THE *SECURITIES REFERENCE:* THE SUPREME COURT GOT IT RIGHT

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On December 22, 2011, the Supreme Court of Canada released its opinion in *Reference re Securities Act*.[1] The federal government had sought the opinion of the Court with respect to a fairly comprehensive piece of proposed legislation that would, among other things, create a national regulator for the trade in securities (publicly traded equity and debt instruments often, though not exclusively, from corporate issuers).[2] To say that the opinion offered by the Court was not exactly a holiday gift for the newly-minted federal majority government would be an understatement.

The federal government had argued that the general trade and commerce power, provided for under s 91(2) of the *Constitution Act, 1867*,[3] was sufficiently broad to encompass the proposed legislation. The Court disagreed, holding that the proposed legislation did not fit the test for this power, provided for in *General Motors of Canada v City National Leasing*.[4]

The point of this initial posting to the *MLJ Online* blog is not to rehash whether in fact the Court was correct in its application of the *GM* case.[5] For many of my colleagues in academic commercial law circles, it would have been preferable if the Court had found the proposed *Securities Act* to be constitutionally valid. It appears that I am in the minority in believing that the Court got it right when they held that the application of the trade and commerce power would be inappropriate. The following explains why I agree with the Court from a policy perspective.

(a) *Stare decisis*

The first major point is found in the following excerpt:

> Canada does not challenge the proposition that certain aspects of securities regulation fall within provincial authority in relation to property and civil rights in the provinces. Nor does Canada argue that any provisions of the Act fall within federal legislative authority because they are necessarily incidental to the exercise of federal powers. Canada's contention is simply that the securities market has evolved from a provincial matter to a national matter affecting the country as a whole and that, as a consequence, the federal general trade and commerce power gives Parliament legislative authority over all aspects of securities regulation. This authority, Canada argues, is concurrent with that of the provincial legislatures over all aspects of securities presently regulated by the provinces.
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> The propriety of such a constitutional realignment cannot simply be assumed. The shift in regulatory authority that the proposed Act seeks to achieve requires justification. Canada asserts that this justification is found under the "general" branch of the trade and commerce power.

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[1] 2011 SCC 66 [the "Reference"], *per* The Court. (A full panel of nine judges heard the case and were involved in the opinion. Chief Justice McLachlin, and Justices Binnie, LeBel, Deschamps, Fish, Abella, Charron, Rothstein and Cromwell.

[2] *Ibid*, para 40.

[3] *Constitution Act, 1867* (UK) 30 & 31 Vict, c 3 [*Constitution Act, 1867*]

[4] [1989] 1 S.C.R. 641, *per* Chief Justice Dickson, for the Court.

[5] The specific analysis of the *GM* factors is found in the Reference, at paras 108-130.

> However, it has failed to show that this power, interpreted as required by the case law, supports the proposed Act. [6]

The reference to "constitutional realignment" obliquely brings to the forefront questions of *stare decisis*. As Professor Debra Parkes explained:

> *Stare decisis* is an abbreviation of the Latin phrase *stare decisis et non quieta movere*, and may be translated as "to stand by decisions and not to disturb settled matters."[7]

It is quite clear from the above excerpt from the Reference[8] that even the federal government had recognized that it was fairly settled law that the regulation of the trade in securities was largely a provincial responsibility.[9] It is clear that *stare decisis* does not *per se* prevent reconsideration of constitutional principles.[10] But, with more than 60 years of jurisprudence on this point, a very strong reason would be required. In my view, an allegation that bad things will befall the economy without a change was properly viewed by the Court as insufficient for this purpose.

It is also said that Canada is an international outlier in not having a central national regulator. The Court itself refutes this.[11] However, in my view, even if the allegation made were true, this alone does not justify an alteration of accepted constitutional principles. To upset the applecart entirely to fit the expectations of other countries seems to be the ultimate in international peer pressure.

I suspect that the Court might have decided the matter differently if unshackled from prior case law, but I agree with the Court that one cannot simply ignore it. The case law is very consistent that the lion's share of the securities industry belongs to the provinces. But the Supreme Court does not deny that there might be a better way to regulate securities. Rather, it holds that it has not been demonstrated that the facts have shifted sufficiently to warrant a reconsideration of constitutional principles.

As a co-author and I have argued elsewhere,[12] *stare decisis* is a powerful reason in favour of the status quo, though it is not so powerful that it demands inertia on the part of the part of either the courts or the legislature in the face of a cogent argument to the contrary. However, I agree with the Court that the cogent argument needed to overwhelm the doctrine of *stare decisis* was not present here.

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[6] Reference, *supra* note 1 at paras 4-5.

[7] Debra Parkes, "Precedent Unbound? Contemporary Approaches to Precedent in Canada" (2008), 32 Man LJ 135 [Parkes] at 135, citing Gerald Gall, *The Canadian Legal System* (Toronto: Carswell, 2004) at 431

[8] *Supra* note 1, and at para 6.

[9] See the Reference, *supra* note 1 at para 46. Here, the Court refers to the ability of the federal government to use the criminal law in securities regulation. Therefore, even before the Reference, federal powers do apply in the securities context. This is virtually beyond debate, because the securities industry cannot claim to be beyond the reach of offences such as fraud. However, as a general proposition, the regulation of securities is predominantly an area of provincial constitutional competence.

[10] Parkes, *supra* note 7 at 137.

[11] The Court points out that Germany has a system divided between the federal government and the states (see the Reference, *supra* note 1 at para 49). Australia works on a model of cooperative federalism (para 50). The US seems to have consolidated the regulation of securities in the federal government (paras 51-52).

[12] See Sunita Doobay and Darcy L. MacPherson "*Craig* and Stare Decisis" *Canadian Tax Highlights*, (a publication of the Canadian Tax Foundation) Volume 20, No 2 (February, 2012), at 2-3.

(b) Balance

The division of powers in sections 91-95 of the *Constitution Act, 1867*[13] is a balance between the federal government and the provinces. The Court held that constitutional balance must be maintained, and one level of government must not be allowed to simply overwhelm the other.[14] Much of the argument of the federal government (joined by the Attorney-General of Ontario) focused on the fact that, as far as securities are concerned, Canada is really one market, as opposed to 13 provincial and territorial ones. The premise of the argument may be sound, that is, Canada may effectively be one market for many purposes,[15] in the same way that we are a single country.[16] But the conclusion that securities regulation ought to be moved from the provincial to the federal sphere of constitutional jurisdiction may not be sound.

My main problem with this conclusion is that it can be applied to so many areas of commercial law. In the United States, the *Uniform Commercial Code* (UCC) is a model law, although adopted by all of the States. Article 9 of the UCC is the rough equivalent of the provincial Personal Property Security Acts.[17] Yet, if the Reference were decided in favour of the federal government, the same logic could be applied to say that there ought to be a single, federal registry for security interests[18] taken in personal property.[19] In fact, it is arguable that there is a stronger case for federal constitutional power in the area of secured transactions, given that the *Bank Act*[20] already has a special regime for the taking of security interests in particular types of

[13] *Supra* note 3.
[14] *Supra* note 1 at para 71.
[15] In fact, at least in the area of securities, the Court seems to agree that much of the securities industry is international in scope. See the Reference, *ibid*, at para. 115. Yet, the Court, in the same paragraph, also holds that regulation must also respond to the exigencies of the needs of businesses and investors at the local level. See the Reference, *ibid*, at para. 115.
[16] The concept of uniformity specifically within the Canadian federation is clearly evident in areas such as the recognition of judgments. On this point see, for example, *Morguard Investments Ltd v De Savoye* [1990] 3 SCR 1077, *per* Justice LaForest, for the Court.
[17] For clarity, the PPSAs are: *Personal Property Security Act* RSA 2000 c P-7; *Personal Property Security Act* RSBC 1996 c 359; *Personal Property Security Act* CCSM c P35; *Personal Property Security Act* SNB 1993, c P-7.1; *Personal Property Security Act* SNL 1998 c P-7.1; *Personal Property Security Act* SNWT 1994 c 8; *Personal Property Security Act* SNS 1995-1996, c 13; *Personal Property Security Act* SNWT 1994, c. 8 [Nunavut] (Nunavut was created by statute as of 1999. In order that it would have a statutory framework in place, the *Nunavut Act* SC 1993, c 28, s 29, gave Nunavut the laws of Northwest Territories as a starting point); *Personal Property Security Act* RSO 1990 c P.10; *Personal Property Security Act* RSPEI 1988 c P-3.1; *Personal Property Security Act 1993* SS 1993, c P-6.2; *Personal Property Security Act* RSY 2002, c 169.
[18] While not a comprehensive definition, for the purposes of this discussion a security interest exists where the holder of property (the "debtor") wishes to borrow money from another person (the "creditor"), and in order to ensure repayment of the loan, the debtor gives the creditor the right to seize personal property of the debtor if the loan is not repaid on time. The interest given by in the debtor's property the debtor to the creditor is a "security interest". In other words, "security in personal property" is designed to ensure the repayment of an obligation by the debtor. Therefore, despite the linguistic similarities, security in personal property is quite different
[19] "Personal property" is very broadly defined to include, for example: goods, documents of title (including bills of lading), money, instruments (including cheques), intangibles (including accounts showing the debtor is owed money, such as a bank account in a credit position), and chattel paper (the money owed to a creditor, plus the security interest that the creditor has in other property).
[20] SC 1991 c 46.

personal property. Currently, this is restricted to banks,[21] as the security provisions of the *Bank Act* are constitutionally ancillary to the regulation of banks and banking.[22]

If the Reference had been decided in favour of the constitutionality of the proposed Act, the federal government could have later argued that the security regime no longer needed to be ancillary to banking. In other words, since the federal government would have already had a regime in place for taking security interests in personal property, the logic that Canada is a single economic market could be applied to give the federal government concurrent jurisdiction over security interests in personal property beyond the banking context.

One can see other areas where similar logic might also be applied. Consumer protection particularly comes to mind. If Canada is a single market, it could be argued that many of the remedies offered to consumers in cases of misleading practices in Alberta should be comparable to those offered in Nova Scotia. Yet, all of these things (securities, security interests in personal property, and consumer protection) have a contract as their basis. Therefore, if accepted, the "single market" thesis would allow the federal government to assert a significant amount of constitutional power in the commercial sphere. A large federal role in contracts would be a sea change to the Constitution.

(c) Co-operative Federalism

It is important to realize that, notwithstanding the result of the Reference, this does not necessarily spell an end to the debate around the merits of a single regulator, nor necessarily to the execution of such a scheme. Rather, the result in the Reference spells only an end to unilateral federal power. Co-operative federalism remains an option.[23] The Court itself recognizes this where it writes as follows:

> No doubt the provinces possess constitutional capacity to enact uniform legislation on most of the administrative matters covered by the federal Act, like registration requirements and the regulation of participants' conduct. By way of administrative delegation, they could delegate provincial regulatory powers to a single pan-Canadian regulator.[24]

If the provinces wish to opt in to a federal scheme, they may always do so by provincial legislation. Such an opt-in would respect the current constitutional division of powers while still allowing provinces to opt out where appropriate.

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[21] *Bank of Montreal v Hall* [1990] 1 SCR 121.

[22] *Constitution Act, 1867*, *supra* note 3, s 91(15).

[23] Interestingly, throughout some of its opinion, the Court uses "co-operation" in a very different way. It uses the term to refer to the inclination of the courts to find a route to allow both levels of government to be involved in regulation of a particular area (see the Reference, *supra* note 1 at paras 57 and following). This might also be described as avoiding "watertight compartments" of constitutional analysis. I entirely agree with the Court that such exclusionary principles are to be eschewed in assessing constitutional jurisdiction.

However, I use "co-operation" as a negotiation of a sharing of power between the central government, on the one hand, and the provinces, on the other. The Court itself seems to adopt this latter approach in para 130 of its opinion in the Reference, when the following was written: "While the proposed Act must be found *ultra vires* Parliament's general trade and commerce power, a cooperative approach that permits a scheme that recognizes the essentially provincial nature of securities regulation while allowing Parliament to deal with genuinely national concerns remains available."

[24] The Reference, *supra* note 1 at para 118.

Furthermore, the Reference had the effect of creating an adversarial approach between various jurisdictions. Canada and Ontario were on one side of the debate arguing in favour of federal concurrent jurisdiction, while Alberta and Quebec took a diametrically opposed view. All of the other jurisdictions were asked to pick a side, and many interveners did the same. However, one point made by the federal government in the Reference that is relatively uncontroversial is the need to deal with systemic risk.[25] All levels of government have a legitimate interest in helping to avoid systemic risk. Surely no one should be opposed to legislation designed to protect against systemic risk and the potential economic collapse the crystallization of such risk might cause. Yet fear, no matter how well-founded that fear might be, cannot in and of itself take away the need to consult and work co-operatively.

Regulation of the securities industry should not be a matter of constitutional territory control. Investment is ideally an enterprise that sees success for all. Litigation, on the other hand, is typically a zero-sum game. Co-operation between a corporation and its creditors and equity holders typically produces reasonable results. One would hope that co-operation at the political level might have a similar effect.

(d) A Practical Concern

No system of regulation is ever perfect. No set of human eyes catch everything, every single time. I value the current system in part specifically because multiple regulators should be looking at the documents for pan-Canadian offerings of securities to the public. Any system that relies on the review of a single person (or even a small group) is susceptible to errors. The more regulators that look at something, the less likely it is that errors will be missed. As such, whatever the efficiency advantages of a single pan-Canadian securities regulator (of which there are undoubtedly many), the need for multiple sets of eyes to pass over important transactions to ensure that proper oversight has been exercised is a wise course of action. Speed is not the only goal of securities regulation. If multiple regulators are one part of getting it right for the capital markets, in my view some loss of efficiency is not only tolerable, but necessary.

Conclusion

In the end, the opinion of the Supreme Court of Canada in the Reference is unlikely to quell calls for reform in the way that the trade in securities is regulated in this country. Perhaps someday, politicians will amend the Constitution to specifically provide for the federal power (as they did to give the federal government the power to regulate unemployment insurance in the 1940s).[26] Alternatively, perhaps co-operative federalism will be successful. But the Supreme Court said that absent one of these, more evidence is needed before the federal government can unilaterally claim the right to restructure the balance of Canadian federalism. I agree with that

[25] Systemic risks are those that, if they come to fruition, may lead to the collapse, not of a single transaction or issuer, but of the entire system of checks and balance underlying the issuer or transaction. As the Court explains, at para. 103 of the Reference: "Systemic risks have been defined as "risks that occasion a 'domino effect' whereby the risk of default by one market participant will impact the ability of others to fulfill their legal obligations, setting off a chain of negative economic consequences that pervade an entire financial system" (M. J. Trebilcock, *National Securities Regulator Report* (2010), at para. 26). By definition, such risks can be evasive of provincial boundaries and usual methods of control. The proposed legislation is aimed in part at responding to systemic risks threatening the Canadian market viewed as a whole. "

[26] See the *Constitution Act, 1867, supra* note 3, s 91(2A).

opinion, largely because I value *stare decisis*, and because the argument of the federal government could have entailed a massive reworking of the principles of federalism in the commercial arena. The Supreme Court got it right, and told the federal government to do what legal academics have been doing about this issue for quite some time: keep talking. Persuasion, not litigation, is the only way to achieve change in this area of the law, at least for the foreseeable future.