Chairman** and Executive Director of the Corporate Finance Division. In 1992 he was promoted to **Deputy Chairman.** Some key policy initiatives included:

- The development of the regulatory framework for the direct listing by Chinese State Enterprises on the HKEx;
- A restructuring of listed company regulation, including implementation of insider reporting legislation, upgrading financial disclosure requirements and a comprehensive revision of the listing rules to meet international disclosure and governance standards;
- A comprehensive revision of the regulations of takeovers & mergers and the introduction of a regime for issuer bids;
- A conceptual change in the regulation of listed companies in response to the "redomiciling" by Hong Kong listed companies to Bermuda and other offshore jurisdictions; and
- Various market development initiatives related to pre-emptive rights, private placements, derivative warrants, etc., in order to facilitate financing flexibility while maintaining high standards of investor protection.

INTERNATIONAL SECURITIES CONSULTANT

International consulting assignments include:

- Advisor to the **Dubai Financial Services Authority** on legislation to establish the Dubai International Financial Center according to the highest international standards (Dubai, UAE) (2002 – present)
- Advisor to the **Hong Kong Exchanges and Clearing Limited** ("HKEx") on restructuring the regulation of listed companies (Hong Kong, SAR) (2002 – 2004)
- Co-Project Leader of Stikeman Elliott team advising the **Trinidad & Tobago SEC** on a comprehensive revision of securities legislation (2002 – 2004)

LAW PRACTICE

Ermanno Pascutto is admitted to practice as a lawyer in Canada (1979) and Hong Kong (1997). In Hong Kong, he was Senior Advisor with **Troutman Sanders,** a U.S. law firm (February 2004 to

2008). In Canada, he was counsel to **Stikeman Elliot** (2000 to December 2004) and Counsel to **Groia & Company** (a securities litigation boutique) (February 2004 to 2008).

Mr. Pascutto has:

- Acted as an expert witness on securities regulation in civil and criminal cases,
- Represented Canadian, Hong Kong and US financial intermediaries and licensed individuals in licensing and disciplinary matters, including hearings, and regulatory reform proposals,
- Represented Hong Kong listed companies in takeovers, corporate restructuring, rights issues and other transactions, and
- While managing a major Canadian law firm's Hong Kong office, he led a high profile comprehensive review of company law on behalf of the Hong Kong Government (1995 – 1997).

Mr. Pascutto practiced law with **Osler Hoskin & Harcourt** (1977-1980) until he joined the TSE, originally on a secondment. He joined **Goodman Phillips & Vineberg** (1994-2000) after completing his 5 year contract with the Hong Kong SFC. Mr. Pascutto practiced with **Stikeman Elliot** (2000-2004) until the firm closed its Hong Kong Office.

DIRECTORSHIPS AND MEMBERSHIPS OF COMMITTEES

Relevant experience includes:

- Independent director and member of the audit and corporate governance committees of **Market Regulation Services Inc.**, the independent regulation services provider for Canadian equity markets (2004 until its merger with IDA in 2008).
- Currently an independent director of a TSX Venture listed company including chairman of the corporate governance committee and member of the audit committee.
- A member of the Stock Exchange of Hong Kong's Corporate Governance Committee (1995 – 1997).
- Chairman of the Hong Kong Takeovers Committee.

PUBLICATIONS

Mr. Pascutto is author or co-author of several articles and papers, including:

The "Role of Ontario Securities Commission Staff" in the *Law Society of Upper Canada Special Lectures* (1989);

Co-author of the Stikeman Elliott report to the Trinidad & Tobago Securities and Exchange Commission *"Final Report – Review and Revision of the Trinidad & Tobago Securities Industry Act, 1995 and Related By-laws and Associated Legislation"* (December, 2004);

Lead Consultant in the Hong Kong Government review of the Companies Ordinance leading to production of the *Consultancy Report on the Review of the Hong Kong Companies Ordinance* (March 1997);

The "Administration of the Hong Kong Takeovers Code" in *The Practitioner's Guide to the Codes on Takeovers and Mergers and Share Repurchases* (1993); and

"Regulation and Ethical Standards around the World: Hong Kong" in *Good Ethics: The Essential Elements of a Firm's Success*, Association for Investment Management and Research (Washington, D.C.), 1993.

In addition, Mr. Pascutto has been speaker on securities regulation at numerous conferences organized by the International Organization of Securities Commissions ("IOSCO"), Institute of Directors, Institute of Chartered Secretaries and Administrators, International Bar Association, ABA and Inter-Pacific Bar Association, Association for Investment Management and Research (Washington, D.C.), Group of Thirty (London), and the Securities Industry Association (New York).

PERSONAL

- Graduate of the **Faculty of Law, University of Toronto** (L.L.B. Dean's Honour List)
- **HL Gazzard Memorial Award** (1981 tied) for highest marks in the Canadian Securities Course

This is Exhibit "B" to the
Affidavit of Ermanno Pascutto
Sworn this 29th day of October 2010

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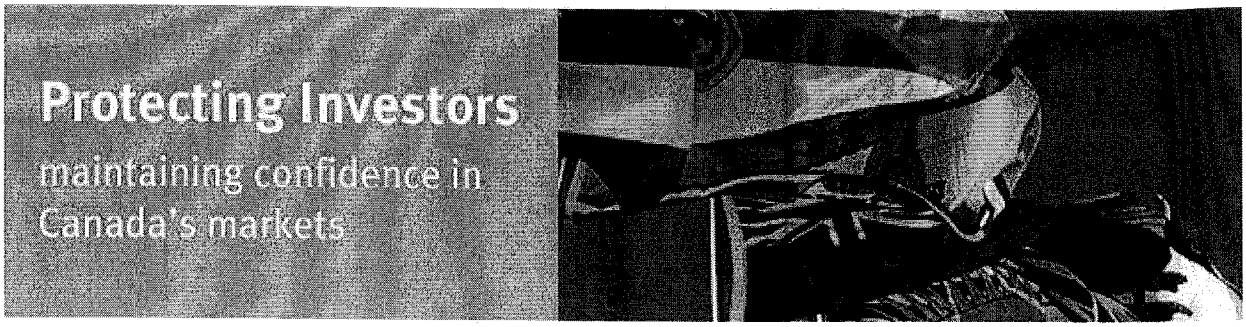
A Commissioner for taking affidavits



Overview

The Canadian Securities Administrators (CSA) is a voluntary umbrella organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets.

It aims to achieve consensus on policy decisions which affect our capital market and its participants. It also aims to work collaboratively in the delivery of regulatory programs across Canada, such as the review of continuous disclosure and prospectus filings.

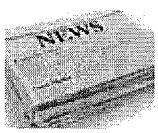
Your Regional Securities Regulator Is There For You

While the CSA co-ordinates initiatives on a cross-Canada basis, provincial or territorial regulators handle all complaints regarding securities violations in their respective jurisdictions. This provides a more direct and efficient service since each regulator is closer to its local investors and market participants. Enforcement of securities regulations is also done on an individual basis by each province or territory.

For more information or if you wish to make a complaint, **contact your local securities regulator**.

Who We Are

The 10 provinces and 3 territories in Canada are responsible for securities regulations.
Learn More »



What's New

Find the latest and archived news releases.
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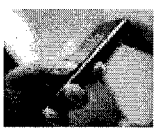
Letters and Statements

Find the latest and archived letters and statements issued by the CSA.
Learn More »

Regulatory Cooperation

For the CSA, regulatory cooperation occurs both at national and international levels.
Learn More »



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Introduction to CSA
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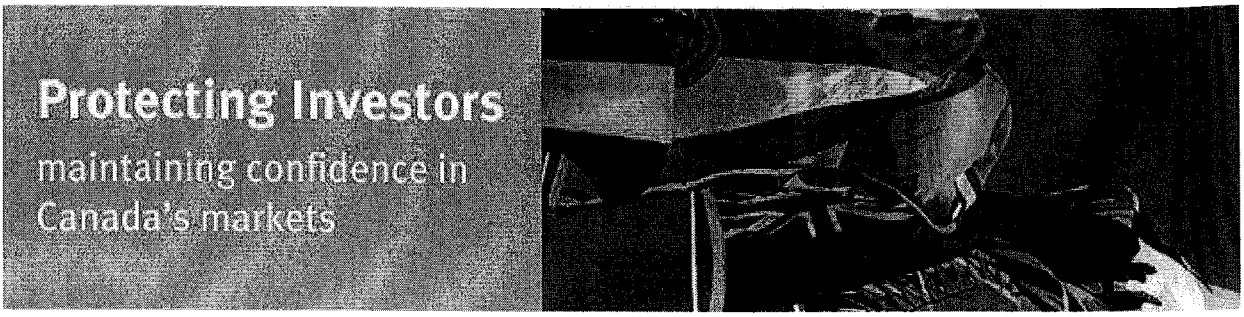


Who We Are

The 10 provinces and 3 territories in Canada are responsible for securities regulations. Securities regulators from each province and territory have teamed up to form the Canadian Securities Administrators, or CSA for short. The CSA is primarily responsible for developing a harmonized approach to securities regulation across the country.

The CSA brings provincial and territorial securities regulators together to share ideas and work at designing policies and regulations that are consistent across the country and ensure the smooth operation of Canada's securities industry. By collaborating on rules, regulations and other programs, the CSA helps avoid duplication of work and streamlines the regulatory process for companies seeking to raise investment capital and others working in the investment industry.

In recent years, the CSA has developed a the "passport system" through which a market participant has access to markets in all passport jurisdictions by dealing only with its principal regulator and complying with one set of harmonized laws. It is a major step forward in improving Canada's securities regulatory system by providing market participants with streamlined access to Canada's capital markets.

The CSA's impact on most Canadians comes through its efforts to help educate Canadians about the securities industry, the stock markets and how to protect investors from investment scams.

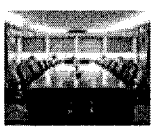
The CSA provides a wide variety of educational materials on securities and investing. It has produced brochures and booklets explaining various topics such as how to choose a financial adviser, mutual funds, and investing via the internet. All CSA materials are available in the Investors' Tools section of the CSA Website and through your local securities regulator.

Our Mission

To give Canada a securities regulatory system that protects investors from unfair, improper or fraudulent practices and fosters fair, efficient and vibrant capital markets, through developing the of a national system of harmonized securities regulation, policy and practice.
Learn More »

CSA Members

Learn about our members and how to contact them.
Learn More »



CSA Structure

As an informal body, the CSA functions through meetings, conference calls and day to day cooperation among the securities regulatory authorities. The CSA Chairs meet quarterly in person and monthly by conference call.
Learn More »

This is Exhibit "C" to the
Affidavit of Ermanno Pascutto
Sworn this 29th day of October 2010

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A Commissioner for taking affidavits

circumstances the Ontario cease trading order will normally be lifted when the cease trading order in the other jurisdiction has been lifted.

(Former Policy 3-34. First published (1977), O.S.C.B. 155. First published as OSC Policy 1.4 (1982), 4 O.S.C.B. 354E.)

OSC POLICY 1.5

DISTRIBUTION OF SECURITIES OUTSIDE ONTARIO

(Repealed and replaced by Interpretation Note 1, effective March 25, 1983. Interpretation Note 1 is reproduced following the Notice, below. (Policy first published (1982), 4 O.S.C.B. 355E.))

NOTICE

O.S.C. Policy 1.5 (formerly Draft Policy 3-47) entitled "Distributions of Securities Outside Ontario" primarily addresses the policy concern that securities distributed prospectus-free abroad not be illegally distributed or redistributed into Ontario or to Ontario residents.

Policy 1.5 adopts a broad construction of the definitions of "trade" and "distribution" in the *Securities Act* (Ontario) (the "Act") and states that in light of the breadth of these terms, a distribution of securities by an issuer outside Ontario may also be considered to be a distribution of securities in Ontario requiring compliance with the prospectus provisions of the Act or an exemption therefrom. The subject matter of Policy 1.5 is thus relevant both to distributions by issuers incorporated or continued under the laws of Ontario or whose head office is situate in Ontario ("Ontario issuers") and to distributions by all other issuers ("non-Ontario issuers") regardless of their connection, if any, with Ontario.

Policy 1.5 does not apply to issuers who satisfied the criteria for eligible reporting issuers set forth in O.S.C. Policy 5.6 entitled "Prompt Offering Qualification System" [repealed February 19, 1993] whether or not such issuers intended to effect distributions outside Ontario in accordance with Policy 5.6.

The Commission has received a considerable number of comments with respect to Policy 1.5. Some commentators have expressed the concern that Policy 1.5 will seriously interfere with the capital formation process for issuers effecting financings outside Ontario where it is manifest that there is no intention that the securities abroad will find their way into Ontario and where no question arises of bringing the Ontario capital markets into disrepute.

The Commission is of the view that Policy 1.5 may have unduly interfered with legitimate distributions outside of Ontario. Therefore, as of the publication of this Bulletin, the Commission has repealed Policy 1.5. At the same time the Commission wants to make known its views on the application of the Act to distributions of securities outside of Ontario. The Commission is therefore publishing, in place and stead of Policy 1.5, the following Interpretation Note.

INTERPRETATION NOTE 1

DISTRIBUTIONS OF SECURITIES OUTSIDE ONTARIO

1. THE PROVISIONS OF THE ACT

The basic prospectus requirement of the Act is contained in subsection 52(1) which provides, in part, as follows:

> No person or company shall *trade* in a security on his own account or on behalf of any other person or company,
>
> ...
>
> (*b*) ... where such trade would be a *distribution* of such security,

unless a preliminary prospectus and a prospectus have been filed and receipts therefor obtained from the Director. (emphasis [Italics] added)

The term "trade" is defined in paragraph 1(1)42 of the Act, in part, as follows:

"trade" ... includes,

i. any sale or disposition of a security for valuable consideration whether the terms of payment be on margin, instalment or otherwise, but does not include a purchase of a security or, except as provided in subparagraph iv, a transfer, pledge or encumbrance of securities for the purpose of giving collateral for a *bona fide* debt,

...

v. any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the foregoing;

The term "distribution" is defined in paragraph 1(1)11 of the Act, in part, as follows:

"distribution", where used in relation to trading and securities means,

i. a trade in securities of an issuer *that have not been previously issued*

...

iii. a trade in previously issued securities of an issuer from the holdings of any person, company or combination of persons or companies holding a sufficient number of any securities of that issuer to affect materially the control of that issuer, but any holding of any person, company or combination of persons or companies holding more than 20 per cent of the outstanding voting securities of an issuer shall, in the absence of evidence to the contrary, be deemed to affect materially the control of that issuer, ... (emphasis [Italics] added)

A "distribution" thus includes a sale by an issuer of its previously unissued securities to a purchaser, whether or not such purchaser is an underwriter of the securities. While a sale by an issuer to an underwriter acting as purchaser is exempt from the prospectus requirements of the Act by paragraph 71(1)(*r*), the sale by the underwriter of such securities constitutes a distribution pursuant to subsection 71(6) of the Act.

The term "underwriter" is defined in paragraph 1(1)43 of the Act, in part, as follows:

"underwriter" means a person or company who, as principal, agrees to purchase securities with a view to distribution or who, as agent, offers for sale or sells securities in connection with a distribution and includes a person or company who has a direct or indirect participation in any such distribution, but does not include, ...

2. STATEMENT OF PRINCIPLE

In light of the outlined provisions of the Act, including the broad definition of "trade", *and depending on the connecting factors with Ontario*, a distribution of securities outside Ontario by Ontario or non-Ontario issuers might also be considered to be a distribution of securities in Ontario requiring compliance with the prospectus provisions of the Act or an exemption therefrom.

However, where a distribution of securities is effected outside of Ontario by Ontario or non-Ontario issuers and where reasonable steps are taken by the issuer, underwriter and other participants effecting such distribution to ensure that such securities come to rest outside, of Ontario, the Commission takes the view that the prospectus is not required under the Act, nor is an exemption from the prospectus requirements necessary. Reasonable precaution and restrictions should be implemented by the issuer, underwriters and other participants in the distribution to ensure that the securities are not distributed, or redistributed, into Ontario or to Ontario residents and that such securities come to rest outside Ontario. Such precaution and restrictions should be designed to ensure that the entire distribution process results in the securities being held by or for the benefit of non-residents, as opposed to intermediaries in the distribution chain holding securities for resale to Ontario residents.

3. THE OPERATION OF THE PRINCIPLE

The number and nature of the restrictions that should be implemented and precautions taken, in connection with the distribution of securities outside Ontario to ensure that such securities come to rest outside Ontario will, of necessity, vary with the circumstances surrounding each distribution.

In some financings, some of the following restrictions or precautions might be advisable:

(1) A restriction in the underwriting agreement against the underwriters selling the securities being offered to any Ontario resident;

(2) A similar restriction in the banking group or selling group agreements requiring banking group members or selling group members not to offer securities to Ontario residents;

(3) An "all-sold" certificate by the underwriters that they have not, to the best of their knowledge, sold any securities to Ontario residents;

(4) A statement provided in the confirmation slip sent by underwriters to purchasers of the offered securities that it is the underwriters' understanding that the purchaser is not a resident of Ontario; or

(5) A provision in the transfer agency agreement between the transfer agent and the issuer requiring the transfer agent not to register securities in the name of any Ontario resident for a period of time (e.g. ninety days) from the date of closing.

In Eurobond or Eurodollar financings sufficient precaution will generally have been taken where:

(1) the offering circular contains a legend stating that the securities are not qualified for sale in Ontario or Canada and may not be offered or sold directly or indirectly in Ontario or Canada;

(2) the underwriters contractually agree that they will observe this restriction regarding the prohibition of offering in Ontario or Canada; and

(3) the securities to be distributed are initially issued in temporary form exchangeable for definitive securities 90 days after completion of the distribution upon certification that the definitive securities are not beneficially owned by Ontario or Canadian residents.

In other cases other factors will be relevant, including the class and nature of the securities being distributed, the attractiveness to Ontario investors of such securities, the likelihood that, absent such restrictions or precautions, the securities would come to rest in Ontario, whether a market for the class of securities being distributed or any other securities of the issuer already exists in Ontario, the likelihood of the development in the future of a market in Ontario for the securities being distributed, the way in which the distribution is proposed to be effected, the relationship between the capital markets of Ontario and the jurisdictions in which the securities are being distributed and the ease of access of one to the other, whether or not the underwriters and other participants in the distribution are, or are affiliated with, investment dealers that conduct substantial activities in Ontario and the presence of the issuer in Ontario (whether through the conduct of business in Ontario, a number of shareholders resident in Ontario, the issuer being closely followed by Ontario investors or otherwise).

In cases of private placements outside of Ontario, where hold periods would have been applicable if the placement had taken place in Ontario, the Commission takes the view that the restrictions made or precautions taken to ensure that the securities come to rest outside Ontario need not be effective beyond the time for the hold period which would have applied had the placement been made in Ontario.

The onus is on the issuer, underwriters and other participants in the distribution to determine the number and nature of the restrictions to be implemented and precaution to be taken.

4. ONTARIO REGISTRANTS

Each Ontario registrant has the duty to take reasonable steps to ensure that trades in securities effected by or through such registrant do not involve trades of securities into Ontario or to Ontario residents without compliance with the prospectus requirements of the Act or in reliance on an exemption therefrom. More particularly, a registrant who sells, on behalf of one of his clients, securities in Ontario or who purchases securities outside Ontario must take reasonable steps to ensure that the transaction does not involve the distribution of securities not qualified in Ontario coming to rest in Ontario or with Ontario residents.

All Ontario registrants should establish standard procedures to prevent unlawful distributions of securities into Ontario and to ensure that the registrant meets its continuing responsibility to know both its clients and the securities being sold by or to its clients.

See also National Policy 20.

5. THE INTEGRITY OF THE ONTARIO CAPITAL MARKETS AND THE JURISDICTION OF THE OSC

Needless to say, the Commission will not hesitate to intervene, to the extent of its powers, in distributions of securities outside of Ontario which negatively impact upon the integrity of Ontario capital markets.

Where the Commission becomes aware distributions abroad by Ontario issuers that bring the reputation of Ontario's capital markets into disrepute, the Commission is of the view that it has the jurisdiction, for the due administration of the Act and in order to preserve the integrity of the Ontario capital markets, to exercise its cease trade powers or to take other appropriate action against issuers, underwriters and other participants so distributing securities abroad.

March 25, 1983.

((1983), 6 O.S.C.B. 226.)

OSC POLICY 1.6

STRIP BONDS

(Rescinded (1998), 21 O.S.C.B. 80, effective May 1, 1998, upon the coming into force of OSC Rule 91-501.)

OSC POLICY 1.7

THE SECURITIES ADVISORY COMMITTEE TO THE OSC

(Renumbered as OSC Policy 11-601, effective February 1, 2002.)

(First published (1985), 8 O.S.C.B. 943; replaced (1991), 14 O.S.C.B. 4133.)

OSC POLICY 1.8

CANADIAN OVER-THE-COUNTER AUTOMATED TRADING SYSTEM (COATS) — POLICIES

(Repealed (1991), 14 O.S.C.B. 857, effective March 1, 1991.)

(First published (1986), 9 O.S.C.B. 2035; amended (1987), 10 O.S.C.B. 3441, (1990), 13 O.S.C.B. 123.)

This is Exhibit "D" to the
Affidavit of Ermanno Pascutto
Sworn this 29th day of October 2010

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A Commissioner for taking affidavits

U.S. Securities and Exchange Commission

CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

Schedule Announced for Completion of U.S.–Canadian Mutual Recognition Process Agreement

FOR IMMEDIATE RELEASE
2008-98

Paris, France, May 29, 2008 — The Chairmen of four Canadian securities regulators and the Chairman of the U.S. Securities and Exchange Commission (SEC), following a series of meetings coinciding with the annual conference of the International Organization of Securities Commissions (IOSCO), announced today a schedule for the completion of a process agreement that would open the way for discussions of a potential U.S.–Canada mutual recognition arrangement.

Canada has a system of securities regulation in which 13 separate provincial and territorial securities regulators administer and enforce highly harmonized laws and regulations. In order to facilitate discussions between Canada and the United States and more closely coordinate their systems of securities regulation, the SEC and the Canadian Securities Administrators (CSA) are working on an agreement setting forth the process to be followed in discussing mutual recognition arrangements.

Under the schedule announced today, the process agreement would be concluded in mid-June 2008.

The process agreement, once concluded, would open the way for substantive discussions between the CSA and the SEC on the subject of mutual recognition. Mutual recognition could provide Canadian securities exchanges and certain other Canadian financial service providers with greater freedom to operate in the United States under Canadian regulatory oversight, while U.S. securities markets and certain other U.S. financial service firms could gain greater freedom to operate in Canada under SEC oversight. In this manner, dual regulation, redundancy, and regulatory overlap could be eliminated.

"The work that we have accomplished with our Canadian regulatory counterparts over many months has brought us to a significant milestone in our ongoing discussions on the subject of mutual recognition," said Chairman Cox. "The process agreement we hope to execute next month will provide an efficient means to focus the U.S.–Canada discussions. That,

in turn, could pave the way for an eventual arrangement with our Canadian counterparts that would deepen cooperation among securities regulators in North America and strengthen the regulation of ongoing cross-border securities activity, while reducing the barriers investors face in connection with cross-border investment opportunities. The bonds we have strengthened during these months of discussions have already led to closer enforcement and regulatory coordination among U.S. and Canadian securities regulators, and investors are the clear winners."

Mr. Jean St-Gelais, Chairman of the CSA, stated that he was pleased with the progress of the discussions and the workplan. Mr. St-Gelais noted that the CSA continues to be committed to establishing a well-designed process with the SEC.

In March 2008, the SEC announced that it would explore the possibility of a limited mutual recognition arrangement with one or more foreign regulatory counterparts, and that those arrangements could provide the basis for the development of a more general approach to mutual recognition through rulemaking. Since then, in addition to the work underway with Canada, the SEC has announced that it is in discussions concerning a possible mutual recognition arrangement with Australia, and that it is pursuing a process agreement, similar to the proposed agreement announced today with Canada, with the European Commission and the Committee of European Securities Regulators. Any eventual mutual recognition arrangement with any individual country would be based upon a comparability assessment by the SEC and by the foreign authority of each other's securities regulatory regime.

The SEC has a long-standing and close relationship with its Canadian counterparts in the areas of regulatory and enforcement cooperation. Since 1988, Canadian securities regulators and the SEC have had formal mechanisms in place to assist each other in enforcement investigations. Since 1990, the SEC and Canada's securities regulators have participated in the Multi-Jurisdictional Disclosure System that permits issuers in the United States and Canada to use the same disclosure forms when selling securities in each other's markets.

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The CSA, the council of the securities regulators of Canada's provinces and territories, co-ordinates and harmonizes regulation for the Canadian capital markets.

http://www.sec.gov/news/press/2008/2008-98.htm

This is Exhibit "E" to the
Affidavit of Ermanno Pascutto
Sworn this 29th day of October 2010

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A Commissioner for taking affidavits

Return of the Exploreco Spin-off /Private Placement

Canadian corporate governance and shareholder protection below international standards.

From 2003 to 2006 the integrity of the Canadian markets and regulatory system was undermined by a series of transactions, largely in the energy sector. During this period mergers (most often between an oil and gas royalty trust and an oil and gas producer ("E&P company")) featured what were referred to as exploreco spin-off listings. A portion of the assets of the E&P company would be transferred to a new "exploreco" which would then list on the TSX or TSXV. The same management team would also run the new exploreco (a slimmed down version of the existing E&P company).

Exploreco spin-offs included problematic features including a private placement to directors and senior management ("insiders"). Public shareholders of exploreco were not invited to participate in the private placements, which were done at major discounts (one report showed discounts of 40% - 80%) to fair market value. The result was a transfer of wealth from public shareholders to directors and senior management of the exploreco.

The TSX rules generally prohibit private placements to insiders at discounts greater than 10% of the market price of the shares. Exploreco private placements were structured to "end run" the stock exchange rules by being completed the day before the shares of the exploreco commenced trading. One would have expected the TSX would reject these private placements as being contrary to the spirit of its rules. The failure of the TSX to reject these deals may raise questions of whose interests the TSX serves. Likewise, the securities commissions, who are mandated to protect investors, were aware of these transactions but failed to take any action.

The merger transactions between oil and gas royalty trusts and E&P companies (and related spin-offs and private placements) appeared to have come to an end with the demise of income trusts on October 31, 2006. However, a press release by Accrete Energy Inc (TSX: GZ) on July 23, 2008 may signal the return of these transactions, including a junior exploreco spin-off and a private placement that does not treat shareholders fairly and equally.

The exploreco spin-offs and related private placements raise a number of important regulatory and investor rights issues.

1. Fairness - It is a fundamental principle of securities regulation that shareholders are to be treated fairly and shareholders of the same class are to

be treated equally. Shareholders were not treated fairly or equally in th private placements. Only insiders (whose responsibility it is to protect the interests of all shareholders and their associates) were permitted to participate in the private placements.

2. Pricing of Private Placements - The private placements were generally priced based on the net asset value ("NAV") per share of the new exploreco. Shareholders were given the impression in the circular for the shareholder meeting that NAV was a fair price. However, a study of junior E&P exploreco valuations in the 2003-2005 period showed that they immediately commenced trading at significant premiums to NAV per share, ranging from 1.8x to 4.4x and averaging 2.7x. This means that the insiders, on average, made an immediate average profit of 170% from the private placements. Not a bad return.

3. Dilution - It is a basic right of shareholders not to have their shareholdings diluted unfairly. The private placements significantly diluted public shareholders to the benefit of insiders by issuing cheap stock to these insiders. For Accrete insiders this is the second time around. In the exploreco spin-off that created Accrete in 2004, the dilution was over 100% and the average 5 day closing price was $1.86 at the commencement of trading compared to a private placement price of $1.00.

4. Disclosure - The cornerstone of securities regulation is "full true and plain disclosure". Disclosure to shareholders in these transactions tended to be less than full, true or plain. Shareholders were not told that the private placement was being done at a significant discount to the anticipated fair market value of the shares. Instead, the inference was that NAV per share was a fair price for the shares. Additional disclosure deficiencies are referred to below.

5. Duty of Directors - Directors have a duty to act in the best interests of all shareholders. They also have a duty not to issue shares to themselves for the

purpose of obtaining or consolidating control. It is unclear how these private placements were consistent with the fiduciary duties of the board of directors, nor was there any disclosure in this regard or as to whether they gave rise to a right of action by shareholders against the directors for oppression and breach of fiduciary duty.

6. Fairness Opinion - Generally the plan of arrangement for the merger included a fairness opinion from an independent financial advisor, which would opine that the plan was fair and reasonable to shareholders. Oddly, the fairness opinions did not address the fairness of the share price in the private placement. In effect, the unfair aspects of the transaction were "carved out" of the fairness opinion. What was the point of a fairness opinion that fails to deal with the unfair and unreasonable aspect of the overall transaction?

7. Shareholder Voting - In some cases there was a vote by independent shareholders on the private placement. However, in many cases, the private placement vote was part of the vote on the plan of arrangement. In order to reject the private placement, shareholders also had to reject the takeover bid from the oil and gas royalty trust which was generally advantageous to shareholders. Accordingly, most investors who objected to the private placement "held their noses" and voted in favour of the plan of arrangement.

8. Voting Irregularities - In some cases there was an independent shareholder vote on the private placement, albeit with inadequate disclosure to shareholders. In some of these cases there were some indications of voting irregularities. In one case, the plan of arrangement circular stated that insiders holding approximately 4% agreed not to vote on the shareholder resolution approving the private placement. What the circular did not disclose was that a year earlier, the annual information form for that company had reported that insiders and their associates held approximately

20% of the outstanding shares. There had been no subsequent report of sale by insiders and associates to explain the discrepancy. Why did the circular not disclose this inconsistency. Were these other shares voted in the so-called "independent" shareholder vote? Did the TSX or securities regulators ever follow up to see if the independent shareholder vote was conducted properly?

9. Other Abuses - Some of the exploreco transactions included other abusive features such as "termination pay" for senior management and directors amounting to millions of dollars. These termination payments were made even though in substance there was no termination: the senior management and directors continue to hold the same positions in the new exploreco spin-off and the merged company.

The exploreco spin-offs and private placements were clearly unfair and abusive of public shareholders and inconsistent with the spirit of the TSX rules on private placements. They were done on the basis of inadequate disclosure, meaningless fairness opinions, and sometimes questionable shareholder voting. Directors may have breached their fiduciary duties to shareholders.

This article is a generic discussion of the issues raised by private placements in exploreco spin-offs and does not discuss the proposed Accrete transaction announced on July 23, 2008 in any detail. The current Accrete deal is not as offensive as the 2004 Accrete deal and actually permits some public shareholder participation through purchase warrants though some shareholders (i.e. insiders) continue to be "more equal" than others (i.e. public shareholders).

We wrote to the board of directors of Accrete with a copy to the TSX and the Alberta and Ontario securities commissions raising our investor protection concerns. We received a reply from the lead director of Accrete which set forth their arguments in favour of the private placement to insiders and why the overall deal is fair to Accrete shareholders. The current credit crisis and crash in commodities since the Accrete announcement of July 23 has had a severe adverse impact of the share price of junior E&P companies. This may have eliminated much of the private placement discount in the Accrete deal. While the Accrete reply does not address the regulatory and investor rights issues, the markets may have made the "fairness" a moot issue in this case.

The circular for the plan of arrangement has now been mailed and the shareholders of Accrete will have an opportunity to vote on the plan of arrangement and the private placement on September 29, 2008.

The larger questions remain unanswered. Does this deal represents a return of the exploreco spin-off with unfair private placements and related abuses? Will the securities regulators finally step in to protect investors or will they continue to remain on the sidelines. The abuses we see in these deals would not be permitted in leading international markets where they take corporate governance and shareholder rights more seriously. Only in Canada you say? Pity!

Ermanno Pascutto, Executive Director
Canadian Foundation for Advancement of Investor Rights