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Securities Regulation of Ontario Venture Issuers: Rules or Principles?

A Dissertation submitted to the

Faculty of Graduate Studies

in Partial Fulfillment of the Requirements

for the Degree of Doctor of Philosophy

Osgoode Hall Law School

York University, Toronto, Ontario

By

John Pearson Allen

December, 2013

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ABSTRACT

Should the securities regulation of Ontario venture issuers be based primarily on rules or principles? Advocates for rules argue that detailed rules, with predictable meaning and scope, allow participants to focus on matters other than compliance. Advocates for principles argue that when an activity is complex, such as securities trading, detailed rules can become a confusing web, obscuring core values and discouraging creative solutions.

The rules and principles literature is reviewed, along with the topics of risk-based, responsive, outcomes oriented and proportionate regulation. Governance theory is addressed and various compliance theories are discussed. From this, eight factors are gleaned to assess where along the rules/principles continuum a particular area of regulation should lie: (i) Is there a shared understanding of regulatory principles within the community being regulated? (ii) Are the regulated committed to the public interest? (iii) Are the regulated able to find analogous solutions? (iv) Are there institutions or actors which promote regulatory collaboration? (v) Do the regulated see enforcement as fair and effective? (vi) Are regulatory issues predictable? (vii) Should historical transactions be disclosed? and (viii) Should future projections be disclosed?

These factors are then explored with a survey of 175 managers of venture issuers, followed by in-depth consultations with six experts in the industry and by a consideration of other matters. The assessment of the eight factors suggests that in some respects, principles could be effective for Ontario venture issuers since they are more flexible and can adapt to the changing complexities of securities regulation. However, principles-based regulation requires a shared understanding of, and commitment to, regulatory principles, and the answers given by many of the respondents to the survey and the discussions with the six experts consulted suggest that more work needs to be done before principles-based regulation could be effective.

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DEDICATION

To my wife Meredyth; to my children Zoe, Pearson and Cian; and to my father William—encouragement, purpose and example.

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ACKNOWLEDGMENTS

I would never have completed this journey without the advice and help of Professors Mary Condon and Liora Salter. Thank you.

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Introduction to the Research Question

Should the securities regulation of Ontario "venture issuers" be based primarily on rules or principles? Venture issuers are small– and medium– sized enterprises—"SMEs"—which sell securities to the public on the Toronto Venture Exchange or the Canadian National Stock Exchange.[1] There is a debate among Canadian securities regulators as to whether detailed, prescriptive rules should be published with known, after–the–fact penalties (a "rules approach"), or whether securities regulators should publish salutary objectives and engage participants in a before–the–fact, best practices dialogue (a "principles approach"). The Ontario Securities Commission (OSC) shifted towards rules in 1995 in response to the Ainsley case, and further in 2004 by adopting detailed rules based on the US Sarbanes-Oxley Act ("US SOx"), with some exemptions for venture issuers. In contrast, the BC Commission (BCSC) proposed a principles–based Securities Act in 2004, with a simplified, plain language rulebook with an overarching

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[1] "Venture issuer" is defined in the Canadian Securities Administrators' National Instrument 52–100 as a company or trust which publicly trades its securities but is not quoted on the Toronto Stock Exchange, a U.S. marketplace, or a marketplace outside of Canada and the United States of America.

Venture issuers are a subset of small and medium enterprises, "SME", which have been variously studied in the corporate and tax context according to their total annual sales, total value of capital assets and/or number of employees. Industry Canada defines SMEs as companies with up to 500 employees and annual sales of less than $50 million. (Nicol and Heidrick 2002)

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“Code of Conduct” of twenty–eight general principles. The proposed national securities regulator (declared unconstitutional by the Supreme Court of Canada in December 2011) was intended to be principles–based.

This paper begins by examining the context of the research question—it reviews the rules/principles debate among Canadian securities regulators, some background facts about Ontario venture issuers, the opinions of various expert reports, and the academic literature regarding rules and principles generally. Eight factors are developed in chapter three to assess whether rules or principles are better for a particular field of regulation. These factors are then applied to Ontario venture issuers with a web-based survey of 175 managers of venture issuers discussed in chapters four and five, followed with in-depth consultations with six experts in the industry discussed in chapter six, and by a consideration of other matters. By assessing the regulation of venture issuers according to the eight factors developed in chapter three, the debate shifts from a philosophical discussion about how laws should be written in general (rules or principles?) to an empirical question about which language strategy is best in the particular context of Ontario venture issuers.

The Context of the Research Question – chapter one

Chapter one notes that the OSC has had detailed policy statements for many years, then shifted towards rules in 1995 in response to the Ainsley case, and towards more detailed rules in 2004 in response to US Sarbanes Oxley regulations. To illustrate how complex Ontario securities regulations have become, a table is presented comparing Ontario securities regulation with the

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Canadian *Income Tax Act*, the Ontario *Employment Standards Act*, the Ontario *Business Corporations Act,* the U.S. *Sarbanes-Oxley Act of 2002* and part of the U.K. *Financial Services Authority Handbook*. Although the Ontario *Securities Act,* as a statute, is of average complexity, various rules published by the Ontario Commission are as detailed as the notoriously complex *Income Tax Act*.

Chapter one reviews the British Columbia and federal proposals for principles–based regulation and summarizes the recommendations of various Canadian expert studies, including the 1979 Federal Proposals, the 1993 Ontario Task Force Report, the 1994 Ontario Securities Commission proposals, the 2002 Wise Person's Committee, the 2006 Crawford Report, and the 2009 Expert Panel. Chapter one situates the rules/principles debate within the context of other regulatory concerns. It identifies the importance and regulatory challenges of venture issuers generally and then narrows the discussion to the regulatory risks of junior mining exploration in particular, which comprise the majority of ventures listed on the TSX Venture exchange. Chapter one summarizes some of the more important securities rules which affect venture issuers and the cost of securities regulation. It describes the competition among Canadian and foreign regulators to attract venture issuers to their markets, and it assesses the argument that securities disclosure can be a "public good".

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Literature Review – chapter two

Chapter two is a literature review regarding the rules and principles debate, generally. The debate illustrates two competing philosophies of law. One philosophy is that rules which comprehensively regulate behaviour makes law predictable, less discretionary, and easier to enforce. Advocates for rules say that they enhance certainty because outcomes are proscribed *ex ante*—that clearly expressed rules, with predictable meaning and scope, reduces administrative discretion and allow participants to focus on matters other than compliance. Critics argue that despite their apparent simplicity, rules often require knowledge of their underlying purpose. For example: a traffic sign might say "no standing"—the obvious (unstated) purpose is that it applies to vehicles and not to pedestrians. There are risks with detailed rules, especially if the field of activity faces unpredictable change. With rules, the regulated can develop a check–list mentality. Rather than taking responsibility for assessing risks, they mechanically follow bright-line standards.

Principles–based regulation is grounded on the philosophy that when an activity is complex, such as securities trading, detailed rules can evolve into a confusing web, obscuring core values and discouraging creative solutions. The ingredients for effective principles–based regulation are reviewed in chapter two. For example, principles must be clearly communicated and the regulator and regulated should collaborate, so that the development of principles is coherent. A critique of principles–based regulation is presented, including the view that broad principles gives the regulator too much power to interpret compliance after-the-fact, risking arbitrary enforcement.

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Chapter two situates the debate about rules and principles within the discussion of “risk–based”, “outcomes–oriented”, “responsive” and “proportionate” regulations. Although these topics don’t easily map onto the principles/rules debate, the best language strategy for securities regulation is one which addresses these regulatory goals.

Chapter two discusses various theories of why the regulated do (or do not) comply with the law—the incentive motive, the reason-driven motive, the social identity motive, the justice motive and the citizenship motive. One aspect of the incentive motive, which rules-based regulation is often based on, is deterrence theory—the argument that individuals and corporations are self–interested and will “rationally” bend or break rules, unless the amount and probability of the penalty is clearly prescribed. A related theory is reviewed—that regulators can engineer social compliance by enforcing clearly stated rules with predictable penalties greater than the expected gain from the wrongful activity. A critique of deterrence theory is then presented—that individuals and companies can have other motives, often with greater influence than reward and punishment; motives such as status, influence and fame. The discussion of the reason-driven motive, the social identity motive, the justice motive and the citizenship motive leads into a discussion of governance theories, including management-based regulation and an assessment of new governance.

Chapter two discusses special considerations when regulating conflicts of interest. Conflicts can arise in many ways, both financial and social. Venture issuer managers often make transactions between the issuer and themselves or with related parties. Is self–dealing better controlled by rules or principles? Also, a discussion of two accounting methods—the “historical cost model”

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and the "mark to market model"—is presented; the former is more rules–based and effective in some situations; the latter is more principles–based and effective in other situations.

A comparison of the use of rules-based and principles-based regulation in other fields are reviewed—income tax compliance, accounting standards, the Australian Competition and Consumer Act, and some other regulated fields. The review illustrates the theories of compliance and governance discussed and identifies some of the factors for effective regulation.

Chapter two describes how some academics have rejected the bipolar, either/or, debate between rules or principles, and have argued that different areas of regulation should lie on different points along a continuum from rules on one end to principles on the other. For example, in securities law, Cristie Ford[2] argues that periodic and prospectus disclosure should be rules–based, with uniform document presentation, so that investors can efficiently compare similar circumstances. Principles should be used where a flexible approach is needed to ensure good corporate conduct; for example, material fact and material change disclosure, which can arise in unanticipated ways, should be principles–based.[3]

Factors to consider on continuum of rules to principles – chapter three

Chapter three draws from the literature review in chapter two and advances what has been missing in the literature—a series of factors for assessing where along the rules/principles

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[2] (Expert Panel on Securites Regulation 2009)

[3] (Ford, Principles-Based Securities Regulation, A Research Study 2009).

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continuum a particular area of regulation should lie. Regulation is a form of communication. Different communities will have different experiences and cultures requiring different language strategies, including different combinations of rules and principles. By analogy, consider the detail required in a cookbook. One for the beginner can assume knowledge of such terms as "boil", "poach" or "garnish", but ignorance of "braise", "blanch" or "flambé". Recipes for the beginner are more "rules–based" since tasks should be described in detail; those for the chef can be shorter and more "principles–based".

Knowledge of technical language is an important factor (for the chef, knowledge of food principles), but other factors are important too. The eight factors, gleaned from the literature review in chapter two, are these: (i) Is there a shared understanding of regulatory principles within the community being regulated? (ii) Are the regulated committed to the public interest? (iii) Are the regulated able to find analogous solutions? (iv) Are there institutions or actors which promote regulatory collaboration? (v) Do the regulated see enforcement as fair and effective? (vi) Are regulatory issues predictable? (vii) Should historical transactions be disclosed? and (viii) Should future projections be disclosed?

The first factor is—is there a shared understanding of regulatory principles within the community being regulated? As discussed in the literature review, regulatory communities can exist at a surface level or at a deep level. At a surface level, an interpretive or regulatory community might consist of only a shared "sociolinguistic register or understanding of

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practices". At a deep level, it might consist of "shared validity claims and normative commitments."[4]

The second factor is—are the regulated committed to the public interest, within the meaning of Ontario securities regulation? Principles are more effective if the regulated wish to enhance their reputation among peers. Conversely, rules may be required where reputation is not valued and deterrence and the threat of punishment are necessary. The public interests protected by Ontario securities regulation are animated in part by the stated purposes of the Securities Act: "to provide protection to investors from unfair, improper or fraudulent practices" and "to foster fair and efficient capital markets and confidence in capital markets".[5]

The third factor reviewed is—are the regulated able to find analogous solutions? Problems in one field of regulation are often analogous to problems in another field, and those who can draw from related experiences are probably better at recognizing patterns and solving problems. In the literature review in chapter two, Shearing and Ericson describe how a community can apply rules consistently by evolving a shared storyline from varied experiences to explain how to act or decide in a particular situation. It can be a process of "mythological thinking", "myth–making" or "poetic logic". "People simply do not walk around with rules in their heads that they apply to situations in the midst of action", suggest Shearing and Ericson. Rather, knowledge is communicated through a culture by "analogous reasoning" from layered meanings in stories

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[4] (Black, Regulatory Conversations 2002) p.179

[5] Section 1.1 of the Ontario Securities Act, RSO R.S.O. 1990, Chapter S.5.

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based on analogous experiences. I argue that boards of directors that can draw from related fields are more likely to effectively manage the company when faced with complex issues.

The fourth factor reviewed is—are there institutions which can promote regulatory collaboration? Principles–based regulation requires collaboration in order to flesh out the meaning of broad principles.

The fifth factor reviewed is—do the regulated see enforcement as fair and effective? In chapter two, Feld and Frey describe tax compliance as a psychological contract—the more that the taxpayers believe that the government is using their money to benefit their community, the greater is their compliance. Kahan argues that individuals who believe that others are paying their taxes will likely treat honest payment as a moral duty. The same "psychological contract" is probably true for securities law compliance.

The sixth factor reviewed is—are regulatory issues predictable? If a field of activity is complex, with unpredictable outcomes, detailed rules can obscure risk. In simple systems, with known risks, rules can have a predictable scope, allowing participants to focus on matters other than compliance.

The seventh factor—should historical transactions be disclosed? As described under the topic "Accounting for Conflicts of Interest", detailed rules can measure the conflict when a promoter solicits public funds for a company which is buying property indirectly from the promoter. Financial statements disclose historical transactions and, perhaps, can be rules-based.

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The eighth factor—should future projections be disclosed? Arguably, forecasts should lie at the principles–based end of the continuum, because they are subject to changing considerations.

Survey of managers of venture issuers – chapters four and five

The eight factors developed in chapter three are tested in chapters four and five with a voluntary, web-based survey of 175 managers of issuers listed on the TSX Venture exchange. One email invitation was delivered to 1,581 TSX-V issuers. A total of 133 respondents answered all of the questions and an additional 42 respondents answered some of the questions. In order to assess how representative the respondents' were to the population of managers of venture issuers as a whole, a comparison with known qualities of the population are considered.

Chapter five summarizes the results of the survey and other facts about venture issuers in order to address the eight factors identified in chapter three. The most disturbing result of the survey was the commonly held view among respondents that promoters are primarily motivated by the short-term share price of the issuer's shares, rather than the long-term value of their business or their reputation for ethics. Also disturbing were deep level misunderstandings of many respondents regarding the principles which underlie securities regulation.

Consultations with Six Experts

Six industry experts were consulted by personal interview. Each interview was in the nature of a conversation of approximately one hour each, initiated with open-ended questions, as opposed to a formal interview or survey.

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The experts consulted, in alphabetical order, were: Ian Bandeen, Elaine Ellingham, Brian Prill, Edward Thompson, Michael White and Al Workman. Thompson and Workman were chosen because of their extensive experience in the junior resource industry, which comprise the majority of venture issuers listed in Ontario. Ellingham was chosen because of her knowledge of the TSX and TSX-V exchange. Bandeen and Prill were chosen to gather insight about market intermediaries including the Exempt Market Dealers Association, and White was chosen to reflect the practical interests of one Exempt Market Dealer / Broker which has consistently raised capital for venture issuers over many years.

The experts gave their opinions about the eight factors developed in chapter three, as well as opinions of a more general nature, such as whether or not Ontario securities regulations currently are, or should be, principles- or rules-based, what is the practical effect of the application of principles or rules in this industry, what mandatory paper disclosure should the regulator require for investors, how should market intermediaries be regulated, and should there be mandatory continuing education for those working in the industry? These opinions were relied upon when formulating the summary and recommendation chapter of this paper.

Summary and Recommendations – chapter seven

The answer to the research question—should the securities regulation of Ontario venture issuers be based primarily on rules or principles?—is summarized in chapter seven. It is not a simple choice of all principles or all rules in all cases. Rather, the assessment of the eight factors suggests that in some respects, principles can be effective since they are more flexible and can

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adapt to changing complexities of securities regulation. However, principles-based regulation requires a shared understanding of, and commitment to, regulatory principles, and the answers given by many of the respondents to the survey and the discussions with the six experts suggest that more work needs to be done before principles-based regulation could be effective for venture issuers.

Chapter six makes the following recommendations to improve securities regulation for Ontario venture issuers: (a) better education of market participants, (b) enforcement based on compliance motives, (c) regulators should encourage diversity on boards of directors and should accept analogous solutions from similar situations in other regulatory fields, (d) use rules for historical transactions and principles for ongoing disclosure and forecasting, and (e) simplify the private placement rules.

Regardless of the assessment of the eight factors and how representative the survey respondents were, the value of this paper is that it develops eight factors to assess rules or principles. It shifts the debate from a philosophical discussion about rules and principles generally to an empirical question about which language strategy is best in the particular context of Ontario venture issuers. It could contribute to a new line of evidence-based inquiry.

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Chapter 1: The Context of the Research Question

This chapter begins with a review of the regulation of Ontario venture issuers and the OSC's shift to more rules when rule-making authority was granted to the OSC in 1995. It assesses the relative complexity of Ontario securities rules by comparing them with the Canadian federal *Income Tax Act*, the Ontario *Employment Standards Act*, the Ontario *Business Corporations Act*, the U.S. *Sarbanes-Oxley Act of 2002*, and part of the United Kingdom *FSA Handbook*. British Columbia's proposed principles–based approach is reviewed, as well as the proposed Canadian national regulator's principles–based securities regulation. The regulatory risks of venture issuers are discussed. The costs of securities regulation and the use of regulation to create a "public good" are addressed. The competition among regulators to attract issuers and various expert reports on securities regulation are reviewed.

Regulation of Ontario venture issuers

There are two major securities regulators for Ontario venture issuers: the OSC and the TSX-V Exchange.[6] In my experience, as a solicitor with twenty years of practice, the most important OSC and TSX-V rules for venture issuers are the following:

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[6] The Canadian National Stock Exchange is a relatively minor influence—only 1.3% of the TSX-V capitalization. See note 408 at p. 207

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National Instrument 45-106 provides exemptions from the requirement to file a prospectus with the OSC when an issuer sells or distributes securities. The most common exemption used by venture issuers to avoid the cost of a prospectus (which can cost hundreds of thousands of dollars[7]) is the accredited investor exemption,[8] which permits an issuer to sell shares without a prospectus to investors who meet defined wealth or income thresholds.[9] If the accredited investor is given any document that purports to describe the business and affairs of the issuer, whether or not the document is called an "offering memorandum", it must contain full disclosure and the investor has various rights of rescission, and damages against the issuer and any seller for a misrepresentation (which includes an omission of a material fact).[10]

National Instrument 31-103 requires that only an "Exempt Market Dealer" can engage in, or be in the business of, advising or soliciting exempt investors. The Exempt Market Dealer must be

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[7]See "The Cost of Securities Regulation" at p.50 below

[8] As to its use, see Table 6 at p.212 below

[9] For individuals, the investor must certify that he or she, either alone or with a spouse, beneficially owns financial assets having an aggregate realizable value before taxes, but net of any related liabilities, exceeding $1 million, or whose net income before taxes exceeded $200,000 in each of the two most recent calendar years or whose net income before taxes combined with that of a spouse exceeded $300,000 in each of the two most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year. By National Instrument 45-102, the accredited investor will not be able to re-sell the shares for a period of four months.

[10] Section 1 of the *Ontario Securities Act* defines an "offering memorandum" It must include a statement of the rights in section 130.1 of the Act. A copy of the document must be filed the Commission.

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registered with the OSC, pass the Canadian Securities Course, pass the Exempt Market Products Exam, have 12 months experience in the last 3 years, and meet various capital and compliance requirements.

National Instrument 51-102 regulates continuous disclosure of venture (and other) issuers, to give investors continuous access to all material facts about the issuer via the public website www.sedar.com and National Instrument 55-102 requires insiders to publicly report their trades on the website www.sedi.ca.[11] For mining issuers, National Instrument 43-101 requires that an independent Qualified Person supervise all technical statements on becoming a reporting issuer, on filing a non-POP prospectus, information circular, takeover bid, or "any other document that discloses for the first time resources or reserves on a property material to the issuer [with] a 100 percent or greater change, from the most recently filed report..." National Instrument 51–101 imposes similar disclosure requirements for oil and gas issuers.

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[11] On July 29, 2011, the Canadian Securities Administrators published for comment Proposed National Instrument 51-103, which would tailor regulations for venture issuers. It would improve access to key information, eliminate less valuable disclosure obligations, and provide supplemental disclosure where relevant. It would consolidate disclosure of the venture issuer's business, management, governance practices, audited annual financial statements, associated management's discussion and analysis (MD&A) and CEO/CFO certifications in a single document, the annual report. It would introduce substantive corporate governance requirements relating to conflicts of interest, related party transactions and insider trading. It would require the delivery of disclosure documents only on request, in lieu of mandatory mailing requirements, and it would allow for the incorporation of public disclosure documents in certain kinds of exempt offerings.

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Multilateral Instrument 61-101 regulates insider bids, issuer bids, business combinations, and related party transactions, and imposes minority shareholder approval and in some cases formal valuations in order to assess the fairness of these transactions. As discussed below (“Controlling shareholders of venture issuers” at page 38), a significant percentage of Canada’s largest non–financial public companies have controlling shareholders, or major shareholders, and so good policy in Canada regulates self-interested transactions of the controlling shareholders.

The TSX Venture Exchange Corporate Finance Manual regulates venture issuers listed on its exchange, with policies regarding sponsorship by a broker, listing procedures, corporate governance, private placements, loans and bonuses, finder’s fees, shares for debt, and other matters. The TSX-V manual is currently 791 pages in length, of which 341 pages are for the rules and 450 pages are for the associated forms and appendices.[12] For example, Policy 4.1 regulates private placements, and requires a news release, disclosure of the details of a transaction, and TSX-V approval before closing a transaction. The price per share cannot be less than the “Discounted Market Price” as defined in Policy 1.1 and there are also limits on the amount of any finder’s fee.

[12] (TSX Venture Exchange 2013)

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Ontario shifts to rules

The OSC has been rules-based for many years through detailed policy statements, shifting further to rules in 1995 with the grant of rule-making authority in response to the Ainsley case described below, and then further again to rules in 2002 in response to US Sarbanes Oxley legislation.

1993 Ontario Task Force

The October 7, 1993 Ontario Ministry of Finance and Ontario Securities Commission Task Force on Securities Regulation (the "Ontario Task Force")[13] was appointed by the Ontario Finance Minister to recommend a legislative response to court decisions which had questioned the enforceability of OSC policy statements (which were often very detailed[14]). On August 13, 1993, in the Ainsley case,[15] Justice Blair held that Ontario's Draft Policy Statement 1.10 (which was intended to control penny stock brokers) was mandatory and thus regulatory in nature. Because the OSC had no statutory authority to make regulations, it was *ultra vires*. This was despite the OSC's declaration that the policy was "a mere guideline". In a notice announcing the policy, and in other statements and evidence, the OSC indicated that it would "strictly" enforce

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[13] (Daniels 1994)

[14] Former Ontario Policy 5.2 was in force from 1988 to 2001. This was a very detailed document regulating resource issuers which were reporting issuers in Ontario, but which were not listed trading on the Toronto Stock Exchange—for example, resource issuers that were listed on the then Vancouver Stock Exchange or Alberta Stock Exchange

[15] Ainsley Financial Corp. v. Ontario (Securities Commission), 1993 CanLII 5552 (ON S.C.)

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the policy's detailed rules. Also, the policy's stated purpose included a warning to penny stock brokers that failure to comply would be considered grounds by the OSC to take enforcement action under its public interest powers in section 27(1) of the *Securities Act*, including the power to suspend, cancel, restrict or reprimand a broker. By issuing policies of general application, and then warning those who might fail to comply with its terms, Blair held that the OSC was effectively making law, not a guideline. At the time, the *Securities Act* did not delegate to the OSC power to make rules of general application. Instead, the OSC was required to assess the public interest in each particular case, including penny stock broker compliance, based on the evidence presented in each case.

On appeal, Justice Doherty agreed with Blair's characterization of Policy 1.10. As Doherty noted, administrative guidelines connote general statements of principles, standards, criteria or factors intended to elucidate and give direction. Policy Statement 1.10, on the other hand, set out a "minutely detailed regime complete with prescribed forms, exemptions from the regime, and exceptions to the exemptions." The threat of sanction for non–compliance was essentially a mandatory requirement, in the nature of regulation, not a guideline.[16]

The Ainsley case illustrates the tension between rules and principles. The rules approach requires the legislature to delegate rule–making authority to the regulator, i.e. the power to promulgate rules, with known, after–the–fact penalties. Administrative guidelines, on the other hand, are a more flexible approach—the regulator is directed to achieve broad principles, but the application

[16] Ainsley Financial Corp. v. Ontario (Securities Commission), 1994 CanLII 2621 (ON C.A.)

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of those principles is to be determined in each case on the evidence presented, typically with a hearing or an opportunity to be heard in writing. The problem with the Ainsley case was that the OSC had used a rules–approach with enforceable regulation, but the Securities Act at the time gave it no such authority.

The Ontario Task Force responded to the Ainsley case with a report based on several "foundational principles". The first was the "need for flexibility and responsiveness in securities policy–making and regulation". To achieve this, the report said that the OSC should continue to issue policy statements and blanket orders which are valuable because of their flexibility, but they should be treated as guidelines only.[17] Regarding guidelines, the Ontario Task Force quoted from the administrative law scholar Kenneth Culp Davis:

> "…through case–to–case consideration, where the human mind is often at its best, [it] nibbles at the problem and finds little solutions for each little bite of the problem. Creativeness in the nibbling sometimes opens the way for perspective thinking about the whole big problem, and large solutions sometimes emerge."

The Ontario Task Force recommended that the OSC be granted rule-making authority. "[A]ppropriate political responsibility for the system of securities regulation, building on existing political traditions and institutions" was noted. This was to be addressed by notice and public

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[17] This parallels the literature review later in this paper, under the topics of "Rules and Complexity" (page 70), "Rules and Precision" (page 76) and "Rules and Risk" (page 83). Essentially, detailed rules can evolve into a patchwork of narrow solutions to past problems, missing the mark when new situations arise. Principles, on the other hand, are more flexible and can be applied differently in different circumstances.

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comment on proposed rules, with at least one round of public consultation based on a published request for comments in the OSC Bulletin, and often two or more rounds of such consultation. This principle was discussed by Professor MacIntosh, who prepared extensive briefs for the Ontario Task Force, and who was quoted in the report as follows:

> "[T]he classic expression of the Rule of Law amounts at bottom to a statement about how law in a representative democracy differs from the arbitrary law of potentates. In a representative democracy, law derives legitimacy only to the extent that it emanates from the democratic institutions of the polity, and only insofar as those who exercise authority are acting within the sphere of authority properly delegated to them by the legislature."

The Commission was given rule-making authority pursuant to *the Securities Amendment Act,* 1995. Subsection 143(1) of the current *Securities Act* specifies the matters in respect of which the Commission may make rules of a binding nature. Unless an exception to the notice requirement applies, the Commission is required to publish proposed rules for public comment (s. 143.2). This publication must include, among other things, the proposed rule, a summary of the rule, the anticipated costs and benefits of the rule, and a reference to the authority under which the rule can be made. The public is provided at least 90 days to consider a proposed rule and submit comments to the Commission.

2002 OSC response to US Sarbanes Oxley

In August 2002, David Brown, the former Chair of the OSC, issued an open letter to all Ontario market participants asking for comments on the new US Sarbanes–Oxley Act (US SOx). Although Mr. Brown called for a "made–in–Canada solution," he noted that more than half of the total market capitalization of companies listed on the Toronto Stock Exchange (the "TSX",

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which is senior to the Toronto Venture Exchange TSX–V) were inter-listed in the United States. He stated that "our approach to reviewing these initiatives is based on the assumption that it makes regulatory sense to harmonize with the U.S. initiatives unless there are cogent reasons for not doing so."[18] In another open letter of October 31, 2002, he referred to the importance of maintaining domestic and international confidence in Ontario markets, the "spillover effect in Canada from the damage to investor confidence in the U.S.", and the ongoing dialogue with the U.S. Securities Exchange Commission regarding cross–border issues.[19]

US SOx was not in response to venture issuers, but in response to major corporate and accounting scandals, including those of Enron, Tyco, Adelphia, Peregrine and WorldCom. Contributing factors included: (1) directors failed to supervise complex business issues, or did not have the expertise to do so; (2) audit committees were not independent of management; (3) auditing firms were not independent "financial watchdogs" for the shareholders—many were being paid lucrative non–audit or consulting fees by management; (4) securities analysts issued buy or sell recommendations while being paid for lucrative investment banking services by the companies being analyzed; and (5) executive stock option and bonus practices, combined with volatile stock prices, encouraged management to manipulate earnings.

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[18] (D. Brown, Open Letter to Market Participants 2002-Oct)

[19] (D. Brown, OSC Open Letter to Market Participants 2002-Nov) Pierre Lortie argues that the push to harmonize with US rules stems from the erosion of competitiveness of the TSX. Between 1990 and 2008, the aggregate value traded on Canadian stock exchanges relative to that on US exchanges declined from 4.05 per cent to 2.4 per cent. Lortie argues that this is because of deeper liquidity on US exchanges rather than better regulation (Lortie 2010) p. 18

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Under US SOx rules, listed companies, except for "controlled companies", are required to have a majority of independent directors, and a nominating/corporate governance committee and compensation committee composed entirely of independent directors. A member of the audit committee may not be an affiliate of the company or a subsidiary. Each listed company is required to adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code. The chief executive officer is required to certify that he or she is not aware of any violation by the company of exchange listing standards, to maintain internal controls, and to certify each annual and quarterly report. Auditors cannot perform non–audit services for the issuer. There are a number of other detailed amendments, including enhanced disclosure in periodic reports, enhanced conflict of interest provisions, and stiffer penalties for securities offences and fraud.[20]

Although the Toronto Stock Exchange ("TSX") argued that changes to audit committees should be voluntary with only a requirement that companies disclose whether they complied, Mr. Brown said that strict enforcement was necessary in Ontario because the 1999 Dey Committee found

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[20] Although the US Sarbanes-Oxley Act is quite detailed, a U.S. "small business issuer" can file a registration statement (equivalent to a prospectus in Ontario) in a simplified question and answer format, in non-legalistic terminology, provided its publicly-held stock is worth no more than $25 million. US small business issuers can raise up to $10 million in any twelve-month period with a simplified Form SB1U.S. Securities Exchange Commission website, accessed November 21, 2010 <http://www.sec.gov/info/smallbus/qasbsec.htm#eod4>

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that "the response of Canadian corporations to the governance initiatives was more formal than substantive and the corporate sector in Canada had not yet achieved a 'culture of compliance."[21]

Ontario adopted rules similar to US SOx in 2004 with new requirements regarding financial statements, annual information forms, management discussion and analysis (MD&A), material change reporting, information circulars, proxy solicitation, restricted share disclosure, and other matters.[22] National Instrument 52–107 sets out the accounting principles and auditing standards for various transactions. National Instrument 52–110 requires all issuers to have an audit committee to which the external auditors must report, and which must pre–approve all non–audit services to be provided by the auditor [23] National Instrument 52–108 requires the auditor to participate in the oversight program of the Canadian Public Accountability Board. National Instruments 58–101 and 58–201 require issuers to disclose their best practice standards, including: maintaining a majority of independent directors on the board, adopting a written board mandate, adopting a written code of business conduct and ethics, and a compensation committee composed entirely of independent directors. National Instrument 52–109 was perhaps the most

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[21] Mr. Brown also noted that in the year ended March 31, 2002, the OSC Continuous Disclosure team reviewed nearly 30 per cent of Ontario–based reporting issuers, of which 23 per cent agreed to enhance their future disclosure practices, and 9 per cent were required to refile certain materials due to deficiencies in their original filings. To Mr. Brown, voluntary compliance with principles was not enough—strict enforcement of clear rules was required. Open letter dated October 31, 2002 to All Ontario Capital Market Participants, from David Brown, QC.

[22] National Instrument 51–102 Continuous Disclosure Obligations.

[23] Except for "venture issuers", every audit committee would require at least three members, each of whom must be "financially literate" (though not necessarily a "financial expert").

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controversial. The Chief Executive Officer and Chief Financial Officer must personally certify that the issuers' annual and interim filings do not contain any misrepresentations and that the financial statements and other financial information in the annual and interim filings fairly present the financial condition, results of operations and cash flows.

The disclosure rules are somewhat relaxed for "venture issuers."[24] Interim financial statements do not need to be audited; venture issuers have 120 days (rather than 90 days) to file year–end statements; they need not file Annual Information Forms; they are exempt from the audit committee requirements provided they disclose that they are relying on the exemption to their shareholders. [25]

Assessing the complexity of Ontario's rules

When an issuer sells securities to the public in Ontario, the OSC mandates a "plain language" prospectus, disclosing all material facts with simple, accessible sentences, with "an easy–to–read format", with everyday words and the active voice.[26] Ironically, the Ontario regulations which

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[24] See footnote 1 for definition of "venture issuer".

[25] As noted in footnote 11 above, on July 29, 2011, the Canadian Securities Administrators published for comment Proposed National Instrument 51-103, which would tailor regulations for venture issuers.

[26] See Ontario Prospectus form 41–101F1 and Companion Policy 41–101CP: "Issuers should apply plain language principles when they prepare a long form prospectus including: using short

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prescribe what must be included in a prospectus are anything but plain—they are a patchwork of complex, detailed rules. For example, National Instrument 41-101 *General Prospectus Requirements* is 34 pages in length; its appendices are an additional 17 pages, its Form 41-101F1 *Information Required in a Prospectus* is 46 pages, or 38 pages for an investment fund, and its Companion Policy 41-101 is an additional 29 pages. The text is often dense and difficult to read. For example, section 11.2 of NI 41-101 regulates when securities can be distributed to the underwriter, and it states in part:

> "No person or company may distribute securities under a prospectus to any person or company acting as an underwriter in connection with the distribution of securities under the prospectus, other than …(b) securities issued or paid as compensation to one or more persons or companies for acting as an underwriter in respect of other securities that are distributed under the prospectus, where the number or principal amount of the securities issued as compensation, on an as-if-converted basis, does not in the aggregate exceed 10% of the total of the base offering plus any securities that would be acquired upon the exercise of an overallotment option."

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sentences; using definite everyday language; using the active voice; avoiding superfluous words; organizing the document into clear, concise sections, paragraphs and sentences; avoiding jargon; using personal pronouns to speak directly to the reader; avoiding reliance on glossaries and defined terms unless it facilitates understanding of the disclosure; avoiding vague boilerplate wording; avoiding abstract terms by using more concrete terms or examples; avoiding multiple negatives; using technical terms only when necessary and explaining those terms; using charts, tables and examples where it makes disclosure easier to understand."

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How do Ontario securities regulations compare with similar regulations, regarding language complexity? The following table compares the Ontario *Securities Act*, some of the more important rules of the OSC, with the Canadian federal *Income Tax Act*, the Ontario *Employment Standards Act*, the Ontario *Business Corporations Act*, the U.S. *Sarbanes-Oxley Act of 2002*, and an excerpt from the U.K. Financial Services Authority Handbook.

Of course, measuring language complexity is more than simply counting the number of words, sentences or pages. Readability tests, readability formulas, or readability metrics are formulae for evaluating the readability of text, usually by assessing syllables, words, and sentences. Some word processing computer applications have readability tests built-in. The difficulty I found in comparing these statutes and rules is that it can become somewhat arbitrary to distinguish between sentences separated by periods and subordinate clauses separated by commas or semi-colons. To generate this table, for the most part, I have treated clauses separated by semi-colons as sentences. Furthermore, the complexity of language involves many other factors, such as the plainness of words, the active voice, the use of an index, and the logical sequence of topics. This table, therefore, presents only a very basic comparison.

	Sentences	# of words	Words / sentence
Ontario Securities Act	2,172	77,737	36
Canada Income Tax Act	3,867	707,805	183
Ontario Employment Standards Act	1,688	44,804	27
Ontario Business Corporations Act	2,040	71,183	35
NI 41–101 – prospectus requirements	187	15,350	82

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NI 45-106	468	47,280	101
NI 51-102	425	76.878	180
Rule 61–101 special transactions	226	23,420	104
US Sarbanes-Oxley Act 2002[27]	507	28,719	56
UK FSA Handbook – Disclosure and Control of Inside Information[28]	21	833	40
Law Society of Upper Canada bylaws 1 to 3	342	16,933	50
Law Society Rules of Professional Conduct	226	10,394	46

Table 1 Complexity of Regulations - Methodology—see footnote [29]

The federal *Income Tax Act* has the largest average number of words per sentence, at 183. The Ontario *Securities Act* has only slightly more than the *Business Corporations Act* and *Employment Standards Act*. It appears, therefore, that the enabling legislation—the *Securities Act*—is of average complexity. However, the rules of the OSC have a large number of words per sentence, approaching the complexity of the notoriously complex *Income Tax Act*. The Ontario Securities Act, and the Rules and Policies of the OSC, comprise a book of over 3,000 pages of small print, of which 156 pages are for the Securities Act passed by the legislature and 25 pages

[27] (SOX Online 2011)

[28] (UK Financial Services Advisory 2011)

[29] This table was calculated by copying and pasting the relevant acts, rules and policy into Microsoft Word, and then using Word statistics to compute the table. The values are approximate only, as the distinction between sentences and subordinate clauses is somewhat arbitrary.

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are for the General Regulation; thus, there are over 2,500 pages of OSC rules in small print.[30] It would seem, therefore, that Ontario regulations are a combination of principles-based legislation and detailed OSC rules.

British Columbia proposes a principles approach

In contrast to Ontario's rules–based approach, in October 2002, B.C. Securities Commission Chair Doug Hyndman warned against rushing to adopt U.S.–style securities regulatory reforms:

> "Canadian regulators would do a serious disservice to Canadian markets and investors if we adopt more rules just to keep pace with our neighbours...Our duty is to regulate the markets under our jurisdiction as efficiently and effectively as we can. We should pay attention to what is happening in the U.S. and elsewhere but we shouldn't adopt new rules just for the sake of harmonization."[31]

Hyndman said that rather than adopting more prescriptive and detailed rules, Canadian investors would be better protected from the accounting fraud, governance lapses, and other market abuses that have been revealed in the U.S. by having regulators do a better job of enforcing the rules already in place.

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[30] *Consolidated Ontario Securities Act, Regulations and Rules*. Paul Findlay, Carswell, 2013. Approximately 3,350 pages

[31] In an October 2002 breakfast speech at the Economic Club of Toronto.

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> “This is probably the worst time for us to adopt prescriptive requirements for governance," he said [in 2002]. "As a result of the train wrecks of the past year, investors are now taking governance more seriously and asking companies hard questions about what their directors are doing. We should let the market work, as only it can, rather than stepping in as if we had all the answers.”[32]

Stephen Sibold Q.C., the Chair of the Alberta Commission, agreed with Hyndman’s cautious view, and described the US SOx as a confusing and reactive array of new regulations. “When faced with a bunch of detailed prescriptive rules and processes people can lose sight of the purpose of the rule. They perform all the formalized rituals but fail to question whether they are meeting the golden rule”.[33]

The BC Commission did not participate in the Canadian Securities Administrator’s “Investor Confidence” rules, because in its view the auditor oversight rule contained more detail than necessary, the certificate rule added nothing to the existing legal duty of the officers to insure that disclosure is not false or misleading, and there was no evidence that the certification would add any benefit. As John Hinze, Director of Human Resources and Administration and Chief Financial Officer and Chair of the BC Commission, later argued, too many rules are complex

[32] Ibid

[33] Address to the Calgary Chamber of Congress, Nov 15, 2002.

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and confusing. Few business people or investors can decipher them without professional advice, making them accessible only to a narrow "priesthood" of securities lawyers.[34]

In 2004, the BC Commission proposed a principles–based Securities Act with a simplified, plain language, rulebook. An overarching "Code of Conduct," consisting of 28 general principles arranged under eight broad "standards" would regulate advisers and dealers, and a simplified "Continuing Market Access" structure would regulate prospectus requirements.[35] Although BC later deferred its proposal in favour of the "passport" system (which harmonizes BC regulations with the other detailed disclosure provinces[36]), as of writing, BC still intends to simplify its regulations in keeping with the spirit of the principles–based approach.

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[34] (Hinze 2007) Measuring plain language at the British Columbia Securities Commission.

[35] This would replace the prospectus–based system and allow certain issuers to access the market at any time based on their continuous disclosure record. There would be no mandated offering document, except for an issuer's IPO. For issuers in the system, the prospectus exemptions regime, hold periods, and resale restrictions would disappear. An enhanced continuous disclosure regime would be introduced, requiring issuers in the system to maintain "evergreen" disclosure of all material facts.

[36] The "Principal Regulator System", Multilateral Instrument 11–101, or "passport system", allows market participants access to the capital markets in multiple jurisdictions by dealing with its principal regulator. A market participant's principal regulator will usually be the regulator in the jurisdiction where its head office is located. Ontario, however, does not support the system because the passport system endorses the idea of different regulatory standards for market participants depending on where their head office is located.

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The BC Securities Act would "engage firms in their own endogenous learning about compliance" by focusing on objectives and results, rather than on detailed rules. As stated by the BC Commission:

> "We prefer non–rule solutions, because rules are generally the most intrusive and expensive form of regulatory intervention, and this expense filters down to investors. Rules can also have adverse effects, such as limiting competition, slowing innovation, increasing costs, encouraging a loophole mentality, or creating other unanticipated or undesired responses."[37]

The BC Securities Commission (BCSC) later suggested that "principles–based regulation" had become a trendy term[38] and now uses the phrase "outcomes–based regulation" to describe an approach which includes rules, but which emphasizes principles. If the regulator finds it necessary to intervene, the BCSC will consider "all regulatory tools in searching for outcomes–based solutions", such as compliance monitoring, enforcement, guidance, education, and rule–making.[39]

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[37] (Aitken 2005), p. 9

[38] (Expert Panel on Securites Regulation 2009) Submission of the British Columbia Securities Commission, July 15, 2008

[39] For further discussion about outcomes–based regulation, see the topic Risk–based, Responsive, Outcomes–Oriented and Proportionate Regulation" at p. 100

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The BCSC outcomes–based regulation would require market participants to think about what is best for investors and markets, rather than looking to the regulator for instructions on what to do.[40] The regulator's assessment of compliance is based on whether the market participant exercised reasonable judgment in fulfilling its compliance responsibilities.[41]

Even if the BCSC were to adopt a simplified, principles-based framework, venture issuers listed on the TSX-V exchange would still need to comply with the detailed TSX-V rulebook, which as mentioned above,[42] is currently 791 pages in length, of which 341 pages are for the rules and 450 pages are for the associated forms and appendices. In other words, the BC proposal would be a shift towards principles for venture issuers, but not an elimination of all securities rules. Arguably, the TSX-V rulebook would fill in any gaps of the principles-based BC proposal.

Furthermore, the rulebook for the TSX-V may become more detailed and rigid over time, as did the application of TSX rules (for senior issuers) following demutualization of the TSX in 2000. As one of the experts consulted in this paper (Elaine Ellingham, from page 349 below) describes, prior to demutualization in 2000, the TSX accepted listings in a discretionary, principles-based

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[40] This is also called "management based regulation" by Cristie Ford: "Under a management–based regulatory approach, the regulator provides incentives to the regulated to achieve socially desired goals. The regulated must do their own planning and decision making about how to achieve goals. Outcome–oriented regulation focuses on the final stage. Management–based regulation focuses on the planning stage." (Ford, New Governance, Compliance, and Principles-Based Securities Regulation 2008) at pp. 10–11

[41] *Ibid*, at p. 6.

[42] Supra, note 12

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manner. When the TSX became a for-profit business, the OSC no longer saw the TSX as a regulatory partner focused on protecting investors and there was a major paradigm change within the TSX listings department. The TSX became more rigid in its application of rules and standards, because rules-based decisions could more easily be verified on an OSC audit. The same may hold for the application of TSX-V rules—they may become more rules-based over time.

Proposed National Securities Regulator—a principles approach

There have been proposals to centralize Canadian securities regulation in a national commission for many years.[43] In 2007, Finance Minister Jim Flaherty re–introduced the idea in a document entitled "Creating a Canadian Advantage in Global Capital Markets."[44] Provincial regulation of Canada's capital markets is too complex, he argued, raising financing costs and lowering Canada's competitiveness. He noted that Canada is the only jurisdiction among the Organization of Securities Commissions without a national regulator.[45] Flaherty referred to "numerous studies, analyses and commentary" showing that the fragmented structure of Canadian securities

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[43] See the 1979 federal Department of Consumer and Corporate Affairs, "Proposals for a Securities Market Law for Canada", a three volume set of recommendations written by Anisman, Grover, Howard and Williamson (Anisman, et al. 1979) See also the Wise Persons' Committee report of 2003 (Wise Persons' Committee to Review the Structure of Securities Regulation in Canada 2003) and the Crawford Panel (Crawford Panel 2006).

[44] (Department of Finance 2007)

[45] (Department of Finance 2007) at p. 21

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regulation impairs the ability to finance businesses in Canada. He referred to a 2007 study by the Canadian Bankers Association which found that smaller issuers spend proportionately more on regulatory expenses than larger issuers, and that costs for smaller issuers increase on average by 7.5 per cent for each additional province or territory in which funds are sought.[46]

The proposed national Act would have permitted provinces and territories to opt in, with the hope of creating an effective unified national securities regulation system. It included registration requirements for securities dealers, prospectus filing requirements, disclosure requirements, specific duties for market participants, a framework for the regulation of derivatives, civil remedies and regulatory and criminal offences pertaining to securities. It was based on the report of the "Expert Panel on Securities Regulation" (the "Expert Panel")[47] which advanced a proportionate, principles–based, national regulator.[48] The national regulator would derive its

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[46] (Canadian Bankers Association 2007) The conclusions of this study are disputed by Pierre Lortie, who argues that costs for multi–provincial offerings by Alberta and BC venture issuers increase because Ontario has not adopted the "passport system", and because offerings in Quebec require expensive translation. Under a national regulator, translation costs would increase for all offerings, even if there were no Quebec investors, because the federal government is committed to bilingualism. See (Lortie 2010) at p. 12

[47] (Expert Panel on Securites Regulation 2009)

[48] (Expert Panel on Securites Regulation 2009) "Mandate". Lortie (Lortie 2010) is critical of the national regulator proposal; he notes that under the existing provincial passport system: (i) Canada was ranked second in terms of the quality of overall securities regulation in the OECD 2006 report "Going for Growth", ahead of the USA (4th), the UK (5th) and Australia (7th). (ii) Compared to 178 economies, Canada was ranked 5th in terms of investor protection in the World Bank Doing Business 2008 Report, ahead of USA (7th), the UK (9th) and Australia (51st). (iii) The aggregate value of equity raised in Canada through initial public offerings ("IPOs") relative

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initial rules from the existing, harmonized, provincial "passport system".[49] In June 2009, Flaherty appointed Doug Hyndman to head a "Transition Office"[50] for the national regulator—as noted above, Hyndman was Chair of the BC Securities Commission and is committed to principles–based regulation.

On December 22, 2011 the Supreme Court of Canada released its decision on the constitutionality of the proposed federal Act.[51] It ruled that the proposed Act was "in pith and substance" concerned with the day−to−day regulation of all aspects of contracts for securities within the provinces, including all aspects of public protection and professional competences. These are essentially "property and civil rights" powers within the jurisdiction of the provinces, not related to the federal power to regulate trade and commerce as a whole. Some aspects of the

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to GDP compares favourably to the United States: the total value of IPOs over the 1996—2000 period was 8.57 per cent in Canada compared to 5.47 per cent in the United States. (iv) Canadian junior issuers have a higher survival rate and longer life expectancy than equivalent–size companies in the United States.

[49] In 2004, all provinces and territories, except Ontario, agreed to a single window of access to Canada's capital markets for domestic and foreign issuers. Under this "passport" system, participants can clear a prospectus, obtain an exemption, and register as a dealer or adviser, by obtaining a decision from the securities regulator in their home province and have that decision apply in all other jurisdictions. See Multilateral Instrument 11–101. Critics of the national securities regulator argue that it is unnecessary since the current passport system works well.

[50] (Minister of Finance Canada 2009)

[51] Reference by the Governor in Council concerning the proposed Canadian Securities Act (2011 SCC, Docket 33718).

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Act did relate to trade as a whole, including management of systemic risk and national data collection, but the thrust of the Act was not aimed at these national concerns. The Supreme Court said that a cooperative approach, recognizing provincial securities regulation, but allowing Parliament to deal with national concerns, would be constitutional. Following the decision, Flaherty seemed to have followed up on the suggestion of federal regulation of national standards and systemic risk.[52] It is likely that any new federal proposal will be principles-based. National standards and the management of systematic risk would be designed to combat recurring financial crisis, which can arise from different and unpredictable sources. High level principles can more easily be adapted to the circumstances.

Background Facts about Ontario Venture Issuers

The importance of venture issuers

Venture issuers are a subset of "small and medium enterprises" or "SMEs". Industry Canada defines SMEs as companies with up to 500 employees and annual sales of less than $50 million.[53] All but the largest 245 companies listed on the TSX, and all companies listed on the TSX Venture Exchange ("TSX–V"), would be considered "small cap" (or even smaller)

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[52] (Larocque 2012)

[53] (Nicol and Heidrick 2002)

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companies in the United States. The SME sector, both privately and publicly held, is an important contributor to the economy. According to a report by the Canadian Federation of Independent Business (Debus 2005), a total of 32 per cent of employed Canadians have a job in a small firm with fewer than 50 employees, while 24 per cent work for mid–sized businesses employing between 50 and 500 workers.[54] Canadian SMEs, including venture issuers, invest in research and development (R&D) proportionally more than big corporations.[55] Companies with up to 100 employed workers represent a total of 85 per cent of Canadian exporters. Small establishments with fewer than 50 employees represent 72 per cent of all Canadian exporting businesses and are responsible for close to a quarter of the total value of exports.[56]

On the other hand, 95% of Canadian small businesses do not achieve high-growth. High-growth firms are defined by Statistics Canada as those with average annualized growth rates greater than 20 percent per year, over a three-year period, and with 10 or more employees at the beginning of the period. Only 4.7 percent of Canadian small businesses achieved high growth in terms of employment—however, they created 45 percent of net new jobs from 2003 to 2006.[57]

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[54] Statistics Canada, Survey of Employment, Payrolls and Hours (SEPH), 2004.

[55] Statistics Canada, Industrial Research and Development – 2004 intentions, Catalogue. No. 88–202–XIB, January 2005.

[56] Statistics Canada 2004

[57] (Industry Canada 2011)

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Industry concentration of Canadian venture issuers

A significant percentage of Canada's public companies operate in a handful of key sectors: mining, oil and gas, and financial services—these three sectors collectively account for just over 65 percent of the market capitalization of the TSX (which is senior to the TSX–Venture). Almost 65% of issuers listed on the TSX Venture Exchange are mining issuers and almost 15% are oil and gas issuers.[58] Ontario is heavily concentrated in the financial services sector, with large institutions inter–listed in the United States. British Columbia is concentrated in junior mining. Alberta is concentrated in junior oil and gas. Quebec has a more diversified but localized concentration in forestry and transportation.

Controlling shareholders of venture issuers

Nicholls notes that a significant percentage of Canada's largest non–financial public companies have controlling shareholders, or major shareholders (shareholders with voting interests of at least 20 per cent are considered "controlling" and those with at least 10 per cent are considered "major").[59] Also, dual–class shares and pyramidal holding structures are common. Controlling

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[58] Table 3 Industry Type on TSX-V at page 209 below

[59] (Nicholls 2006) at 134–5. See also (MacIntosh and Daniels 1992) which says, at page 884, one of the most distinctive features of Canadian capital markets is the high degree of concentration of share ownership. Only 14 per cent of the companies that make up the TSE 300 Composite Index are widely held. Of the remainder, 60.3 per cent are owned by a single shareholder with legal

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shareholders can accumulate sufficient proxies to control management.[60] In contrast, widely held corporations (which are more common in the United States), leave dispersed shareholders with

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control (in excess of 50 per cent of the voting shares). 25.4 per cent are owned either by one shareholder with effective control (between 20 per cent and 49.9 per cent of the voting shares) or by two or three shareholders (each owning between 10 per cent and 20 per cent of the outstanding voting shares of the corporation) having the ability to combine and establish joint legal or effective control. In contrast, American markets are characterized by a much greater preponderance of widely held companies. Approximately 63 per cent of the companies that make up the Fortune 500 companies are widely held, and 18 per cent are controlled by a shareholder or group of shareholders with effective control. Only about 12 per cent are controlled by a shareholder or group of shareholders with legal control.

See also (Davis 2003-2004) at 982: "The Canadian capital market is constructed differently [than the US market]. It consists of a majority of thinly–traded companies, with little or no institutional investment. Of those companies on the Toronto Stock Exchange (TSX) index, a majority have a single shareholder with legal control and more than three–quarters of them have either a single shareholder or a group of three or less shareholders with either legal control or effective control of the corporation. There is a much higher proportion of corporations with restricted voting or nonvoting stock such that the owner of a minority of the equity owns the voting shares. There is also a high degree of corporate interconnection, with many of the one hundred most profitable corporations holding up to ten percent of the stock of the other companies on the list. Directorships are interconnected as well, with a higher proportion of directors having multiple directorships. For most publicly traded Canadian corporations, the problem is not the inability of widely dispersed shareholders to monitor managerial conduct, but rather that an alliance between the management and majority or controlling group of shareholders will conduct corporate affairs so as to disadvantage the minority shareholders or other corporate stakeholders."

[60] (Davis 2003-2004) at 984: "the capital structure of most of Canada's publicly–traded corporations does not raise these concerns [as in the US]. Large blockholders can capture most of the gain from monitoring, and thus the disproportion between costs and benefits of monitoring is eliminated. In addition, since he or she will possess legal or de facto control over the directors'

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little control over management; usually, they can only "vote with their feet"—i.e. sell their shares on the market if they are dissatisfied.[61]

Therefore, in the United States, good policy controls management on behalf of dispersed shareholders. In Canada, good policy controls the controlling shareholders.[62] As Nicholls argues, the prevalence of controlling or dominant shareholders in the Canadian market indicates that the

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election, the controlling shareholder can impose discipline on errant managers. Thus, the conflict in the Canadian capital markets is not between managers and shareholders, but rather between controlling shareholders and noncontrolling shareholders over intrashareholder transfers of wealth or use of the corporation for the nonpecuniary ends of the majority shareholder."

(MacIntosh and Daniels 1992) at 885: "The predominance of shareholder controlled corporations in Canada changes the nature of conflicts that are likely to be important. Large block holders have better incentives than small investors to monitor management, since poor management affects the interests of a large stakeholder much more substantially than a small investor with a transient interest. Furthermore, the free rider problem that commonly makes coordinated shareholder action difficult is ameliorated, since a much more substantial portion of the benefits of monitoring is captured by the large block holder. The result will be more effective monitoring of hired managers. Moreover, since the controlling shareholder will effectively control the board of directors, which is legally empowered to hire and fire"

[61] Most large publicly traded corporations in the US are incorporated under corporate administration friendly Delaware law, and because the US's wealth has been increasingly securitized into various corporate entities and institutions, the rights of individual owners and shareholders have become increasingly derivative and dissipated.

[62] Investors in corporations owe few if any duties to fellow investors, because the financing device for these firms achieves substantial separation of management and risk bearing. We then take it as common (if not desirable) for a person investing in one public corporation to invest in its rival too (perhaps even to manage its rival). See (Easterbrook and Fischel, Contract and Fiduciary Duty 1993) 447

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Canadian regulation should protect minority investors in the context of (a) related–party transactions; (b) going private transactions; and (c) unlawful trading on the basis of undisclosed material information (i.e., insider trading).[63]

Regulation risks of venture issuers

Venture issues have fewer shareholders, smaller trading volumes, and less share liquidity. Revenues are often unpredictable, but compliance costs are fixed. Illiquidity is a concern because of the uncertainty regarding the price of new shares and access to capital. Illiquidity is also a concern for the regulator, since share prices can be manipulated to the detriment of innocent outside investors. As Nicholls notes, this highlights a regulatory paradox: The very companies least able to afford enhanced regulation are also those which pose the greatest investment risk for retail investors. Shares of venture issuers are subject to greater price volatility, greater illiquidity risk, and are less likely to be monitored by sophisticated institutional investors.[64] Securities analysts tend to focus on larger capitalized issuers because that is where they can make brokerage commissions sufficient to fund their research budgets.[65] Canada's venture issuers can

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[63] (Nicholls 2006) at pp. 137–38

[64] (Nicholls 2006) at p.135

[65] Ironically, the "efficient market" hypothesis holds that a broker's costs for researching larger issues is wasteful. Disclosure about larger issuers are rapidly distributed in the market, faster than investors can adjust on the basis of the new information. As a consequence, no trader can

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be orphaned by the market, left to wither on the vine or to become targets of stock manipulation, despite real business opportunities.[66]

Seligman reviewed US securities statistics and concluded that "the evils of high–pressure salesmanship and of selling on the basis of inadequate information are particularly prevalent in small issuers".[67] Managers of venture issuers are often paid with stock options (which appreciate with a rising stock price) and have an incentive to publish only "good news".[68] Carpentier and Suret argue that strong listing requirements for venture issuers should be maintained, because of

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earn (financial) arbitrage profits in an efficient market because no one can identify (except by chance) securities which are under– or over–valued. See: (Gordon and Kornhauser 1985) at 770: Corroboration of this theory appeared in several studies which documented that the professional investors who managed mutual funds did not outperform randomly selected investment portfolios. See: Seligman, J. The Transformation of Wall St. New York: Houghton Mifflin, 1982. Pgs ix–xii; 561–568 in Historical & Comparative Approaches to Securities Regulation, by Mary Condon, at p.316.

[66] (The Task Force 2006) at p.141. Also, see p. 32: "being a cost centre, analysts will logically specialize in stocks for which there is large trading and substantial investor interest in an effort to demonstrate that this cost centre has value. However these are not always the stocks that most require information and analysis, since they are already heavily followed. It is the small stocks that do not generate the same trading activity that are under represented in analyst coverage. ."

[67] (J. Seligman 1983) at p. 57.

[68] See "The Role of Compliance in Securities Regulatory Enforcement", in Volume 6, (The Task Force 2006).

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information asymmetry and because of the very poor returns that are typical among venture issuers; otherwise, the venture market will become a "lemon market".[69]

There is a greater risk that management of a venture issuer will abscond with the firm's assets, since they are generally less tangible, easier to transfer, and harder to trace than those of larger firms. Thus, investors must rely on, and promoters must acquire, reputation capital.[70]

Junior mining risks

Junior mining exploration ventures (which comprise 65% of listings on the TSX Venture exchange) usually fail, are expensive to finance, and are susceptible to market manipulation.

Success is unlikely

In his study for the 1964 Porter Royal Commission on Banking and Finance,[71] E.K. Cork found that of the 6,679 public mining companies chartered in Ontario between 1907 and 1953, only 348 found a producing mine (a 95% failure rate) and only 54 ever paid dividends (less than 1%). However, as Kalymon notes, a small number of producing mines can yield enormous results,

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[69] (Carpentier and Suret, Entrepreneurial Equity Financing and Securities Regulation: An Empirical Analysis 2009).

[70] (Fuller and Yumiao 2006) p.290

[71] (Cork 1962) p. 37. "The chance of an average prospect becoming a profitable mine is one in a few thousand; one estimate is one in three thousand." Similar results were found in Quebec.

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more than compensating for failures. From 1945 to 1975, the total gross value of minerals discovered by junior exploration companies in Canada was about $70 billion and the funds raised by juniors was about $2 billion. After deducting development and extraction costs, taxes and opportunity costs, the total residual profit for juniors exceeded the total funds raised by a factor of 2.4. Like a gambling casino, however, the profits were concentrated in the hands of a small number of winners and the vast majority of investors lost.[72]

The odds of a mining exploration success are similar to the odds of an industrial product idea becoming commercially successful. According to Stevens and Burley[73], it takes 3,000 raw ideas to produce 300 patent disclosures to the patent office. Fifty percent of these disclosures are filed, of which seventy-five percent are issued patents. Of this, 8 percent have some commercial value and less than 1 percent represents major commercial significance. In other words, the odds of a product idea becoming a significant commercial success are less than one-third of one percent. Similar results were found when assessing how many products reviewed by venture capitalists are successful.

Financings are expensive

Historically, most of the funds invested for junior mining exploration have gone to the brokers and promoters. Cork estimated that of the $850 million invested in Canada in mining between

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[72] (Kalymon, Halpern and Waters 1978) chapter 2

[73] (Stevens and Burley 1997)

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1953 and 1960, 60% went to sales costs and promotional profits and only 40% went into corporate treasuries. Of the 40% that went into corporate treasuries, 20% was spent on corporate maintenance ("working capital") and only 20% was spent on exploration.[74] These percentages were confirmed in a 1977 study by OSC staff.[75]

Prior to 1966, most Ontario mining exploration was financed on the Toronto Stock Exchange (TSE) by broker-dealers who used direct telephone sales to solicit investors across North America. As a result of complaints in the U.S. and other Canadian provinces, the 1967 Ontario Securities Act prohibited junior mining companies from issuing new shares through the TSE and companies could be de-listed if they failed to maintain working capital requirements. Juniors were now required to file a prospectus with the OSC and trade on the over-the-counter market. In addition, in 1976, the Commission prohibited underwriter options, replacing them with bonus shares, up to a maximum of 15 to 20% of the issue. In 1986, Ontario's Policy 5.2 limited dealer commission to a maximum of 35%, and the minimum net proceeds to the issuer became $100,000. No other commissions, direct or indirect, were available, with two limited exceptions.[76]

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[74] (Cork 1962)

[75] (C. Armstrong 2001), p. 277

[76] The first exception was the "green shoe" option of up to 15% of the primary offering. The second exception was available in a firm underwriting - a compensation option of up to 10% of the issued shares exercisable up to 60 days following the offering. Both these exceptions are relatively minor, and the net result became a maximum dealer commission of 35%.

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What was the effect of removing junior mining companies from the stock exchange and limiting broker compensation? Although other factors may have been in play, including tax changes and high interest rates, from 1951 to 1955, on average $120 million was raised per year in 1977 dollars by junior mining companies in Ontario. From 1971 to 1977, it was reduced to one-tenth of that amount—only $12 million per year.[i] Broker-dealers left the Ontario junior mining market. (Many moved west to the Vancouver stock exchange. In 1999, Vancouver stock exchange and the Alberta stock exchange merged with the Toronto over-the-counter market, to form the Canadian Venture Exchange, which later became the TSX Venture exchange in 2001.) There were 75 broker dealers in Toronto in 1965 and only 13 in 1978.[77] Kalymon et. al. note that private communication with researchers in the Department of Energy Mines and Resources revealed that the junior mining sector accounted for approximately 41.8% of reported exploration expenditures in 1969, then dropped to 17.7% in 1975.[78]

An argument can be made that brokers and promoters of junior mining exploration ventures should enjoy high levels of compensation, as a percentage of the funds raised. Given that most of the deals are small, the amounts earned are not comparatively large, when considering the fixed costs of due diligence and running an office.

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[77] (Kalymon, Halpern and Waters 1978) pp. 7-8

[78] (Kalymon, Halpern and Waters 1978) p. 25

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Fraud and manipulation

Junior issuers are susceptible to market manipulation, generally in three ways: (i) publishing false information in an offering document, circular or news release; (ii) withholding material information from investors, and (iii) creating a false impression of the value of a security by spreading false rumours and manipulating the market.

Spreading false information

The Bre-X fiasco is a classic example of the damage that can be caused by false statements. The Busang drill cores were salted with gold particles taken from a different location. Press releases proclaimed the Indonesian gold mine to be the richest ever found. The price of Bre-X stock rose steadily from about 50 cents a share in May, 1993 to $228 when the stock split ten for one in May, 1996. The euphoria ended on March 19, 1997 with a report that the company's chief geologist Michael de Guzman had committed suicide by jumping from a helicopter over the jungles of Borneo. When independent sources were unable to verify the gold resources, the share prices plummeted. On May 7, 1997, following a public announcement that there was no gold in the Busang, the TSE delisted Bre-X.

The fraud was exposed because of independent due diligence reviews. In late 1996, Barrick Gold began discussions to joint venture with Bre-X and conducted a limited review. Barrick found insignificant mineralization in the retained "in-fill" samples and the small uncrushed 10 cm cores. On February 18, 1997, Bre-X made a joint venture deal with Freeport-McMoRan Copper and Gold, Inc. ("Freeport"), subject to Freeport's independent review. Freeport's due

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diligence, conducted between March 1 and March 19, 1997, discovered that the Bre-X in-fill samples contained “alluvial gold”, the kind found on the surface and not by drilling hard rock.

Soon after the scandal broke, the TSE and OSC formed a joint “Mining Standards Task Force”, which proposed the strictest mining disclosure rules in the world. The Task Force recommended that “Qualified Persons” (an engineer, geologist, geophysicist or other geoscientist with at least five years’ experience) be responsible for all exploration programs, the estimation and classification of resources and reserves, and the approval of all scientific and technical disclosure for public and regulatory purposes. The recommendations were later incorporated in National Instrument 43-101, which require that an independent Qualified Person supervise all technical statements on becoming a reporting issuer, on filing a non-POP prospectus, information circular, takeover bid, or “any other document that discloses for the first time resources or reserves on a property material to the issuer [with] a 100 percent or greater change, from the most recently filed report...”

Withholding material information

In 1964, Viola MacMillan (a former president of the Prospectors and Developers Association) and her husband George MacMillan’s company Windfall Oils and Mines Ltd. staked claims adjacent to Texas Gulf Sulphur Company’s massive Kidd Creek discovery. Rumours spread that drilling on their claims encountered significant mineralization. Windfall’s stock price rose from 56¢ on July 3rd 1964 to $5.60 on Jul 21st. It fell to 80¢ by the end of the month, after over 13 million shares had traded and after an announcement was made that no commercial ore had been

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discovered. Justice Kelly's report of 1965 revealed that the MacMillans had withheld negative assay reports in July and, through a network of five brokers and twenty-one trading accounts, sold almost one million shares for a trading profit of almost $1.5 million (a considerable sum in the early 1960s). It was essentially a case of the MacMillans selling shares on the market with knowledge of undisclosed material information.

A new Securities Act came into force in Ontario in 1967 which relied on the 1964 Porter Royal Commission on Banking and Finance and the Kimber report in 1965 (Kimber was former chair of the OSC). The new act broadened the discretionary powers of the OSC and required the continuous disclosure of material facts. It required more information in prospectuses filed with the OSC, uniform accounting principles, better takeover disclosure rules, proxy solicitation disclosure, and insider trading prohibitions.

Market manipulation

In a typical small issuer manipulation scheme, unscrupulous promoters and dealers hype a thinly traded stock through the use of "boiler room" direct marketing and telephone calls, company websites, bulletin boards, mass e-mails, chat rooms or on-line investment newsletters. They place "wash trades" to give an impression of price and volume increases. After the price jumps, the manipulators aggressively sell their shares to unsuspecting investors and pocket the profits. Share prices eventually collapse, leaving investors with worthless securities. This is known as the "pump and dump".

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Justice Blair heard expert testimony concerning market manipulation in R. v. Campbell [1993] O.J. No. 3094 [Ont Ct Gen Div] at paragraph 11:

> "Mr. Cleland [an expert in the regulation of penny stock trading] described it as a three-phase process, involving an "accumulation" phase, a "mark-up" phase, and a "liquidation" or "blow off" phase. He said: ... Manipulation of stock is normally done to make money and it seems to fall into a three-phase pattern.
>
> There is an accumulation of stock where stock becomes under the control of a person who has a plan to manipulate the market.
>
> There is a period during which the price is raised, referred to as a mark-up phase generally in the trade, and
>
> if the stock has been raised to a sufficient price or during the mark-up phase, and stock is sold, and it is the liquidation of the stock that creates the profitability of the manipulative activity, and the so-called blow off of the stock is the third phase."

The Cost of Securities Regulation

The detailed rules in US SOx has contributed significantly to the expense of doing an IPO ("initial public offering") in the United States. By 2006, the cost of the legal and accounting work for an IPO was approximately $2 million, up from $500,000 a few years before. According to some, these U.S. regulatory costs are driving venture capital companies to other markets.[79]

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[79] Statement of Keith Crandell, Committee on Small Business: House of Representatives, "Sarbanes-Oxley Section 404: What Is The Proper Balance Between Investor Protection And

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In Canada, the Regulatory Burden Task Force found an overwhelming number of complaints regarding the unnecessary complexity of securities regulation. Issuers and registrants have difficulty in understanding their obligations and must often resort to costly and time–consuming legal advice. Even experienced securities lawyers expressed concerns regarding the increasingly prescriptive nature of securities regulation.[80] Ontario securities regulations are frequently amended and only partially harmonized with other provinces. This further increases complexity. Puri and Condon note that “an unintended consequence of a rigorous compliance programme might be that these requirements become a way for larger issuers to preserve a monopoly, in the

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Capital Formation For Smaller Public Companies?” Washington, DC, May 3, 2006 Serial No. 109–51 p.10.

As cited in the April, 2006 final report of the Advisory Committee on Smaller Public Companies, the discrepancy between the initial Section 404 cost estimate of $91,000 versus the actual cost of $900,000 raises the question of cost benefit for the shareholders of smaller public companies. (Statement Of Bill Broderick, Analytical Graphics, Inc., p. 7)

See also: Remarks to the Association of Professional Compliance Consultants 5 March 2008), online: FSA <http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2008/0305_lt.shtml> The FSA approach to risk–based regulation is also proportionate. The FSA does not subject small firms to the same scrutiny as larger ones, or require the same kinds of structured and detailed responses from them, because of their sheer number and because on an individual level each one poses a relatively small risk to consumers. See also (Titcomb 2008)

[80] (Regulatory Burden Task Force 2003) at p.13. See also #11 on page 8: “regulation be scaled according to the size of an issuer’s market capitalization and other issuer specific considerations in order to ensure that regulation is appropriate.”

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sense that they are better able to meet the costs of compliance initiatives and so can drive out smaller operations."[81]

However, advocates for adopting US SOx requirements refer to the so–called "made in Canada discount" for securities traded only in Canada—securities which are inter–listed with US exchanges tend to trade 25 basis points higher. Tom Allen, Chairman of the Task Force, suggested that the reason for this discount is that enforcement in Canada is considered less rigorous than in the United States. With less enforcement, inappropriate managerial behaviour is considered more possible, so investors discount the prices if trading only in Canada.[82] Others dispute the reasons for, or the existence of, this discount in Canada[83], but logically, investors who trust that the regulations compel full and true disclosure would pay a premium over securities trading only in less reliable jurisdictions.

Competition for Regulation

With globalization and the growing use of the internet, foreign stock exchanges compete for

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[81] (Puri and Condon, The Role of Compliance in Securities Regulatory Enforcement 2006)

[82] (The Task Force 2006) at p.33

[83] See, for example, (Lortie 2010) at pp. 15–16 and (Carpentier, L'Her and Suret, On the Competitiveness of the Canadian Stock Market 2009) who notes that the premium for listing on US exchanges applies to all countries and not just Canada; it doesn't last for long but is temporary. As Carpentier et. al. suggest, "There is no strong empirical support for the so called "Canadian discount." pp.15–17

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Canadian and American listings.[84] How can Ontario's premier exchanges, the TSX and TSX–V (together, the "TMX") compete for listings internationally? Is it simply a question of better regulation?

The UK Alternative Investment Market ("AIM"), which regulates with principles rather than rules, has been growing steadily since 1995.[85] As of July 2011, there were 1,151 companies listed on the AIM market, of which 929 were UK companies and 222 were international companies. According to Mallin and Ow-Yong, while AIM saw phenomenal growth from 2004 to 2006, there has been a declining trend in admissions since 2007[86]. Mallin and Ow-Yong ascribe this downward trend to the global financial crisis of 2008. US exchanges, which must comply with detailed US SOx rules, have lost the listings of many small– and medium– sized

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[84] As stated by (The Task Force 2006), p.50: "we have all witnessed the reaction of issuers to avoid, where possible, the costs associated with compliance with the Sarbanes–Oxley Act in the United States. We have observed that stock exchanges in the United States have a high level of concern regarding the impact of this extensive regulatory framework on the attractiveness of U.S. capital markets. At the same time other markets where capital is in adequate supply are distinguished by "toned down" regulation, by outsourcing to gatekeepers who have reputational capital at risk if they perform their task inadequately.

[85] See, e.g., (Parkinson 2006) Whether this shift actually represents a reduction in the perceived value of an American listing is less obvious. For example, see (Doidge, Karolyi and Stulz 2007) who argue that the decline in cross–listings on the New York and London stock exchanges between 1990 and 2005 is explained by changes in firm characteristics rather than by changes in the benefits of cross–listings.

[86] (Mallin and Ow-Yong 2013) at p.114

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issuers, which have either gone private or gone to the illiquid "pink sheet" quotation system.[87] Moran describes the contrasting regulatory philosophies in London and New York: London has emphasized trust, flexibility and voluntary compliance; but for over 50 years U.S. regulation has been adversarial, detailed and dominated by an administrative agency with statutory power. The City of London has been able to keep its own regulation off the conventional political agenda. By contrast, American financial institutions have worked in an environment of restraint because of populist suspicion of the "money trusts", and because of the suffering caused by the financial collapses of 1929–33[88] and the financial upheaval caused by the credit crisis of 2008.

In 2009, Cetorelli and Peristiani, staff of the Federal Reserve Bank of New York, undertook a detailed review of the attractiveness of various capital markets and the "patterns of relationships" among them. They found that, although the London Stock Exchange, the Deutsche Borse, and the Hong Kong Stock Exchange, were becoming more competitive, the U.S. exchanges remained the destination of choice for foreign issuers which wish to cross–list on multiple exchanges.[89]

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[87] (Knowledge@Wharton 2003). Detractors such as Congressman Ron Paul contend that US SOX was an unnecessary and costly government intrusion into corporate management that places U.S. corporations at a competitive disadvantage with foreign firms, driving businesses out of the United States. In an April 14, 2005 speech before the U.S. House of Representatives, Paul stated, "…According to a survey by Korn/Ferry International, Sarbanes–Oxley cost Fortune 500 companies an average of $5.1 million in compliance expenses in 2004, while a study by the law firm of Foley and Lardner found the Act increased costs associated with being a publicly held company by 130 percent." (Paul 2005)

[88] (Moran 1980)

[89] (Cetorelli and Peristiani 2009)

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This is because of the “prestige effect” of listing on a U.S. exchange. Since the Second World War, U.S. exchanges have become the financial node for multinational companies, a stepping–off point for additional financings in other markets.

As to the competitiveness of Canadian exchanges, they have never achieved the same international prestige as U.S. exchanges. The TSX is not a common destination for foreign IPOs. As Lortie says, “[w]hy would a leading Chinese bank list its newly issued stock on the TSX when it can list on the NYSE?”[90] Canadian issuers going global will list in New York, but U.S. and foreign issuers going global will not usually list in Toronto. Between 1900 and 2006, a total of 98 foreign companies listed in Canada compared to 651 Canadian companies that listed abroad. Furthermore, once Canadian companies do cross–list on U.S. exchanges, brokers tend to trade more on New York exchanges, because of increased liquidity and price competition in New York. Lortie refers to various estimates which suggest that, for an institutional trader, trading costs on the TSX are significantly higher than in New York.[91]

However, the competitiveness of the Toronto market does not lie in its overall size, but in its international reputation for choice industries, especially mining. The TMX lists more public mining companies than any other exchange in the world—1,434 in 2009, compared to Australia, the next highest at 610, then the London AIM at 134. $79.1 billion mining shares traded on the

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[90] (Lortie 2010) p.16

[91] (Lortie 2010) p.17 However, Canadian brokers will typically reduce their prices once the issuer cross–lists on the U.S. to maintain market share. See (Foerster and Karolyi 1998)

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TMX in 2009. The number of financings on the TMX was 1,962 in 2009, compared to the next highest, Australia, at 186. The mining companies listed on the TMX are international in operations: 50 per cent of the 9,700 mineral exploration projects financed on the TMX are outside of Canada.[92]

Toronto brokers, advisers and analysts have developed an international reputation for mining expertise. Over 200 analysts cover TMX–listed mining companies. The Prospectors and Developers Association of Canada, which is located in Toronto, is a national organization of 6,000 individual members (including prospectors, developers, geoscientists, consultants, mining executives, and students, as well as those involved in the drilling, financial, investment, legal and other support fields) and 950 corporate members (including senior, mid–size and junior mining companies and organizations providing services to the mineral industry)[93]. Ontario has excellent mining engineering and geophysics schools. Canadian securities commissions insist upon compliance with National Instrument 43–101, which requires that only a qualified engineer or geoscientist can make public statements about mining prospects. Although Toronto may not be a destination for foreign issuers generally, Toronto is the destination of choice for financing mineral projects anywhere in the world. Also, as described above (under the topic "Background Facts about Ontario venture issuers") all but the largest 245 companies listed on the TSX, and all

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[92] (Toronto Stock Exchange and TSX Venture Exchange 2009)

[93] See "About the PDAC" at < http://www.pdac.ca/pdac/about/index.html >

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companies listed on the TSX Venture Exchange ("TSX–V"), would be considered "small cap" (or even smaller) companies in the United States.

It would seem, therefore, that a good way for Toronto and Ontario to compete internationally is to recognize the source of one of its main strengths—junior mining exploration.

Regulation to Create a Public Good

There are some areas where it is generally accepted that venture issuers should be compelled to gather rules–based, detailed information, whether or not it is justified on a cost–benefit basis for the particular transaction. For example, National Instrument 43–101 requires that mining issuers cannot disclose any information about a mineral resource to the public, or its quantity or grade, unless the disclosure uses only the detailed categories set out in the Instrument. Also, any public mineral resource statement must be approved by a "qualified person", being an engineer or geoscientist with the appropriate training and experience. A "technical report" about the mineral resource must be filed when an issuer becomes a reporting issuer (i.e. a public issuer) or when any document is circulated to the public for a mining issuer (other than an offering memorandum delivered solely to accredited investors), so that investors have professionally approved

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information before making any investment decision.[94] These detailed disclosure rules are considered effective because the issuer is in the best position to accumulate mineral resource estimates, and it is material information to investors generally,[95] even if the cost to acquire such information exceeds the value of any particular transaction.

Another example is noted by Georgakopoulos[96]: shareholders typically do not vote at shareholder meetings or control management. Without securities regulations requiring ongoing (and often expensive to produce) disclosure, most corporations would prefer spending retained earnings on long-term, more strategic, projects. Disclosure and market liquidity enhances the market generally, which corporations may otherwise choose to ignore. As Coffee argues, some

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[94] National Instrument 51–101 has similar prescriptive requirements for oil and gas activities. These rules followed the Bre-X salting scandal, described on page 47 above.

[95] The "efficient market" model referred to in note 276 , *supra*, would seem to discourage investors from acquiring information about a firm, because the information is so rapidly disseminated in the market that no gain can be made from its analysis. (Gilson and Kraakman 1984) at 572 describes how, even though corporate insiders and exchange specialists can enjoy easy access to information that would be too costly for others to obtain, the advantage is quickly diminished by information leak and "derivatively informed trading", i.e. traders can glean information by observing the public reports of insider trades. As (Gordon and Kornhauser 1985) note, the efficient market theory leads to a paradox: if participants fail to acquire costly information, the production of information may diminish generally and the market itself might fail to remain efficient.

[96] (Georgakopoulos 1995), p.95

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information about issuers is a “public good” that can spread throughout the market for the benefit of investors generally.[97]

Some areas of mandated disclosure may not be so necessary, however. For a small mining exploration company, for example, details about its audit committee, best practice standards, written code of business conduct and ethics, and CEO and CFO certifications may not be worth the cost. Disclosure which is tailored to the needs of venture issuers and their investors is consistent with proposed National Instrument 51-103, which is designed to “improve access to key information and facilitate informed decision-making by venture issuer investors by tailoring disclosure requirements to the circumstances of venture issuers, eliminating certain disclosure obligations that may be of less value to venture issuer investors, and providing supplemental disclosure that…is relevant to venture issuer investors.” By tailoring disclosure for venture issuers, the intent of NI 51-103 is to “allow venture issuer management more time to focus on the growth of their company's business by reducing the time venture issuer management must spend

[97] (Coffee, Market Failure and the Economic Case for a Mandatory Disclosure System 1984) at 725. Coffee describes how research is likely to be undercompensated because market news is leaked so easily. Thus, the gatherers of such information, including analysts, do not retain the benefits of accumulating market information (the “free rider” problem) and so it should be treated as a public good. So long as free riders do not pay, market information will be underprovided, especially as investors use discount brokers.

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reading and trying to understand disclosure requirements through reducing the overall length and complexity of the instruments…and streamlining and reducing disclosure redundancies."[98]

As Sarra notes, proportionate disclosure should be based on what is relevant to investors. Investors in a junior venture may attach considerable importance to the track record of management in finding the resource or mineral sought, in building equity, and in securing mineral rights or licences, probable reserves, or intellectual property rights in the case of some sectors such as biotechnology. In contrast, detailed financial statements with extensive notes may not be as important to the investors of venture issuers.[99]

Some Recent Securities Law Reports

Various studies have advocated principles–based regulation, often in the context of promoting a federal securities commission.

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[98] On July 25, 2013, the Canadian Securities Regulators published CSA Notice 51-340, which said that "After reviewing the comments received and further consideration, we have determined not to pursue the implementation of proposed NI 51-103. However, we are currently considering implementing some of the proposals within proposed NI 51-103 as amendments within the existing regulatory regime for venture issuers."

[99] (Sarra 2008) at p.14

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1979 Federal Proposals

In 1979, the federal government published a three–volume treatise entitled "Proposals for a Securities Market Law for Canada" (the "1979 Proposals"). The 1979 Proposals contained draft legislation, commentary and fourteen comprehensive studies supporting a national securities regulator. One of its authors, Williamson, argued that investor protection and market efficiency would best be achieved through a national marketplace. In the 1970s, computerized systems for trading were centralizing markets in Canada and the US, and so, according to Williams, regulators needed to centralize to manage the new technology. For example, the Toronto Stock Exchange's work on CATS ("computerized assisted trading system") started in 1969 and testing started in 1977. The Montreal Stock Exchange was faced with a dilemma: Over 90 per cent of its firms also belonged to the Toronto exchange. The Montreal exchange, with resources considerably smaller than Toronto, could not economically compete, so Montreal proposed the development of a Canada–wide trading system, to discourage its brokerage business from emigrating to Toronto. The Toronto, Vancouver and Alberta exchanges, and the Investment Dealers Association, adopted Montreal's proposal by 1975. Williamson argued that competition with US electronic trading systems and reduced commissions south of the border, required systems for better operational efficiency and the centralization of electronic trading in Canada.[100]

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[100] (Anisman, et al. 1979) Chapter 1, "Capital Markets" pp.104–131

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To regulate this centralization, the argument was that Canada should adopt a national securities commission.

Although computerized trading seemed to require centralization and harmonization of rules, other authors of the 1979 Proposals noted the complex politics of securities regulation. Howard described how legislatures, for political reasons, delegate to commissions outside of government departments, the resolution of problems too complex for ordinary bureaucrats, who normally apply static rules and standards. As Howards notes, "…[A] commission can take on a novel and complex task, explore and analyze an industry, apply its expertise to refine very broad statutory policy through adjudication and regulation–making, and maintain continuous oversight of the regulated market or industry to determine the effectiveness of that policy."[101] Howard's analysis parallels the comments later in this paper (see Rules and Complexity, Rules and Precision and Rules and Risk). When faced with a complex field such as securities trading, detailed rules can become a tangled web as the regulator tries to anticipate and correct all risks. Principles–based regulation, on the other hand, gives the regulator flexibility to adapt principles to new circumstances. The draft Securities Act in the 1979 Proposals avoided precise, technical language. One its authors Philip Anisman said that the draft was written "in a clear manner that would be understandable to a knowledgeable layman without losing the precision required in technical legislation."[102]

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[101] (Anisman, et al. 1979) at .1614–1615

[102] (P. Anisman 1981) at343

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Nothing came of the 1979 Proposals, however, because of the resistance to federal control over securities regulation at the time. There were also political concerns: Quebec was disputing the federal repatriation of the constitution with its new Charter of Rights—federal expansion into provincial regulation of securities could have exacerbated the constitutional and political debate.[103]

1994 Ontario Securities Commission proposals

The topic of a federal securities regulator lay relatively dormant until 1994, when the OSC published a proposal by the Atlantic provinces which contemplated a Canadian Securities Commission, headquartered in Toronto, reporting to the Minister of Finance of Canada. Flexibility and responsiveness to local concerns would be achieved through regional offices in British Columbia, Alberta and one of the Atlantic Provinces—Quebec was not expected to participate. After some initial interest and comment, the proposal lay dormant until the federal government revived it in a 1996 Throne Speech.[104] At a first ministers' conference in June 1996, the federal and provincial governments (excluding British Columbia and Québec) endorsed the concept of giving securities regulation to a federally–run commission. The parties expected a formal agreement within a few months, with draft legislation to follow. However, the 1996

[103] See the review in (Harris 2002) pp. 20–24. As of April 2011, the Supreme Court of Canada is hearing a reference case, to determine if the federal government has the constitutional power to regulate securities under the "trade and commerce" head of power, or whether jurisdiction is purely provincial under the "property and civil rights" power. See (Campbell and McLeod 2011)

[104] (Harris 2002), p.27

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revival proved short–lived, and the topic of Canadian securities regulatory reform once again dropped from the political agenda.[105]

2002 Wise Person's Committee

In the fall of 2002, Harold MacKay delivered a report on securities regulatory reform to the federal Minister of Finance and recommended the establishment of the Wise Persons' Committee (the "WPC") to review the existing securities regulatory system and propose an appropriate model for the future. After an exhaustive research and public consultation process, the WPC published "It's Time" in December 2003. The report recommended a cooperative model of securities regulation involving the federal and provincial governments. The WPC concluded that, if the cooperative approach was not successful, the federal government had the authority to regulate in the field of securities matters and should use that authority to create a national securities regulator.

2006 Crawford Panel

In May 2005, Ontario's Minister of Government Services asked Purdy Crawford to chair the

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[105] (Harris 2002), p.35

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"Crawford Panel on a Single Canadian Securities Regulator". Its terms of reference were to recommend a framework for a common securities regulator. Its "Blueprint for a Canadian Securities Commission" in June 2006 argued that inconsistencies between jurisdictions would be reduced and regulations would be easier to follow under a central regulator. The panel consulted widely with capital market participants as well as federal and provincial ministers and officials, securities regulators and other informed parties. The panel's third "message", from those with whom they consulted, was that "small and medium–sized enterprises require special regulatory attention to reduce compliance costs and help them access capital as efficiently as possible" and their fifth message was "to have as much principles–based regulation as is feasible, to replace bureaucratic legalese with plain language and to make the system more user friendly."

2009 Expert Panel

The Expert Panel on Securities Regulation in Canada published its final report and recommendations on January 12, 2009, entitled "Creating an Advantage in Global Capital Markets". The Expert Panel was appointed by Canada's Minister of Finance (see above at page 33). It made a number of recommendations, including a national regulator and principles–based regulation. It commissioned seven research studies to support its deliberations, some of which are discussed later in this paper, including Cristie Ford's "Principles–Based Securities

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Regulation"[106] and Janis Sarra's report "Proportionate Securities Regulation: The Potential for Scaled Treatment of Junior Issuers"[107].

The Expert Panel noted that capital markets are becoming increasingly sophisticated and dynamic. Principles–based regulation would better achieve regulatory outcomes since it would give businesses greater flexibility to adapt compliance practices to the latest innovations in the capital markets. This topic is discussed elsewhere in this paper—see, for example, reference to the empirical study in which the BC Securities Commission compared the current, rules–based, account supervision system of the Investment Dealers Association ("IDA") with the principles–based, B.C. proposal ("Effectiveness of Principles" at page 94).

The Expert Panel argued that businesses, under principles–based regulation, when confronted with an ambiguous situation, would be responsible for actively developing and managing compliance practices to achieve the desired regulatory outcomes. This topic is discussed in the section of this paper titled "Principles and Regulatory Collaboration." Principles–based regulation might facilitate better enforcement actions by being able to hold businesses accountable for rule infractions as well as actions that, although technically compliant, violate the public interest. This topic is discussed under the general topic of the "Rules Approach" in this paper.

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[106] (Ford, Principles-Based Securities Regulation, A Research Study 2009)

[107] (Sarra 2008)

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Chapter 2: Literature Review – Rules, Principles and Compliance

This chapter reviews the academic literature regarding rules and principles. It begins with a description of the rules approach; then discusses the complexity, precision and language of rules. The principles approach is discussed, and how, in order to flesh out principles, the regulator and community must learn to collaborate.

To assess rules or principles requires a consideration of what makes regulations effective, and to do that, the regulatory goals of "risk–based", "responsive", "outcomes–oriented" and "proportionate" regulation are discussed in this chapter.

Governance theory is addressed. The choice of rules or principles must take into account how regulations are translated and implemented through organizations. Large issuers may have more resources for legal experts to interpret rules, but smaller issuers may have more direct contact with its employees and may find compliance easier to monitor. "Meta-regulation" is discussed, in which principles are set by the regulator, with discretion to participants to implement procedures to achieve these principles.

Also discussed are theories of regulatory compliance—why do the regulated comply? What motives are in play? It is not enough for regulations to make sense or to be laudable; they must be followed, and so, the mix of rules and principles should take into account compliance motives.

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Conflicts of interest are discussed. As noted in chapter one, a significant percentage of Canada's public companies have controlling or major shareholders[108] and Canadian securities regulation seeks to protect minority investors in the context of related–party and going private transactions. How should conflicts of interest be regulated—with detailed rules or broad principles?

Also reviewed in this chapter are the rules/principles language strategies in other fields of regulation, in order to draw comparisons. Income tax compliance, accounting standards, competition laws and other fields are reviewed to see what mix of rules and principles they use, how effective they are, and whether analogies can be made to securities regulation.

Rules Approach

In a rules–based approach, detailed rules prescribe all of the "do's and don'ts". Most traffic laws, for example, are rules–based. Speed limits say "Maximum—100 km/hr" rather than "Don't drive too fast". Signs say "Stop", "No Left Turn", "Yield", or "Watch for Children". There is little room for interpretation in traffic rules, with the exception of a few offences such as "careless" driving. As Sunstein argues, in a rules–based regime,

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[108] See "Controlling shareholders of venture issuers", above at p.38

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> "…an assessment of facts, combined with an ordinary understanding of grammar, semantics, and diction and of conventions – and more substantive ideas on which there is no dispute—is usually sufficient to decide the case." [109]

Rules can be simple or complex. "A law could say, for example, that no one under eighteen may drive. Or it could be somewhat more complex, by saying that people under eighteen may not drive unless they pass certain special tests. [And] it could be quite complex, creating a formula for deciding who may drive."[110]

Rules can be general or specific. A general rule may prohibit driving more than 50 km/hr. on any city road. A specific rule may prohibit driving more than 40 km/hr. near a particular school.

Advocates for rules say they enhance certainty because outcomes are forbidden *ex ante*. As Wallison[111] argues, clearly stated rules, with predictable meaning and scope, reduces administrative discretion and allows participants to focus on matters other than compliance. Braithwaite argues that vague principles are "a common affliction of regulatory standards, especially those that rely on such open–ended terms as 'in the public interest', 'feasible', or

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[109] (Sunstein 1995), at 962

[110] (Sunstein 1995), at 962

[111] (Wallison 2007). Also, as Sunstein notes, *supra* note 109, at 977: "A special advantage of rules is that because of their fixity, *ex ante* quality, and generality, they make it unnecessary for citizens to ask an official for permission to engage in certain conduct. Rules turn citizens into right–holders, able to expect certain treatment as a matter of right. Standards, guidelines, or factors are more likely to make citizens into supplicants, requesting official help."

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‘reasonable.’[112] As David Brown, former Chair of the Ontario Securities Commission, wrote in an open letter regarding securities regulation:

> “To force market participants to determine what is expected of them is to shift the regulatory burden down to those participants. To force investors to interpret a set of principles and to make a judgement as to whether their application by an issuer or registrant is adequate is neither efficient nor would it inspire confidence. We believe that rules are necessary to amplify and clarify clearly articulated principles.”[113]

Rules and Complexity

Although a rule can be clearly worded and have a predictable meaning on its own, it can become uncertain if juxtaposed with other rules.[114] For example, consider parking in downtown Toronto, with signs: “No Parking between 12:00 and 6:00”, “No Stopping between 7:00 and 9:00 a.m.”,

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[112] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002), at p. 4–5. See also (The Task Force 2006) (p.14, #57) “the ‘contrary to the public interest’ regulatory tool be used sparingly and only with the greatest care if the behaviour which is criticized has not been publicly identified in advance as unacceptable. Where the behaviour that is criticized has not been publicly identified, the contrary to the public interest provision should only be used if the conduct is egregious and a reasonable person in the circumstances would view it to be contrary to the public interest. If the conduct is not egregious, the public should be duly warned before any enforcement action is taken. The risk that so–called “gotcha” enforcement brings the entire securities enforcement apparatus into disrepute must not be overlooked”

[113] (D. Brown, Open letter to BC Securities Commission: Comment on the proposed BCSC model 2003).

[114] (Expert Panel on Securites Regulation 2009) at p.55

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"Tow Away Zone", "No Standing". Each rule on its own is clear enough, but their applicability becomes complicated as their numbers increase.

Despite its clear language, a rule sometimes requires an understanding of its purpose.[115] As Braithwaite says, certainty does not flow so much from the precision of the words used as it does from a tacit understanding within a community as to objectives.[116] Braithwaite describes how rules are more certain when the field is "simple, stable and does not involve huge economic risks" (e.g. traffic laws). But where the field is "complex, changing and involves large economic interests" (e.g. securities law), principles are more certain.[117] Braithwaite found that, with nursing home regulation, experienced practitioners reason by analogy when faced with a thicket of complex rules. They look through the surface features of a problem and identify the key relationships and principles involved (which is why Braithwaite advocates principles for nursing home regulation. Nelson argues that task complexity generally harms judgment by encouraging coping strategies. For accounting standards, practitioners often complain that voluminous rules create such a "standards over–load" that very few are able to absorb. Coping strategies include disregarding potentially important information and combining information in simplistic ways.[118]

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[115] (L. Fuller 1958) at 663 The example he gives is, a rule may say "no vehicles in the park", but is the mounting of a World War II truck on a pedestal in the park for memorial purposes also prohibited?

[116] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002) at p.71

[117] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002) at p.75

[118] (M. Nelson 2003) at p.94

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Some complex accounting transactions can be regulated by rules if they have predictable characteristics – for example, leases with a contractually defined cash flow, because numerical thresholds can specify lease life and remaining value. Other accounting topics are less predictable and require judgment—for example, estimates of the probability of something occurring are better regulated with principles.[119]

The Enron debacle (where debt–ridden, "special purpose entities" were structured in tortured ways to avoid consolidation on Enron's balance sheet) is an example of detailed rules gone bad; arguably, had the substance of these technical transactions been reported, the Enron bubble would have burst earlier.[120] But as Paul Williams says, things may have been just as bad under a principles–based approach:

> "All the principles in the world are not going to lead to better reporting so long as the culture of Big 4 professional accounting remains as it is. If Andersen manipulated the rules to allow Enron to misrepresent itself imagine how much more creative one can be when one only has a principle defining the boundaries!"[121]

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[119] (M. Nelson 2003) at pp.94–95

[120] According to Robert Kershaw, the common – though mistaken – view in the United Kingdom is that it avoided Enron style scandal in the early years of this millennium because its approach to accounting regulation is principles-based rather than rules based. (Kershaw 2005) The dispute has receded somewhat, given recent transnational convergence of accounting principles around International Financial Reporting Standards. See, e.g., News Release, FASB and IASB Reaffirm Commitment to Enhance Consistency, Comparability and Efficiency in Global Capital Markets (Feb. 27, 2006), <http://www.fasb.org/news/nr022706.shtml>

[121] (Williams 2003) What exactly the "culture of Big 4 professional accounting" is, is not defined by Williams.

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As Wood notes,[122] additional rules may increase or decrease task complexity, depending on the circumstances. Component complexity increases with more rules, coordinative complexity increases when a new rule must be considered in light of existing rules, and dynamic complexity increases by changing the pattern of rules over time. Adding an exception or precedent heightens total task complexity. On the other hand, adding an implementation guideline that sequences the decisions necessary to implement a standard, or adding an index that better relates existing rules and precedents, can lower total task complexity by reducing coordinative complexity to more than offset any increase in component and dynamic complexity.

Frequent amendments to rules can substantially increase compliance costs. An interesting analogy is the cost of corruption. Ogus[123] assessed the costs of corruption in Zaire, the Philippines, and South Korea. Where corruption is unpredictable (as in Zaire), it undermines the certainty of property rights and the enforceability of contracts and its impact on the economy is worse than where it operates as a predictable charge, like taxation, on productive activities (as in South Korea). Similarly, if regulations are frequently amended or reinterpreted, the unpredictability can become unmanageable. However, if the cost of securities compliance becomes a predictable charge on economic activity, it can be absorbed like taxes.[124] Ontario

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[122] (Wood 1986) and discussed by Nelson (M. Nelson 2003) at pp.94–95

[123] (Ogus 2004) at p.334

[124] As to the importance of predictability of regulation, see also Canadian Federation of Independent Business Tax Research Series, Report 1, The Hidden Tax Burden, A business

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securities rules are subject to frequent amendment, comment and re-publication, making them difficult to navigate. This is illustrated by the following page from the OSC website dealing with the private placement rule:

History of 45-106 - Prospectus and Registration Exemptions[125]

Table 2 Frequency of amending private placement rule

Date	Item
April 25, 2013	Proposed Amendments to NI 45-106 Prospectus and Registration Exemptions ***Comments Received***
March 27, 2013	Proposed Amendments (Related to Modernization of Investment Fund Product Regulation (Phase 2))
March 14, 2013	CSA Notice of Consequential Amendments to Registration, Prospectus and Continuous Disclosure Rules Related to NI 25-101 Designated Rating Organizations
September 13, 2012	Republication and Request for Comment: Proposed NI 51-103 - Ongoing Governance and Disclosure Requirements for Venture Issuers and Related Amendments ***Comments Received***
April 26, 2012	CSA Staff Notice: 45-308 - Guidance for Preparing and Filing Reports of Exempt Distribution under NI 45-106 Prospectus and Registration Exemptions
April 13, 2012	Unofficial Consolidation of National Instrument 45-106 and Companion Policy as of April 13, 2012
November 10, 2011	Public Consultation: CSA Staff Consultation Note: 45-401 - Review of Minimum Amount and Accredited Investor Exemptions
June 15, 2011	CSA Staff Notice 11-315 - Extension of Consultation Period

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perspective on the cost of complying with taxes, August 2008: "property taxes ranked higher when business owners were asked which forms of taxation affect the growth of their business the most. This suggests that with respect to property taxes it may not be complying with the tax that is such an issue, but rather the unpredictable changes or increases in property taxes that we typically see from year to year."

[125] At <http://www.osc.gov.on.ca/en/15126.htm> accessed May 2012

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April 1, 2011	Request for Comments: Proposed Amendments to NI 45-106 ***Comments Received***
December 10, 2010	Final: IFRS-Related Amendments to Securities Rules and Policies
December 10, 2010	Notice of Ministerial Approval of IFRS-Related Amendments to Securiities Rules and Regulation 1015 under the Securities Act
October 1, 2010	Notice of IFRS-Related Amendments to NI 45-106 Prospectus And Registration Exemptions and Companion Policy 45-106CP Prospectus And Registration Exemptions
April 23, 2010	Proposed Consequential Amendments to NI 51-102: Request for Comment: NI 43-101 Standards of Disclosure for Mineral Projects ***Comments Received***
November 27, 2009	CSA Staff Notice: 45-304 - Notice of Local Exemptions Related to NI 45-106 Prospectus and Registration Exemptions and NI 31-103 Registration Requirements and Exemptions
October 16, 2009	CSA Notice and Request for Comment – Proposed Amendments to National Instrument 45-106 Prospectus and Registration Exemptions
September 18, 2009	Amendments
September 18, 2009	Notice of Ministerial Approval of Repeal and Replacement
July 17, 2009	National Instrument: NI - 45-102 - Resale of Securities
July 17, 2009	Notice of Commission Approval of Repeal and Replacement: NI - 45-102 - Resale of Securities
May 22, 2009	Notice and Request for Comment: NI - 45-102 - Resale of Securities
February 29, 2008	Notice and Request for Comment: NI - 45-102 - Resale of Securities ***Comments Received***
January 6, 2006	Notice of Ministerial Approval: NI - 45-106 - Prospectus and Registration Exemptions
January 6, 2006	Ontario Amending Instrument: NI - 45-106 - Prospectus and Registration Exemptions
December 9, 2005	Notice: NI - 45-106 - Prospectus and Registration Exemptions
December 9, 2005	Amendment: NI - 45-106 - Prospectus and Registration Exemptions
December 2, 2005	CSA Staff Notice: NI - 45-106 - Prospectus and Registration Exemptions
October 21, 2005	Request for Comment
October 21, 2005	CSA Request for Comment
October 7, 2005	Notice of Correction: NI - 45-106 - Prospectus and Registration Exemptions
September 9, 2005	CSA Staff Notice: 45-304 - Notice of Local Exemptions Related to NI 45-106 - Prospectus and Registration Exemptions

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September 9, 2005	Notice of Ministerial Approval
September 9, 2005	National Instrument and Consequential Amendments
July 8, 2005	CSA Table of Concordance: NI - 45-106 - Prospectus and Registration Exemptions
July 8, 2005	National Instrument and Consequential Amendments
July 8, 2005	Notice of Commission Approval: NI - 45-106 - Prospectus and Registration Exemptions
December 17, 2004	Notice: NI - 45-106 - Prospectus and Registration Exemptions ***Comments Received***

Rules and Precision

"Bright–line" rules may appear to be precise because they limit discretion. But limiting discretion is not necessarily fair. Bright–line rules are arbitrary at the border. They force the regulator to distinguish cases even though they could be factually very similar. "A decision favoring rules thus reflects the judgment that the danger of unfairness from official arbitrariness or bias is greater than the danger of unfairness from the arbitrariness that flows from the grossness of rules."[126]

Braithwaite describes how a rule will have a core meaning and a "penumbra", i.e., a grey area where the rule may or may not apply. If the field is complex and subject to change, lawyers may "aim for the penumbra" and exploit language uncertainties. "This problem multiplies as the state enacts more and more rules to plug loopholes opened by legal entrepreneurs. The thicket of rules

[126] (Sullivan and Amar 1992) at p.62

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we end up with becomes a set of sign–posts that show the legal entrepreneur precisely what they have to steer around to defeat the purposes of the law."[127]

It is not just lawyers, acting as legal entrepreneurs, who "aim for the penumbra". Nelson describes how auditors will usually not require their clients to adjust aggressive reporting structured to meet precise standards. Precise standards can create targets that managers use to achieve particular accounting objectives.[128]

As staff of the U.S. Securities and Exchange Commission described in a report to the United States House of Representatives, in a rule-based system, accountants tend to develop a "check–list" mentality. Rather than take responsibility for determining whether financial reporting fully reflects the objectives in an accounting standard, they mechanically check that the treatment is not prohibited by the "bright–line" standards within GAAP. One unintended consequence is that the rules themselves come to serve as a roadmap in structuring transactions that appear sanctioned by the rules, but which are, in fact, misleading. "To the financial engineer seeking to

[127] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002), at 56. See also (Black, Forms and Paradoxes of Principles Based Regulation 2008), where she describes an "interpretive paradox" of principles: "although principles may facilitate interpretation of the regulatory objectives and responsibilities of firms more clearly for some, they can also impede interpretation for others, particularly lawyers."

[128] (M. Nelson 2003) at p. 10. On the other hand, as Nelson notes, "there are situations in which auditors know more about precise accounting rules than do their clients, and therefore are better able to identify the specific rules and precedents that prohibit a client–preferred accounting treatment. However, another explanation is that auditors' negotiating positions are particularly strong when they can point to precise rules that preclude the client's preferred accounting treatment." At p. 10.

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structure transactions that transform debt into equity, shift revenue recognition, create an operating rather than a capital lease, or otherwise obscure the financial condition of a reporting company, the rules do not constrain so much as merely constitute challenging puzzles."[129]

The reverse is also true—the application of complex rules can be unpredictable, giving the regulator too much power. The thicket of rules can obscure activity and strangle innovation. As Braithwaite notes, "The larger the smorgasbord of standards, the greater the discretion of regulators to pick and choose an enforcement cocktail tailored to meet their own objective. A proliferation of more specific laws is a resource to expand discretion, not a limitation upon it."[130]

Colin Diver distinguishes three elements of regulatory precision: "transparency", "accessibility" and "congruence".[131] Transparent rules are those which are easily applied within a relevant community; for example, driving over the speed limit or failing to pay at a toll bridge. Some terms are transparent only to a subset of the population; for example, the legal terms "obscenity", "reasonable care" and "insanity" are too vague for the general population, but the legal community of lawyers and judges can apply them from case law. Accessible rules are those

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[129] Study Pursuant to Section 108(d) of the Sarbanes–Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles–Based Accounting System" U.S. Securities Exchange Commission, 07/25/2003 http://www.sec.gov/news/studies/principlesbasedstand.htm

[130] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002) at 64

[131] (Diver 1984) p.67

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which can be easily understood, though not necessarily easily applied. Congruent rules are those which produce a socially desired behaviour. [132]

Diver argues that rules usually require a tradeoff between their transparency, accessibility and congruence. For example, consider the following formulations of a rule to retire pilots when the risk of accident becomes unacceptable:

Model I: No person may pilot a commercial airplane after his sixtieth birthday.

Model II: No person may pilot a commercial airplane if he poses an unreasonable risk of an accident.

Model III: No person may pilot a commercial airplane if he falls within one of the following categories. (There follow tables displaying all combinations of values for numerous variables, including years and level of experience, hours of air time logged, age, height, weight, blood pressure, heart rate, eyesight, and other vital signs, that would disqualify a pilot from further eligibility to pilot aircraft.)"

Model I is transparent because age is easily understood and measured, but it can ground pilots who should fly and it can overlook pilots who should be grounded. Model II may be congruent

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[132] (Diver 1984) p.67

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with underlying safety goals, but is so vague as to be inaccessible. Model III may seem objective but difficult to apply.[133]

Diver argues that, when drafting a particular rule, its transparency, accessibility and congruence should be prioritized. For example, definitions of criminal liability should be precise (for predictability), whereas sentencing should be principles–based (to achieve congruence and rehabilitation).[134] Licensing should be principles–based to achieve congruence (since there are so many factors to consider), whereas prohibitions should be precise and transparent.[135] Internal rules (which regulate the various branches of the regulator) should be principles–based and external rules (which regulate the public) should be more transparent, since "agency personnel are typically more homogeneous than the regulated public" and will develop a shared understanding of principles.[136]

Applying Diver's analysis to securities regulation, licensing market participants, such as brokers and public accountants, should be principles-based, with a discretion to consider the many

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[133] (Diver 1984)73–74. Diver summarizes the effect of increased precision in a rule: (i) it will increase the rate of compliance since it is easily understood, (ii) it will increase the arbitrary distinction between intended and unintended application, (iii) it will increase the social cost of formulating the rule since "regulatory line–drawing increases the risk of misspecification and sharpens the focus of value conflicts", and (iv) it will decrease the cost of enforcement since it is more easily applied.

[134] (Diver 1984) pp.77–78

[135] (Diver 1984) p.79

[136] (Diver 1984) p.76

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factors comprising “good character” before granting a licence. Enforcement regulations should be rules–based, precise and transparent, to enhance predictability. Also, the more homogeneity there is among a regulated group, the more that principles should be used. Diver’s reference to the homogeneity of a group and the use of principles is similar to the analysis of “interpretative communities”, described later in this paper (page 164).

Ellinghaus and Wright[137] conducted three experiments involving the participation of 1800 subjects (law students and non–law students) in the resolution of contract disputes and the evaluation of judgments, using three different law models: (1) the common law of contracts, which mediates broad principles with detailed rules; (2) UNIDROIT Principles of International Commercial Contracts, a model code with 194 articles; and (3) The Australian Contract Code, a model code, which has only 27 Articles with commentary of 47 short paragraphs (Article 3 of which states: “Neither past nor future decisions govern the application of the Code.”—thus reliance on broad principles under the Australian Contract Code was overt.)

Students were given the facts of ten disputes and a statement of relevant law, either as broad principles or detailed rules. The disputes had all produced split decisions by the Australian appellate court. Five of the disputes were classified as “easy” and five were classified as “harder”. Participants were asked to decide the outcome and consensus was measured by the proportion of participants agreeing with the majority decision in each case. For the “easy” cases, they found a large consensus when students used broad principles and a moderate consensus

[137] (Ellinghaus and Wright 2005)

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when students used detailed rules. For harder cases, consensus was moderate under both the principles and rules–based models. Ellinghaus and Wright concluded that broad principles promote greater consensus, especially in easier cases.[138] "Detailed rules seem to have a tendency to increase the scope for plausible disagreement over the outcome of simple disputes, thus possibly promoting litigation. On the other hand, broad principles appear to make it clear when a decision is difficult, thus possibly leading to outcomes that are more just."[139] Judgments based on principles were more likely to be based on fairness.[140] "The direct application of broad

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[138] Braithwaite seems to propose a similar test in (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002) at p.60: "One research strategy would be to persuade a media company, say Court TV, to try a large number of cases twice with a panel of retired judges in a randomised controlled trial. Or retired judges could be hired to make real awards to real volunteer litigants in a laboratory setting. The objective would be to assess whether different judges deciding the same case using the rules of existing law would be statistically more likely to deliver consistent judgements than judges and/or juries instructed to rely only on a set of prescribed legal principles. A prediction of research questions 1 and 2 would be that rule–based decisions would prove more consistent with simple matters, principle–based decisions more consistent for complex matters. To add thrther research and viewer interest to a Court TV program, litigants and observers could be polled on whether they found the rule of principles or the rule of rules procedurally and substantively fairer, more respecting of their rights, win–win, win–lose, lose–lose, more dignified, less damaging to human relationships and so on. As our research group has found in Canberra, randomised controlled trials to courtroom adjudication of legal cases are very difficult to do, technically and politically. But it can be done and must be done if we want empirical answers to what are empirical questions."

[139] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002) p. 22

[140] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002) p. 28

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principles, which implies the relegation of mediating rules to the status of illustrations, is, if anything, more likely to produce more just and predictable results."[141]

Rules and Risk

Precise rules can obscure risk. Driving under the speed limit is not a "safe harbour"—it won't protect us if we drive 100 km/hr in dangerous conditions, such as fog.[142] Many disasters follow a common pattern—managers focus on technical compliance but fail to notice anomalies. The assessment of risk is often, and perhaps always, subjective.[143] When all participants comply with

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[141] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002) pp. 28–29

[142] (Braithwaite, Making Tax Law More Certain: A Theory 2002) at p.6. In Ontario, principles of safety are enforced by the somewhat vague offences of "careless driving" and "dangerous driving".

[143] The notion that a risk assessment could be entirely objective is suspect, since facts and truth do not present to one's mind unfiltered by one's perception. Objective and subjective is a matter of degree. (Trebilcock and Fraiberg 1998) argue that the regulatory process often overreacts to small and speculative risks while leaving larger and more certain risks unattended (at 838) because of difficulties in understanding probabilistic processes, biased media coverage, misleading personal experiences. Instead of judiciously assessing the magnitude of the risks that are subject to citizen demands and weighing the costs and benefits of regulation, governments frequently respond with highly visible, direct forms of regulation, such as ex ante or ex post bans on hazardous products, and ex ante or ex post minimum standard setting. Often this results in over–regulation of some risks and the under–regulation of others (at p.842)

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the regulator's rules and risk model, they can all react in the same way, exacerbating a crisis.[144]

Some outcomes are not easily measured. Peter May describes how some systems are too complex or the outcomes may be unobservable. For example, the safety of a nuclear power plant cannot be directly observed, nor can the safety of a building with respect to earthquakes, fire, or other potential harms.[145]

As Power notes, when rules are complex, middle–managers focus on process rather than substance, and where this 'risk game' is closely bound up with a 'blame game' the effect can be highly defensive reactions from organizational participants. For example, in the face of new reporting responsibilities for professionals relating to money laundering, a wave of 'defensive reporting' is being anticipated as a risk management strategy, reducing the usefulness of the regulations, because authorities may be overwhelmed with information.[146]

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[144] For example, managerial and auditor certifications, which do not challenge the "notional normality" of the details of what is to be certified, can constrain diversity and adaptability. (Power 2004)

[145] (May 2003) at p.386

[146] (Power 2004) p. 46. See also (US Securities Exchange Commission 2003): "Internal inconsistencies, exceptions and bright–line tests reward those willing to engineer their way around the intent of standards.2 This can result in financial reporting that is not representationally faithful to the underlying economic substance of transactions and events. In a rules–based system, financial reporting may well come to be seen as an act of compliance rather than an act of communication. Additionally, because the multiple exceptions lead to internal inconsistencies, significant judgment is needed in determining where within the myriad of possible exceptions an accounting transaction falls."

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Haines and Sutton describe the dilemma facing the chief engineer (the manager) of a public hospital when faced with a "plethora of rules and regulatory standards". A "juridification" develops, in which detailed rules overwhelm and effectively strangle the manager's judgment, undermining the likelihood of effective compliance.[147] As the Regulatory Burden Task Force Report to the Ontario Securities Commission noted

> "Prescriptive rules can ossify the relationship between regulator and regulated. Where behaviour is exhaustively prescribed, the regulator becomes enforcer, not problem solver. In recent years the Ontario Securities Commission has adopted a more prescriptive rules–based regime. It should come as no surprise, then, that legal practitioners have said that Staff "is typically reluctant to sit down and discuss issues of concern, preferring to gather information through a prolonged exchange of correspondence."[148]

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[147] (Haines and Sutton 2003) They also argue that juridification is the product of deep–seated crisis tendencies in late modern capitalist democracies. Fiscal and legitimacy problems are causing governments and regulatory authorities to pressure the engineer to try to satisfy contradictory demands. Simultaneously the engineer must be a cost–conscious entrepreneurial risk–manager while not losing sight of the twin role as risk–averse maintainer of professional standards. "Ultimately, the resolution of juridification must be a political not a technical exercise. Politicians need to be more open about the trade–offs made between risk and economic factors. They must acknowledge that satisfying popular and media expectations that risks to people in dependent situations (eg hospital patients, airline passengers) be kept to an absolute minimum may well require either substantially increasing taxes and/or interefering with markets in other ways (eg supporting cartels and protecting professional privilege)." (at p.18)

[148] (Regulatory Burden Task Force 2003)

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Principles Approach

A principles–based approach uses high–level directives rather than detailed rules. As described by Cristie Ford, principles–based regulation uses plain language, fewer details, and is more outcome–oriented.[149] Of course, most systems use a combination of principles and rules, so it is a matter of degree. As Korobkin describes, choosing rules or principles is a choice "among points on a spectrum" with rules at one end and principles at the other.[150] No regulatory system is entirely based on rules or principles, which is why the U.K.'s FSA uses the term "a more principles-based approach" in describing its framework.[151]

Principles and Regulatory Collaboration

Principles–based regulation requires collaboration, in order to flesh out the meaning of broad

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[149] (Ford, Principles-Based Securities Regulation, A Research Study 2009) p.5

[150] (Korobkin 2000) p. 24–25. Korobkin refers to standards instead of principles, but the same considerations apply.

[151] (Financial Services Advisory 2001)

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principles. For example, industry should develop best practices to achieve stated principles, which the regulator can then monitor and analyze.[152]

Black advocates a "decentred" approach, since knowledge within an industry is often fragmented: "[R]egulation should be a process of coordinating, steering, influencing and balancing interactions between actors/systems to organize themselves, using such techniques as procedularisation [sp.], collaboration, feedback loops, redundancy, and above all, countering variety with variety."[153] Cristie Ford notes that principles–based regulation must be accompanied by transparent and accessible guidance from the regulator and the incorporation of industry experience and best practices.[154] In its narrowest sense, guidance means the official comments from the regulator, such as policies. In its broader sense, guidance includes the regulator's speeches and "no action" letters. As Ford warns, guidance can be a flexible method of communication, but it has to be well–managed—if it resides in too many places, it becomes difficult to monitor.[155]

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[152] (Ford, New Governance, Compliance, and Principles-Based Securities Regulation 2008) "content to the principles is to be filled in through cooperative but realistic (and enforcement–backed) collaboration between industry and regulator, taking advantage of industry's greater contextual knowledge while maintaining a credible regulatory capacity to ensure law-abiding behaviour and punish law violators."

[153] (Black, Critical Reflections on Regulation 2002) at p.9

[154] (Ford, Principles-Based Securities Regulation, A Research Study 2009) at p.9

[155] (Ford, Principles-Based Securities Regulation, A Research Study 2009) at p. 12

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In the U.K., to facilitate communication in the securities market, the FSA appoints a "relationship manager" for medium–sized firms, and a "supervisory team" for larger firms. According to a FSA letter issued to market participants in April 2006[156], firms assigned a relationship manager should expect them to "be the focal point for your relationship with us", "carry out an open, two–way dialogue with you", "know your industry", "know the regulatory framework related to your activities", "assess the major risks posed by you and communicate this in detail to you"; and "set out and actively monitor an appropriate and proportionate risk mitigation programme for you."

For smaller firms, which do not have a relationship manager, the FSA will "engage constructively with the firms' management, talking about regulatory outcomes and what they mean for the firm."[157] However, to do this economically,

> "[t]he main contact these firms have with us is through the firm contact centre (which handles queries from firms without a dedicated relationship manager), information on our website, regulatory returns and occasional 'themed' visits (i.e. when we conduct a review on a particular topic)… Firm contact centre staff will be able to answer firms' reasonable questions on a timely basis and provide clarity and assurance around our expectations."[158]

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[156] (Advisory Financial Services 2006)

[157] (Financial Services Authority 2007)

[158] (Financial Services Authority 2007) p.12

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Prior to the global financial crisis of 2008, the FSA enforcement regime did not take formal enforcement action nearly as often as the rules–based U.S. SEC. and UK penalties were not as severe. For example, in 2005/06, the financial penalties imposed by the SEC exceeded those imposed by the FSA by a ratio of thirty to one, which, even after adjustment for differences in market capitalization, still translated into a ten–to–one ratio.[159] Rather than focusing on *ex–post* enforcement actions, the FSA tries to maintain an open and cooperative relationship with firms based on dialogue, proactive supervision, and a focus on compliance. However, following the 2008 global financial crisis, according to Julia Black, the FSA's deferential approach was replaced with a more activist approach by regulators to ensure that the systems and processes deliver the right outcomes.[160]

Fairman and Yapp argue that the ongoing "regulatory encounter" is often more important than any particular outcome or sanction. For example, environmental health law in the UK is enforced on the ground with discretion and flexibility. It is a negotiated process, where the scope and degree of negotiation is contested. The enforcer and business have a continuing relationship which tends to be flexible and conciliatory.

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[159] (Coffee, Law and the Market: The Impact of Enforcement 2007) p.2. In addition, as Coffee notes, the greater use of public enforcement is paralleled by the corresponding increase in private sanctions and class action lawsuits. At pp. 2–3

[160] (Black, LSE Law, Society and Economy Working Papers 17/2010 2010)At pp.22-23

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As Braithwaite and Makkai[161] found, small– and medium– sized businesses comply with the law where local authorities use educative enforcement approaches. In the long term, non–coercive and informal alternatives are more effective than coercive enforcement.

As Ford argues, for principles–based regulation to work, the relationship between regulator and regulated should be trusting and collaborative, not adversarial or cat–and–mouse. The regulator must provide clarity around principles. The regulated must communicate industry experience and share information with regulators. This may require a "shift in orientation, and robust educational resources and other support—especially for smaller market actors."[162] Puri and Condon suggest "a reorientation of the [securities] regulatory approach to more proactive, ongoing, organizationally embedded monitoring", such as requiring written policies and documentation of actions taken, new monitoring by sub–committees of the board or compliance officers, external auditing of processes, gatekeeper involvement (such as auditors, brokers and legal counsel), and enhanced self–reporting of policies.[163] However, as Puri notes, the regulatory collaboration in the Ontario venture issuers market is generally with issuers and not investors.

> "…[I]ssuers are more likely than investors to apply pressure on local regulators to develop locally and regionally–specific rules and policies. Issuers and their professional advisors have frequent and sustained contact with securities regulators and many

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[161] (Braithwaite & Makkai 1991)

[162] (Ford, Principles-Based Securities Regulation, A Research Study 2009) at p. 22

[163] (Puri and Condon, The Role of Compliance in Securities Regulatory Enforcement 2006) See also (The Task Force 2006) p. 62: "Regulators should focus their attention in areas where external gatekeepers are less common and less central to the regulatory system"

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> opportunities to have their views heard… This statement cannot be made with the same force about investors." [164]

To encourage regulatory collaboration, the BC Securities Commission has criticized the Expert Panel's proposal which would separate the enforcement and adjudicative functions of the national securities commission from its policy functions. According to the BC Commission, those who adjudicate securities cases are involved closely with the development and implementation of securities law and policy, and so have an extensive background in securities regulation and its public interest implications. If the adjudicative arm were separate, a gap would develop between the policy objectives and the enforcement outcomes. If that happened, the regulator's ability to regulate markets effectively in the public interest would be seriously impaired.[165]

Communicating Principles

To communicate shared principles in a complex area of law, Braithwaite proposes a combination of rules and principles (Braithwaite was referring to tax law): "...[L]aws can be written by setting

[164] (Puri, Local and Regional Interests in the Debate on Optimal Securities Regulatory Structure 2003) at 227

[165] Expert Panel on Securities Regulation, Submission of the British Columbia Securities Commission, July 15, 2008 , p. 9

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down binding principles, then detailed rules to illustrate how the principles should be applied to perhaps a dozen common concrete commercial arrangements. If there are 1000 rare ways of setting up the kinds of arrangements covered by the law, but only a dozen are used with any frequency then these are the 12 concrete arrangements that should be fleshed out in rules."[166]

Principles should link to clear objectives. As Fairman and Yapp found in the U.K. food service industry, rules linked to known risks were most followed because their importance was understood. Temperature controls were most complied with, because compliance is relatively easy to assess and because inadequately cooking or freezing food is an obvious health risk.[167]

Standards should be organized to illustrate any relationships between principles. Research in psychology and tax law shows that, in a complex field, decision makers will look through the

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[166] (Braithwaite, Making Tax Law More Certain: A Theory 2002) at p. 79–80. According to Braithwaite,the best way to integrate rules and principles in complex areas of tax law is: (a) Define the overarching principles and make them binding on taxpayers; (b) Make one of those overarching principles a general anti–avoidance principle; (c) Define a set of rules to cover the complex area of tax law; (d) The legislature lays down, perhaps through an Acts Interpretation Act, that in a contest between a rule and an overarching principle, it will not be the rule that is binding; (e) In a complex field of tax, write specific sets of rules for the most commonly used types of transactions or business arrangements; (f) Follow each of the dozen sets of illustrative rules with the explanation that the reason for the rules being this way in this concrete situation is to honour the overarching principles; (g) When judges fail to do this, reverting to old habits of privileging rules, enact a simple statute that says the 11A shelter violates named principles in the tax law and should be disallowed in future; (h) Foster educative dialogue with judges, company directors and the community about the principles in the tax law (at page 3)

[167] (Fairman and Yapp 2005) p.491

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surface features of a problem to identify key relationships.[168] They reason by analogy, mapping relations between standards. As Nelson notes, “Even standards with relatively few rules could benefit from increased structure and carefully chosen examples that facilitate analogy development.”[169] See, for example, the following quote from the US Financial Accounting Standards Board regarding audits:

> “Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting an accounting principle that appears appropriate when applied in a manner similar to the application of an established principle to an analogous transaction or event.”[170]

For a principles–based accounting standard, Shortridge and Myring suggest that key objectives of good reporting be articulated, with examples. While some rules are necessary, guidance for every possible situation should be avoided. Where there is a gap, the reader should be directed back to the principles.[171] As Nelson argues, “Adding an implementation guideline that sequences

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[168] (Marchant, et al. 1993) pp. 95–119

[169] (M. Nelson 2003) p.95

[170] “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles”, Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA), paragraph 9, at <http://www.aicpa.org/download/members/div/auditstd/au-00411.pdf

[171] (Shortridge and Myring 2004) Note: they also say “Many accountants seem to prefer rules–based standards, possibly because of their concerns about the potential of litigation over their exercise of judgment in the absence of bright–line rules. The number of requests for implementation guidance received by FASB has always been high, and their significance

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the decisions necessary to implement a standard, or adding an index that better relates existing rules and precedents, could lower total task complexity."[172]

Effectiveness of Principles

The BC Securities Commission ("BCSC") cites the following empirical studies to support principles–based securities regulation:

In November 2003 the BCSC published a regulatory impact analysis comparing the then current, rules–based, account supervision system of the Investment Dealers Association ("IDA") with the principles–based, B.C. proposal.[173] The IDA requires daily and monthly account reviews for trading violations, suitability, and business risk factors. These were detailed reviews, requiring daily assessments of each trade against nineteen criteria (and more if a trade is in futures or options). There were many thresholds. For example, every account with over $1,500 of commissions in a given month had to be reviewed. In contrast, the BC model included general

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resulted in the formation of the Emerging Issues Task Force. If financial statements conform with accepted rules, the bases for a lawsuit are diminished."

[172] (M. Nelson 2003) pp. 95–96

[173] (Wolf 2003)

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conduct rules (rules against misrepresentation, manipulation, fraud, etc.[174]) and eight broad principles (integrity and fairness, etc.)[175]

The report analyzed four firms: two were national dealers (one, a Toronto bank–owned firm; the other, a large but independent local firm) as well as two regional dealers (one, a medium sized firm; the other, a small firm). None of the firms found the IDA daily and monthly transaction reviews useful in detecting abuses characterized by patterns of behavior, which is where they believed the biggest risks were. For example, concentration of securities is a potential problem, but the daily and monthly reviews did not aggregate concentration anomalies. Similarly, front running and stock manipulation is characterized by patterns of trading behaviour, which were difficult to detect through the transactional IDA focus. Each of the firms developed a parallel system, to better manage risk. One of the large firms said that it detected 90 per cent of potential compliance problems through its proprietary system, which it ran first, and that daily IDA reviews caught the remaining 10 per cent of potential problems. Thus, firms developed their own

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[174] The BC Model includes general conduct rules for all market participants in Part 10 of the Draft Legislation. These include prohibitions against: misrepresentations, manipulation and fraud, unfair practices, insider trading or tipping, front running, false or misleading statements to the Commission, obstruction of justice. Most of these exist in some form under the current legislation. A dealer or adviser who contravenes any of the provisions of the legislation or rules, including the Code of Conduct, would be exposed to administrative sanctions, civil liability, and, in some cases, criminal prosecution.

[175] The resulting 28 rules in the Code are arranged under eight broad principles, each addressing a key area of investor protection: 1 Integrity and fairness, 2. Dealings with clients, 3. Confidentiality, 4. Proficiency, 5. Know your client and suitability, 6. Conflict of interest, 7. Compliance systems, 8. Client complaints

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systems to ensure their accounts were adequately supervised regardless of IDA requirements, for civil liability reasons, for reputational reasons, and for good business practice.

In 2004, the BC Securities Commission completed a survey and found that most enforcement cases were prosecuted with principles rather than rules.[176] The survey was limited and may not be very representative, as it analyzed only two decisions and 15 settlements relating to registrant misconduct between January 1, 2002 and November 14, 2003. However, of the 66 contraventions, 68 per cent were in the areas of "know your client" and suitability, fair dealing, prudent business practices, misrepresentation and fraud, which are broadly worded, principles–based, contraventions.

Critique of the Principles–Based Approach

Cunningham argues that broad principles (such as that public companies must "disclose all material facts") give the regulator too much power to interpret, after-the-fact, whether principles are being achieved, risking arbitrary enforcement.[177] Better if regulators publish detailed (before-the-fact) rules, with safe harbours, so that certainty and power is transferred to the regulated.

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[176] (British Columbia Securities Commission 2004)

[177] (Cunningham 2007) . See also (K. Sullivan 1992): "[t]hose who favor rules are skeptical of the possibility of normative argument; they believe that supposedly "reasoned elaboration" grounded in normative argument is really personal value preferences in thin disguise."

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As Wallison notes about the U.S. income tax system, which is heavily rule–based,

> "[Su]ppose that the Internal Revenue Service (IRS) were to use a principles–based system in which the rule was simply that everyone should pay a fair percentage of his income. This general principle would leave the IRS in control of how the rule is interpreted and in possession of most of the power associated with the rule." [178]

As the staff of the U.S. Securities and Exchange Commission note, "Under a principles–only standard setting regime, the increased reliance on the capabilities and judgment of preparers and auditors could increase the likelihood of retrospective disagreements on accounting treatments. In turn, this could result in an increase for both companies and auditors in litigation with both regulators and the plaintiffs' bar."[179]

To Black, there is a danger of "over compliance" by the regulated, unless principles are enforced in a predictable, rational and consistent manner. Firms may become too conservative, fearing after–the–fact penalties. "Over–zealous enforcement action" (whether or not in good faith) will lead to a deterioration of the relationship between regulator and regulated.[180] Law consists in

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[178] (Wallison 2007)

[179] "Study Pursuant to Section 108(d) of the Sarbanes–Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles–Based Accounting System" U.S. Securities Exchange Commission, 07/25/2003 <http://www.sec.gov/news/studies/principlesbasedstand.htm>

[180] (Black, Principles Based Regulation: Risks, Challenges and Opportunities 2007) p.18. See also (Black, Forms and Paradoxes of Principles Based Regulation 2008) at p.4 where she describes the communicate paradox of principles: "although [principles based regulation] can provide flexibility to firms, allowing them to innovate in the ways that they comply, in practice a

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drawing lines. If principles are vague and participants believe they were *almost* prosecuted, they may view the "near miss" as a fortunate, but unpredictable, outcome.[181] As Gill says, "If you draw a bright line in the middle of a room and tell people not to cross it or else something bad will happen to them, people will walk confidently right up to that line. But if you tell people there is an invisible line somewhere in the middle of the room and if they cross it something bad will happen to them, people will tend to stand back from the middle of the room for fear of stepping on a line they don't see."[182] Experimentation and diversity may be constrained when firms become too conservative and fearful of litigation.

To Peter May, there is an opposite danger of "under–compliance" in a principles–based approach, unless enforcement is a credible threat. May reviewed New Zealand's move to a performance–based building code in 1986. Detailed rules were replaced with vague objectives, such as "protecting people, their health and safety, and the environment". Unfortunately, market competition forced builders to choose the cheapest building solutions. The vague principles were

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lack of certainty as to what enforcers will accept as compliance can lead firms to adopt quite conservative behaviour." She also describes how regulators too can adopt a too–conservative application of principles, where there is little political support for enforcement.

[181] The concern about over–compliance and "near misses" is described by (Hirsch and Mitchell 2008) who suggest that the "near miss" psychology is strongest when there is a blizzard of fine lines, so that the borders of law are squeezed out of existence. Arguably, principles, which have unpredictable or no borders, are even less predictable.

[182] (Gill 2003) at pp.978–79

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not enforced by the poorly funded local building authorities, resulting in the "Leaky Building Crisis" of the 1990s.[183]

Black describes a "proliferation of guidance" in a principles–based system, including: informal guidance from speeches, industry guidance, public enforcement actions, decisions, and risk assessments.[184] As regulatory guidance increases, a principles–based regime can become as complex as a rules–based regime. "One reason why relatively younger standard setting regimes

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[183] (May 2003) pp.391–392

[184] (Black, Principles Based Regulation: Risks, Challenges and Opportunities 2007) p.15. See also (US Securities Exchange Commission 2003) regarding the "objectives oriented" proposal, which seems quite similar to a principles approach: "Implementation Guidance – there is a demand among accounting professionals for implementation guidance. This can be seen in the number of issues that are addressed each year by the EITF, the number of inquiries that the staffs of the FASB and SEC receive, and the volume of non–authoritative guidance that is published each year. The question is not whether such guidance will be provided, but when and by whom. Ultimately, under an objectives–oriented regime, there will still need to be guidance provided both at the time a standard is issued and subsequently… the standard setters should provide some implementation guidance as a part of a newly issued standard. We believe, however, that the amount of detail provided by the standard setter under an objectives–oriented regime would likely be less than that provided under a rules–based regime. [comment – sufficient reasons are not given why the "objectives oriented" proposal would require less guidance.] Otherwise, the guidance would quickly transform what could be an objectives–oriented regime back into a rules–based regime, with all the consequent disadvantages discussed herein."Study Pursuant to Section 108(d) of the Sarbanes–Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles–Based Accounting System"

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like the IAS appear more principles–based is that they haven't had as much time to accrete rules."[185]

Ford describes how "regulatory creep" can extend a regulator's scrutiny into new areas of jurisdiction.[186] This can lead to questions of accountability. The FSA can effect significant shifts in regulatory policy by promulgating a new interpretation of a principle through discussion papers and the like.[187]

Risk–based, Responsive, Outcomes–Oriented and Proportionate Regulation

What makes regulations effective? To assess this requires a consideration of the topics "risk–

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[185] (M. Nelson 2003) p. 2

[186] (Ford, Principles-Based Securities Regulation, A Research Study 2009) at p.16. See also (Black, Making a success of Principles-based regulation 2007) p.198 The example Black gives is the FSA extended its review into areas such as "product design" which it had not previously regulated.

[187] (Black, Principles Based Regulation: Risks, Challenges and Opportunities 2007) p.17 The requirement on firms to undertake a "TCF programme" [i.e. "Treat Customers Fairly" programme] has been imposed without any specific rule being made. TCF has been developed quite independently from the handbook. TCF is based on the Principles for Businesses, but it reaches much further into the deeper recesses of firms' activities, and indeed those of the retail product supply and distribution chain, than the handbook ever did. However, its elaboration has not been subject to the consultation processes that the FSA is obliged to go through when making rules...there is concern that Principles–based regulation could effectively be used to bypass the key statutory requirements to which the FSA is subject when it issues formal rules and guidance.

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based", "outcomes–oriented", "responsive" and "proportionate" regulations. These topics don't easily map onto the principles/rules debate, since they are not so much about language strategy as they are about what regulations should achieve and how they should work. However, the choice of rules or principles is not an isolated question. The best language strategy is one which makes securities regulation for venture issuers risk-based, outcomes oriented, responsive and proportionate.

Risk-based regulation

"Risk–based" regulation is where the compliance burden is greater or less, depending on the risk of non–compliance. It targets the regulator's resources to problems which are the most likely to arise and which could cause the greatest impact, so that resources are effectively employed. It is an evidence–based, calculated approach.[188] It generally consists of six stages: (i) defining the problem and putting it in context (ii) analyzing the risks associated with the problem in context (iii) examining options for addressing the risks (iv) making decisions about which options to implement (v) taking actions to implement the decisions (vi) conducting an evaluation of the

[188] (Baldwin and Black, Really Responsive Regulation 2008) pp. 59–94

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action's results.[189] It is not just a matter of mathematically calculating the probability and magnitude of various harms, but also the "acceptability of risk".[190]

Although risk–based regulation could be applied in either a rules–based or principles–based regime, with principles–based regulation, the regulator can more effectively adjust its response. In a rules–based regime, there is a danger that all participants will follow one risk model, reacting in the same way, potentially exacerbating a crisis. With diversity comes strength. An analogy can be made to monocropping in agriculture. Monocropping is the high-yield agricultural practice of growing a single crop every year on the same land, without crop rotation. Corn, soybeans, and wheat are three common crops often grown using monocropping techniques. While an economically efficient system in the short-term, allowing for specialization in equipment and production, monocropping can damage the soil ecology and provide an unbuffered niche for parasitic species, increasing crop vulnerability to opportunistic insects,

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[189] Douglas Powell, "Risk-Based Regulatory Responses in Global Food Trade: A Case Study of Guatemalan Raspberry Imports into the United States and Canada, 1996-1998" in G.Bruce Doern and Ted Reed, eds., *Risky Business. Canada's Changing Science-Based Policy and Regulatory Regime* (Toronto: University of Toronto Press, 2000) at 137-138 states that this integrative framework for risk managers was developed in 1997 by the U.S. Presidential/Congressional Commission on Risk Assessment and Risk Management.

[190] Jeremy D. Fraiberg and Michael J. Trebilcock, "Risk Regulation: Technocratic and Democratic Tools for Regulatory Reform" (1998), 43 McGill L.J. 835 at 857.

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plants, and microorganisms. The result is a more fragile ecosystem with an increased dependency on pesticides and artificial fertilizers.[191]

The dangers of uniform response in complex systems are not always caused by regulation, however. Greed and panic can cause uniform response. For example, the credit crisis of 2008 was triggered by a complex interplay of government policies that encouraged home ownership, providing easier access to loans for sub-prime borrowers, overvaluation of bundled sub-prime mortgages based on the theory that housing prices would continue to escalate, compensation structures that prioritized short-term deal flow over long-term value creation, and a lack of adequate capital holdings from banks and insurance companies to back the financial commitments they were making. [192] There was a rush to trade in bundled sub-prime mortgages in 2006 and 2007 caused by the high short-terms commissions—an example of greed taking over what should have been careful financial analysis. Then, in the fall of 2008, there was panic in the market when the banks and institutions which held sub-prime mortgage products did not know their true value. Essentially, greed caused the market to swing in a uniform way in 2005 and 2006, and then panic followed in 2008 as institutions tried to unload their investments. It is a familiar "herd instinct" theme in markets, where lack of disclosure, or insufficient time to assess disclosure, can cause excessive market reactions.

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[191] This is a well-known principle of agriculture (similar to the "don't put all your eggs in one basket" observation). I am familiar with the science as I have a Bachelor of Science degree in Agriculture from the University of Guelph. For further explanation, see "Agriculture Society" at <http://agriculturesociety.com/tag/monocropping/>

[192] (Arner 2009)

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Arguably, what is needed from the regulator is careful analysis of market risk by applying basic principles, rather than applying the rules that may have worked in previous situations. The UK Financial Services Agency ("FSA") uses a risk–based approach. It identifies the main risks to its regulatory objectives, prioritizes them, and then assesses the costs and benefits of alternative regulatory tools. The FSA takes a "differentiated approach" to supervision under which fewer regulatory resources are devoted to firms designated as "low impact."[193]

In 2002, the OSC issued "Staff Notice 11–719: A Risk–based Approach for More Effective Regulation".[194] As then Chair of the OSC, David Brown, stated:

> "With finite resources, we can't attempt to do everything and do it well. A selective approach allows us to apply greater scrutiny to the situations most likely to have an adverse impact on the capital markets, while reducing the regulatory burden on those market participants who pose a lower risk."[195]

However, the OSC withdrew Staff Notice 11–719 on December 12, 2008 for the rather cryptic reason that its risk–based approach "does not reflect current practice".

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[193] (Financial Services Authority 2006)

[194] This policy was first described in Notice 20 – Selective Review of Prospectuses and Other Documents, issued in 1994 (17 O.S.C.B. 4386).

[195] Ontario Securities Commission News Release, December 19, 2002, at <http://www.osc.gov.on.ca/Media/NewsReleases/2002/nr_20021219_osc-risk-based.jsp>

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Outcomes-oriented regulation

"Outcomes–oriented" regulation is where the regulatory outcomes achieved are measured against the goals or benchmarks pursued. It can be contrasted with "process–based" regulation, which measures success according to whether or not processes are followed. Outcomes-oriented regulation accepts that there may be more than one process to achieve a regulatory goal. Outcomes–oriented regulation is usually principles–based, since the outcomes to be measured are usually principles–based goals, but one could conceivably have a system that is both rules–based and outcomes–oriented.[196]

Responsive regulation

"Responsive" regulation is where the regulations are enforced through a series of escalating tools depending on the seriousness of the violation. At the base of the "regulatory pyramid" is an educational, dialogue approach, with informal rewards such as praise, rather than sanctions ("soft words before hard"). Then, ascending and more demanding strategies (such as penalties) are invoked for serious or repeat non–compliance.[197] This approach is "bottom heavy" since most action takes place at the base of the enforcement pyramid. In Ayres and Braithwaite's view,

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[196] (Ford, Principles-Based Securities Regulation, A Research Study 2009) p. 10

[197] (Healy and Braithwaite 2006)

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regulatory agencies are most effective when they are “benign big guns.” That is, regulators can “speak softly” and carry “big sticks”, including a hierarchy of increasing sanctions. Punishment is “expensive” whereas persuasion is “cheap”. [198]

Although the regulatory pyramid could be used in either a rules–based or principles–based regime, with principles–based regulation, the regulator must respond proportionally to any unacceptable behavior as part of the “regulatory collaboration” model discussed later in this paper from page 86.

Proportionate regulation

“Proportionate” regulation is where regulations are adjusted according to the ability of the regulated to comply. For example, the Canadian Securities Administrators (CSA) uses a proportionate approach in its disclosure rule—venture issuers have 120 days to file their annual financial statements instead of 90. This recognizes that small issuers lack in–house expertise and public auditing firms tend to give their larger clients priority. Giving venture issuers more time is a proportionate response which does not significantly compromise investor protection.

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[198] (Ayres and Braithwaite 1992) p.35

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Risk–based and proportionate regulations both seek to minimize compliance costs without sacrificing investor benefits. However, they are slightly different—some regulation may be proportionately very expensive for small issuers, but necessary because of the unacceptable risk to the whole market as a whole if left unregulated. For example, in response to the Bre–X salting scandal,[199] Canadian securities commissions now require "qualified person reports" as specified in National Instrument 43–101 for any public mining disclosure. The costs to obtain such mining reports are proportionally expensive for small issuers, but the reputation damage to the Canadian market as a whole from the possibility of another Bre–X scandal is considered to outweigh the costs.

The FSA uses proportionate regulation. It does not subject small firms to the same scrutiny as larger ones, nor does it require the same kinds of structured and detailed responses from small firms, because of their sheer number and because, on an individual level, each one poses a relatively small risk to consumers:[200]

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[199] Bre–X was a major Canadian gold mining scandal in 1996-97. Bre-X Minerals Ltd., based in Calgary, bought the Busang mineral site in Indonesia in March 1993. In October 1995, Bre-X announced significant amounts of gold had been discovered, sending its stock price soaring. Originally a penny stock, its stock price reached a peak at CAD $286.50 (split adjusted) in May 1996 on the Toronto Stock Exchange (TSE), with a total capitalization of over CAD $6 billion. Bre-X Minerals collapsed in 1997 after the gold samples were found to be salted with gold from another site—an elaborate fraud.

[200] See e.g. Lesley Titcomb, See e.g. (Titcomb 2008)
See also the (The Task Force 2006) at p.53, which proposes that "at one end of the scale will be issuers with the lowest market capitalizations that should be required to comply with regulations

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In her research study for the Expert Panel on Securities Regulation, Janis Sarra describes eight tools that can be used to implement proportionate regulation for venture issuers:[201]

(i) *Specific exemptions should apply for junior issuers, if the time and resources required outweigh the benefits*. [The observation is correct, in my view. In fact, on September 13, 2012, the Canadian Securities Administrators published for comment Proposed National Instrument 51-103[202], which would tailor disclosure requirements for venture issuers and eliminate certain disclosure obligations that may be of less value to venture issuers. See the discussion under the topic "Regulation to Create a Public Good" at page 57.]

(ii) *Periodic disclosure timelines should be relaxed for juniors, since external consultants are frequently involved.* [In fact, Canadian securities regulators have accommodated venture issuers. National Instrument 51-102 gives venture issuers 120 days to file their annual, audited, financial statements (rather than 90 days for larger issuers), and 90 days to file their interim financials (rather than 60 days for larger issuers). This is because auditors will usually prioritize

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that are appropriate and consistent with their size, the complexity of their business and their resources. Of course, investors should be duly warned of the risks associated with issuers at this end of the scale. At the other end of the scale will be issuers with the highest market capitalizations."

[201] Janis Sarra, (Sarra 2008) A Research Study Prepared for the Expert Panel on Securities Regulation

[202] Proposed 51-103 was withdrawn by the CSA on July 15, 2013. Supra, note 98.

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completion of their larger clients' statements, leaving it more difficult for venture issuers to meet deadlines.]

(iii) *Transition timelines should be scaled, to give more time for new governance, financial controls, or other new standards.* [This is consistent with the observation of Puri and Condo, supra note 81 at page 52 that "an unintended consequence of a rigorous compliance programme might be that these requirements become a way for larger issuers to preserve a monopoly, in the sense that they are better able to meet the costs of compliance initiatives and so can drive out smaller operations." Allowing venture issuers more time for new governance and financial controls is reasonable.]

(iv) *Different frequency of reporting should be permitted, such as semi–annually instead of quarterly, where it is determined that investors and other market participants may not be interested in quarterly financial reporting if they receive timely, full and accurate material change disclosure.* [Canadian securities regulators appear to agree. Proposed National Instrument 51-103 would still require interim financial reports, but rather than being accompanied by a full Management Discussion and Analysis form, interim statements would only require a short discussion of the venture issuer's operations and liquidity. The first proposal of 51-103 would have eliminated the 3 and 9 month interim periods for financial statements, but after receiving comments from the industry, the revised proposal eliminated only the Management Discussion and Analysis requirement.]

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(v) *Formal governance or internal control requirements, and the level of detail of disclosure, should be modified*. [Canadian securities regulators appear to agree. Proposed National Instrument 51-103 would require venture issuers to develop and implement policies and procedures relating to conflicts of interest, related party transactions and insider trading. Disclosure relating to these matters, as well as other corporate governance matters, would be included in the annual report.]

(vi) *Set disclosure requirements based on technical information particular to a sector, should be tailored to the issuer's history in the market, or to its revenue–generating capacity.* [Canadian securities regulators agree. For example, proposed National Instrument 51-103 would require a technical mining report if the venture issuer files a prospectus, or if it is a first time disclosure of mineral resources or reserves, or a preliminary economic assessment, or if it is a material change in these.]

(vii) *Guidance should be given as to best practice, in terms of offering junior issuers information and guidance on a range of compliance options that may be responsive to their capital and operational structure, such as the design of control systems*. [I would agree, since principles–based regulation requires collaboration, in order to flesh out the meaning of broad principles (see the discussion above at page 86).]

(viii) *High–level principles should be used that should govern the conduct of issuers, to allow issuers to develop best practices appropriate to their size or resources.* [This is a rather general comment by Sarra. In my view, the choice between rules and principles depends on the particular

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issues being regulated. This is discussed more fully below, under "(vi) Are regulatory issues predictable?" at page 194, "(vii) Should historical transactions be disclosed?" at page 197 and "(viii) Should future projections be disclosed?" at page198]

Governance theory

Governance theory examines how regulations are translated and implemented through an organization. To go beyond "nice policy statements", the directors and agents of the venture issuer should incorporate compliance into internal procedures. What follows is a discussion of governance theory and how it intersects with the rules/principles debate.

Parker describes three nodes of governance: (1) the adoption of formal compliance systems; (2) the perceptions, motivations and strategies of individuals within the corporation; and (3) the local norms and habituated practices that mediate between the structures and the agents.[203] The first node can be easily confirmed by checking an issuer's policy statements. As to the second node, later in this paper, I develop a series of factors to assess the proper balance of rules and principles for an industry, and the first and second of those factors are: (i) Is there a shared understanding of regulatory principles, and (ii) Are the regulated committed to the public

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[203] (Parker and Gilad, Internal Corporate Compliance Management Systems: Structure, Culture and Agency 2011)

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interest? As Parker argues, the success of regulation is not whether the regulator wins a particular judgment in court, but the extent to which a shared understanding is developed and how that understanding is translated and implemented. As to the third node described by Parker regarding local norms and habituated practices, the fourth factor developed in chapter three of this paper is: "Are there institutions or actors which promote regulatory collaboration?" This is similar to the node identified by Parker, in that both address what catalysts exist for compliance.

Parker further describes compliance in the context of "meta-regulation", similar to principles-based regulation, which recognizes that the regulator may not know what the right processes are, or even the right results, but must insure that those involved will responsibly work out the details in their own circumstances.[204] "Management-based regulation", as described by Coglianese and Lazer,[205] is also similar to principles-based regulation—it does not specify technologies to be used, nor does it require specific outputs. Rather, it requires firms to do their own planning, to identify hazards, risk mitigation procedures, employee training, and measures for evaluating and refining management. According to Coglianese and Lazer, the problem with "technology-based regulation", which is similar to rules-based regulation, is that it imposes specific requirements which can eliminate incentives to seek out new solutions that would achieve public goals at a lower cost.

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[204] (C. Parker, Meta Regulation: Legal Accountability for Corporate Social Responsibility 2006)

[205] (Coglianese and Lazer, Management-Based Regulation: Prescribing Private Management to Achieve Public Goals 2003)

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Hopkins[206] notes that most accidents are not caused by a failure to follow rules, but by a failure to notice warning signs and adopt a "safety culture". Compliance must be treated as important and not just a cost of doing business. This relates to the second factor identified in chapter three: "Are the regulated committed to the public interest?" If they are committed, then principles-based regulation may work. As Hopkins describes, strategies to improve risk judgment include: auditing the auditors, proactive investigation, supporting company safety staff, advising on organizational design, and exposing performance.

Parker, Ainsworth and Stepanenko argue that enforcement actions should hold as many parties legally responsible, to spread the threat to individuals who may be more sensitive to smaller penalties, or the shame of having a finding of liability against them.[207] These observations are incorporated into the recommendations of this paper, under the topic "Enforcement strategies based on compliance motives" at page 281.

Another consideration from governance theory is that the proper mix of rules and principles may depend on the size of the organization and what resources are available to it. Hutter reviewed data from two research projects in the United Kingdom to assess the application of new governance.[208] Large businesses such as British Railways can afford better advice and risk compliance systems, but this does not necessarily lead to compliance within the organization. A

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[206] (Hopkins 2007)

[207] (Parker, Ainsworth and Stepanenko, The Impact of ACCC Enforcement Activity in Cartel Cases 2004) at pp.105-6

[208] (Hutter 2011)

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large organization can be structurally complex and suffer from information asymmetries, increasing the risk of deviance by its agents.[209] Smaller organizations, with a less formal structure, may not be able to afford expert advice or compliance systems, but they may be better able to communicate with their agents, and understand the culture of its employees through ongoing, face-to-face, dialogue. Ontario venture issuers are relatively small organizations, with limited budgets for compliance. One of the factors identified in chapter three is: "Are there institutions or actors which promote regulatory collaboration?"—the more that Ontario venture issuers can access external resources to interpret principles, the more effective they will be.

Ford describes how the BC principles–based model is consistent with "New Governance" theory, in which the regulator is not the "central articulator of non–negotiable, specific requirements" but "defines broad themes, to articulate them on a flexible and dynamic basis, to accept input from the ground level of regulated entities, and to effectively manage varied incoming information from industry actors."[210] Following the global financial crisis of 2008 and the apparent regulatory failures, Ford identified four lessons for effective principles-based regulation: (i) regulators must have the necessary capacity in terms of numbers and expertise; (ii) regulators must have transparent and reliable information about industry; (iii) regulators must

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[209] (Parker and Gilad, Internal Corporate Compliance Management Systems: Structure, Culture and Agency 2011) at p.25

[210] (Ford, New Governance, Compliance, and Principles-Based Securities Regulation 2008) p.27

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independently scrutinize information; and (iv) regulators must have healthy skepticism about industry.[211]

Compliance theories

Why do people comply with the law? Is it because they are self–interested and will comply if the amount and probability of the penalty is greater than the illegal gain? Are other motives in play? It is an important question, since the choice between principles and rules is not a philosophical question, but a question of compliance. As discussed next, a rules approach with known, after–the–fact penalties is premised on the incentive motive, whereas the principles approach is based on other theories of compliance.

Feldman[212] reviewed the literature and identified five motives to comply with the law, which will be explored in this section: (i) the "incentive" motive, i.e. the cost-benefit calculation of rewards and punishment; (ii) the "reason-driven" motive, where the regulated look to the law for convincing policy reasons for doing (or not doing) certain things; (iii) the need for "social identity" and to join the right community and to adopt its norms; (iv) the desire for justice and morality; and (v) the "citizenship-oriented" motive, i.e., those who choose to comply simply

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[211] (Ford, Principles-Based Securities Regulation in the Wake of the Global Financial Crisis 2010)

[212] (Feldman 2010)

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because it is the law. Feldman argues that policy makers should assess the motives of the particular group being regulated in order to design a behaviorally-responsive regime.

Incentive Motive

The incentive or "carrot and stick" theory is that individuals and corporations are self–interested and will "rationally" follow or break rules in order to maximize their personal gain. It leads to the view that the regulator can engineer social compliance by enforcing clearly stated rules with predictable rewards and penalties.[213]

The "stick" (rather than carrot) approach can be subdivided into two deterrence goals: (i) "specific deterrence", where the goal is to deter a particular person from committing or recommitting an offence, and (ii) "general deterrence", where the goal is to deter the general population by "making an example" of the offender.

Specific deterrence

Scholz describes four assumptions of the "simple deterrence model", in order to deter a specific corporation: [214]

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[213] (Puri, Sentencing the Criminal Corporation 2001) at p.617

[214] (Scholz 1997) at p.254. Note – I have changed the order of Scholz's assumptions.

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(1) Corporations are fully informed utility maximizers;

(2) Legal punishment provides the primary incentive for corporate compliance;

(3) Legal statutes unambiguously define misbehaviour; and

(4) Enforcement agencies optimally detect and punish misbehaviour, given available resources.

If (1) and (2) were true (i.e. if corporations are fully informed and effectively amoral), then the unambiguous rules in (3) and the strict enforcement in (4), would seem logical.

Are corporations "rational" (i.e., amoral) as described by deterrence theorists? Do they comply simply because of the amount and probability of reward and punishment? Puri has argued that the rational economic actor model is a realistic model of corporate criminal behaviour.[215] Business corporations are formed to make profits. In the securities market, for example, decisions are usually based on the trading price of shares. Pearce and Tombs argue that, "[e]ven if a corporation wished to act with a primary commitment to social responsibility, this would entail ignoring the very rationale of the corporation and the nature of the existing economic system".[216] Bakan suggests that corporations are pathologically amoral, as their only constituent motive by law is profit.[217] While some corporations comply with rules to foster good relations

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[215] (Puri, Sentencing the Criminal Corporation 2001) at p.617

[216] (Pearce and Tombs, Ideology, Hegemony, and Empiricism 1990) at p.425

[217] (Bakan 2004) argues that the corporation is created by law to function much like a psychopathic personality whose destructive behavior, if left unchecked, will lead to scandal and ruin.

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for long–term value, Pearce and Tombs argued [in 1990] that in the current era of hostile takeover bids, leveraged buy–outs and asset–stripping, long–term strategies are rare.[218] “After all, an enterprise subscribing to standards higher than those of its competitors would, in the long run, render itself unviable or, minimally, unprofitable”, they say.[219]

However, Braithwaite and Makkai[220] note that the specific deterrence model for a corporation only applies if its managers have a profitability interest in the corporation and lack any personal, outside, commitment to compliance. Management will not always act in the financial interests of the shareholders of the corporation; they may be self–interested and seek to enhance their own personal, long term, reputation within the industry, rather than the short-term interests of their current employer. Management may have outside group loyalties—for example, loyalty to their profession, loyalty to their co–workers, or loyalty to their government.”[221] Managers may be

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[218] (Pearce and Tombs, Policing Corporate 'Skid Rows': A Reply to Keith Hawkins 1990) at p.424

[219] (Pearce and Tombs, Policing Corporate 'Skid Rows': A Reply to Keith Hawkins 1990) at p.425

[220] (Braithwaite and Makkai, Testing an Expected Utility Model of Corporate Deterrence 1991) p.9

[221] (Braithwaite and Makkai, Testing an Expected Utility Model of Corporate Deterrence 1991) p.10

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unwilling to risk their personal reputation by participating in the illegal conduct of the corporation.[222]

General deterrence

General deterrence conveys to the public at large the consequences of committing a particular offence by making "an example" of the offender. Punishment serves an educational role by warning the public that they will suffer a similar fate if they commit the offence.

Thornton, Gunningham and Kagan[223] reject "fear–based", general deterrence theory, at least for environmental regulations. After examining 233 firms in several industries in the United States, they found that the threat of punishment for environmental offences was not the primary motive for compliance, since consciousness of the penalties imposed was "remarkably inaccurate." Respondents "overwhelmingly underestimated" the actual penalties imposed in the "signal cases" when they were presented as hypotheticals. At the same time, Thornton, Gunningham and Kagan referred to studies which indicated that compliance is far more common than deterrence theory would expect—relatively high levels of compliance exist for environmental offences even when the threat of enforcement appears to be remote.

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[222] See also (Hawkins 1990) at 455: "How much do people in business behave as individuals or as organizational actors? And if people act self–interestedly, in whose interest do they act, their organization's or (sometimes?) their own? …For instance, are we to assume that the captain of the Exxon Valdez was prepared to risk his job, and possibly other sanctions, by allegedly drinking heavily while in charge of a vessel laden with oil?"

[223] (Thornton, Gunningham and Kagan 2005) p. 272

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Making “an example” of an offender can serve a denunciation role which relates to general deterrence, but which also relates to the expression of justice and morality, as described below in Feldman’s fourth motive to comply. Denunciation is public repudiation of wrongful conduct. It reinforces the sense within the community that the law should be obeyed. [224] Although regulatory offences are not typically based on morality, as is criminal law, denunciation can legitimize the regulatory authority and its rules, especially if the denunciation involves reasons and explains why the behavior is wrongful.

Reason-Driven Motive

The second regulatory motive posits a reason-driven person, who looks to the regulator as an ally with superior knowledge who can demonstrate the wisdom of complying with certain laws. For example, if the authorities prohibit public smoking and give good reasons for doing so, people may update their beliefs. Vickers et.al. note that “proactive” and “positive” small businesses

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[224] As stated by the Supreme Court of Canada [in the context of criminal law], “[t]he objective of denunciation mandates that a sentence should also communicate society’s condemnation of that particular offender’s conduct... In short, a sentence with a denunciatory element represents a symbolic, collective statement that the offender’s conduct should be punished for encroaching on our society’s basic code of values as enshrined within our substantive criminal law.” R. v. M.(C.A.), [1996] 1 S.C.R. 500, 105 C.C.C. (3d) 327 at 369 (C.C.C.).

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(those which are motivated to learn) responded to pollution control and workplace regulatory requirements and improved their management processes and technology.[225]

Sutinen[226] argues that, although there is a core of chronic offenders, the usual reason why corporations comply is that those who operate them perceive the law to be consistent with their internalized norms.[227] As Parker suggests, regulators must convince people that the law represents shared values.[228] Regulators must avoid what Parker calls the "compliance trap"—i.e., where compliance becomes difficult to improve because the values underlying compliance are contested.

Social Identity Motive

The third compliance motive identified by Feldman relates to group identity and the individual's need to belong. There are two aspects: (i) the desire to join the right community; and (ii) the fear of unnecessarily joining and following rules, while others do not and enjoy more freedom.

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[225] (Vickers, et al. 2006)

[226] (Sutinen 1999), p. 179

[227] For example, most fishermen comply with regulatory catch limits even though the probability of detection and the severity of punishment are both low. Why? It is because the sense of moraal obligation is common throughout society, according to (Sutinen 1999) pp.177–78

[228] (C. Parker, The Compliance Trap - The Moral Message in Responsive Regulatory Enforcement 2006) at p.34

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Desire to join the "right" community and peer pressure

As Sutinen argues, joining the right community and peer pressure affects compliance. "Social influence plays a significant role in everyday social exchange, often taking the subtle forms of ostracism or withholding of favors."[229] Peer groups can reward and punish, by withholding or conferring status, or by channeling material resources toward or away from a member of the group.

A report of environmental enforcement in BC found that "[i]f the public knows that violators have broken an environmental law, this embarrasses the violator. They may lose business or be shunned by former friends. Peer pressure, and the financial implications of bad press, can be a powerful tool."[230] Petts and Horne note (for SMEs): "Adverse publicity and damage to company image, and hence competitiveness, were viewed by both managers and non–management employees as pressures at least equal to that of prosecution if not greater."[231] Similarly, as Puri and Condon suggest, "Issuers that became known as 'compliance leaders' …might be expected to reap reputational rewards"[232]

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[229] (Sutinen 1999) p.181

[230] (Oakes 2007)

[231] (Petts, et al. 1999) pp. 14–30.

[232] (Condon and Puri 2006)

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Grasmick and Bursik argue that embarrassment and loss of respect affect compliance as much as state imposed penalties.[233] They reject the *homo economicus* notion at the core of deterrence theory—the fictional man who cares only about the net present value and probability of the potential penalty, utterly indifferent to the attitude of his friends, neighbors, co–workers, and fellow corporate managers.[234] Kahan argues that individuals in society are not *homo economicus* but rather, the more emotionally nuanced *homo reciprocans*. When they perceive that others are behaving cooperatively, they are moved by honour, altruism, and like dispositions to contribute to public goods even without the inducement of material incentives. But when they perceive that others are shirking, they can be moved by resentment and pride to retaliate and withhold beneficial forms of cooperation even if doing so exposes them to significant material disadvantage.[235]

Ford and Hess[236] discuss the use of settlement agreements and the appointment of independent monitors. Sometime around 2003, following the Enron, Worldcom and similar debacles, the Department of Justice and the U.S. SEC moved from a deterrence strategy of imposing large fines on corporate wrongdoers (which are indirectly paid by the shareholders) with requirements that wrongdoers implement compliance systems and hire independent monitors. Ford and Hess

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[233] (Grasmick and Bursick 1990) who don't so much as reject the theory of deterrence, but argue that shame and embarassment are additional non–state costs for deterrence theory.

[234] (Logue 2007) at p. 3

[235] (Kahan 2001) at pp.333–4

[236] (Ford and Hess, Corporate Monitorships and New Governance Regulation: In Theory, in Practice, and in Context 2011)

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cite a survey of over 5,000 employees across several industries which found that the "root cause" of misconduct within an organization was most often the organization's ethical culture—such as "pressure to do whatever it takes to meet business targets" and a belief that "their code of conduct is not taken seriously." Only one-third of those surveyed attributed wrongdoing to someone within the organization bending rules for personal gain. Thus, independent monitors must determine what aspects of the corporate culture contributed to the wrongdoing, and then motivate management and employees to participate in compliance measures that go beyond formalism. Monitors should develop information-forcing techniques such as reason giving, dialogue, benchmarking, and outcome analysis, to emphasize root causes rather than superficial compliance. However, Ford and Hess found frequent breakdown of the monitor program, especially where the monitors were former prosecutors. They tended to see the root cause of wrongdoing to be ignorance of laws and corporate policy, rather than management pressure to meet performance goals.

Reputation capital

Modern game–theorists suggest that repeated contact within a community can enforce the need for reputation capital. Small, entrepreneurial organizations require participative managers and coalition building in order to access investors, suppliers and opportunities. Acquiring reputation capital can be just as "rational" as acquiring economic capital, since reputation capital can be

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converted from one form to another, to gain advantage in the form of additional funds, power or allies.[237] Moore and Spence found that small firms are not less ethical than large firms, because they depend on good relations with their community for financing, support and customers.[238] As Edwards and Sen Gupta describe, small firms in highly competitive markets might be expected to be driven to short–term sales techniques, but in fact are embedded in networks that supply information and help to generate trust.[239]

Lepoutre and Heene argue that, while small business operators do not have the time to recognize responsibility issues, those which engage in networks are more likely to find ways to resolve issues, and that "the case for a culture of shared responsibility and the creation of institutions for joint responsibility is compelling" because of networked opportunities for learning, risk sharing,

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[237] (Fuller and Yumiao 2006) p.288

[238] (Moore and Spence 2006) See also: (Edwards, et al. 2006) at 702: "...small firms in highly competitive markets... might be expected to be driven only by market logics, but in fact they are embedded in networks that supply information and help to generate trust; moreover, the extent of network embeddedness has important implications for productive success."

[239] (Edwards, et al. 2006) at 702 See also (Petts, et al. 1999) at 25, which found that "Adverse publicity and damage to company image, and hence competitiveness, were viewed by both managers and non-management employees as pressures at least equal to that of prosecution if not greater. These were the two motivators that were mentioned most frequently when individuals were asked 'what would encourage your company to comply with regulation?'. This provides an indicator of the potentially greater influence of the market and social domains upon compliance."

See also: (Bucar and Hisrich 2003): "The belief in the goodness of people is far stronger among Americans and is probably one of the psychological barriers in former Eastern European countries. Without trust it is difficult to build entrepreneurial teams and obtain outside private equity capital; these difficulties are hindering the growth of the economy."

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and access to resources.[240] This is echoed by Vickers et. al., who are pessimistic about the compliance of small firms in general, but who identify some which are "proactive learners" and "positive responders"—who have developed compliance awareness from external agencies, inspectors and customers, and are more tolerant of and more responsive to regulation.[241]

A study by Petts et al. (1999)[242] demonstrated that managers of SMEs believe that environmental compliance is important, but that regulation on its own is inadequate. Adverse publicity and damage to company image were viewed by managers and non–managers as pressures ''at least equal to'' that of prosecution. Brown and King handed out questionnaires to 122 small business respondents (those who worked for businesses with fewer than 100 employees) and 95 "others"—i.e. professionals and those employed by large corporations or government. Small business respondents placed more emphasis on "situational" or "relative" business ethics than on general ethics.[243] Small businesses which are embedded in local communities are more likely to

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[240] (Lepoutre and Heene 2006) at p.267

[241] (Vickers, et al. 2006) at p.161

[242] (Petts, et al. 1999) at p. 25: "Adverse publicity and damage to company image, and hence competitiveness, were viewed by both managers and non–management employees as pressures at least equal to that of prosecution if not greater. These were the two motivators that were mentioned most frequently when individuals were asked 'what would encourage your company to comply with regulation?'. This provides an indicator of the potentially greater influence of the market and social domains upon compliance."

[243] (Brown and King 1982) at p.13: Rankings were done of various internalized factors – both respondent groups agreed that "norms and pressures from community and peers" come first in importance, that "fear of punishment" comes last, and that "upholding the law regardless" comes next to last. Small business owners placed "anticipation of rewards" in second place, followed by

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act socially.[244] Small businesses which draw their customers from a close geographical group (e.g., local auto repair shops) are more likely to feel "morally proximate" to their clients than, for example, web designers.

Chau and Siu[245] reviewed various studies and concluded that small, entrepreneurial organizations, require participative managers and coalition building. Whereas executives in traditional organizations follow routines, gather information within their own unit, and rarely prepare themselves to encounter opposition, executives of small organizations directly face conflicting ideas and regulators and must examine their own organizations from a broad perspective, combining ideas from unconnected sources.

Concern about unnecessarily joining

Feldman suggests that some people are "conditional cooperators" and will usually comply only when they have a reason to believe that others will do the same.[246] Kahan has suggested that the individual needs to believe that other members of society share his or her commitment to the law in order to maintain his or her own commitment to society and to its rules, i.e., the fear of being

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"higher moral or religious principles." The other respondents reversed the order of "rewards" and "higher principles"

[244] (Moore and Spence 2006) at p.222

[245] (Chau and Siu 2000)

[246] (Feldman 2010)

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the only "sucker" who obeys the law. According to Kahan[247], statistical analyses of tax evasion suggest the dominant role of reciprocity. Tax compliance rates vary across nations. This cannot be explained by differences in the expected penalty for evasion, but by different public attitudes toward tax laws. "In some nations (including the United States), individuals tend to view paying their taxes as an important civic obligation, and are highly motivated to pay for that reason. In other nations (including many in Western Europe), individuals regard tax obligations much more casually (akin, say, to traffic regulations in the United States), and display no particular moral aversion to evading them if they feel they can safely do so." These "tax climates" are constructed by individuals' beliefs about the willingness of others to comply with tax laws: those who believe that others will comply believe that paying taxes is a moral duty; those who believe cheating is widespread believe that evading tax is not a serious wrong. Individuals will only act like *homo economicus* if they believe that others are acting like *homo economicus*. Compliance is reciprocal.[248]

Smaller issuers have fewer resources for compliance, and so, are concerned about spending funds to comply unnecessarily. As Puri and Condon note, SMEs could be a greater source of risk of insider trading practices because of their greater difficulty in educating their employees about the prohibition, and the prevalence of stock option compensation.[249] Wayne and Scholz[250] argue

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[247] (Kahan 2001)

[248] (Kahan 2001) at pp.341–42

[249] (Puri and Condon, The Role of Compliance in Securities Regulatory Enforcement 2006)

[250] (Gray and Scholz 2008)

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that large firms are more aware of enforcement activities, and that the managerial effort available for monitoring regulations increases exponentially with the size of the firm.[251] Vickers et. al. note that small enterprises are known to have "a preference for informality and an antipathy towards external regulation" and that the health and safety performance of small firms significantly lags those of larger firms, which can afford the finance, time, competency, training, plant and equipment for compliance.[252]

Justice Motive

The fourth compliance motive identified by Feldman is that some people are motivated by a sense of justice. As Tyler[253] explains, some people obey the law because they believe that the

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[251] (Easterbrook and Fischel, Mandatory Disclosure and the Protection of Investors 1984) at 709: "The securities laws possess many of the characteristics of classic interest group legislation. Existing rules give larger issuers an edge, because many of the costs of disclosure are the same regardless of the size of the firm or the offering. Thus larger or older firms face lower flotation costs per dollar than do smaller issuers. The rules also help existing investment banks and auditing firms obtain an advantage because they acquire expertise and because rivals cannot compete by offering differentiated products."

[252] (Vickers, et al. 2006)

[253] (Tyler 2006) at p.4

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law is founded on justice[254]. Tyler separates the notion of justice into two categories: concern about the justice of outcomes (distributive justice) and concern about the procedures by which decisions are arrived at (procedural justice).

Distributive justice

Distributive justice focuses on the outcomes of legal process, i.e. the distribution of rewards and punishments. It is the desire that all members of the community receive the rewards and punishments that they deserve. It can generate a commitment to comply because "it is the right thing to do", rather than because of a cost/benefit calculation of the incentive motive. It is different than the citizenship-oriented motive, since compliance is based on morality rather than on the legitimacy of the authorities. If this is an important motive for the regulated, then regulations should be justified on the basis of their morality.

People may believe that they themselves are motivated by justice and morality and that they will "do the right thing", but do they believe that others will? Sanderson and Darley[255] conducted

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[254] The justice of the law and the legitimacy of the One can have laws that perceived as just but enforced by a corrupt police force, and one can have a respected police force enforcing unjust laws.

[255] (Sanderson and Darley 2002) See also (Doherty, Weigold and Schlenker 1990) whose social experiment confirmed the "self-serving bias position"— people prefer desirable interpretations of their own motives. Not only do they ascribe their own helpful behavior predominantly to positive motives, they denigrate evaluators who contend that their motives are less pure.

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experiments to show that most people believe that they themselves engage in good conduct because of their internal factors (e.g., moral goodness) and that if any their own conduct appears negative it is because of external forces (e.g., the pressures of a given situation). However, most people are less charitable in their assessment of others, believing that the bad behavior of others is evidence of the poor internal character of other people.

One explanation for this "holier than thou" assessment is social survival. The true motives of others are often unknown and full of risk. We don't know who will obey the law, who will act morally and who may harm us, so we construct archetypes for predicting the behavior of others. Even if our archetypes are unreasonable (perhaps nothing more than prejudice), they give us comfort to think that we can predict the behaviour of others. We ascribe positive motives to ourselves to give us confidence to demand respect and support from our community. We ascribe negative motives to others and seek their denunciation to reinforce the belief that, in the long run, everyone gets their just deserts. As Bénabou and Tirole point out[256], individuals strive to motivate themselves or their children towards effort, educational investment, perseverance in the face of adversity, and away from the slippery slope of idleness, welfare dependency, crime, drugs, etc. In such circumstances, maintaining somewhat rosy beliefs about the fact that everyone will ultimately get their just deserts can be very valuable.[257]

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[256] (Bénabou and Jean 2006)

[257] Trivedi and Umashanker argue the logical extension of this view—that moral reasoning influences regulatory compliance and that those who don't comply usually have anti–establishment views (Trivedi, Shehata and Mestelman 2004)

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Procedural justice

Procedural justice focuses on how decisions are made, rather than what those decisions are. Tyler[258] argues that the way people are treated by the authorities is the main motivation for legal compliance. Where the authority treats the person with respect, gives the person an opportunity to be heard and listens to the person, and then renders a reasoned decision without bias, an unfavorable decision will often be accepted. "People have a tremendous desire to present their side of the story and value the opportunity to be heard."[259] Although their short-term interests may not be achieved, being listened to and being treated fairly in a meaningful procedure reinforces their sense that they are being valued within their community and that, in the long-term, their interests will be respected. "The key point is that having one's views considered is important because it is a message about one's standing in a social group, not because it means that one's views will necessarily prevail."[260]

Citizenship Motive

The citizenship-oriented individual obeys the law because they believe that the authorities have the "legitimacy" to create laws and, within a range of reasonableness, they should be obeyed

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[258] (Tyler 2006)

[259] (Tyler 2006) at p.147

[260] (Tyler 2006) at p.150

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regardless of their content.[261] It is different than the desire for justice, since it is compliance because "it is the law" rather than compliance because "it is the right thing to do".

Empirical studies show that individuals and corporations in democracies comply with tax laws more than would be expected by deterrence theory and the estimate of the amount and probability of punishment[262]. Frey and Jegen[263] argue that this civic virtue shows a commitment to citizenship and respect for the law. Citizens who consider that the authorities are fair and respectful are more compliant than those with negative perceptions of government.[264] Greater democratic participation enhances civic virtue, a motivation not explained by deterrence theory.[265]

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[261] (Scholz &Pinney, 1995)

[262] (Rummel and Feinberg 1988) used 45 experimental studies covering the period 1971–85. They also cite 20 studies from Wiersma (1992) covering 1971–90, 10 and cite 50 studies from Tang and Hall (1995) from 1972–92. These meta–analyses, according to Rummel and Feinberg, support their findings that intrinsic motivation is undermined if the externally applied rewards are perceived to be controlling by the recipients (pp.9–10) see also the heading "Income Tax Compliance" in this paper.

[263] (Frey and Jegen 2001). They also refer to an analogy by Deci with Flaste 1995 regarding a perfectionist child in violin class. Once 'gold–stars' were introduced as a symbolic reward for a certain amount of time spent practicing the instrument, the girl lost all her interest in trying new, difficult pieces. Instead of improving her skills, the aim shifted towards spending time playing well–learned, easy pieces in order to receive the award. At p.596.

[264] A further discussion in this paper regarding tax compliance is found at p. 146.

[265] Equally, according to Frey and Jegen, "crowding–out theory" holds that when the regulator exercises excessive control over the regulated, self–determination is "crowded out" and the regulated just follow the commands of the regulator. (Frey and Jegen 2001) pp.9–10.

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Tyler[266] argues that regulations cannot be effectively enforced without the cooperation (i.e., the "normative accord") of the population it hopes to control.[267] In democratic societies with a strong rule of law tradition, business managers have "internalized" the social norms which "under–gird" many regulatory rules.[268] Most corporations are "contingent good apples" which are educated by "signal" enforcement cases and are motivated by the corporation's ongoing reputation within its community of suppliers and customers.[269] Thornton, Gunningham and Kagan surveyed 233 firms in several industries in the United States and found that most corporate officials are less concerned about environmental penalties than they are about informal social and economic sanctions.[270]

Tax compliance research shows that individuals will reciprocate and cooperate with others, even when their self–interest suggests that they should not. For example, people often contribute to public goods (including charities), even though they could maximize their personal finances by not contributing. Contribution happens even in anonymous situations.[271] People generally want

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[266] (Sutinen 1999) at p. 182

[267] (Gunningham and Kagan 2005) at 215. Procedural justice is often more important than outcomes. Civil penalties and other sanctions should match the value of the harm done or gains realized; individuals subject to surveillance and monitoring should be treated with dignity and respect; and regulations should be reasonable and "make sense." (Sutinen 1999), p.183

[268] (Thornton, Gunningham and Kagan 2005) at p.264

[269] (Thornton, Gunningham and Kagan 2005) at p.267

[270] (Thornton, Gunningham and Kagan 2005) at p.271

[271] See: (Lederman 2003) p. 1453; and (Kahan 2001)

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to be seen as good. Monetary incentives can taint the public image of a pure charitable action, so monetary incentives are more effective in private than in public situations.[272]

Rules or principles for Conflicts of Interest?—Literature Review

This section reviews the literature about whether conflicts of interest should be regulated by rules or principles. Those in a conflict of interest have a tendency to favour themselves and to minimize the importance of any conflict. Which language strategy best regulates conflicts of interest? Some authorities favour rules, since principles can be interpreted in a self–serving manner; others say principles, since rules have predictable borders which the clever can side–step.

Regulating conflicts of interest and self–dealing

If left unregulated, those who control a corporation (whether as managers or controlling shareholders) can use their power to divert corporate wealth to themselves rather than sharing it with other investors.[273] Various forms of such self–dealing include: executive perquisites,

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[272] (Ariely, Bracha and Meier 2007)

[273] (Djankov, et al. 2008)

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excessive compensation, transfer pricing, appropriation of corporate opportunities, self–serving financial transactions such as directed equity issuance or personal loans to insiders, and outright theft of corporate assets.[274]

The efficient market hypothesis asserts that the prices for publicly traded securities are efficient in two senses: (1) the current price of a security best predicts its future price and (2) the prevailing price immediately assimilates new information provided to the market.[275] If the hypothesis were true for a particular market, then, arguably, the market will reflect how well management deals with conflicts of interest and other governance issues—that investors will pay a premium for well–managed companies, and will discount those which are not.[276] But, as Djankov notes, virtually no society accepts this "do nothing" approach as "the temptation to 'take the money and run' in an unregulated environment is just too great."[277]

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[274] (Shleifer and Vishny 1997) at p. 742

[275] (Gordon and Kornhauser 1985) at pp.770-71

[276] (Gordon and Kornhauser 1985) at p.824: "In an efficient market, the market prices of the firm's securities will signal the relative quality of management because evidence of management shirking, misappropriation or incompetence will presumably be reflected in the firm's securities prices."

[277] (Djankov, et al. 2008) at p.431. See also at p.463 where the conclusion is that "corporate governance, particularly in the area of self–dealing transactions. Perhaps the most basic conclusion from the data is that laissez–faire—the strategy of no public involvement at all—does not lead to more developed financial markets. The public sector clearly has a central role to play, but principally as the designer of the rules of the game, which are then enforced by private action. .. Countries with successful stock markets mandate that shareholders receive the information they need and the power to act—including both voting and litigation—on this

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There are two regulatory approaches to self–dealing: One approach is to facilitate private enforcement. The private law approach imposes disclosure requirements, approval procedures for transactions, and private litigation when self–dealing is shown. In the private law approach, the government regulates the contracting framework, but leaves enforcement to private parties.

A more invasive approach is to add public enforcement, including fines and prison terms for self–dealing.[278] For example, section 426 of the Criminal Code prohibits "secret commissions":

> 426. (1) Every one commits an offence who
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> (*a*) directly or indirectly, corruptly gives, offers or agrees to give or offer to an agent or to anyone for the benefit of the agent — or, being an agent, directly or indirectly, corruptly demands, accepts or offers or agrees to accept from any person, for themselves or another person — any reward, advantage or benefit of any kind as consideration for doing or not doing, or for having done or not done, any act relating to the affairs or business of the agent's principal, or for showing or not showing favour or disfavour to any person with relation to the affairs or business of the agent's principal; or
>
> (*b*) with intent to deceive a principal, gives to an agent of that principal, or, being an agent, uses with intent to deceive his principal, a receipt, an account or other writing
>
> (i) in which the principal has an interest,
>
> (ii) that contains any statement that is false or erroneous or defective in any material particular, and
>
> (iii) that is intended to mislead the principal.

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information. There is no evidence that these countries rely heavily on fines and criminal sanctions."

[278] (Djankov, et al. 2008) p. 431

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Argandoña lists private enforcement solutions to conflicts of interest, including: (1) prevention by recusal of the person who has to make the decision, or the divestiture by the agent of his or her private interests, and/or (2) "process solutions", such as full disclosure of the conflict of interest and a level of competition so that the principal can consider alternatives.[279] Djankov[280] further divides process solutions between those which are *ex ante* (where the independent directors and/or shareholders must approve the transaction before its completion) and those which are *ex post* (where after–the–fact disclosure is made and shareholders can sue if there is undue self–interest).

As explained by Djankov, modern regulation of self–dealing evolved from the original common law rule of equity under which directors, being subject to fiduciary duties, cannot enter into engagements with their company when they have a conflict of interest, unless they first obtain shareholder approval (*ex ante*). However, during the 19th century, this rule of equity lost its bite as courts came to accept that shareholder approval could be granted in general, rather than for specific transactions, in the organizing documents. Thus, legislators stepped in with constraints on self–dealing.[281]

Canadian corporate law requires directors of the corporation to obtain *ex ante* approval for self–interested transactions. The Ontario and Canada business corporations acts require a director of a

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[279] (Argandoña 2004)

[280] (Djankov, et al. 2008)

[281] (Djankov, et al. 2008) at p.439. According to Djankov, US corporate law places greater emphasis on ex post litigation rather than ex ante shareholder approval. (at p. 463)

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corporation who is a party to a proposed material contract or transaction to disclose the interest in writing and not to vote on any resolution to approve the contract.[282] The Ontario and Quebec securities commissions have gone further and require controlling shareholders to obtain *ex ante* approval for certain transactions by adopting Multilateral Instrument 61–101 to regulate insider bids, issuer bids, business combinations and related party transactions, i.e., transactions favouring a controlling shareholder. Related party transactions require a formal valuation and the approval of the majority of the remaining shareholders. Multilateral Instrument 61–101 is a rules–based approach to conflicts of interest. Together with its Companion Policy, it is 44 pages in length. As shown above (Table 1) it has more words per paragraph than comparative legislation and approaches the complexity of the *Income Tax Act* when considering the average number of words per sentence.

Should conflicts of interest be regulated by rules or principles?

One approach is to use rules, since vague principles can be narrowly interpreted by the self–interested agent. As Argandoña notes, agents can be selective when assessing evidence; they are more likely to find evidence that supports their desired conclusion and value it uncritically. If evidence contradicts their desired conclusion, they tend to ignore it or examine it more

[282] See: Section 132 of the Ontario *Business Corporations Act*, R.S.O. 1990, Chapter B.16, and sections 83 and 120 of the Canada Business Corporations Act R.S., 1985, c. C–44, s. 1; 1994, c. 24, s. 1(F)

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critically.[283] Arguably, by itemizing in advance what must be disclosed, the agent's opportunity to narrowly interpret principles will be controlled.

Ford proposes rules where compliance is especially important, such as safeguarding participation and procedural rights.[284] On the other hand, detailed rules may not fully account for all of the factors affecting an agent. Antony Page describes how agents are not only biased by material or financial benefits (*"homo economicus"*[285]*)*, but are biased by other factors, including group loyalties, friendship, and nonpecuniary self–interest.[286] Principles are more flexible and can refer to softer influences on the agent, influences which cannot easily be itemized in advance by a rule.

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[283] (Argandoña 2004) p.7

[284] (Ford, Principles-Based Securities Regulation, A Research Study 2009) p.43. See also page 42 where Ford states: "A legislature that was concerned about regulatory overreaching or lack of transparency would ensure that the regulator had very little discretion (i.e., expectations were cast as rules rather than principles and were enshrined in the statute) when it came to such things as access to information, the handling of complaints, or accountability to parliament. A legislature that was concerned about individual rights would limit discretion (i.e., would craft rules not principles) regarding hearings, procedural fairness, and consultation/participation rights."

[285] *Supra*, note 234

[286] (Page 2009) at 240. See also at p.265:"[N]umerous studies have shown that people will frequently either neglect or reject disconfirming information. This process, termed confirmation bias, creates a tendency for people to search for and interpret new information as supportive of current beliefs and to fail to search for, ignore, discredit, or underweight unsupportive information. Although some people are corrupt and do this consciously, many people will do this in good faith. In other words, they are unaware of the self–interested bias by which they process information."

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According to Nelson, regardless of the precision of standards, practitioners consciously or unconsciously make financial reports that are consistent with their own personal incentives. Precise standards can help an auditor discourage aggressive reporting by a client who was previously unaware of a precise standard. However, once the standard is known, the client can later contort evidence to superficially comply with the precise standard.[287]

Applying principles for conflicts of interest is not necessarily too vague. Consider the broad description of the offence of "fraud" in section 380 of the Criminal Code[288] which controls self–interested economic behaviour analogous to the selfish transactions of a conflicted agent. Criminal courts have applied the broadly worded offence of fraud for years in a variety of fact situations. Although courts cannot articulate in advance all behaviour which is fraudulent, when presented with sufficient facts they can identify the wrong. Arguably, regulators could assess conflicts of interest with principles just as easily as courts can identify fraud.

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[287] (M. Nelson 2003) p.17

[288] Criminal Code (R.S., 1985, c. C–46), section 380: "Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service…is guilty…". "Fraud" itself is not defined but determined by Judge–made case law.

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Accounting for Conflicts of Interest

There are two accounting models to measure the value of assets and liabilities of a corporation: the "historical cost" model and the "mark–to–market" model. Both have advantages and disadvantages when assessing conflicts of interest.

Under the "historical cost" model, assets and liabilities are recorded at their values when acquired (their "book values") and only restated when there is a later transaction. One of the advantages of using book values is that financial statements are relatively straightforward to produce and less open to manipulation, as they are prepared from the verifiable records of a firm's transactions. Detailed rules can regulate historical costs, since it is generally a matter of accurately recording the transactions and presenting them in a standardized format.

Under the "mark–to–market" model, assets and liabilities are periodically restated to reflect their current fair market values, regardless of whether there has been a transaction. Where the fair market values of assets can be readily determined (such as liquid securities listed on a stock exchange), mark–to–market can provide objective financial statements. Where assets are illiquid, however, fair market values can be difficult to ascertain, and marking the value of assets to the market can be manipulated. Principles are best for assessing the mark–to–market value of assets, since the assessment of fair value (what an arm's length purchaser would pay) depends on many factors which typically cannot be itemized in advance.

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The historical cost model

One advantage of disclosing historical costs, with detailed rules, is described by Mahoney. It can measure the conflict of interest when a promoter solicits public funds for a company which is buying property indirectly from the promoter. Mahoney describes how a promoter can arrange transactions at artificial prices among family or business associates to hide the promoter's personal gain as an agent of the corporation. For example, a promoter could transfer mining claims to a private company owned by associates controlled by the promoter, which then sells them to the public company at what may appear to be a third–party transaction. The final transfer to the public company may indeed be at fair market value, but to fully assess the compensation of the promoter, shareholders should know the historical cost when the promoter originally acquired the mining claims and the history of the transactions. If the promoter acquired the claims at less than fair value at the start, it doesn't necessarily mean that the public company is paying too much at the end, but it is important information to fully assess the promoter's personal interest.[289]

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[289] According to Mahoney (Mahoney 1995), the English *Companies Act*, 1867 provided that a prospectus must disclose the parties to and dates of "any contract entered into by the company, or the promoters, directors, or trustees thereof, before the issue of such prospectus. The statute gave a direct right of action to shareholders, notwithstanding their lack of privity with the promoter and directors. Failure to make the required disclosures was deemed fraudulent "as regards any person taking shares in the company on the faith of such prospectus". Also corporations had a minimum par value for shares, so that promoters couldn't issue themselves shares at a discount.

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Mahoney describes how, beginning in the late 19th century, this "promoter problem" led to the first mandatory disclosure rules for transactions before the initial public distribution. Common law agency laws (fiduciary duty, full disclosure, etc.) were adapted to securities markets in England by the English *Companies Act, 1867*, with an evolving list of mandated items that promoters were required to disclose in a prospectus. It was essentially a rules–based approach, with itemized lists of historical transactions, in order to fully assess the compensation of the promoter.

Mahoney argues that, given the scarce resources of smaller issuers, regulators should focus on historical cost disclosure with a rules–based regime, to address the promoter problem. Mahoney is critical of the increasing requirement of forward–looking statements and estimates of current market values. Rather than having the regulator mandate expensive disclosure for small issuers, based on a mark–to–market accounting model, let investors negotiate the kind of valuation

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Faced with a promoter who discloses a substantial adverse interest, most investors would refuse to invest unless they were assured that someone–either a knowledgeable and independent board of directors or a sophisticated "lead" investor with a large sum at stake–was going to negotiate the terms on which the corporation would be willing to purchase the promoter's property and services. The disclosure rule is therefore, in Frank Easterbrook and Daniel Fischel's phrase, "contract–inducing." It encourages the creation of the promoter/investor relationship, notwithstanding the promoter's potentially conflicting interests, by forcing the promoter to negotiate the terms of the self–interested transaction, pp. 1090–91

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necessary for a particular transaction. Mahoney is critical of what he sees as the US Securities Commission's move towards a future–oriented "accuracy enhancement" model of disclosure (based on current and future estimates, rather than historical costs).

The mark–to–market model

Marking the value of assets to their current fair market value can add valuable information for the investor generally, and also for assessing the agent's conflict of interest. For example, regardless of what the promoter paid for the mining claims, and whether they were vended through controlled corporations, the current investor should know whether the current price being paid to the promoter (directly or indirectly) is a fair price. For this reason, in situations of related party transactions, Multilateral Instrument 61–101 requires a professional, independent, business valuator to give an opinion as to the value, or a range of values, representing the fair market value of the assets being transacted. The opinion must also provide sufficient disclosure to understand the principal judgments and principal underlying reasoning of the valuator, so as to form a reasoned judgment of the merits of the valuation.[290]

Valuing assets is a complex process, requiring an assessment of the asset, market conditions, future market changes, and complex tax considerations. Such a range of factors is best regulated

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[290] 61–101 Section 6.4

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by principles as many industries and transactions face unique circumstances and it would be overwhelming for the regulator to itemize each consideration in advance.

Rules or Principles—Comparison with other Regulated Activities

This section briefly reviews the use of rules and principles in other regulated fields. It starts with a review of income tax compliance, accounting standards, and some other regulated fields. The purpose of this review is to look for similarities with issues faced and the effectiveness of language strategies in those other contexts.

Income Tax Compliance

The Canadian Income Tax Act ("ITA"), regulations, interpretation bulletins, and policy statements are an enormous compendium of rules–based regulation. The ITA was enacted in Canada in 1917 as a temporary means to finance the Great War. Income taxes were introduced in the United Kingdom over a hundred years earlier, to finance another major war—the Napoleonic war. The 1799 English statute was 150 pages in length, imposed on all residents of Britain, against their entire world income; it was a relatively low rate of tax (by modern standards)—ten percent on total income from all sources above £60, with reductions on income

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up to £200[291]. When the English income tax was imposed for the first time during peacetime, in 1842, the tax was about three percent of income. Progressive rates of tax were introduced by Lloyd George in his "people's budget" of 1909, but this "supertax" still amounted to only eight percent of the incomes of the wealthy.

As the rates of income tax increased after the First World War, so too did the incentive to avoid. Many scholars, including McBarnet[292], describe the growth of "creative compliance"—the (mis)characterization of property transactions to comply with the letter but not the purpose of tax law. Braithwaite describes a "contrived complexity" of many commercial transactions, as part of a cat-and-mouse game with authorities to avoid tax. But other scholars, including Picciotto[293], give an alternative explanation for disputes about the application of tax rules. So-called "mischaracterizations" can arise from honest disagreement about the purpose or fairness of rules. As Fuller notes, a rule sometimes requires an understanding of its purpose[294]; and as Braithwaite argues, certainty does not flow so much from the precision of the words used as it does from a tacit understanding within a community as to objectives.[295]

The purpose of tax laws may seem straightforward until we scratch the surface. For example, the ITA starts simply enough with the principle that tax shall be paid on the taxable income for each

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[291] (Customs 2011) and see (E. R. Seligman 1911)

[292] (McBarnet 2003)

[293] (Picciotto 2007)

[294] (L. Fuller 1958) at p.663

[295] (Braithwaite, Rules and Principles: A Theory of Legal Certainty 2002) at p.71

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taxation year of every person resident in Canada at any time in the year (section 2 of the ITA). But "income", according to Prebble, is "an artificial construct"– an invented calculation of what is identified by the authorities as revenue less what the authorities permit as deductions during a defined period of time. For example, tax rules prescribing the period over which an asset can be depreciated (i.e. expensed) may have little factual connection with the economic life of the particular asset. Similarly, some economic income is not taxable at all (e.g., gifts, inheritances, gains on the principal residence) and some economic income is only half-taxable (such as the capital gain on most assets).

Even if the purpose of tax rules is understood, their fairness can be challenged. For example, Canadian and UK income tax is imposed on residents on all sources of income from across the globe. When incorporations became more common in the late 1800s, the determination of residency in UK law was applied to international corporations, including those registered overseas. The decisive precedent involved the De Beers mining company, formed under South African law; with its head office, general meetings, and all mining operations in South Africa. The House of Lords held that De Beers resided in England because England was where its central management and control was exercised.[296] Leaders of international corporations rejected the fairness of this decision and argued that only corporate income earned in England should be taxed in England. Mining income earned in South Africa should be taxed in South Africa, whether or not management uses offices in England. Following the De Beers decision,

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[296] DeBeers Consolidated Mines Limited v. Howe, (1906) A.C. 455

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corporations set up complicated decision structures so that central management and control was not located in Britain, and in some cases, set up non-resident trusts to hold the corporate shares of British residents (i.e., the majority of trustees would reside in a foreign jurisdiction, so that income could accumulate for years in the non-resident trust without being subject to British tax.)[297]

Two of the factors discussed in chapter three for choosing principles-based or rules-based regulations are "is there a shared understanding of regulatory text" and "do the regulated see enforcement as fair and effective"? The dispute about taxing a corporation on its world income shows how these factors can be intertwined—if the regulated are not committed to the public purpose because they do not see the principles as fair and effective, then they may engage in "creative compliance" or "contrived complexity". This will be discussed further in chapter three.

Another issue in tax law, which parallels that of securities law, is the concern about the cost of compliance. In addition to the actual tax payable, compliance includes the administration costs, the costs to collect data, complete forms, deal with authorities, stay current with tax laws, and the costs of tax consultants. The Canadian Federation of Independent Business surveyed a total of 8,271 business owners during the period December 10, 2007 to February 13, 2008 and found that the average tax compliance cost per SME was $18,321 per year. Because compliance costs are relatively fixed, there is an economy of scale—cost per employee range from $3,928 for very

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[297] (Picciotto 2007) at p.22

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small firms (those with fewer than five employees) to $481 for larger firms (with 50 to 499 employees).[298]

How can compliance be improved at a minimum cost? Feld and Frey note that deterrence theory does not explain behaviour. The probability of tax evasion being detected, and the size of fines in many countries, is so low that individuals who are motivated only by personal gain would be rational to evade taxes.[299] Thus, tax compliance is a "quasi–voluntary act" and can best be explained as a psychological tax contract, rather than by deterrence theory. Tax morale is a complicated interaction between taxpayer and the government. The more taxpayers believe that the government is using their money to benefit their community, the greater is their

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[298] (Charron, Chow and Halbesma 2008). See: p.16: "…there is currently more support within the tax administration system for larger businesses. For example, the Canada Revenue Agency (CRA) has special employees and software dedicated to help the economy's larger businesses and sectors comply with the tax system. There are no SME "specialists" within the CRA and in trying to comply with the tax system small and mediumsized business owners often have to put up with extremely burdensome processes, (a) such as long wait times on the telephone, inconsistent information and rulings, unwillingness to provide written rulings or interpretations, and lengthy audits to name but a few."

As to securities regulation, see (Bradford 2004): "whether exemptions for small businesses and small transactions that appear in many regulations are economically efficient. As demonstrated by many empirical studies of regulatory compliance costs, the fixed costs of regulation, and some of the variable costs, are subject to economies of scale that benefit larger firms and larger transactions."

[299] (Feld and Frey 2007)

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compliance.[300] The more that procedural rules appear fair and taxpayers are treated with respect, the greater is their willingness to pay.

> "If the taxpayer in question indeed did not intend to cheat but simply made a mistake, he or she will most likely be offended by the disrespectful treatment of the tax authority. The feeling of being controlled in a negative way, and being suspected of tax cheating, tends to crowd out the intrinsic motivation to act as an honorable taxpayer and, as a consequence, tax morale will fall. In contrast, if the tax official makes an effort to locate the reason for the error by contacting the taxpayer in a friendly way, the taxpayer will appreciate this respectful treatment and tax morale will be upheld."[301]

Of course, not all taxpayers will pay if the authorities treat them with respect. Plumley[302] describes five categories of explanation for tax compliance. Following each category of explanation, I will analogize to the Ontario securities market in italics.

(i) "Tax Policy": For example, marginal rates of tax may affect compliance rates; those with higher income have a greater incentive to evade than those with lower income (the penalties for underreporting with low income represents a larger share of net income).[303]

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[300] See also (Wahl, Kastlunger and Kirchler 2010) at 385: `Findings from prior research on national and international survey data show that trust in tax authorities is positively related to tax compliance.`

[301] (Feld and Frey 2007) at pp.107–108

[302] (Plumley 1996)

[303] (Plumley 1996), p.16

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A comparison to the Ontario securities industry is this: Smaller issuers, in general, have less ability to withstand penalties or administrative proceedings For example, a small issuer, doing a significant transaction once every few years, would find it hard to absorb the costs of a regulatory review or an administrative hearing. A larger issuer, with many transactions and regulatory filings, is in a better position to absorb the risk of regulatory review of any particular transaction. If so, then smaller issuers are more likely to cooperate with the regulator and not take an adversarial approach.

(ii) "Burden/Opportunity": The more complex the tax system becomes (and the more difficult it is to know how to comply), the more people become noncompliant — either unintentionally due to confusion, or willfully out of frustration;[304]

The rules of the Ontario Securities Commission seem to be in a constant flux. For example, the prospectus and dealer exemptions in multilateral rule 45–106 seems to be amended every two or three years (see Table 2*) There are additional exemptions in Ontario's local instrument 45–501, which has been amended a number of times.*[305] *The level of non–compliance can only be conjectured, but it is likely that participants are frustrated with the need to frequently update their legal advice.*

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[304] (Plumley 1996), p.16

[305] See the OSC website at < http://www.osc.gov.on.ca/en/15146.htm >

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(iii) “Enforcement”: Audits have a strong, positive impact on reporting compliance, according to Plumley. As word of the audit spreads among friends and associates, there is a deterrent “ripple effect”. The ripple effect in the general population is about eleven times larger than the adjustments proposed by the audits themselves, according to Plumley. Even without formal audits, the perception that the authorities review taxpayer filings have a deterrent effect.[306] Nonfiler notices, information document matching (for example, comparing the disclosure documents of opposite parties to a transaction) and return preparation assistance are more cost–effective than audits in boosting revenue. Tax evasion convictions also have a deterrent effect, for the reasons described above by Thornton, Gunningham and Kagan: that knowledge of the “signal enforcement cases” reassures that compliance is not foolish and is a reminder to check compliance routines.[307]

Securities enforcement would benefit from a similar approach. As noted under the topic “Risk–based, proportionate and responsive enforcement”, responsive regulation employs a series of increasing enforcement techniques depending on the seriousness of the

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[306] See also (Rechberger, et al. 2010) at p.215: tax amnesties must be structured so as not to signal to taxpayers that enforcement is weak. When taxpayers expect future amnesties, they may lower their tax compliance. To be effective, amnesties should bring back offenders into compliance for the future.

[307] (Gray and Scholz 2008) at p. 198, who found that, regarding occupational health compliance, the likelihood of being penalized may be a greater deterrence than the amount of penalty.

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violation. Notices for defective or late disclosure, information document matching and other low level reviews, would likely be more cost–effective than formal audits of an issuer's compliance or enforcement proceedings. This low–level approach would especially be effective if (i) was true—that smaller issuers tend to be cooperative.

(iv) "Authorities' Responsiveness": Generally, a pleasant experience with a tax collection agency such as the IRS (e.g., getting the correct answers in a reasonable amount of time) ought to contribute to higher voluntary compliance. For this reason, Leslie Book discourages the "audit first" approach "given agency resource issues and the backlash that would likely accompany a meaningful increase in IRS audits of preparers and small business taxpayers." Instead, "[f]irst steps can be tied to educating, serving and informing preparers of best practices, so long as the IRS is willing to continue monitoring and to impose more intrusive sanctions on bad actors."[308]

As noted above,[309] Staff of the OSC are "typically reluctant to sit down and discuss issues of concern, preferring to gather information through a prolonged exchange of correspondence." This is because Staff take a rules–based approach and leave it to counsel for the issuer to provide compliance advice. Improved compliance could result if

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[308] (Book 2009)

[309] *Supra*, note 148

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Staff tried educating, serving and informing issuers with a less formal, proactive approach.

(v) "Demographics/Economics": Trivedi and Umashanker found that an individual's personal characteristics like moral reasoning, attitudinal variables and intentions are the most significant predictor of their tax compliance.[310] However, Plumley suggests that one's perception of ability to pay is more important. One is more likely to pay high taxes if one is optimistic about future income, and less likely to pay if facing unemployment.

As with tax compliance, it is more likely that venture issuers will comply if they are optimistic and less likely to comply if they are on the verge of collapse and desperate to raise funds from any source possible. The logical response, of course, is for the regulator to keep close watch on under–financed issuers.

Accounting Standards

The purpose of accounting standards is similar to that of securities regulation—full and true disclosure of financial information. Company auditors assess information provided by management, who may be in a conflict of interest, so that the shareholders are fully informed.

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[310] (Trivedi, Shehata and Mestelman 2004)

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Although the focus of auditing is different than the focus of securities law (auditors report to current shareholders whereas securities disclosure reports to the market generally), similar issues can arise.

As with income tax principles, accounting principles can sometimes be interpreted (or misinterpreted) depending on one's underlying values or culture. This is why the first two factors identified in chapter four are "Is there a shared understanding of regulatory principles?" and "Are the regulated committed to the public interest?" In 1988, Gray noted four cultural values which have influenced the evolution of different international accounting standards:[311]

> *Professionalism versus Statutory Control*—some cultures impose prescriptive accounting requirements; other cultures rely on individual professional judgment and self-regulation.
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> [Gray argues that in the U.K., presentation of a company's financial position depends on the judgment of the accountant as an independent professional, with fairness comments not specifically required by law. In contrast, Gray notes that France and Germany have traditionally imposed prescriptive and detailed standards. Harrison and McKinnon describe how, after WWII, Japanese culture resisted American efforts to enhance independent audits, because Japanese business culture emphasized the protection of relationships and mutual interests—a third-party independent audit was considered "alien" to Japanese business practice.[312]]

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[311] (S. Gray 1988)

[312] (Harrison and McKinnon 1986) At p.245

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Uniformity versus Flexibility—some cultures impose uniform accounting practices among companies; other cultures allow for flexibility based on the circumstances of each business.

[Gray argued that in France, the tradition has been a uniform accounting plan to facilitate national planning and macroeconomic goals. In contrast, in the U.K. and in the U.S.A. there is more concern with inter-temporal consistency together with some degree of inter-company comparability subject to a perceived need for flexibility.]

Conservatism versus Optimism —some cultures favour cautious financial statements because of uncertainty; other cultures permit a more optimistic, laissez-faire, risk-taking approach.

[Conservatism or prudence in asset and profit measurement is perceived as fundamental by accountants the world over. However, according to Gray, the degree of conservatism varies according to country, ranging from a strongly conservative approach in France and Germany, to a less conservative approach in the U.S.A. and U.K.]

Secrecy versus Transparency — some cultures favour confidentiality and the restriction of information to management; other cultures favour a transparent, open and publicly accountable approach.

[Secrecy is related to conservatism; a cautious approach to disclosure can avoid conflicts of interest and can avoid leaks of intellectual property to competitors. According to Gray, the extent of permitted secrecy varies across countries, with lower levels of disclosure in France and Germany, compared to the U.S.A. and U.K.]

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Just as "mischaracterization" in income tax compliance can arise from honest disagreement about meaning and fairness, different cultural attitudes can result in different interpretations about financial disclosure. According to Gray, accounting culture in France evolved into standardized rules as an instrument of national economic planning, whereas the British tradition has been one of professional independence and flexibility. Neither is "correct" in an absolutist sense. Standardization and flexibility are different goals; with different risks and benefits.

In January 2011, Canadian public issuers were required to shift from generally accepted accounting practices ("GAAP") to International Financial Reporting Standards ("IFRS"). IFRS is a more principles-based approach. IFRS principles must be applied based on judgment and assumptions given the specific facts at hand. IFRS provides entities with more accounting policy choices and greater use of professional judgment than Canadian GAAP. Critics have argued that IFRS provides management with too much flexibility."[313]

Although American accounting standards have been influenced by the British tradition of flexibility and professional independence, U.S. accounting regulations are very detailed and complex. The primary U.S. accounting standard setter, the Financial Accounting Standards Board (FASB), was criticized after Enron for relying too much on detailed rules. According to Gill, judging by the sheer volume of authoritative accounting literature, U.S. accounting standards are the most detailed in the world.[314] The FASB considered principles–based

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[313] (Romano and Grewal 2009)

[314] (Gill 2003) at p.972

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accounting in a 2003 proposal, and discussed its costs and controls. It said that a principles–based approach could lead to good–faith, but different, professional interpretations for similar transactions, raising concerns about comparability. Guidance would be necessary, and if FASB did not provide it, others would become *de facto* standard setters without the due process provided by the FASB. The FASB concluded that principles–based regulation could lead to abuse if the standards were not applied in good faith. The FASB decided that it would be difficult for the SEC and other participants in the U.S. financial accounting and reporting process to adjust to a principles–based approach.[315]

A bright–line rules approach, as advocated by the FASB, is not necessarily more effective. Similar to the discussion regarding "Rules and Precision" (page 76 above), Cuccia and Nelson investigated whether replacing a vague standard with a numerical threshold would reduce aggressive tax reporting. What they found was that practitioners were equally aggressive under the rules–based regime; practitioners compensated for the loss of latitude in standards by relaxing their interpretation of evidence supporting detailed rules.[316] And the reverse appears true. Nelson and Kinney found that auditors respond to the ambiguity of a vague standard by reporting more conservatively.[317]

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[315] (Financial Accounting Standards Board 2002) at p. 9

[316] (Cuccia, Hackenbrack and Nelson 1995) at p.228

[317] (Nelson and Kinney 1997)

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Australian Competition and Consumer Act

Parker, Ainsworth and Stepanenko[318] reported on the different enforcement techniques and messages used by the Australian Competition and Consumer Commission (ACCC) in the field of anti-competitive and collusive cartels (which includes price-fixing and market sharing agreements). Four case studies were examined by interviewing ACCC staff, by interviewing the lawyers and business people involved, and by reviewing documentary reports. The four cases examined were the Freight, Concrete, Transformers and Queensland Fire Protection cases. Each was associated with boom times in the Australian economy from the 1940s to the 1960s, which was responsible for the formation of large, oligopolistic firms in the 1980s, with a culture of collusion and price fixing.

Just as the fairness of income tax and accounting standards can be disputed, the fairness of rules prohibiting price-fixing was disputed by some Australian managers. "Price-fixing" is a disparaging term for what some consider "orderly marketing". For example, unions, governments, and agricultural marketing boards have been regulating minimum prices and

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[318] (Parker, Ainsworth and Stepanenko, The Impact of ACCC Enforcement Activity in Cartel Cases 2004) at p.13

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market share for many years. Many Australian managers felt justified in negotiating prices and market share arrangements because of the smaller revenues in the Australian market.[319]

The ACCC began tougher enforcement proceedings in the early 1990s, including proceedings against the TNT Australia, Ansett Transport, Mayne Nickless Limited and nearly twenty individuals, alleging collusive behavior (the "Freight case").[320] Although staff of the ACCC believed that enforcement penalties which were the greatest deterrent, industry interviews suggested that negative publicity was as at least as effective. In an age where much of business is about managing brand value and reputation, media coverage motivates defendants to agree to consent orders, rather than engage in prolonged and adversarial litigation. Media coverage deters future conduct ("specific deterrence"—see page 116). Thirdly, it sends a message out to the industry about the dangers of price fixing ("general deterrence"—see page 119).

Even though the negative publicity and the threat of enforcement had a significant impact on industry attitudes (and cartels were no longer considered acceptable), Parker, Ainsworth and Stepanenko found that the new attitudes did not necessarily result in improved behaviour. Compliant behaviour is dependent on specific contextual factors (such as opportunity, surveillance, social networks and knowledge). Enforcement action must change the contexts for

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[319] (Parker, Ainsworth and Stepanenko, The Impact of ACCC Enforcement Activity in Cartel Cases 2004) at p.12

[320] (Parker, Ainsworth and Stepanenko, The Impact of ACCC Enforcement Activity in Cartel Cases 2004) p.23

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behavior, with a web of controls straining against anti-competitive behavior.[321] This corresponds to the discussion of "Responsive regulation" (above, page 105).

Other Regulated Fields

The importance education for principles-based regulation is illustrated by Fairman and Yapp in the food–service industry in the UK. In "making sense" of prescriptive requirements they didn't understand, the most common response was to ignore them. However, compliance was better if rules were linked with harm in the mind of the business owner.[322] Where the enforcement authorities took an educative approach, with warnings and graduating penalties, compliance was generally improved. Such an approach requires a greater regulatory investment.[323]

Commodity futures regulation in the U.S. illustrates the importance of enforcement and monitoring in a principles-based regime. In contrast to the rules-based regulation of traditional capital markets by the SEC, in 2000, commodities regulators adopted a more principles-based approach for the regulation of futures and derivatives. The pace of change in these markets was considered too rapid to allow for a comprehensive system of rules to govern market participants.

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[321] (Parker, Ainsworth and Stepanenko, The Impact of ACCC Enforcement Activity in Cartel Cases 2004) at pp.104-5

[322] (Fairman and Yapp 2005) p.505

[323] (Fairman and Yapp 2005) p. 504

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The *Commodity Futures Modernization Act* has several principles-based components, with a set of "core principles". As Ford notes, the core principles share features with the FSA's Principles for Business and the BCSC proposed code of conduct for dealers and advisors.[324] Critics have argued that the *Commodity Futures Modernization Act* came with a philosophy of de-regulation in 2000. Derivative transactions between "sophisticated parties", such as banks and securities firms, were largely unregulated. These derivatives, especially credit default swaps, were at the heart of the credit crisis of 2008 and subsequent global recession.[325]

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[324] (Ford, Principles-Based Securities Regulation, A Research Study 2009) at p. 18 and in the Appendix A to her research report.

[325] (CBS News: 60 Minutes 2008)

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Chapter 3: Eight Factors to Consider on Continuum of Rules to Principles

This chapter gleans eight factors from the literature review in chapter two in order to assess where along the rules/principles continuum a particular area of regulation should lie, and then applies those factors to reach tentative conclusions about the regulation of Ontario venture issuers. Chapters four and five will further assess those conclusions with a survey, and chapter six assesses those factors by consulting six industry experts.

(i) Is there a shared understanding of regulatory principles?

Description of factor

Is there a shared understanding about regulatory principles, or must every facet of activity be either approved or proscribed? As noted in the Introduction, a cookbook for the novice might assume knowledge of "boil", "poach" or "garnish", but ignorance of "braise", "blanch" or "flambé". Similarly, a capital gains tax article for the layperson may require a detailed explanation of the meaning of "disposition" or "deemed capital gain", but an article for the tax lawyer could simply refer to the relevant section numbers in the *Income Tax Act*.

The question parallels the discussion of "interpretive communities", a literary concept developed by Stanley Fish—that text has no meaning outside of the cultural assumptions, or "interpretive

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templates", which give meaning to words.[326] The communication between writer and reader is a cultural exchange, based on shared meanings. It includes the author's intent, but is not limited to it.[327] Thus, Fish challenges the notion that text is self–sufficient and argues that "interpretive strategies" give texts their shape, making them rather than, as is usually assumed, arising from them.[328] Fish argues that the "business of criticism" (of literary criticism) is not to uncover evidence of the author's intent but to persuade the literary community of the context and assumptions from which the text should be interpreted.[329] The critic shapes the community's understanding of text, and the community's appreciation of meaning evolves.

The same applies to interpreting law—good legal argument is not so much an historical investigation into the legislature's intent when proclaiming the law (by evidence of parliamentary debate, for example); rather, it persuades the legal community that a particular interpretation fits best within the community's current understanding of legal purpose (and places the interpretation within a body of existing precedent). This is especially true when

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[326] This is similar to Braithwaite's statement that certainty does not flow so much from the precision of the words used as it does from a tacit understanding within a community as to objectives. See footnote 116

[327] (Fish 1980) pp. 147–174. See also (Spaak 2008). As Julia Black argues, (Black, Regulatory Conversations 2002) at p.167: "language is not an abstract system of normative forms, and meaning is never fixed. Reference is always various and open ended. Meaning and use of language will vary with the context in which it is used, with different genres (for example, formal parliamentary debate, or gossip between friends), and with different speech communities."

[328] (Fish 1980) at p.13

[329] (Fish 1980) at p.16

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interpreting the constitution. The “living tree doctrine” of constitutional interpretation holds that the constitution is an organic document that should be read in a broad and progressive manner so as to adapt it to changing times. As Chief Justice Lamer stated in *Re B.C. Motor Vehicle Act* (1985), “[i]f the newly planted 'living tree' which is the Charter is to have the possibility of growth and adjustment over time, care must be taken to ensure that historical materials, such as the Minutes of Proceedings and Evidence of the Special Joint Committee, do not stunt its growth.”[330]

The court’s understanding of purpose is not necessarily what is most efficient from an economic or regulatory perspective. For example, the 2011 reference to the Supreme Court of Canada on the proposed national securities act[331] illustrates the kinds of arguments required to interpret the constitutionality of legislation. At issue was whether the regulation of the securities industry is a valid exercise of the federal “trade and commerce” power (like federal competition laws) or whether it was in pith and substance the regulation of property and civil rights, which is a provincial power (like insurance regulation). The court did not decide on the basis of which level of government could better coordinate investment or regulate the industry. “[A]rguments in the reports as to whether securities should be regulated federally or provincially as a matter of policy are irrelevant to the constitutional validity of the legislation.” (at paragraph 127). Rather, the decision turned on the division of powers as previously interpreted by the courts: “The

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[330] Re B.C. Motor Vehicle Act, [1985] 2 SCR 486 at par.53

[331] See note 51 and discussion at page **Error! Bookmark not defined.** of this paper.

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Secession Reference affirmed federalism as an underlying constitutional principle that demands respect for the constitutional division of powers and the maintenance of a constitutional balance between federal and provincial powers." (at paragraph 61). The problem with the federal proposal was that it went beyond matters of national interest of orderly markets and reached down into the detailed regulation of all aspects of securities regulation.

Meidinger argues that it is through communicative interactions that regulatory issues are defined and redefined and identities constructed.[332] The regulatory conversation forms spaces in which concepts can be constructed, knowledge created, issues and problems defined, and cooperation facilitated. Braithwaite and Drahos, in their analysis of global business regulation, observe the ability of regulatory conversations to define problems and create new sets of knowledge, and to facilitate the modelling process through which that knowledge is disseminated and the patterns of regulation adopted.[333]

Black describes the regulatory conversation through "discourse analysis", which "governs the way that a topic can and cannot be meaningfully talked and reasoned about, and influences how ideas are put into practice and used to regulate the conduct of others". [334] For example, "the vogue for 'proceduralization', in the form of structuring institutional processes so as to require

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[332] (Meidinger 1987)

[333] (Braithwaite and Drahos, Global Business Regulation 2000)

[334] (Black, Regulatory Conversations 2002)

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and facilitate deliberation, is a conversational technique."[335] If there is a requirement or expectation of transparency, this may affect who participates in the conversation.

Black argues that discourse is the basis of social action because it is constitutive, functional, and coordinative.[336] It is "constitutive" because it builds objects, worlds, minds, identities, and social relations, not just reflects them. For example, regulation as discourse builds and defines problems (e.g. "market failure" and "risk"), suggests solutions (e.g. "criminalization", "meta–regulation") and creates categories (e.g. "compliance"). Discourse is "functional" because it achieves certain ends, such as persuading others through rhetoric and argument (often by regulatory hearings). Discourse is "coordinative" because, through shared meaning and perception, it produces social coordination. For example, regulatory discourse can produce new norms and practices within a regulated community.[337]

Black describes how regulatory communities can exist at a "surface" level or "deep" level. At a surface level, an interpretive or regulatory community might consist of only a shared "sociolinguistic register or understanding of practices"—for example, enforcement strategies. At

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[335] (Black, Regulatory Conversations 2002) at 172. See also (Black, Proceduralizing Regulation: Part I 2000) at p.599 where she notes that the nature of participation may take a number of forms. "It could be the egotistical bargaining and voting of interest group pluralism or liberal democracy. This may be described as a "thin" conception of proceduralization, where procedures are aimed simply at bargains and compromises. Alternatively, participation could be orientated towards the mutuality, consensus, and inter–subjective understanding of deliberative democracy. This deliberative form of proceduralization may be described as a "thick" conception."

[336] (Black, Regulatory Conversations 2002) pp.164–65

[337] (Black, Regulatory Conversations 2002) p.165

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a deep level, it might consist of shared validity claims and normative commitments. Developing an interpretive community at this deep level requires a shared commitment to the values of the regulatory system. As Black says: “The development of shared understandings and tacit knowledge will help to address issues of certainty, rule entrepreneurship … of ‘honest perplexity’, and will also contribute to the development of ‘instinctive’ compliance: the inculcation of the habit of compliance on which successful regulation depends.”[338]

For example, lawyers in Ontario share a common education—law school and the Bar Admission exams. “Thinking like a lawyer”, which is a deductive process based on the application of law and precedent, is not a natural process for some students. Law students take time to acquire the distinctions, categories, and notions of relevance and irrelevance that comprise “thinking like a lawyer”.[339] On learning the templates, they join the interpretive community and can discuss such principles as “reasonable care”, “due diligence” and “administrative discretion”, which, to the non–lawyer, can seem to be nothing more than vague and meaningless phrases. As Black notes, “Formal systems of control are always supplemented by informal structures: practices, attitudes, experiences, personal codes of morality. The task for any system of regulation, be it of firms, bureaucrats, employees, and so on, is to ensure that those informal systems support the formal system by enhancing cohesion, initiative, and morale.”[340]

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[338] (Black, Regulatory Conversations 2002) p.179

[339] (Patterson 1996) p. 110

[340] (Black, Regulatory Conversations 2002) at p.182

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To apply this analysis to the principles versus rules question, the more that there is a “deep level” understanding of values, the more that principles will be understood. Otherwise, specific rules may be necessary to enforce all of the “do’s and don’ts”.

Application to Ontario venture issuers

Shared understanding of principles can come from education or experience, or both. The OSC regulates who can be a dealer (either directly or through an SRO) and the TSX–V limits who can be a director or manager of a public issuer. To be registered as a dealer in Ontario requires compliance with National Instrument 31–103, a detailed document which prescribes educational and capital requirements for different categories of registration. The educational courses are provided by the Canadian Securities Institute (for dealers and advisors), the CFA Institute (for chartered financial advisors), the Institute of Canadian Bankers (for bank–related mutual funds) and the Investment Funds Institute of Canada (for mutual fund dealers). Most dealers have qualified analysts to assist them before recommending an investment.[341]

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[341] Unfortunately, most analysts follow a “herd instinct”, according to The Task Force to Modernize Securities Regulation They tend to be too optimistic about the market generally and about popular stocks (including Enron). “The empirical evidence supports this hypothesis that career concerns motivate securities analysts to stick close to consensus earnings forecasts – and in particular to avoid downward deviations. According to this research, accuracy does not improve analysts’ career prospects as much as do predictions that err systematically on the side of optimism.” It may be (and the proposed survey will test this), that when the analyst leaves the herd and assesses a venture issuer “out on a limb”, the tendency is reversed, and the analyst

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To be approved as a director or manager of a TSX–V issuer, management, directors and officers must have (a) adequate experience and technical expertise relevant to the issuer's business and industry; and (b) adequate reporting issuer experience in Canada or a similar jurisdiction (see TSX–V Corporate Finance Manual Policy 3.1). The TSX–V considers previous involvement with public and private issuers, and whether the person has satisfactorily completed any corporate governance or reporting issuer management courses acceptable to the TSX–V.[342]

Every Chief Financial Officer of a TSX–V issuer, and every member of the audit committee, must be "financially literate" as defined by National Instrument 52–110, meaning someone who "has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements." Although a comprehensive knowledge of GAAP and GAAS is not required, the capacity to understand and evaluate the issuer's financial statements is. It seems reasonable to

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becomes overly pessimistic because a false buy recommendation for an obscure issuer is more embarassing than a false "don't buy". (The Task Force 2006) Final Report, at pp.137–138.

[342] The CSNX is a smaller exchange, with smaller issuers and a lower threshold of entry. The main advertised benefit of listing on the CSNX, according to its website <www.csnx.ca>, is the reduced listing fees. CSNX Policy 4 states that its investors expect issuers to comply with good governance. I would expect similar education levels to those venture issuers listed on the TSX–V.

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expect that financial managers of venture issuers have at least an undergraduate degree in business or accounting.

As to non–financial managers, each industry brings its own educational requirements. The venture issuers listed on the TSX–V are primarily mining and oil and gas ventures.[343] OSC Staff, the TSX–V, and the more senior TSX exchange, have experts with mining and energy experience. National Instrument 43–101, which governs the scientific and technical disclosure of mining prospects, is considered a global standard in mining disclosure.[344] There are also a number of trade organizations for the mining sector, including the Prospectors & Developers Association of Canada ("PDA"), which hosts an annual conference in Toronto each year.[345] In addition, under National Instrument 43–101, only a "qualified person" can publicly disclose mineral information, and to be qualified, the person must (a) be an engineer or geoscientist with at least five years of experience in mineral exploration, mine development or operation or mineral project assessment, or any combination of these; (b) have experience relevant to the

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[343] The "quoted market value" (The number of shares outstanding multiplied by the quoted price per share.) for junior mining issuers on the TSX–V in December 2007, which was a record year, was $34.5 billion. Although it plummeted after the market meltdown to $8.7 billion on December 31, 2008 and the quoted market value for oil and gas issuers was reduced to $3.2 billion, they still far exceeded the remaining sectors on the TSX–V: technology at $1.4 billion, life sciences at $0.4 billion, and "cleantech" at $0.6 billion as of December 31, 2008.

[344] http://www.tsx.com/en/pdf/Mining_Sector_Sheet.pdf

[345] The PDA courses in 2009 on such topics as "Aboriginal awareness training seminar", "Geometallurgy", "Remote sensing and spectral geology", "Framework for Responsible Exploration: Principles and Performance Guidelines" and "Special session on continuous disclosure and financial reporting".

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subject matter of the mineral project and the technical report; and (c) be a member in good standing with a designated professional association.

In addition, advisers to venture issuers, including their accountants and solicitors, tend to be specialized. Since 2004, and as a result of various accounting scandals[346], the Commissions enacted National Instrument 52–108 which requires an auditor of public issuers to participate in the oversight program of the Canadian Public Accountability Board. As for solicitors, securities law tends to be a specialized field practiced by the large or boutique firms in Toronto, Vancouver and Calgary.

(ii) Are the regulated committed to the public interest?

Description of factor

Is there a deep level commitment to shared principles, as described by Black? Such a

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[346] Enron, Tyco, Adelphia, Peregrine and WorldCom. Contributing factors included: (1) directors failed to supervise complex business issues, or did not have the expertise to do so; (2) audit committee were not independent of management; (3) auditing firms were not independent "financial watchdogs" for the shareholders – many were being paid lucrative non–audit or consulting fees by management; (4) securities analysts issued buy or sell recommendations while being paid for lucrative investment banking services by the companies being analyzed; and (5) executive stock option and bonus practices, combined with volatile stock prices, encouraged management to manipulate earnings.

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commitment could be based on one or more of the compliance motives discussed above—i.e., the "reason driven motive" (page 111), the "social identity motive" (page 121), the "justice motive" (page 129), or the "citizenship motive" (page 132). As to the social identity motive and the desire to join "the right community" (page 122), as Carol Rose notes, those with a shared religion or family derive benefits from cooperation and trust: "Modern game–theorist mathematicians buttress this point, telling us that if we can arrange things in such a manner that we have repeated contact with our opposite numbers, then we can enforce cooperation through the game of 'Tit for tat'."[347] The importance of trust arises, for example, among the community of lawyers in specialized fields or small towns, who must negotiate with one another later, on different cases. The value of one's reputation becomes important—that the lawyer can be trusted, will "play by the rules", will honour their undertakings, and will refrain from "sharp practice" for tactical advantage. As Gunningham describes, "Self–regulation works best where there exists a sense of professional or collegiate responsibility on the part of a business community, and a sense of shared values at the institutional or professional level. Professions such as doctors or lawyers have a collective ethos that ensures the maintenance of appropriate standards and justifies the trust placed in them to run their own affairs."[348]

Arguably, principles will work when the regulated wish to enhance their reputation within the community. Conversely, rules are required where reputation is not valued and deterrence and the

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[347] (Rose 1988) at pp.601–602

[348] (N. Gunningham 2006) p. 442

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threat of punishment are needed. For example, Gunningham describes how the precariousness of the 1987 Hong Kong stock market, in the shadow of impending Communist control, created a culture of immediacy—brokers and traders invested short–term to accumulate funds and emigrate as soon as possible. Unlike the "gentleman's club" in London, where high ethical standards prevailed and where a "chap's word is his bond", the Hong Kong market was open to abuse.[349]

As noted under governance theory (above, page 113), Hopkins observes that most accidents are not caused by a failure to follow rules, but by a failure to notice warning signs and adopt a "safety culture". Strategies to improve risk judgment treat regulatory consequences as important and not just a cost of doing business.

Application to Ontario venture issuers

As Edwards and Sen Gupta describe, small firms are embedded in networks that supply information and help generate trust[350] and, as Chau and Siu argue, successful small organizations build coalitions in order to benefit from these networks.[351] As noted in Table 6 at page 212 of this paper, 85% of investment funds raised by TSX-V issuers are from private placements—close

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[349] (N. Gunningham 2006) See also (Bucar and Hisrich 2003) at p. 271 who found that insider trading was considered unethical by Americans (with the US tradition of stock exchange operations) but highly acceptable for Russians.

[350] *Supra*, note 239

[351] *Supra*, p. 127

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friends and family, existing business contacts and private investors introduced by an arm's length broker. Presumably, a reputation for success and honesty among friends, family, business contacts, and the broker community is essential to raise capital. Also, in order to acquire good assets for their venture, such as promising mining claims or industrial patents, a reputation for financial success would seem important. This is because most start-up ventures do not have the cash to purchase such assets from the prospector or inventor, and so will issue shares in the venture in exchange for the property. A reputation for financing success is therefore important, since the prospector or inventor who has received shares in the venture is tied to the venture's ability to finance development.

Regardless of how important a reputation for success may be for the managers of venture issuers within networks, the question for the rules/principles factor is whether or not the managers of venture issuers are committed to the "public interest" as defined by Ontario securities regulation. Section 1.1 of the Ontario *Securities Act* defines the public interest as "to provide protection to investors from unfair, improper or fraudulent practices"; and "to foster fair and efficient capital markets and confidence in capital markets".[352] The primary means to achieve these purposes are threefold: (i) requirements for timely, accurate and efficient disclosure of information,[353] (ii)

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[352] See also *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37 (CanLII), [2001] 2 SCR 132, <http://canlii.ca/t/521n> retrieved on 2013-12-17, per Iacabucci J. at paragraph 41.

[353] See also section 56(1) of the Ontario *Securities Act* requires "full, true and plain disclosure" for a prospectus; section 130.1 prohibits a "misrepresentation" in an offering memorandum and "misrepresentation" is defined as an untruth or an omission of a material fact.

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restrictions on fraudulent and unfair market practices and procedures, and (iii) requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.[354]

What follows is a discussion of whether or not venture issuers are committed to the public interest of securities regulation, including: (i) full, true and plain disclosure of all material facts to investors, (ii) insiders should not take advantage of information which has not been publicly disclosed,[355] and (iii) high standards of fitness and business conduct to ensure honest and responsible conduct.

Commitment to "Full, True and Plain Disclosure"

Are venture issuer promoters and their professional advisers committed to the "fundamental principle" of giving investors timely, accurate and efficient disclosure (section 2.1 of the Ontario *Securities Act*)?

Financing venture issuers requires extensive use of "private placement" securities exemptions because of the prohibitive cost of filing a prospectus. The usual exemptions are the "private issuer exemption" which permits securities to be sold among family, friends and close business

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[354] Ontario *Securities Act*, section 2.1(2). An example of the public interest of Ontario securities regulation being more than protecting investors in a particular transaction is Multilateral Instrument 72-101, which regulates a distribution of securities outside of Ontario.

[355] Section 76(1) of the Ontario *Securities Act.*

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associates of the directors and control persons, and the "accredited investor" exemption, which permits securities to be sold to certain wealthy individuals and well–capitalized organizations.

Most junior mining ventures, which comprise 64% of the number of issuers on the TSX-V[356], are exploration companies with no revenues. They trade on the possibility of a major discovery, but, as described from page 43, success is unlikely (less than 1%). No revenues are required for a mining venture to list on the TSX-V—only adequate working capital and financial resources to carry out stated work program for the next 12 months and $100,000 in allocated funds[357]. Exploration can easily cost millions of dollars. Thus, repeated rounds of private placements are usually required before a bankable "feasibility study" is available to assess the economics of mining the ore. The mining promoter must maintain the confidence of his or her core of investors as they will be approached again and again as exploration proceeds. If, along the way, results are negative, the promoter who is motivated by a long term reputation in the industry will disclose the results and not seek additional financing for what may be a failing property.

Some junior venture promoters may look to excite their investors with a short-term bump in the stock price. The promoter's approach may depend on what their investors are seeking. Some investors may have a six–month investment horizon, looking for a bump in share price from the announcement of a discovery, while others may have a long–term horizon, looking for solid management to develop the property. If the investors do have a short-term horizon, then it

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[356] Table 3 at p.209

[357] TSX-V Policy 2-1 for Tier 2 Issuers. < http://www.tmx.com/en/pdf/Policy2-1.pdf>

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makes sense for the promoter to reciprocate with short-term developments, to maintain ongoing and steady financing of the project during its development stage.

Most promoters are required to hold a portion of their shares with an escrow agent until certain targets are met, thus reducing any incentive to dump the founder's shares on unsuspecting investors before disclosing results.[358]

As for the professional advisers of venture issuers, solicitors are regulated by the Law Society and have ethical and regulatory duties to their profession. Investment dealers have similar obligations. Probably, such gatekeepers are reluctant to spoil their professional reputation for the short–term success of a particular issuer; however, those who hold significant options or shares in the venture, or who are expecting the closing of a transaction in order to be paid substantial fees, may be pressured to compromise their professional standards in order to secure the success of a transaction—I am not aware of any statistics which measure this. In contrast, auditors are prohibited from owning shares or benefiting from other financial interests in the company they are auditing, as part of their professional obligations.[359]

If promoters are motivated by the short-term trading price of their issuer's shares, rather than their long-term value or the promoter's personal reputation, arguably, their commitment to the public interest is lessened. However, as mentioned above, the promoter's approach may depend

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[358] National Policy 46–201 and TSX-V Policy 5-4

[359] See Guide to Canadian Independence Standard, 2009 update, <http://www.icao.on.ca/CAfirms/PracticeMatters/Articles/1011page1628.pdf>

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on what their investors are seeking. Some investors may have a six–month investment horizon, looking for a bump in share price from the announcement of a discovery, while others may have a long–term horizon, looking for solid management to develop the property.

Insider trading and business ethics

Trading with material nonpublic information is not, by itself, illegal in Ontario. It depends on how the information was acquired. A trader who innocently happens upon nonpublic information can trade to the detriment of others with impunity, unless he or she is an "insider" or a "person in a special relationship" with the issuer.[360] (Someone who receives a tip from an insider—a "tippee"—is a person in a special relationship.[361]) It is an evolution of the common law self–dealing rule, which prevents a fiduciary and his or her associates from using the principal's

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[360] Section 75 of the Ontario Securities Act requires "forthwith" publication of a news release of any material change, unless publication would be detrimental to the issuer and then disclosure can be filed confidentially with the Commission; section 76(1) prohibits trading before the news release is published, and section 76(2) prohibits "tipping" another of material undisclosed information.

Security analysts are generally not "insiders". They gather and compile information, talk to corporate officers and other insiders, and issue recommendations to traders. Their reports may contain a variety of information that is "pieced together" without violating insider trading laws, under the mosaic theory. This information may include non–material nonpublic information as well as material public information, which may, when amalgamated together, be as valuable as individual pieces of material piece of information. Those who trade on this amalgamated information can take advantage of others in the market. See (Investopedia, a Forbes Digital Company 2010).

[361] The person is a "tippee" if they know, or ought reasonably to know, that the person who tipped them is an insider. Section 76(5)(e) of the Ontario *Securities Act.*

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property (including informational property) for personal gain.[362] Fiduciary law allows for the tracing and return of property in the hands of a third party, unless the third party is a *bona fide* purchaser for value without notice of the breach.[363] U.S. insider trading laws have similar fiduciary law origins. As stated by the U.S. Supreme Court in United States v. O'Hagan[364], "[a] company's confidential information...qualifies as property to which the company has a right of exclusive use. The undisclosed misappropriation of such information in violation of a fiduciary duty… constitutes fraud akin to embezzlement."

Some academics reject the application of fiduciary law to insider trading. Although corporate law makes directors and officers fiduciaries for the company's current security holders, creditors, directors and officers[365], no fiduciary duty should be imposed on insiders to protect third persons

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[362] Trustees, for example, cannot deal with trust property unless the beneficiary (or testator) specifically permits it. Even if it is a fair price (or a better than fair price) and the beneficiary suffers no loss, the transaction can later be cancelled by the beneficiary. It is a prophylactic rule based on loyalty, to prevent the trustee from ever acting in a conflict of interest. See Re Estate of Ronald R. Mitchell [1970] N.S.J. No. 106 and Re Ballard Estate [1994] O.J. No. 1898

[363] Bank of Montreal v. I Trade Finance Inc, 2009 ONCA 615 (CanLII)

[364] 521 U.S. 642, 655 (1997)

[365] The oppression remedy in section 241 of the Canada *Business Corporations Act* and section 248 of the Ontario *Business Corporations Act* protects the company's security holders, creditors, directors and officers from any act by the corporation which is oppressive or unfairly prejudicial or unfairly disregards the interests of these persons. Where conflicts arise among these stakeholders, the directors should resolve them in accordance with their fiduciary duty to act in the best interests of the corporation, viewed as a good corporate citizen. See at par. 81 of *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, [2008] 3 SCR 560 The Supreme Court quoted approvingly from the Revlon case in Delaware, which held "in general, the directors owe

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with whom they trade on the stock market. Manne[366] argued in 1966 that trading by employees in advance of favourable news can be an appropriate means of compensation, without any cost to current shareholders. The alternative is to issue directors and employees options, which, if exercised, dilute the ownership of current shareholders. Insider trading does not distort the market price, according to Manne. If an insider buys shares knowing of favourable news, the increased bidding for shares will drive up the price to its true value sooner than if insiders were excluded from trading. Similarly, if an insider sells knowing of impending bad news, the increased selling will decrease the price to its true value sooner. Thus, insider trading is efficient in the sense that the market price will sooner reflect its true value, and current shareholders who do not buy or sell during the period of non–disclosure remain unaffected.

Rather than justifying insider trading laws on the basis of how quickly prices adjust to new information, they should be justified on the basis of fairness— that insiders should publicly disclose material information forthwith, so that those with whom they trade have access to the same information.[367] This duty to disclose information is reinforced by the civil liability

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fiduciary duties to the corporation, not to the stockholders." (at par. 87). Note, however, that the neither the Supreme Court nor the corporate legislation imposes a corporate law obligation to third parties.

[366] (Manne 1966)

[367] One of the twin purposes of the Ontario Securities Act is "to foster fair and efficient capital markets and confidence in capital markets" (section 1.1). To achieve this, the Commission is to

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consequences of section 138.3(4) of the *Securities Act*: any person who acquires or disposes of shares during a period of late disclosure will have a right of action against the issuer and any director or officer who authorized, permitted or acquiesced in the late disclosure, and a right of action against those who "knowingly influenced" the late disclosure.[368] The principle which underlies the insider trading rule is fairness; not efficiency.

(iii) Are the regulated able to find analogous solutions?

Description of factor

As mentioned above,[369] research in psychology and tax law shows that, in a complex field, decision makers will look through the surface features of a problem to identify key relationships. They reason by analogy, mapping relations between standards. Arguably, the greater the diversity of related experience from which decision makers can draw, the greater is the

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impose "requirements for timely, accurate and efficient disclosure of information" (section 2.1(2)(i)).

[368] Manne accepted in 1970 that allowing insiders to trade would be incentive to delay disclosure until after they trade, but "there was little reason to believe they would normally take much time… insiders will usually be in a very great hurry to use their information before others get it or before it becomes worthless for unforeseen reasons." (H. G. Manne 1970) at p.553

[369] See footnote 168 at page 93 above

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possibility of finding analogous solutions. A board composed of like-minded individuals with identical backgrounds is less likely to find analogous solutions in complex situations.

Experience and analogies must be organized in a meaningful way, notes Black (see page 169). Without a "storyline", past experience becomes too detailed and a distraction. Shearing and Ericson describe how a community can apply rules consistently by evolving a shared storyline from a variety of experience to explain how to act in a particular situation. It is a process of "mythological thinking", "myth–making" or "poetic logic". "People simply do not walk around with rules in their heads that they apply to situations in the midst of action".[370] Rather, knowledge is communicated through a culture by "analogous reasoning" from layered meanings in stories developed through experience. For example, police officers exercise their discretion by assessing behaviour through a "story book rather than a rule book."[371] When asked how decisions are taken in the course of action, officers tell stories that cite experience. "Unlike law, which formulates precedents as rules, police culture articulates a vocabulary of precedents in the form of anecdotes that provide a practical capacity to act.[372] Using figurative language, experience provides a capacity to improvise across a range of contexts.

Black notes that within an organization there may be competing stories, with competing identities and patterns to make sense of what is occurring. To influence the regulatory "story

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[370] (Shearing and Ericson 1991) at pp.481–82

[371] (Shearing and Ericson 1991) at p.493

[372] (Ericson 2007) pp. 377–78

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lines", Black advocates a "strategy of compliance rather than deterrence" through education.[373] There needs to be close engagement based on mutual trust; firms need to be concerned beyond the minimal compliance and seek clearly communicated outcomes.[374]

Application to Ontario venture issuers

Many of the compliance matters that arise in securities law parallel similar requirements in corporate, trust and tax law. For example, regarding disclosure, the Ontario *Business Corporations Act* requires that notice of an annual meeting in which special business is to be conducted must disclose "the nature of that business in sufficient detail to permit the shareholder to form a reasoned judgment thereon". Regarding the fiduciary obligations of corporate directors, they mirror those of the trustee in private trust law. Yearly financial statements required for tax returns are similar to the financial reporting obligations under securities law.

The more closely that securities regulation parallel other legal obligations, the greater the likelihood that issuers will analogize compliance solutions from the related experiences. For example, a venture issuer facing a financial disclosure issue may draw from tax accounting experience, or an issuer facing a conflict of interest question may draw from the restrictions on a

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[373] (Black, Rules and Regulators 1997) at p.43

[374] (Black, Forms and Paradoxes of Principles Based Regulation 2008) at p.4

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trustee buying property from the trust. If venture issuers (and their professional advisers) can reasonably interpret securities law principles from parallel business law and compliance experiences, then principles–based regulation may be effective and detailed rules may not be as necessary.

(iv) Are there institutions or actors which promote regulatory collaboration?

Description of factor

Principles–based regulation requires collaboration, in order to flesh out the meaning of broad principles (see the discussion at page 86). Industry should develop best practices to achieve stated principles, which the regulator then monitors and analyzes. For example, in the U.K., to facilitate communication in the securities market, the FSA appoints a "relationship manager" for medium sized firms and a "supervisory team" for larger firms (see note 156).

Collaboration can be achieved in a number of ways. Puri and Condon, in their report for the Task Force,[375] studied the strengths and limits of a compliance–based approach to securities regulation. They note that rules which are considered legitimate embed compliance, and they recommend incentives (such as reduced sanctions) for self–reporting. This is further to the

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[375] (Condon and Puri 2006)

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discussion about governance theory (at page 111) and management based regulation (at page 112), which discuss a more collaborative relationship between the regulator and regulated, to incorporate the regulated's "context-specific experience". As Ford and Condon note[376], collaboration gives the regulated greater autonomy to design processes to meet principled objectives, with mechanisms for transparency and accountability, emphasizing problem solving and experimentation in the design of regulatory strategies.

As Black describes, principles–based regulation reframes the regulatory relationship "from one of directing and controlling to one based on responsibility, mutuality and trust."[377] The relationship moves from "telling and doing", to one of communicating goals and expectations. As Black says, "regulatees adopt a self–reflective approach to the development of processes and practices to ensure that these goals are substantively met, and, critically, both trust each other to fulfill their side of this new regulatory bargain."

As noted above, Hopkins promotes a "safety culture" with proactive investigations that embed compliance.[378] Hutter observed that smaller companies may not have the capacity to retain experts and complex systems, but they can be motivated to comply to maintain a good

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[376] (Ford and Condon, Introduction to "New Governance and the Business Organization", Introduction to Special Edition 2011)

[377] (Black, Rules and Regulators 1997)

[378] (Hopkins 2007) *supra*, note 206

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reputation.[379] And as Ford and Hess note,[380] independent monitors should motivate management to participate in compliance.

To encourage regulatory collaboration, the BC Securities Commission has criticized the Expert Panel's proposal which would separate the enforcement and adjudicative functions of the national securities commission from its policy functions. According to the BC Commission[381], those who adjudicate securities cases are involved closely with the development and implementation of securities law and policy, and so have an extensive background in securities regulation and its public interest implications. If the adjudicative arm were separate, a gap would develop between the policy objectives and the enforcement outcomes. If that happened, the regulator's ability to regulate markets effectively in the public interest would be seriously impaired.

Application to Ontario venture issuers

Principles–based regulation requires collaboration, in order to flesh out the meaning of broad principles (see the discussion at page 86). In addition to the regulatory authority of the Ontario Securities Commission, there are a number of non–governmental organizations ("NGOs") which monitor and regulate venture issuers. For example the TSX–V Exchange regulates venture

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[379] (Hutter 2011)

[380] (Ford and Hess, Corporate Monitorships and New Governance Regulation: In Theory, in Practice, and in Context 2011)

[381] *Supra*, note 165

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issuers with its “TSX Venture Exchange Corporate Finance Manual”. It has rules respecting initial listing requirements, sponsorship requirements, corporate governance requirements, continuous and timely disclosure requirements, limits on commissions and finder’s fees, private placement procedures, escrow requirements, and other rules to control venture issuers.

Advisers to venture issuers, including their accountants and solicitors, tend to be highly qualified. Since 2004, National Instrument 52–108 requires an auditor of public issuers to participate in the oversight program of the Canadian Public Accountability Board. As for solicitors, securities law tends to be a specialized field practiced by specialists within larger or boutique firms in Toronto, Vancouver and Calgary. The role of “gatekeepers” (brokers, securities lawyers and auditors) and of third–party regulatory surrogates (SROs, trade organizations) is essential for venture issuers. They provide information, ongoing support, and practical guidance.[382] Their reputational capital is at risk if they interpret regulations improperly.[383]

Do rules or principles better assist gatekeepers when advising or regulating venture issuers? As Nelson notes, “auditors' negotiating positions are particularly strong when they can point to precise rules that preclude the client's preferred accounting treatment.” As Gibbins et al. (2001)

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[382] (Ford, New Governance, Compliance, and Principles-Based Securities Regulation 2008)

[383] (The Task Force 2006) p. 50. See: (Bazerman, Morgan and Loewenstein 1997) p. 99 suggest that identification with their client's situation might encourage auditors to allow aggressive reporting, while (King 2002) provides evidence that identification with an auditor peer group might discourage aggressive reporting.

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note in their survey of 93 audit partners, precise standards can increase the auditor's power to compel clients to disclose matters as determined by the auditor. Vague standards can lead to multiple rounds of negotiation between auditor and issuer as to what should be disclosed.

On the other hand, precise standards can create targets which managers use to achieve particular objectives. Auditors may be reluctant to argue "substance over form" when a client clearly complies with precise accounting criteria, even when those criteria are accompanied by qualifiers indicating the criteria do not apply in all circumstances.[384] Precise standards can be less effective in constraining aggressive reporting when managers have latitude in interpreting the evidence related to the standard.[385]

(v) Do the regulated see enforcement as "fair" and "effective"?

Description of factor

Principles-based regulation requires a commitment to interpret principles reasonably and to

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[384] (M. Nelson 2003) at pp. 96–7

[385] See (Cuccia, Hackenbrack and Nelson 1995) who found that professional tax preparers respond to a more stringent tax practice standard by interpreting evidence more liberally, such that decisions made under a more stringent standard are as aggressive as decisions made under a less stringent (principles–based) standard.

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refrain from an adversarial, "cat-and-mouse" approach (see "Principles and Regulatory Compliance" at page 86). As described above at page 129, some people comply because of their sense of justice, whether it is distributive justice or procedural justice. Generally, the more that regulations and enforcement are considered to be fair, the greater is the "justice motive" and the more likely it is that participants will interpret principles reasonably.

"Social identity" is a compliance motive—the desire to join the "right community" but to refrain from unnecessarily joining or following rules (above, page 121). The more that the regulated believe that others are upholding the spirit of the law the more likely they will too. Kahan argues that individuals who believe that others are paying their taxes will likely treat honest payment as a moral duty[386]. Conversely, if they believe that others are shirking and following only the letter of the law, compliance may be considered an unnecessary expense. Many believe that they themselves are motivated by justice and will "do the right thing", but that the bad behavior of others is evidence of other people's poor character and that the best method to achieve the compliance of others is through deterrence (see page 130). Thus, it is important that the regulated believe that others are following the spirit of the law for principles-based regulation to work.

Another compliance motive is the "citizenship motive" (page 132). Some comply because they believe that the authorities have the "legitimacy" to create laws and, within a range of reasonableness, they should be obeyed. This is consistent with the description of tax compliance

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[386] *Supra*, note 247

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by Feld and Frey—that it is a psychological contract; the more that taxpayers believe that the government is using their money to benefit their community, the greater is their compliance.[387] The same "psychological contract" may be true for securities law compliance.

Thus, an important factor of principles-based compliance is that the regulated see enforcement as both "fair" and "effective". If not, then a rules-based regime with deterrence as its prime motivation is more effective.

Application to Ontario venture issuers

Securities laws are enforced by different agencies: the police enforce white collar crimes, including market manipulation and fraud related offences; the Ontario Securities Commission enforces the *Securities Act* through enforcement procedures before the court and before a Commission Panel, and by various settlement procedures; the TSX Venture enforce compliance with their rules, and the Investment Dealers Association enforce their rules by fines and by the threat of revoking membership.

The Wise Persons' Committee observed that "[t]here is a widely held view that enforcement in Canada is lax in comparison with the United States and other countries"[388] and "[t]here is a perception both in Canada and abroad that serious misconduct in Canada too often goes

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[387] *Supra*, note 299

[388] (Wise Persons' Committee to Review the Structure of Securities Regulation in Canada 2003) at p.7

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unpunished".[389] As Justice Cory and Marilyn Pilkington noted in their report to the Expert Panel, "[i]n our consultations, the most commonly cited reason for the perception of weakness in Canadian securities enforcement is the apparent inability to enforce securities laws in high profile cases that have substantial links to Canada"[390], and "We heard repeatedly that the penalties imposed for white collar crime have not reflected the seriousness of these crimes and their impact."[391] Bhattacharya reports that the number of U.S. Securities and Exchange Commission (SEC) enforcement actions, after scaling for the number of issuers listed on US and Canadian exchanges, are about ten times greater than OSC enforcement and the number of SEC insider trading enforcement cases is about 20 times greater than OSC enforcement.[392]

Some Ontario newspapers have been critical of OSC enforcement. See for example a December 1, 2007 article in the Toronto Star entitled "Why the OSC so rarely gets its man":

> "[A]cademics, lawyers and forensic accountants interviewed for this story say accountability is sorely lacking when it comes to securities enforcement, whether it's regulatory matters overseen by the OSC or violations of criminal law overseen by police…."For me, the hardest part about the Conrad Black trial has been explaining why it happened in Chicago and not in Toronto," former Ontario premier Bob Rae wrote recently in his blog….All this is no surprise to Utpal Bhattacharya, a finance professor at the Indiana University's Kelley School of Business and author of a report comparing the

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[389] *Ibid*, p. 26

[390] (Expert Panel on Securites Regulation 2009), p. 192

[391] *Ibid*, p. 194

[392] Bhattacharya, Utpal, "Enforcement and its Impact on Cost of Equity and Liquidity of the Market", Research Study for the Task Force to Modernize Securities Legislation in Canada, May 24, 2006, at p. 155

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> enforcement records of the OSC and the U.S. Securities and Exchange Commission (SEC). "We found the enforcement in Ontario was pathetic," said Bhattacharya. "Canada is a first–world country with second–world capital markets and third–world enforcement." [393]

(vi) Are regulatory issues predictable?

Description of factor

If a field of activity is complex, detailed rules can obscure risk (see "Rules ***and Risk***" at page 83). As Peter May describes[394], some systems can be too complex for detailed rules to prescribe compliance in advance, or the effects of detailed rules can be unobservable—for example, the safety of a nuclear power plant cannot be directly observed, nor can the effect of earthquakes, fire, or other potential harms on a building. Regulating complex systems with detailed rules is risky—better to regulate with flexible principles, to allow decision–makers to effectively deal with unpredictable problems as they arise. See also the discussion of "juridification"[395] in which detailed rules can overwhelm and strangle the manager's judgment, undermining the likelihood of effective solutions in complex systems.

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[393] (Hamilton 2007)

[394] *Supra*, note 145

[395] *Supra*, note 147

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In simple systems, with known results, clearly stated rules allow participants to focus on matters other than compliance, since the rules have predictable meaning and scope, thus reducing the risk of administrative discretion[396] This parallels Colin Divers discussion about prioritizing the transparency, accessibility and congruence of rules—regulations which require predictability and transparency should be rules-based, whereas regulations which require congruence should be principles-based (see page 80). Cristie Ford argues that periodic and prospectus securities disclosure should be rules–based, with uniform document presentation, so that investors can efficiently compare similar circumstances[397] Principles should be used where a flexible approach is needed to ensure good corporate conduct; for example, material fact and material change disclosure, which can arise in unanticipated ways, should be principles–based.

Application to Ontario venture issuers

Ford argues that material fact and material change disclosure, which can arise in unanticipated ways, should be principles–based so that issuers must use their own judgment about what is material.[398] As stated by the Canadian Securities Administrators in National Instrument 51–201 for Disclosure Standards:

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[396] *Supra*, note 111

[397] *Supra*, note 3

[398] *Supra*, note 3

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> "In making materiality judgements, it is necessary to take into account a number of factors that cannot be captured in a simple bright–line standard or test. These include the nature of the information itself, the volatility of the company's securities and prevailing market conditions. The materiality of a particular event or piece of information may vary between companies according to their size, the nature of their operations and many other factors. An event that is "significant" or "major" for a smaller company may not be material to a larger company. Companies should avoid taking an overly technical approach to determining materiality. Under volatile market conditions, apparently insignificant variances between earnings projections and actual results can have a significant impact on share price once released. For example, information regarding a company's ability to meet consensus earnings published by securities analysts should not be selectively disclosed before general public release."

Mahoney and Ford argue that disclosure about the current and estimated future value of assets should lean towards the principles end of the continuum, because they are subject to many considerations and can change rapidly. Similarly, licensing market participants, such as brokers and public accountants, should be principles-based, with discretion to consider the many factors comprising "good character" before granting a licence.[399] In contrast, periodic and prospectus securities disclosure should be rules–based, with uniform document presentation, so that investors can efficiently compare similar circumstances (see Cristie Ford comments, footnote 397).

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[399] *Supra*, note 135

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(vii) Should historical transactions be disclosed?

Description of factor

As described above, there are two accounting models to measure the value of assets and liabilities of a corporation: the "historical cost" model and the "mark–to–market" model (see "Accounting for Conflicts of Interest" at page 142).

One advantage of disclosing historical costs, with detailed rules, is described by Mahoney. It can measure the conflict of interest when a promoter solicits public funds for a company which is buying property indirectly from the promoter. Disclosing these "historical costs" allows the investor to assess the promoter's self–interest. On the other hand, the "mark–to–market" method values the assets at their current fair market value, which can add valuable information for the investor. For example, regardless of what the promoter paid for the mining claims, and whether they were vended through controlled corporations, the current investor should know whether the current price being paid to the promoter (directly or indirectly) is at its fair market value.

Application to Ontario venture issuers

As described above, disclosing historical costs, with detailed rules, can measure the conflict of interest when a promoter solicits public funds for a company which is buying property indirectly

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from the promoter. Disclosing these "historical costs" allows the investor to assess the promoter's self–interest.

(viii) Should future projections be disclosed?

Description of factor

Mahoney argues that, given the scarce resources of smaller issuers, regulators should focus on historical cost disclosure with a rules–based regime, to address the promoter problem. Mahoney is critical of the increasing requirement of forward–looking statements and estimates of current market values. Rather than having the regulator mandate expensive disclosure for small issuers, based on a mark–to–market accounting model, let investors negotiate the kind of valuation necessary for a particular transaction. Mahoney is critical of what he sees as the US Securities Commission's move towards a future–oriented "accuracy enhancement" model of disclosure (based on current and future estimates, rather than historical costs).

How important are projections made by the industry? It depends, of course, on whether industry insiders can accumulate or assess market information better than outsiders. For example, large pharmaceutical companies, with highly advanced research departments, may be better able to predict the risks of medical side–effects or the chances of market success than outside investors. Thus, pharmaceutical industry predictions could be a "public good" as described above (page

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57). Most venture issuers, on the other hand, may not enjoy the resources or informational advantage to predict market success. For example, a venture issuer which is developing a new computer switching device, may be able to describe how the device will work with existing systems, but may be in no better position than outside investors as to the overall market success of the business. Similarly, a mining exploration venture will issue a "qualified person" 43–101 mining report assessing the property, but be in no position to assess the market price of the minerals, if and when they are mined.

Application to Ontario venture issuers

Mahoney argues that "accuracy enhancement" disclosure (i.e., material disclosure about prospects and current value) should lean towards the principles–based end of the continuum, because such information is subject to many considerations which can change rapidly. Ford seems to agree when she argues that material fact and material change disclosure, which can arise in unanticipated ways, should be principles–based so that issuers use their own judgment about what is material in the circumstances.

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Chapter 4: Survey of Ontario Venture Issuers

This chapter explores the tentative conclusions in chapter three with a survey of 175 managers of venture issuers listed on the TSX Venture Exchange. The research proposals, as they relate to securities regulation of Ontario venture issuers, are these: (i) is there a shared understanding of the regulatory principles? (ii) are the regulated committed to the public interest? (iii) are the regulated able to find analogous solutions? (iv) are there institutions or actors which promote regulatory collaboration? (v) do the regulated see enforcement as "fair" and "balanced"? (vi) are regulatory issues predictable? (vii) should historical transactions be disclosed? and (viii) should future projections be disclosed?

Design and methodology of the survey

Sampling method

It was a voluntary survey. One email invitation was sent to each venture issuer listed on the TSX Venture exchange, with a unique link to a web-based survey, during the first week of February 2011. A reminder email was sent during the last week of February 2011; and then, in February 2012, another round of invitations was sent to those who did not respond in 2011, with an additional reminder in mid-March 2012. Since there was a year's delay between the first round and the second round of invitations, the second was essentially a new survey, addressed to those who did not respond to the first survey.

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The contact information for each venture issuer was obtained from a list on the TSX Venture Exchange's website entitled "Listed Company Directory".[400] Of the 2,035 issuers that were listed on January 31, 2011 (a decrease from September 2010), many did not include an email or website contact address. This left 1,687 issuers which could be contacted by email. Of this, 106 email solicitations were returned as undeliverable, probably because their contact email addresses had changed. This left a database of 1,581 emails.

An invitation was addressed to the President of each venture issuer.[401] If no President was shown on the TSX-V website, then the email was addressed to the CEO, whom failing, the Corporate Secretary, whom failing, to one of the directors of the issuer. The introductory email included the suggestion that someone else on the team could answer the survey: "This is to invite you, or a member of your team, to complete a short survey about how to improve securities regulations for TSX venture issuers." It wasn't considered important who in the organization actually answered the survey, since the first question asked the respondent what his or her role in the venture was, and a variety of managers would be useful.

The survey website fluidsurveys.com was used to generate the invitations, monitor answers to the survey questions, and prepare a summary of results. This was on the recommendation of

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[400] <http://www.tmx.com/HttpController?GetPage=ListedCompaniesViewPage&Language=en&Market=T>

[401] Access to the names of the directors and officers of each venture issuer was obtained from the TSX Venture info database. <http://infoventure.tsx.com/TSX-Venture/TSX-VentureHttpController?SaveView=true&GetPage=LcdbSearch>

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Michael Ornstein, a professor at York University and of the Institute of Social Research, who suggested a Canadian survey company could better control privacy since it would not be subject to the US Patriot Act.

Ethics approval

Ethics approval for the survey was obtained from York University Office of Research Ethics in 2011 and in 2012. The application for approval indicated that the draw for an Apple iPad was given in the first round, that there were no known risks for participating in the survey, that an explanation of the research would be available to respondents, that no deception was involved, that respondents would remain anonymous, and that the data will be destroyed within two years of the survey or when I complete my PhD, whichever is sooner.

Was it a representative sample?

Number of Respondents

A total of 83 respondents answered all of the questions in 2011 and 50 answered all of the questions in 2012, for a total of 133 respondents who answered all of the questions. An additional 42 respondents answered some of the questions for a total of 175 respondents. This was a response rate of 8.5% for all of the questions and up to 11% for some of the questions.

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Although this is a low response rate, the following limitations should be considered: (i) most of the email addresses on the Listed Company Directory were general information boxes, which would have to be forwarded to the person (the President, etc.) to whom the email was personally addressed; and (ii) the vast majority of those who received the email would not know me and would likely conclude that my research would have little effect on them—much different, probably, than had the survey been conducted by the TSX Venture exchange, the PDAC, or the Ontario Securities Commission.

Attempts for assistance

The TSX Venture Exchange and the Prospectors and Developers Association (PDAC) were approached for assistance in distributing the survey, but they ignored the request.[402]

An invitation to the Toronto Geological Discussion Group listserve was submitted. This is a free service provided by Phil Burt that includes email notices about geoscience presentations in Toronto.[403] Eight geologists from the discussion group, each of whom indicated that they were managers of venture issuers, completed the survey.

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[402] The PDAC was mailed a letter on April 12, 2010 explaining the purpose of the survey and a request that a link to the survey be circulated among PDAC members. The request was ignored. Similarly, an email was sent to the TSX Venture for a list of respondent emails and the request was ignored.

[403] <http://www.tgdg.net/contact-us/> Phil Burt is a co-director in a private mining venture with me.

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Sampling error

The data is subject to sampling error, which can be defined as the likely range of difference between the reported results and the results that would have been obtained had everyone in the relevant population completed the survey.[404] Sampling error calculations and theories were developed under the assumptions of a random selection of a population. This was not a random selection, but a voluntary sample. Many reasons can contribute to non-participation among respondents. However, not all contribute to significant bias. Questions that address a sensitive subject (e.g. illicit drug use and sexual activities) may increase the potential for response bias.[405] Anonymous surveys (as in our venture issuer survey) minimize this concern. Some may be too busy to participate, some may not trust the researcher, and some may not believe that any 'good' will come from providing accurate responses.[406]

The motivations of those who participated

One generalization is that people who are interested in a topic are more likely to participate in a survey related to that topic.[407] The email invitation said that "your opinion will contribute to a new, evidence-based, approach to the regulation of venture issuers, and whether securities regulations should be rules-based or principles-based." The invitation said that, if requested,

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[404] (Bartlett, Bartlett and Reio 2008), p.48

[405] (Berg 2005) p.7

[406] (Armstrong and Overton 1977), p.397

[407] (Fowler 2009) at p.52

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respondents could receive a summary of the results. Presumably, respondents interested in the topic of the survey would request a summary of the results.

Of the 112 who participated in 2011, only fourteen respondents requested a summary of the results (12.5%), and of the 82 who participated in 2012, only two respondents requested a summary (1.2%). Although most respondents were apparently not interested in the results, many gave detailed explanations for their answers in the survey though no explanations were required. In the 2011 round, 75% of respondents gave explanations for their answers, and in the 2012 round, 70% of respondents gave explanations. It would seem that, on the one hand, many respondents wanted to express their opinions, but on the other hand, they weren't particularly interested in the opinions of others. One explanation for this is that respondents didn't think that the survey questions were useful. However, that does not explain why so many gave detailed and vigorous answers. I suggest that most respondents felt that the questions were worth answering, but thought that the results were not important as they were only to be used for my PhD and not for any regulatory body. So, in a sense they were just giving me (an academic) their "two cents worth" about an important topic.

There was a financial incentive to participate in the 2011 round which was not present in the 2012 round. In the 2011 round, respondents were told that the names of the first 100 respondents would be entered into a draw for an Apple iPad, worth over $500. In the 2012, the only incentive was that respondents could request a summary of the results. There was little difference in response patterns—those who responded in 2011 gave as many detailed answers as

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those who responded in 2012, and those who responded in 2011 (who might have been expected to be more interested in the draw) were actually more likely to request a copy of the results.

Employment and experience of respondents

In response to the question: “In what capacity do you currently work for a venture issuer?” (Table 7) respondents included directors, officers, employees and professional consultants. The results showed a range of respondents—not just lower level employees, for example.

175 respondents answered the question: “How many years have you worked for a venture issuer?” (Table 8). 2% had worked for a venture issuer for less than one year; 23% had worked from one to five years, 34% had worked from five to ten years; 24% had worked from ten to twenty years, and 17% had worked for more than twenty years. This shows that the majority of respondents were experienced. Even if the population of managers as a whole is not as experienced as those who responded to the survey, it is likely that new managers would be in a more junior capacity and would follow the direction of their superiors, and so the answers of senior managers may be more indicative of the actions of the venture issuer.

Other sampling methods

Another sampling method would have been to invite all managers, allowing for multiple respondents per organization. This might have weighted the responses toward the institutional values and influences of the larger organizations. For example, if a larger organization includes twenty managers, and a smaller organization includes five, only one interview per organization

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puts these two on equal footing, or weighting, within the findings. Allowing all managers to be selected may have allowed the natural weighting of organizations to be represented. However, when comparing the reported market capitalization of the respondents with the TSX Venture market as a whole (Table 5 Market Capitalization, page 211), it appears that, if anything, larger organizations were slightly over-represented. Also, only one email address per organization was listed on the Listed Company Directory and each issuer was sent a unique survey link. Although some recipients may have forwarded the email to its various directors and officers, it would be difficult to know how many individuals in the first round responded multiple times (with different names) to increase their chance of winning the iPad. Given that the names of the first 100 respondents were to be entered in the draw, it would have been easy to increase one's odds by responding multiple times, giving the false appearance of multiple respondents.

Industry participants not surveyed

Some Ontario venture issuers are not listed on the TSX Venture Exchange. 126 issuers of which some are based in Ontario are listed on the Canadian National Stock Exchange (CNSX), which is a junior exchange, with a total market capitalization of $647 million[408] (only 1.3% of the TSX Venture's capitalization). Some Ontario venture issuers are listed solely on a foreign stock exchange. However, given that the market capitalization of the TSX Venture greatly exceeds

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[408] (CNSX Markets Inc. William Woods 2010)

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that of the CNSX, and given that the number of Ontario venture issuers listed solely on a foreign exchange is probably small in comparison with the number listed on the TSX-V, restricting the survey to TSX Venture issuers was considered an adequate representation of the Ontario venture issuer community.

The brokers, lawyers and auditors who advise the managers of venture issuers were not surveyed. It is likely that some of the answers to the business ethics questions would be tempered by professional advice received. The purpose of the survey was to assess whether or not there is an interpretative community among the managers of venture issuers. It should be noted that the findings represent expressions of *intent*, *attitudes*, and *memories* which may differ from actions actually taken.

Most significantly, the investors who are at the heart of securities regulation were not surveyed. Surveying investors is beyond the scope of this paper, since many are "accredited" (those deemed wealthy or sophisticated enough to negotiate terms of investment for their own protection). To find a representative sample of accredited investors would be difficult, since the confidentiality of investors is maintained by the introducing broker and by the issuer.

Comparing respondents to known population parameters

In order to assess how representative the respondents' and their venture issuers were with the

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population of venture issuers as a whole, a comparison with known qualities of the population TSX-V issuers are considered next.[409]

Industry type

Each respondent who answered all of the questions was cross-referenced to their industry as shown on the 2012 list of TSX-V issuers[410]. Some respondents could not be cross-referenced and TSX-V issuers which are "Capital Pool Companies" which have not yet entered into a qualifying transaction (and thus have not yet entered into a particular industry) were not included.

Table 3 Industry Type on TSX-V

	Survey	**Survey %**	**TSX-V**	**TSX-V %**
Mining	64	56%	1294	64%
Diversified industries	15	13%	162	8%
Oil and gas	12	10%	282	14%
Technology	9	8%	82	4%
Clean technology	6	5%	82	4%
Life sciences	5	4%	67	3%
Financial	3	3%	47	2%
Forestry	1	1%	5	0%
Other			11	
Total	*115*		*2021*	

These figures show that the survey slightly under-represents mining issuers and slightly over-represents diversified issuers and technology issuers.

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[409] See (Groves 2006), p.19

[410] (TSX Market Intelligence Group 2012)

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Industry headquarters

Each respondent who answered all of the questions was cross-referenced to the jurisdiction of their headquarters as shown on the 2012 list of TSX-V issuers[411]. Some respondents could not be cross-referenced.

Table 4 Industry headquarters

	Survey	Survey %	TSX-V	TSX-V %
British Columbia	46	39%	1143	50%
Ontario	24	21%	422	19%
Alberta	21	18%	327	14%
Quebec	8	7%	152	7%
USA	9	8%	86	4%
China	4	3%	29	1%
Manitoba	2	2%	17	1%
Nova Scotia	1	1%	17	1%
Saskatchewan	1	1%	16	1%
Other	1	1%	62	3%
	117	100%	2271	100%

These figures show that the survey slightly under-represents British Columbia issuers, which corresponds to the previous statistic which slightly under-represents mining issuers (most junior mining ventures have their headquarters in British Columbia).

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[411] (TSX Market Intelligence Group 2012)

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Market capitalization

The survey identified a range of market capitalization. The QMV (quoted market valuation) of TSX-V companies is summarized by the TSX-V in various spreadsheets.[412] As of January 31, 2011, of the 2,035 issuers on the TSX-V, the following table compares their QMV with those of the respondents.

Table 5 Market Capitalization

	Respondents		TSX Venture	
	Number	**Percentage**	**Number**	**Percentage**
Less than $5 million	33	25%	678	33%
From $5 m to $15 m	32	24%	592	29%
From $15 m to $25 m	13	10%	220	11%
From $25 m to $50 m	22	17%	218	11%
From $50 m to $100 m	13	10%	148	7%
Over $100 m	20	15%	179	9%
	133	100%	2035	100%

These figures show that the survey slightly under-represents venture issuers with QMV less than $5 million. However, the question asked "what is the current market capitalization for the largest

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[412] Mining Companies Listed on Toronto Stock Exchange and TSX Venture Exchange (two worksheets in the attached) at < http://www.tmx.com/en/listings/sector_profiles/mining.html>
<http://www.tmx.com/en/listings/sector_profiles/energy.html>

< http://www.tmx.com/en/listings/sector_profiles/clean_technology.html>

<http://www.tmx.com/en/listings/sector_profiles/life_sciences.html>

<http://www.tmx.com/en/listings/sector_profiles/diversified_industries.html>

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venture issuer the respondent worked for?"—given that almost half of respondents said they worked for more than one venture issuers (Table 9), it seems likely that many respondents also work for smaller issuers.

Exempt market financings

The proportion of equity raised by private placement for all TSX-V issuers is shown in the following table (in billions of dollars).[413]

Table 6 Proportion of raised funds

Year	Private ($)	Public($)	Total	Private	Public
2007	9,754.00	1,388.00	11,142.00	88%	12%
2008	4,666.90	833.60	5,500.50	85%	15%
2009	3,816.70	1,033.30	4,850.00	79%	21%
2010	6,392.40	3,439.30	9,831.70	65%	35%
2011	6,819.70	3,276.50	10,096.20	68%	32%
Average	6,289.94	1,994.14	8,284.08	76%	24%

The figures for 2007 and 2008 are consistent with the sources of equity raised by respondents (Table 16)—15% of financings by respondents (during the previous three years) were from a prospectus, capital pool, take-over, or other. The remaining 85% were from private placements—19% from close friends and family, 25% from existing business contacts and 41% from private investors introduced by an arm's length broker. Although the 2010 figures of TSX-V public

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[413] See the TSX-V Market Intelligence Group listings at <http://www.tmx.com /en/mig/archives.html>

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financings were significantly higher than what respondents reported, it should be noted that public financings are concentrated among a relatively small number of venture issuers. In 2010, the number of public financings recorded was 337 out of a total of 2,603 financings—i.e. only 13% of financings were public. In other words, most financings are private placements, but the occasional public financing involves large dollar amounts. Most venture issuers rely on private placements, but occasionally, a relatively large public financing is undertaken. Arguably, this is consistent with the answers given by respondents to the survey—that a large majority of financings are private placements.

Research proposals

(i) Is there a shared understanding of regulatory principles?

This research proposal was addressed in two ways: (i) do the regulated have the *capacity* to apply securities law principles as they may evolve over time? and (ii) do the regulated *in fact* understand securities law principles as currently applied?

The community may be *capable* of understanding securities law principles, but in fact not understand them because its members are not sufficiently motivated to learn them. As described in the literature review in chapter two, there are four general compliance motives: the incentive motive, the reason-driven motive, the social identity motive, the justice motive and the citizenship motive. If, for example, the regulated do not perceive any reason to learn regulatory principles or do not have a sufficient social identity or justice motive to follow regulatory

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matters, no matter how capable the regulated may be, over time, there will not be a shared understanding of regulatory principles.

To test whether or not venture issuer managers have the *capacity* to understand securities law principles, respondents were asked what formal education they had completed (Table 12) and what formal education their Chief Executive Officer had completed (Table 13). Of course, education on its own does not insure intellectual capacity. However, I argue that achieving higher levels of education shows effort and personal commitment—qualities necessary for a long-term commitment to understanding the regulations of one's own industry. I suggest that an industry composed of highly educated people is more likely to be capable of reading and understanding regulatory principles and administrative decisions in a complex field such as securities regulation than an uneducated community.

As to whether or not managers in fact have a shared understanding of securities law principles as currently applied, a series of business ethics[414] questions were asked to test respondents' recognition of insider trading and fairness principles. These questions were developed after a series of trial questions were asked of one securities lawyer, one professor of law, one professional geologist and one senior manager of a large corporation. The questions were refined after each draft was circulated, in order to reduce the possibility of confusion in the actual survey.

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[414] By "business ethics", I refer to lawful business practice and fiduciary duty as determined by Canadian and other common law courts.

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> Business Ethics Question #1 (Table 32): Suppose that the buyer of a mining claim discovers from independent research (and without involving any trespass on the claim) that the claim follows the line of an adjacent mineral vein, and so the claim is far more valuable than the seller realizes. Should the buyer be legally required to advise the seller about this information before purchasing the claim?

The answer "No" is consistent with the common law legal principle that those who work to acquire informational property should enjoy the fruits of their labour. Acquiring information has a cost. If the buyer is legally required to share the information, there is little incentive to acquire it. If the source is from independent research or analysis, legally, the buyer is entitled to benefit from the intellectual work expended and trade with that advantage. As one of the respondents in the survey noted said: "It's not a commune."

Those who answered "Yes" were bounced to the third ethics question. Those who answered "No" were asked this follow up question.

> Business Ethics Question #2 (Table 34): You answered "no" to the last question. What if some of the valuable information came from an employee of the seller? – an employee who volunteers information to the buyer without realizing its importance and without telling his or her superiors. Should the buyer be legally required to advise the seller about this information before purchasing the claim?

In this case, the buyer is in "knowing receipt" of the seller's informational property and should return it (i.e. disclose it) to the seller. This conclusion is based on the common law of agency and the equitable law of constructive trust.

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As to the common law of agency, the issue is whether or not the employee had “actual” or “apparent” authority, as agent for the seller, to transfer the valuable information to the buyer. If not, then the informational property still belongs to the seller. As to the employee’s “actual authority”, it is doubtful that the employee was in fact authorized to release the information since the employee did not tell his or her superiors. As to the employee’s “apparent authority”, the buyer can only rely on this if a reasonable person in the shoes of the buyer would conclude that the employee was authorized. If the buyer knows that the employee has not told his or her superiors about disclosing this valuable information, no apparent authority for the transfer of valuable information to the buyer would exist.

This relates to the equitable concept of constructive trust. The employee has a fiduciary responsibility to his or her employer. The scope of fiduciary duty will vary, depending on the employee’s degree of responsibility and discretion. Clearly, the employee has a fiduciary obligation not to release valuable information about the seller’s mining claims to a purchaser without telling his or her superiors. The employee has, at a minimum, negligently breached this duty and the equitable issue is whether or not the buyer can appropriate this information with knowledge of the breach. Even though the buyer offered no inducement, the buyer is in “knowing receipt” of proprietary information disclosed in breach of a fiduciary duty. Cases have held that someone in receipt of property, knowing that it comes to them through a breach of

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fiduciary duty, must return the property to the original owner (which in this context, means advising the selling company of the information).[415]

Although the business law concept is not directly regulated by the Ontario Securities Act, it is indirect concern since one of the fundamental principles to be considered by the OSC in regulating the market is maintaining high standards of fitness and business conduct to ensure

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[415] Per La Forest J. in *Citadel General Assurance Co. v. Lloyds Bank of Canada* [1997] 3 S.C.R. 805 at para. 24: "The knowing receipt imposes obligations on strangers to the trust who receive trust property for their own benefit and with knowledge that the property was transferred to them in breach of trust. In all cases, it is immaterial whether the breach of trust was fraudulent." As stated by Iaccobucci J. in *Gold v. Rosenberg* [1997] 3 S.C.R. 767 at para, 49: "…the cause of action in knowing receipt arises simply because the defendant has improperly received property which belongs to the plaintiff. The plaintiff's claim amounts to nothing more than, 'You unjustly have my property. Give it back.' Unlike knowing assistance, there is no finding of fault, no legal wrong done by the defendant and no claim for damages. It is, at base, simply a question of who has a better claim to the disputed property."

See (Parker and Mellows 1979) at p. 156: "The rule is that if a stranger knowingly receives trust property and also knows that it is transferred to him in breach of trust he holds it upon a constructive trust for the beneficiaries." See (Pettit 1984) at p. 448: "The general principle laid down in *Re Diplock's Estate* is that whenever there is an initial fiduciary relationship, the beneficial owner of an equitable proprietary interest in property can trace it into the hands of anyone holding the property, except a bona fide purchaser for value without notice…" And at p. 147, "knowing receipt" is an objective test of knowledge. As stated my Hoffman LJ in the English case of *El Ajou v Dollar Land Holdings plc*, (as quoted by (Thomas 2001) at pp. 242-3), to compel the return of propriety by virtue of "knowing receipt" of trust property, the plaintiff need prove: "First a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets received are traceable to a breach of fiduciary duty"

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honest and responsible conduct by market participants.[416] Arguably, venture issuers which improperly acquire information and then trade to the detriment of another is a matter of honest and responsible business conduct.

The next two business ethics questions were similar to the first two, except that they were in the context of trading shares on the stock market.

> Business Ethics Question #3 (Table 36): Suppose an investor is buying shares of a company trading on a stock exchange. The investor discovers from independent research that the company is far more valuable than the public realizes. Should the investor be legally required to disclose this research to the public before purchasing the shares on the exchange?

This question is similar to the first ethical question. Is there a duty to share information publicly if the investor discovers it from independent research? The answer in a capitalist economy is "No"— the investor who expends the effort of independent research and discovers important information can use it for their personal benefit. Otherwise, there would be little incentive to acquire such information. Those who answered "No" were asked this follow up question.

> Business Ethics Question #4 (Table 38): You answered "no" to the last question. Would your answer change if the source of the information is from an employee of the company who volunteers information to the investor without realizing its importance? Should the investor be legally required to wait for the information to be disclosed to the public before purchasing the shares on the exchange?

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[416] Ontario *Securities Act*, section 2.1(2)(iii)

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The final ethics question is similar to the second—if an employee volunteers inside information to an investor, must the investor wait for it to be publicly disclosed? The legal answer is "Yes". It is a classic insider trading situation, prohibited by section 76 of the Ontario *Securities Act*. Trading on the undisclosed information is illegal, but the ethical basis of the rule has been challenged (see page 219).

(ii) Are the regulated committed to the public interest?

Preliminary questions addressed whether or not respondents had a long-term commitment to the industry. Respondents were asked how many years they had worked for a venture issuer (Table 8), how many venture issuers they were currently working for (Table 9), and on average, how many days per week they currently work for venture issuer(s) (Table 10). To test their long-term view, they were asked if they expected to leave the venture issuer industry in the next three years (Table 11). (The three year time horizon was an arbitrary number.)

Then, to test their commitment to securities disclosure issues, respondents were asked a series of questions about their issuer's primary source of investment (close family, existing business contacts, private investors introduced by a broker, or the public) (Table 16), and what importance the respondent thought that each category of investor would place on management's reputation for honesty, management's past success, and evidence about the issuer's assets and prospects (Table 17, Table 18, Table 19). These questions assess the argument (above, at page 177) that

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the promoter must maintain the confidence of his or her core of investors as they will be approached again and again, and that the promoter's commitment to full disclosure may depend on who the investors are and what information those investors are relying on.

To test the respondents' perception of what motivates promoters, respondents were asked to rank the order of importance they thought that promoters placed on the following: share price over the next 12 months, long-term value of the business, and reputation for ethical business practice (Table 20). Arguably, asking respondents to assess the motivation of promoters is speculative, since many respondents may not be (or may not consider themselves to be) a promoter, and so, for those, it is asking them to assess what are in the minds of others. However, TSX-V issuers are usually small organizations. In order to raise funds for development or exploration, the promoter must be intimately involved in all aspects of the business. I suggest that most respondents would have long associations with promoters and would likely have a good idea of their behaviour and be in a position to infer the motives of promoters.

(iii) Are the regulated able to find analogous solutions?

Analogous reasoning is where current problems are compared with similar problems encountered in other situations. I suggest that a board with a range of experience will more likely find solutions to business issues, including compliance issues, than a board composed of like-minded individuals with identical backgrounds. A board composed entirely of engineers, for example, or a board composed entirely of accountants or lawyers, may see problems from the same angle and

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will more likely suffer from "tunnel vision". Diversity by itself may not assist, but diversity across a broad range of relevant experience promotes analogous reasoning. For example, the board of a technology issuer may need to assess whether or not a new social networking device will be a material change in its business, and the assessment could benefit from a mix of backgrounds with analogous issues, including technical, marketing, accounting and legal. Similarly, the effect of an environmental spill in a foreign country on the long-term finances of a mining company may depend on both scientific and political factors, and a broad range of experience could reach better conclusions.

To assess the potential for analogous solutions, respondents were asked what skills their board of directors included—an engineer, a scientist (e.g., a geologist, computer scientist, biologist or medical scientist), a director with personal experience managing the kind of property the company owns, a finance expert (e.g, broker, financial adviser, financial analyst), a chartered or certified management accountant, or a lawyer? (Table 14).

(iv) Are there institutions or actors which promote regulatory collaboration?

Respondents were asked how frequently their directors had consulted with the following experts on continuous disclosure or press-release questions—a geologist or other scientist, a lawyer, an auditor or accountant, or a securities analyst (Table 22). Respondents were asked how often, during the previous 12 months, their issuer had communicated with staff of the TSX-V and staff

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of the Ontario Securities Commission and how helpful staff had been in terms of explaining or assisting with compliance issues (Table 23).

Respondents were asked to rank how important it was that "issuers and staff of the OSC and TSX-V should collaborate and have regular communication" in order to make principles-based regulation effective (Table 30). Respondents were asked whether "issuers and staff of the OSC and TSX-V should have a shared understanding about what makes the market fair and efficient" and whether "issuers and staff of the OSC and TSX-V should agree about which principles are the most important" (Table 30). The assessment of staff of the OSC may have been unrepresentative, however, since only 21% of respondents had their headquarters in Ontario (Table 4 at page 210 above) and so most respondents would be primarily dealing with other provincial securities commissions.

(v) Do the regulated see enforcement as fair and effective?

Respondents were asked to assess how important they thought that "enforcement should be fair and balanced" in comparison with other factors, in order to make principles-based regulation understandable and effective for venture issuers (Table 30).

The issue of fair enforcement of securities regulation was not further explored in the survey, because a number of questions would have been required. For example, questions could assess fairness as between large and small issuers, as between different industries, as between different

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professional qualifications and cultures of respondents, and as between different kinds of cases and allegations involved. Also, the different regulators would need to be assessed: staff of the Ontario Securities Commission, staff of other provincial securities commissions (since only 21% of the respondent issuers have their headquarters in Ontario—Table 4), staff of the TSX Venture Exchange, and in some cases, the police regarding criminal charges. The fairness of tribunals as well as courts could be addressed. Finally, "fairness" and "effectiveness" of securities enforcement could be compared with other fields, such as competition law and taxation—some respondents might consider all regulation as unfair and ineffective. An evaluation of securities enforcement was beyond the scope of the survey. As it turned out, only 76% of those who started the survey answered all of the survey questions. It was decided to focus on the other questions in order to obtain answers and detailed written comments.

(vi) Are regulatory issues predictable?

To test the attitude of respondents to this research proposal, they were asked:

> To improve public disclosure for venture issuers, how do you think securities regulations should be drafted? (i) Detailed disclosure rules, describing exactly what should be disclosed and when; (ii) Broad principles, with examples of good disclosure in particular cases as guidance; (iii) It depends on what kind of information is to be disclosed; and (iv) No opinion. (Table 25)

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Those who chose detailed rules or broad principles were asked a follow up question asking respondents to explain their answer. Those who answered "It depends on what kind of information is to be disclosed" were asked a follow up question asking which of the various areas of regulation should be principles-based and which should be rules-based, with another follow-up question asking respondents to explain their answer. (Table 26, Table 27)

(vii) Should historical transactions be disclosed?

To test this research proposal, the explanations for those who chose "It depends" in the above questions about using rules or principles will be reviewed in the context of other factors. (Table 26, Table 27)

(viii) Should future projections be disclosed?

To test this research proposal, the explanations for those who chose "It depends" in the above questions about using rules or principles will be reviewed in the context of other factors. (Table 26, Table 27)

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Chapter 5: Results of survey and background facts

(i) Is there a shared understanding of regulatory principles?

As to the capacity to understand securities law principles, most respondents were highly educated and experienced in the industry. 51% had a university degree, 38% had a professional degree and 30% had a Masters degree (Table 12 and Table 13). For those who answered that they were not the CEO, a large percentage had a professional or Masters degree (39%). Regarding experience, 17% of respondents had worked for venture issuers for more than 20 years, 24% had worked more than 10 but less than 20 years, 34% had worked more than 5 but less than 10 years—only a quarter of respondents had worked in the industry for less than five years. 74% of respondents worked full time for venture issuers—i.e. five days or more. 65% of respondents do not expect to leave the industry in the next five years. In addition, the TSX–V limits who can be a director or manager of a public issuer. With this high level of education and experience, it seems reasonable to expect, at a minimum, a capacity to understand securities law principles as they may evolve over time.

As to whether or not respondents do understand securities law principles as currently applied, a series of business ethics questions were asked to test their recognition of fairness principles and insider trading. As to fairness principles, one of the stated principles of the Ontario *Securities*

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Act is that market participants should have high standards of fitness and business conduct.[417] This is a broadly worded principle which includes honest and legal behavior during a business transaction.

Regarding the first ethical question,[418] a high percentage (76%) answered that a buyer who discovers from independent research that a mining claim is far more valuable than the seller realizes should not be legally required to disclose this information to the seller. This is consistent with the common law legal principle that those who work to acquire informational property should enjoy the fruits of their labour. Most argued that the information was available to either party, and the buyer should be awarded for its efforts. As some said, "it's not a commune", or "we do not function in a socialist environment (yet)", and "[i]nformation advantages gained through honest research, diligence, and hard work should be for the benefit the party that has acquired that advantage... that's tantamount to requiring poker players to show each other their hands prior to making bets – it just doesn't make sense." Of the twelve who said that the information should be disclosed, eight gave rather vague explanations (Table 33), such as "it is the right thing to do!", or "because it's fair", or "to maintain honesty and integrity of management."

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[417] Ontario *Securities Act*, section 2.1(2)(iii)

[418] *Business ethics question one:* "Suppose that the buyer of a mining claim discovers from independent research (and without involving any trespass on the claim) that the claim follows the line of an adjacent mineral vein, and so the claim is far more valuable than the seller realizes. Should the buyer be legally required to advise the seller about this information before purchasing the claim? (Table 32)

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In contrast, regarding business ethics question two,[419] where the source of the information is from an employee of the seller who volunteers information to the buyer without telling his or her superiors, there is no congruence of opinion: 34% said that the buyer should be required to advise the seller about this information, 47% said that the buyer should not be required, and 19% were "not sure".[420] The employee has, at a minimum, negligently breached a fiduciary duty to his or her superiors.[421] Even though the buyer offered no inducement for the leak, the buyer is in "knowing receipt" and, according to law, should return the informational property to the owner (i.e. disclose the leak to the selling company). *Prima facie*, this incongruence suggests that there is not a "deep level" agreement about the use of inside information in business transactions. Further review of the explanations provided, however, show that some respondents who answered "no" or "not sure" recognized which principles applied, but saw more nuance in the question.[422] It seems that most of the respondents agreed that, if the buyer assisted in taking (i.e. stealing) information, then the buyer must disclose the information to the seller.

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[419] *Business ethics question two:* "You answered "no" to the last question. What if some of the valuable information came from an employee of the seller? – an employee who volunteers information to the buyer without realizing its importance and without telling his or her superiors. Should the buyer be legally required to advise the seller about this information before purchasing the claim ?" (Table 34)

[420] Table 34 Ethics question 2, p.323

[421] See footnote 415 at p.217

[422] Table 35 Explanations for ethics question 2, p.324

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Those who saw no duty to disclose in the second ethics question may question other principles which underlie business law. The "knowing receipt" principle is akin to the principle that one should return lost property, such as a lost wallet or umbrella. Those who stumble upon lost property, or who innocently receive confidential information, have a duty to preserve and return the property. Capitalism rewards those who seize opportunities overlooked by others, but it doesn't reward those who snatch up lost property when the legitimate owner can still be found.

Question three[423] paralleled question one, except that the investor is buying shares on the stock market rather than claims from a mining company. Again, the information is from an independent source and there is no legal obligation to disclose. 91% of respondents agreed. As one explained: "independent research implies publicly available information" and as another said "people do independent research all the time to try and find undervalued situations. It is part of what makes a market."

The fourth ethics question[424] asked respondents if an investor should be legally required to wait for inside information (volunteered by an employee of the issuer) to be publicly disclosed before

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[423] *Business ethics question three*: "Suppose an investor is buying shares of a company trading on a stock exchange. The investor discovers from independent research that the company is far more valuable than the public realizes. Should the investor be legally required to disclose this research to the public before purchasing the shares on the exchange?" (Table 36)

[424] *Business ethics question four:* "You answered "no" to the last question. Would your answer change if the source of the information is from an employee of the company who volunteers information to the investor without realizing its importance? Should the investor be legally required to wait for the information to be disclosed to the public before purchasing the shares on the exchange?"(Table 38)

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trading the issuer's shares on the exchange. 20% said that the investor need not wait for the information to be publicly disclosed and 13% said they were "not sure". In other words, a third of the respondents apparently failed to recognize that it is illegal for a "tippee" of inside information to trade with knowledge of the tip on the stock market.[425] *Prima facie*, this demonstrates a significant gap in knowledge—a "deep level" misunderstanding of securities law principles among a third of respondents. However, further review of the explanations given by those who answered "no" or "not sure" shows that some recognized that it was an insider trading scenario but felt there was nuance to the question.[426] Some respondents said that it would depend on whether or not the information was "material", suggesting that they might make further inquiry before trading. However, the question was a follow-up to the third ethical question, which stated that the information reveals that the "company is far more valuable that the public realizes". It is difficult to see how this would not be material information, since "material fact" is defined in the Ontario *Securities Act* as a fact that "would reasonably be expected to have a significant effect on the market price or value of the securities."

Some respondents who said that they would use the leaked information were quite bold about their disregard of ethics. One said: "Tough luck for seller…seller may assert [that] an employee

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[425] The person is a "tippee" if they know, or ought reasonably to know, that the person who tipped them is, among other persons, an employee of the reporting issuer. See section 76(5)(e) of the Ontario Securities Act.

[426] See "Table 39 Explanations for ethics question 4" at p.335.

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disclosed information before the sale, but how can it be proven?" Another said, "[e]thics should not be set in the law."

Another question asked of respondents was: "How frequently do the directors of your venture issuer debate among themselves about when or which information should be press-released?"[427] 12% replied that there was "always" a debate among the directors and 32% of respondents replied that there was "often" a debate (44% in total). There are at least two explanations for why directors may disagree about disclosure. A pessimistic explanation is that some directors wish to trade with inside information by delaying public disclosure. As discussed in chapter one, the regulatory risks of venture issuers include: Spreading false information (page 47), Withholding material information (page 48), and Market manipulation (page 49). It seems unlikely, however, that a director who is considering illegal behaviour would risk detection by debating disclosure with other directors—silence would be a better strategy. A more optimistic explanation is likely—that the assessment of what is material information is not always obvious. For example, the sampling of a mineral deposit can provide important information about its characteristics, but whether or not the results should be expected to affect the issuer's share price can be a complex question, open for debate. Conclusions from this question are limited, however, since over half of respondents said that such disclosure debates were "never", "rarely" or "sometimes" argued among directors. All that can really be said is that disclosure debates do occur and many seem to be based on honest disagreements about the application of principles.

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[427] See Table 21, p.298

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(ii) Are the Regulated Committed to the Public Interest?

Respondents were asked how many years they have worked for a venture issuer (most have worked for more than five years[428]); if they currently work full-time or part-time for venture issuers (most work full-time[429]) and if they plan or expect to leave the industry in the next five years (65% said "no"[430]). The answers to these questions suggest that most respondents do have a personal, long term commitment to the industry. Whether or not they are committed to regulatory principles, however, is considered next.

As to the respondents' commitment to the principle of "full, true and plain" disclosure of all material facts to investors, respondents were asked to rank the importance of full disclosure to three different classes of venture investors. According to respondents, close friends and family rely more on management's reputation for honesty and past business success (70% said this was of first importance) than they do on evidence about the issuer's assets and prospects (only 8% said this was of first importance).[431] Similarly, existing business contacts rely on management's reputation for honesty (44% said this was of first importance) and on management's past success

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[428] Table 8, p.292

[429] Table 10, p.293

[430] Table 11, p.293

[431] Table 17, p.296

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in business (43% said this was of first importance).[432] In contrast, investors who are introduced by a broker, and presumably public investors who subscribe based on a prospectus, rely on documentary evidence about the issuer's assets and prospects—48% said this was of first importance and 36% said management's past success was of first importance for these investors. According to respondents, only 18% of investors introduced by an arm's length broker, agent or finder rely primarily on management's reputation for honesty.[433] I suggest these results make intuitive sense. Those who know the promoter and managers of an issuer are more likely to rely on their character before investing. Those who are introduced by a broker are more independent and would more likely rely on documented statements about the issuer.

The principle of full, true and plain disclosure of all material facts can be simplified for close friends and family and business associates, since these investors rely more on management's reputation for honesty than on documentary disclosure. On the other hand, there is a danger that promoters may forgo important disclosure in raising funds from close friends and family and business associates. According to respondents, what is most important for promoters of venture issuers is the short-term share price of the issuer over the next 12 months (73%) rather than the long-term value of the business (24%) or a reputation for business ethics (only 5%).[434] Conclusions are tentative, however. As discussed above (page 130), Sanderson and Darley suggest that most people believe that they themselves engage in good conduct but are less

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[432] Table 18, p.296

[433] Table 19, p.297

[434] Table 20, p.298

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charitable in their assessment of others. Respondents may believe that they themselves care about their reputation and the long-term value of their business, but that promoters in general do not.

Despite the limitations of the survey, probably most promoters do focus on the short-term. As discussed above under the topic "Success is unlikely" (page 43), 95% of junior ventures fail. Mining promoters must raise funds for working capital and for developing a property before any results can be proven and before any revenue.[435] Repeated rounds of private placements are required before a bankable "feasibility study" is available. From personal experience as a solicitor in practice for twenty years and as a director of a venture issuer listed on the TSX Venture,[436] I estimate a minimum "burn rate" of at least $10,000 per month to maintain a public listing and an office. These short-term expenses cannot be overlooked. Often, promoters must raise funds by selling shares to speculative investors who are looking for a quick profit. Considering these financial pressures, it should come as no surprise that many respondents believe that promoters are primarily motivated by short-term share price. If so, and if many of the investors are friends, family or business associates (who do not rely on documented

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[435] See "Commitment to "Full, True and Plain Disclosure", from page 177)

[436] I am a director of Peat Resources Limited, which is a struggling junior venture listed on the TSX Venture Exchange in the business of wet harvesting peat bogs for low CO_2 fuels.

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disclosure)[437] then the commitment of promoters to the securities law principles of full disclosure before an investment is made could be compromised.

(iii) Are the regulated able to find analogous solutions?

To test the potential for analogous reasoning, Table 14 asked about the range of experience of the board of directors. 165 respondents answered the question. 52% of the boards included an engineer; 64% included a scientist; 72% included a director with personal experience managing the kind of property which the company owns; 65% included a finance expert; 59% included a chartered or certified management accountant; and 52% included a lawyer. Thus, the majority of venture issuers surveyed have a diverse range of experience from which to draw analogous solutions. Whether or not boards do in fact draw from this range of experience is not answered in the survey. However, I argue that it is more likely that the board can apply principles-based regulation if they can draw from a broad range of experience. If the board were composed of like-minded experts in one field, then the opportunity to apply principles-based on experience is

[437] Of the ninety-nine respondents who answered where funds were raised during the last three years, the mean amount raised from close friends and family of management was 19%, from existing business contacts of management was 25%, from private investors introduced by arm's length broker was 41%, and from a public financing (such as a prospectus, capital pool or take-over) was 15%.

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reduced. A similar point is made under the topic "Risk-based regulation" (from page 101 above), where I argue that diversity brings strength.

(iv) Are there institutions or actors which promote regulatory collaboration?

Two questions in the survey addressed the level of regulatory collaboration between issuers and regulators. Respondents were asked how frequently they communicated with staff of the TSX-V and with staff of the OSC (Table 23), and how helpful contact has been in terms of explaining or assisting with compliance issues (Table 24). It appears that TSX-V staff are more frequently contacted and considered helpful (58% contacted TSX-V staff 1-4 times, 23% contacted them 5-10 times, and 12% them contacted more than 11 times; only 7% "never" contacted TSX-V staff during the previous 12 months). TSX-V staff is considered "somewhat helpful" or "very helpful" by 81% of the respondents.

Staff of the OSC is infrequently contacted (65% indicated "never" and 29% said less than five times during the previous 12 months) and most respondents (66%) had no opinion of their usefulness. However, only 21% of respondents worked for issuers with their headquarters in Ontario (Table 4), and only 15% (Table 6) of respondents had raised funds through a prospectus, capital pool or take-over in the last three years (which would involve detailed OSC staff review), so it is no surprise that most respondents had little contact with, and expressed no opinion of, OSC staff.

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Some respondents had negative comments about securities regulators and in particular TSX-V staff and some respondents view TSX-V staff as adversaries rather than collaborators. Of course, staff has a duty to investors and to intermediaries as well as to listed issuers. They must balance the desire of issuers to reduce disclosure costs against the investors' need for full, true and plain disclosure. Documents should be clear and consistent among different businesses. It is not surprising that a minority of respondents believe that TSX-V staff is not helpful.

Table 30 lists which factors respondents thought would make principles-based regulation understandable and effective. 56% of respondents said that it was very important that issuers and staff of the OSC and TSX-V should have a shared understanding about what makes the market fair and efficient; 43% said that it was very important that issuers and staff of the OSC and TSX-V should agree about which principles are the most important; and 51% said that it was very important that issuers and staff of the OSC and TSX-V should collaborate and have regular communication.

As to collaboration with experts (regarding continuous disclosure or press release questions—Table 22), respondents consult with geologists and other scientists "very often" 29% of the time, lawyers "very often" 24% of the time, auditors or accountants "very often" 12% of the time, and securities analysts rarely.

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(v) Do the regulated see enforcement as "fair" and "effective"?

As mentioned above (page 190), attitudes to enforcement were not addressed. This is because there are a number of different enforcement strategies employed by a number of different agencies. However, 65% of the respondents said that, for principles-based regulation to be understandable and effective (Table 30), it was very important that enforcement should be balanced and fair.

(vi) Are regulatory issues predictable?

144 respondents answered the question about whether to use detailed rules or broad principles for venture issuers (Table 25). 52% recommended broad principles, with examples of good disclosure in particular cases. 19% recommended detailed rules, describing exactly what should be disclosed and when. Thus, 71% of respondents were either entirely for rules or entirely for principles, which reflects the dichotomy in much of the academic literature. Only 27% said that "it depends on what kind of information is to be disclosed."

Those who chose principles-based regulation argued that detailed rules can become too cumbersome and constricting, and don't allow for the flexibility required for different sized companies and for different controlling positions. One respondent said: "We have a head office staff of six. None of us are lawyers, and legal costs run around $30,000 per year. Much of that

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cost is to ensure that very specific information is declared." Another noted that "There are many different types of venture issuers, from Capital Pool Companies to mining operating companies, etc. Having specific rules for all Venture issuers does not allow for the flexibility that some venture issuers may require." One said "It is impossible to detail all possible examples so the only way to effectively indicate what should be disclosed is through examples covering the broad principles." Another observed that "under a rules-based scenario more time is spent trying to stay between the posts (or bending the posts) than observing the intent, and that can be counterproductive to the disclosure process; indeed, it is quite prone to misinformation." Some suggested principles-based regulation with guidelines and examples.

Those who chose detailed rules explained their answers by saying that rules standardize regulations and "level the playing field." As one respondent explained, "Small venture issuers do not have the luxury of resources (time and money) to have professional staff in the company or have advisors and consult with them as cost effectively and efficiently as an actual "rulebook" might provide." Another said, if regulations are too broad or too loose, the demand for expensive securities lawyers to interpret regulations will increase, which small firms cannot afford. The most common comment was that clear and consistent rules are easier to follow.

27% of respondents answered the question that "it depends on what kind of information should be disclosed". This reflects the more nuanced observations of Cristie Ford, that different areas of securities regulation require a different mix of rules and principles. 37 respondents answered the follow-up question about which areas should be regulated by rules and which should be regulated by principles. Only 11% of these respondents said that mineral and oil and gas

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reserves should be regulated entirely by principles—most said either rules, or a mixture of rules and principles. Similarly, only 16% of these respondents said that related party transactions should be regulated entirely by principles and only 27% said "other conflicts of interest" should be regulated by principles. In contrast, 59% of respondents said that business forecasting and 49% of respondents said that ongoing disclosure about materials facts should be principles-based. It would seem, therefore, that 27% of respondents accept that some areas should be regulated by rules and some should be regulated by principles, and that property evaluation opinions and related party transactions, which are essentially historical or scientific assessments, should be regulated by rules. Future predictions and ongoing disclosure, however, should be regulated by principles. One respondent argued that mineral and oil and gas reserves are matters of measurement and can be rules-based. But forecasts and materiality are subject to interpretation and should be principles-based.

(vii) Should historical transactions be disclosed?

Of the respondents who said that some areas should be regulated by rules and some should be regulated by principles, 49% said that detailed rules should be used for mineral and oil gas reserves and only 11% said principles should be used (30% said that a mixture should be used). Arguably, mineral and oil gas estimates are based on objective data and are quantifiable, making them less open to subjective interpretation, which is why many respondents believe that rules

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would be preferable.[438] Historical transactions are also more objective than forecasts about the future; by the same token, they could more easily be regulated by rules.

(viii) Should future projections be disclosed?

Only 5% of respondents (who said that some areas should be regulated by rules and some should be regulated by principles) said that detailed rules should be used for business forecasting. Arguably, forecasting is a more subjective assessment of a variety of factors, making it difficult to prescribe in advance rules which will fit every situation.[439]

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[438] Table 28 Detailed rules or broad principles? p.308

[439] Table 28 Detailed rules or broad principles? p.308

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Chapter 6: Consultations with Industry Experts

Six industry experts were consulted by personal interview during the summer of 2013. Each interview was in the nature of a conversation of approximately one hour each, initiated with open-ended questions, as opposed to a formal interview or survey. With consent, the conversations were recorded and afterwards each expert was emailed a copy of my interview notes in Appendix B. Approval from York University Office of Research Ethics was obtained for the interviews. In alphabetical order, the experts consulted were:

Experts consulted:

Ian Bandeen

Ian Bandeen ("Bandeen") B.A. LL.B. B.C.L. is a co-founder and past CEO of the Canadian National Stock Exchange (CNSX), which, as mentioned above, is a junior exchange located in Toronto with a total market capitalization of $647 million in 2009.[440] Mr. Bandeen is also a Founding Director of the National Angel Organization and is the Vice-Chairman of its Finance Committee. He is a member of the OSC Small and Medium Enterprises Advisory Committee.

Elaine Ellingham

Elaine Ellingham ("Ellingham") MBA, MSc., BSc., P.Geo. worked with the TSX from 1997 to 2005 in a number of capacities including National Leader, Mining and Manager, Company

[440] (CNSX Markets Inc. William Woods 2010)

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Listings, with a range of responsibilities, including developing and implementing an international business strategy, and advising and participating in TSX policy revisions. She has over 25 years of experience in the mining industry and was responsible for the strategic direction and leadership of the TSX Investor Relations and Communications departments.

Brian Prill

Brian Prill ("Prill"), BA, LLB, MBA, LLM is a lawyer at BLP Law Professional Corporation. Prior to that, he was a partner at Blaney McMurtry LLP in Toronto. His practice focuses on all areas of corporate finance and securities transactions and includes mergers and acquisitions, general corporate matters, cross-border transactions and dealer registration. He is Past-President of the Exempt Market Dealers' Association[441] and now serves its Board of Directors.

Edward Thompson

Edward Thompson ("Thompson"), MA Sc., P.Eng. has more than 50 years of industry experience as a geologist, a professional engineer, and in a variety of senior management positions. He was instrumental in drafting the former OSC policy regarding junior resource issuers and has served as the President of the PDAC and Treasurer and Director of the Canadian Mining Hall of Fame.

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[441] The Exempt Market Dealers Association of Canada (EMDA) is a not-for-profit association founded in 2002 by a group of Canadian business people whose firms were active in the exempt securities market. Prior to September 2009 and the implementation of the exempt market dealer category across Canada through National Instrument 31-103, the EMDA operated under its previous name the Limited Market Dealers Association of Canada.

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Michael White

Michael White ("White"), BA MBA, has been with the exempt market dealer firm IBK Capital since 1992 and is currently its President and Chief Executive Officer. He has been involved in private placement financings totalling over $500 million. He has also been active in financial advisory assignments and mining industry developments including: advisory services to the Government of Newfoundland and Labrador with respect to its arrangements with Inco Ltd. over the development of the nickel deposit at Voisey's Bay.

Al Workman

Al Workman ("Workman") B.Sc., P.Geo., is Vice-President and Owner of Watts, Griffis and McOuat Limited ("WGM"), Canada's longest running independent firm of geological and mining consultants, with expertise in project management, property valuations, mineral resource and reserve estimates, technical reports, and due diligence reviews. Mr. Workman has more than 40 years of experience in the industry.

Why these experts were chosen:

Thompson and Workman were chosen because of their extensive experience in the junior resource industry, which comprise the majority of venture issuers listed in Ontario. Ellingham was chosen because of her knowledge of the TSX and TSX-V exchange. Bandeen and Prill were chosen to gather insight from market intermediaries including the Exempt Market Dealers Association, and White was chosen to reflect the practical interests of one EMD which has consistently raised capital for venture issuers over many years.

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Discussion of the experts' opinions

Are Ontario securities regulations currently principles-based or rules-based?

Bandeen believes that, in comparison to the US, securities regulation in Canada is very much principles-based. Directors of public companies have a fiduciary obligation to operate in the public interest; rules are not exhaustive but are applications in specific cases. This is different than in the US, said Bandeen, where rules are typically seen as limits and market participants will hire lawyers and accountants to skirt them, often with seemingly no care to underlying principles.

Bandeen is correct in that the Ontario *Securities Act* sets out two fundamental purposes in section 1.1 (to provide protection to investors from unfair, improper or fraudulent practices, and to foster fair and efficient capital markets and confidence in capital markets) and then organizes six principles to consider (in section 2.1) when pursuing these purposes. These are high-level directives. Section 127 of the Act gives the OSC power to make various orders if in its opinion it is the public interest to do so, and, as stated by the Supreme Court of Canada, in exercising its discretion, the OSC should consider the protection of investors and the efficiency of, and public confidence in, capital markets generally.[442] Again, these are high-level directives.

However, as illustrated in Table 1, at page 27 above, the rules of the OSC have a large number of words per sentence, approaching the complexity of the notoriously complex Income Tax Act.

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[442] Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission) [2001] 2 S.C.R. 132

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The Securities Act, and the Rules and Policies of the OSC, comprise a book of over 3,000 pages of small print, of which 156 pages are for the Act and 25 pages are for the General Regulation; thus, there are over 2,500 pages of OSC rules in small print.[443] It would seem, therefore, that Ontario regulations are a combination of principles-based legislation and detailed OSC rules.

Bandeen's description of US participants hiring experts to skirt US rules is similar to Moran's description of the contrasting styles of London and New York, at page 54 above: London regulators have emphasized trust, flexibility and voluntary compliance, according to Moran, but U.S. regulation is detailed and adversarial. These different approaches may reflect different British and American social identity and citizenship motives in their business communities. Different cultures can have different commitments to the public interest (the second factor: "Are the regulated committed to the public interest").

Bandeen said that Americans tend to be the pioneers in financial matters—for example, securitization, multiple market trading, and high frequency trading. In the U.S., financial pioneers create new kinds of markets, and then the old guard starts demanding reviews about "unfair trading practices", forcing regulators to embark on time-consuming, consensus-building, exercises. This is partly why US rules are a nightmare, said Bandeen. They don't start from first principles, but react to new products after-the-fact, and so the evolution of US regulations are difficult to navigate and often seemingly circular. Generally speaking, said Bandeen, Canadian

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[443] *Consolidated Ontario Securities Act, Regulations and Rules*. Paul Findlay, Carswell, 2013. Approximately 3,350 pages

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regulators have the luxury of coming to the game later, can see what happens in other jurisdictions, and can structure our markets to adopt the best and avoid the worst practices.

Although Bandeen may be correct that Americans are pioneers in most industries, Canadians are pioneers in those markets which they dominate—mining, oil and gas. As described from page 52 above, the Toronto stock exchanges list more mining companies than any other exchange in the world, and half of those listed in Toronto are for mineral projects outside of Canada. Canadian securities commissions have pioneered mining and oil and gas regulations with new disclosure requirements, such as the requirement for an issuer to file a 43-101 mining report or a 51–101 oil and gas report, as discussed from page 15 above.

Should the regulation of Ontario venture issuers be more principles-based or rules-based?

Workman said that principles are needed in that they provide general guidelines for individuals and companies to understand the rules. Often, professionals will read the rules and are left wondering what they mean. Rules can be abstract. Principles should be used as a preamble to establish the context that surrounds a rule. Principles on their own, however, are often soft and fuzzy said Workman, and regulators can change them without the need for a legislative process and debate. So, principles help to interpret, but industry needs hard and fast rules. Otherwise, the law is defined by decisions through litigation. Industry needs both principles and rules, written in plain language, said Workman.

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Workman's observation that principles should be used as a preamble is similar to Braithwaite's argument—that binding principles should be published, followed by detailed rules to illustrate how those principles should be applied to perhaps a dozen common situations (page 92 above). Similarly, Wood suggests (at page 73 above) that adding an implementation guideline that sequences the decisions necessary to implement a standard, or adding an index that better relates existing rules and precedents, can lower total task complexity by reducing coordinative complexity to more than offset any increase in component and dynamic complexity. The OSC rules most frequently referenced by venture issuers (as I suggest from page 13 above) are: 45-106 (exemptions from the prospectus requirement, of 140 pages), 31-103 (Exempt Market Dealer, of 151 pages), 51-102 (ongoing disclosure requirements, of 239 pages) and 61-101 (insider bids, issuer bids, business combinations and relate party transactions, of 44 pages). Each of these rules is detailed. They each begin with a table of contents, definitions, rules organized by topic, and then a Companion Policy statement and forms. Because they are so long and detailed, and because they are posted on the OSC website along with all of their frequent amendments and proposals (see, for example, Table 2 at page 74), I would agree with Workman that the regulations could be simplified by using guidelines to understand the rules and with Braithwaite that the document should apply the principles to perhaps a dozen common situations.

Workman illustrated his concerns with industry regulation by describing his participation in a round table last April 2013 regarding the new Ontario Mining Act, which he says has become an unreadable assemblage of old articles and paragraphs, modified where needed by new articles and paragraphs, the entirety of which is heavily cross-referenced to other documents and

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appendices. The regulations appear in multiple documents and many of the guiding principles are set forth in policy documents which can be changed without sufficient public comment, said Workman. A professional in the mineral industry may be in breach of the policy without even knowing it. That leaves the company at the mercy of the courts to decide their particular case, said Workman. Also, the mining regulations go into new territory regarding aboriginal issues that has so many qualifications. It should have been an entirely new document. We need a framework that encourages investment, but the law has become unreadable. The mining industry's leading advocate, the PDAC, was simply ignored when the mining code was finalized, said Workman.

Workman's and the PDAC's concerns with the Ontario Mining Act are partly as a result of the amendments made in 2009, which require that companies consult with Aboriginal communities before an exploration permit is granted by the Ministry. Section 2 of the 2009 Act states that its purpose is to encourage prospecting, staking and exploration for the development of mineral resources, in a manner consistent with the recognition and affirmation of existing Aboriginal and treaty rights in section 35 of the Constitution Act, 1982, including the duty to consult, and to minimize the impact of these activities on public health and safety and the environment. The company must file an exploration plan with the Director of Exploration, who shall, before issuing a permit, consider a number of matters, including whether suitable arrangements have been made with the Aboriginal communities which may be affected.[444] Aboriginal communities

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[444] See Ontario Regulation 308/12

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are given an opportunity to dispute the exploration plan under section 170.1 of the Act. The Ministry policy[445] states that the exploration company should consider ways to avoid, eliminate or minimize potential impacts through, for example, geographic or timing adjustments to a project. The problem, according to the PDAC,[446] is that the duty to consult with Aboriginal communities should be the obligation of the Crown, rather than the junior venture which is raising funds for an exploration program.[447] If the Crown and the Aboriginal community agree about what kind of exploration is appropriate, those agreements could then become regulation, so that the venture issuer has clarity before raising funds for exploration.

In my view, the PDAC's position is unrealistic, in that it demands legal certainty in situations where rights may still be undetermined. In *Haida Nation*[448], the Supreme Court of Canada held that the Crown must act honourably, and consult and accommodate Aboriginal claims, as part of a process of fair dealing and reconciliation that continues beyond formal claims resolution. The purpose of requiring a company to disclose to the Aboriginal community a detailed exploration

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[445] See: < http://www.mndm.gov.on.ca/sites/default/files/aboriginal_exploration_ consultation_policy.pdf>

[446] See: <http://www.pdac.ca/public-affairs/lands-regulations/public-affairs/2002/01/06/ontario-government-s-review-of-the-mining-act>

[447] In *Haida Nation v. British Columbia (Minister of Forests)*, 2004 SCC 73, [2004] 3 SCR 511, the Supreme Court of Canada held that third parties cannot be held liable for failing to discharge the Crown's duty to consult and accommodate. The honour of the Crown cannot be delegated, and the legal responsibility for consultation and accommodation rests with the Crown. This does not mean, however, that third parties can never be liable to Aboriginal peoples.

[448] Supra, note 447

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plan is so that an informed discussion can begin before exploration starts. As discussed above under the topic ***Rules and Risk***, from page 83, precise rules may appear predictable, but they can obscure risk. The risk, for a junior mining venture exploring its claims in an area where an Aboriginal community may later assert treaty or property interests, is that the issues may not be certain and rules can lead to a false sense of security. In my view, the new Mining Act, and its regulations and policy, is a principles-based approach to improving dialogue among mining ventures and the Aboriginal communities affected. Although Workman may be correct that the mining regulations should have been an entirely new document, or better organized, the law is not unreadable but deliberately high-level so that specific consultations and negotiations can be fostered early in resource development.

Prill said that the problem with principles on their own is that the regulator may have in mind what they should mean, but the business community may operate on a different understanding for years. Honest business people can believe that they are in compliance with the principles, and then face major adjustments and possibly enforcement proceedings after-the-fact. This echoes the discussion of "interpretive communities" by Stanley Fish from page 165 above—that text has no meaning outside of the cultural assumptions, or "interpretive templates", which give meaning to words.

For example, Prill was providing the initial comment letters on Instrument 31-103 regarding Exempt Market Dealers. The conflict of interest disclosure required for an underwriter in 33-105 is quite clear and rules based—there is a 10% test for related issuer disclosure. But similar requirements for a "connected issuer" in 31-103 are principles-based and hard to assess, said

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Prill. If the connection is less than 2% of the outstanding securities, is it *de minimus*? The principles do not give guidance, said Prill. By comparison, audit committee rules do have a *de minimus* test of 5%. As a solicitor, there is a tendency to be very conservative so that your client isn't the poster child for a 20:20 OSC interpretation, said Prill. Another example referred to by Prill is referral arrangements. Rule 31-103 requires disclosure, but it is unclear whether or not a trailer fee would be allowed among EMDs—it is permitted in the mutual fund industry. Prill has called staff of the OSC for guidance and was told: "We think that all the guidance is out there, and if you need more guidance, contact a solicitor. Well, I am a solicitor and some things need more guidance."

Prill's view that solicitors will be very conservative, so that their client won't become a poster child for a 20:20 OSC interpretation, echoes Gill's comment that if you tell people there is an invisible line somewhere in the middle of the room and if they cross it something bad will happen to them, people will tend to stand back from the middle of the room for fear of stepping on a line they don't see. See above, page 98.

Ellingham said that, when dealing with the smaller issuers on the TSX-Venture exchange, where the management teams are often not as sophisticated as those listed on the TSX, rules may be preferable. Of their 1800 listed TSX-V companies, Ellingham described how many are quite strange. The rules can help control them and avoid reputational risk to the TSX-V and TSX. This is why there are two tiers on the TSX-V, so issuers can graduate and move to the more principles-based TSX, said Ellingham. However, it may not be that junior issuers lack business sophistication generally, but just inexperience with securities rules—a third of respondents to the

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survey failed to recognize the insider trading example. See above page 229. The solution, as will be argued later, is better education rather than more rules.

What is the effect of using principles or rules when regulating venture issuers?

Ellingham described how, prior to demutualization in 2002, the TSX accepted listings in a discretionary, principles-based manner. For example, the foreign company listing policy used to be unwritten, so the TSX imposed requirements without any specific rules—eg. at least two Canadian directors, broker sponsorship, a sufficient distribution of shareholders in Canada, or an office or an investment relations person located in Canada. A larger issuer with noteworthy management, with more ties in Canada, could be listed more easily. If some of the managers had been involved in companies that had imploded, an independent director would be required. Similarly, when the technology boom happened in the late 1990s, technology companies that didn't have any revenues were listed, on an exceptional basis, by the application of underlying principles. It was in some ways an old boys' network, according to Ellingham—a lot depended on reputation and who you knew, but underlying this was a principles-based application of precedent—if we granted an exemption for this one, we should do it for that one, depending on the underlying principle of investor protection. 50% of TSX management were lawyers who understood this precedent-based application of principles.

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When the TSX was demutualized in 2002 and became a for-profit business, there was a major paradigm change, said Ellingham. The TSX looked at where its revenues were coming from and no longer saw itself as a regulator, but as a business. TSX clients were the listed issuers, who paid our fees, and the more listings that the TSX could acquire and the greater their growth, the more profits there would be. The TSX had targets on the number of new listings, and so the focus changed from protecting investors to growing the TSX business.

The OSC had to decide how it was going to audit us, since the TSX was no longer seen as a partner protecting investors, said Ellingham. To meet this concern, the TSX adopted rules and standards, which could more easily be verified on audit, rather than to allow discretion. Though the TSX corporate manuals may not have changed much, the application of those standards changed profoundly, said Ellingham. The TSX also cut costs by hiring people with business, marketing and relationship management experience—MBA graduates who could apply standards to be verified on audit, rather than (more expensive) lawyers who could apply legal precedent.

The effect of moving to standards rather than discretion is that you don't always get a sense of what the company is trying to do, said Ellingham. For example, Ellingham was involved in the listing of Amica retirement homes, which started with the name Ishtar. The prospectus was very confusing: retirement homes, with gourmet food, etc. "It was, as it turned out, middle-eastern people who were immigrating and bringing their parents, and they saw that there were no high-end retirement homes, so they thought it would be a good business. It did become a good

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business and meeting the people and getting outside the strict application of rules was important."[449]

Ellingham's example illustrates the advantage of principles, when assessing applications—it allows for greater flexibility and deeper assessments of merit. Later, I argue that licensing market participants, such as brokers and public accountants, and listing companies on an exchange such as the TSX-V or the CSNQ, should be principles-based, with discretion so that the regulator can consider many factors before deciding to approve an applicant. Ellingham's example also illustrates why principles-based regulation requires regulatory collaboration, as discussed from page 186 above. In order to fully assess an applicant, the regulator needs to collaborate and communicate directly with the applicant.

Is there a shared understanding of regulatory principles in the industry?

I asked White if he thought there was a shared understanding of regulatory principles among the brokers and issuers in the venture issuer community. White has been in the business since 1992 and his father and partner has been in the business for 45 years. White believes that when his

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[449] Amica Mature Lifestyles Inc. is now a leader in the management, marketing, design, development and ownership of luxury seniors residences. There are 23 Amica Wellness & Vitality™ Residences in operation in Ontario and British Columbia, Canada, with a market capitalization of about $260 million as of July 2013.

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father was younger and the street was smaller, principles worked well since everyone knew and trusted each other and reputation was everything. You couldn't become an investment banker unless you had been in the industry for at least 15 years, he said. You had to become part of the club, get to know everyone and build trust, and then you could move up in the business. Now people move around more, said White. If you don't know someone, it's difficult to trust them. I can see why rules are more required now, he said.

Similarly, Workman has been in the resource industry for almost 40 years, in Yemen for four years, Indonesia for two years, and his firm has worked in over 140 countries, and so he draws from a broad range of experience. I asked him whether or not there is a community of shared values in the junior resource industry. He said there are a lot of players, and some come and go. Twenty or thirty years ago, the business was dominated by well-established Canadian, U.S. and European companies with a similar business culture. In the last few decades, the industry has become more cosmopolitan and culturally diverse because foreign companies are accessing Canadian markets. Canadian exchanges are the largest in the world for funding mineral projects—more than half of the money raised globally goes through the Canadian markets. He said: "There is a wide variety of business ethics on this planet, and there are some groups of individuals whom we have never had a good experience with, and there are some individuals out there, some cultures, that are always trying to deceive you and get a one-up on you. These companies or individuals have no scruples when it comes to circumventing rules or principles, including any sense of fair dealing." Workman said that when his firm does a 43-101 mining report, it requires complete disclosure and it is often the most expensive part of the project for a

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client. But, said Workman, for some companies and individuals, it's just not part of their culture to provide full disclosure.

White's and Workman's observations about how industry is changing are, quite frankly, something that I hadn't fully considered when reviewing the literature and conducting the survey. The first factor "is there a shared understanding of regulatory principles" and the second factor "are the regulated committed to the public interest" are not static social relationships that can be measured in a single survey, but evolving conversations between regulators and regulated. The proper balance of rules and principles should address the long term development of the industry. A shared understanding of regulatory principles may be less likely as Ontario's junior resource market becomes more international.

Are the regulated committed to the public interest?

Thompson said that: "I have dealt with people in the industry for 50+ years, most are involved for the long-term, and I usually assume that they are upright and will do a fair deal. Yes, a lot of promoters are opportunists who look for the short term, promoting mining when mining is hot and high-tech when high-tech is hot. In the last upturn, just about anybody could raise money, and so it attracted the fringe players. Canada has become the global place to finance resource exploration, and people from different cultures can think differently about business ethics."

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Thompson reiterates that, although the industry is becoming international, most players are involved for the long term. This is reflected in the survey—most respondents are involved for the long term (Table 8, Table 9, Table 10, Table 11). As one respondent said (Table 27, page 303, line 41), "principles-based regulations gives the fair mindedness that most all issuers have good ethics and morals and that they will do their best for shareholders given limited resources. I believe this is the case and most people in junior mining are trying their best and have good ethics…Education of Boards and their duties and responsibilities is a better means to better disclosure and transparency. Education is the means to get directors to make better decisions in a principles-based reporting system."

Are the regulated able to find analogous solutions?

I asked Workman if greater diversity on the boards of junior companies would allow them to better apply principles, and he said that most companies do try to get a board with a diverse background. A few companies, he said, have got into trouble because they didn't have the specific technical ability for their project. Issues of aboriginal rights, corporate social responsibility and environmental issues are becoming more important, said Workman. Twenty years ago, companies had open access under the mining law, as an essential right on Crown land and on private land subject to dealing with the (surface rights) land-owner. Sometimes, the negotiations relating to access would test the relationship, but the law was always on the

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company's side. Now, much more is required. A company's board should be much broader in terms of its abilities, since local communities can be very demanding and difficult to deal with.

This relates to Workman's earlier comment that the Mining Act has become too complex, and my suggestion that the complexity may partly be because the extent of Aboriginal treaty and property rights in many cases is still uncertain. The solution is not necessarily more rules but greater sensitivity by management. Negotiations with First Nations are a frequent challenge for mining ventures, and so, as Workman said, the board should have the capacity to appreciate these issues. Greater diversity across political and environmental skills can provide better management and better disclosure to investors as to the benefits and risks of investment.

Are there institutions which promote regulatory collaboration?

As to collaboration with the regulator, Thompson said that when he was running companies in the 1970s, he would often meet with OSC staff and discuss what was acceptable without involving lawyers. "You would explain what you were doing and if they had a problem, they would ask you. Now, the OSC doesn't want to talk with the CEO, just the lawyers. This drags the review on for months and months." It seems, according to Thompson, that the OSC staff has a lot of turnover, with employees who work there for just a few years, with a CYA attitude, and they want hard and fast rules so they don't have to exercise judgment. The industry needs experienced staff who we can work with.

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I asked White about collaboration with the regulator, and he said that there used to be more trust with the OSC when members of staff were in positions for a long time and people got to know each other. It used to be that an investment banker would work through a prospectus with a point man at the OSC and one could talk through situations directly, said White. Now, it is rare to have a working relationship with OSC staff and most dealings are conducted through lawyers. There is still, however, direct contact with the exchanges.

I asked Workman if he thinks there is cooperation and collaboration with regulators, and he said there is, if you have a specific question. The regulators in Toronto and Vancouver have been quite responsive, according to Workman, and have been able to clarify what was required in a 43-101 report. But, in some instances, the feedback has often been very myopic, said Workman, in part because the reviewer for the regulator was not truly qualified in the subject matter. We have had to insert qualifying statements to the extreme, and in some cases the redundancy verges on overwhelming, leaving important non-technical aspects overlooked, such as how market forces may affect the viability of a project.

The problem, if indeed the OSC is becoming less cooperative with junior issuers, is that the kinds of opportunities that Ellingham describes under the topic "What is the effect of using principles or rules when regulating venture issuers?", from page 252 above, may be missed. As Ellingham said, the effect of moving to standards rather than discretion is that you don't always get a sense of what the company is trying to do.

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Bandeen said that, yes, the OSC is accessible and there is dialogue and collaboration, but what is missed is that it is disproportionately the larger participants and their agents who are privy to these dialogues. The banks have had a disproportionate effect on the markets in Ontario, according to Bandeen. They will be at the table, 85-90% of the time. Bandeen said that he has seen instances where OSC staff say that they've received 28 comments that said one thing and 2 comments that said the other, so they've assumed the majority of comments reflect the industry; but often, it's just because smaller issuers don't have the resources to follow the regulations and make comments.

It is of course important for the regulator to dialogue with junior issuers as well as financial institutions. As discussed under the topic "Industry concentration of Canadian venture issuers", from page 38 above, Ontario is heavily concentrated in the financial services sector, with large institutions inter–listed in the United States. As reflected in many of the comments in the survey, in Table 26, many junior issuers do not have the financial resources to participate in public forums. Thus, it is important for the OSC to cooperate with junior resource trade associations, such as the PDAC.

Do the regulated see enforcement as "fair" and "effective"?

Whether you have principles or rules, those setting out to misinform investors will find a way, said Workman. Fairness opinions and valuations are an example, he said. The Ontario Business

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Corporations Act only mentions valuation once, in the context of transactions between corporations, where a company is going private, and a valuation is required. When talking of mergers and takeovers, the law is moot on valuations, so companies trot out fairness opinions, disclosing that they are not valuations in footnotes, but the public treats them as though they were valuations. In many cases, the company giving the fairness opinion is in a conflict of interest because the financial institution will receive a success fee if the transaction goes through. This is a problem, said Workman.

Ontario takes a very paternalistic view of securities regulation, according to Prill. The BC securities commission mission statement is "[t]o protect and promote the public interest by (i) fostering a securities market that is fair and warrants public confidence and (ii) a dynamic and competitive securities industry that provides investment opportunities and access to capital."[450] The OSC statutory mandate is "[t]o provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets."[451] The key difference, according to Prill, is that the BC mission expressly includes investment opportunities and access to capital. The OSC seems to focus more on investor protection, according to Prill. BC offers an olive branch to get you to comply. Ontario sees any non-compliance as a problem with integrity. We need to help those who are honestly trying to learn, and we should encourage education, said Prill.

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[450] See: <http://www.bcsc.bc.ca/about.asp> accessed October 2013.

[451] Section 1.1 of the Ontario *Securities Act*

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Thompson noted that the Vancouver Stock Exchange started with guidelines and they were successful in raising money, but there were a few bad examples. Today, the regulators try for perfection and make 98% suffer to regulate the 2% who are bandits, said Thompson. If someone wants to commit fraud, they will do so no matter what your rules or regulations say. The regulators should be prepared for the odd bad case, said Thompson.

These opinions mirror what many of the respondents said in the survey, in Table 26, Table 27, Table 29. However, the notion that the OSC is strict should be contrasted with Bhattacharya's report (above, page 193), that the number of U.S. Securities and Exchange Commission enforcement actions, after scaling for the number of issuers listed on US and Canadian exchanges, are about ten times greater than OSC enforcement and the number of SEC insider trading enforcement cases is about 20 times greater than OSC enforcement. As the Wise Persons' Committee observed that "[t]here is a widely held view that enforcement in Canada is lax in comparison with the United States and other countries."[452]

What mandatory paper disclosure should an investor receive?

I asked Thompson what disclosure documents should be drafted for private placements introduced through a broker, and he said that he subscribes to a number of private placements

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[452]Supra, note 388

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each year, with virtually no paper disclosure, but based on the people involved: "Sometimes, they'll have some documents or a file and I will look at what exploration project they have." Thompson said that many of the juniors have insufficient finances and should consolidate, but the cost to generate the disclosure documents is about $300,000 and that is far too much. It should just be financial statements and the directors' recommendation—future projections, for example, are a waste of time and effort.

I asked White what prospectus exemptions should be available for juniors to raise funds and what disclosure documents should be required. He said that the current private placements exemptions work well and that most of his investor clients look at the people involved, who are running the company, and chat about the opportunities. The people involved in the company are 90% of the decision making process and detailed disclosure documents are not worth the cost, said White. The investor needs to know that, with this type of high risk, management has the ability to make a return of such-and-such a magnitude but the investment could go to zero.

The opinions of Thompson and White reflect the results of the survey. As noted above, according to respondents, close friends and family rely more on management's reputation for honesty and past business success (70% said this was of first importance) than they do on evidence about the issuer's assets and prospects (only 8% said this was of first importance).[453] Similarly, existing business contacts rely on management's reputation for honesty (44% said this

[453] Table 17, p.296

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was of first importance) and on management's past success in business (43% said this was of first importance).[454]

The regulators have said in public that they wish to re-visit the whole subject of disclosure, said Bandeen. There is a school of thought that the prospectus model is broken and that the disclosure process has become lawyered up with reams of unread material. We have to modernize the rules to reflect how the world works, which is a wired, connected, global place, said Bandeen. People have access to a large amount of information. Hardly anyone reads the disclosure documents. Most people who want to learn will Google the business, read about management, and search with a few provocative words to check out the negatives. What they really want is timely financials, material risks, a summary of the product, and a summary of the managers and principals involved. It should be in an accessible language. CSNX is a model with meaningful transparency. We did away with the hundreds of pages of often conflicting prescribed rules such as you would see with the TSXV and went instead for simple to read forms and rules.

The accredited investor concept is outdated and very elitist and paternalistic, according to Bandeen. Just because someone has money, doesn't mean they are sophisticated. Bandeen would rather focus on meaningful disclosure and transparency, and have qualified advisors review for suitability. Younger kids, of 20s and 30s, are more sophisticated about technology businesses. If they want to invest $5,000 in a company that they think will catch on, why do we

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[454] Table 18, p.296

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think that the regulator knows better? At the end of the day, who are you protecting? People should understand that it is a risky venture and that they could lose all their money. The advisor should sign off that the client understands. Suitability rules should be principles-based.

The question of who is sophisticated enough to invest in a public company without a prospectus, especially a junior venture company, is a difficult subject. On the one hand, the OSC's statutory mandate is to protect investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets. The Ontario Securities Act contemplates that most financings should be done by prospectus, with full disclosure and OSC review, to protect the public. The description of junior mining risks from page 43 above illustrates the kinds of risks that junior resource investors face. On the other hand, junior companies usually do not have the funds to file a prospectus, as described above under the topic "The Cost of Securities Regulation" page 50. Many of the respondents to the survey said that access to the exempt market should not be constrained. It is a difficult balance and the OSC is certainly not ignoring the issue. On December 14, 2012 the OSC published a consultation paper which describes four concept ideas for possible new prospectus exemptions in Ontario.[455]

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[455] OSC Staff Notice 45-711.<http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20130124_45-711_extend-comment-45-710.htm>

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Exempt Market Dealers ("EMDs") and investment banks

Bandeen worked at McLeod Young Weir and Burns Fry before they were absorbed by the banks in the late 1980s and early 1990s, and he described the cultural shifts that happened. I-banks were very independent, said Bandeen. "It was your own capital; decisions were made swiftly on the right basis, with the level of risk management that a prudent owner of capital would employ. The IDA was your own club, and the presidents of various investment clubs were rotating chairs, so it was a different world, more clubby, but also perhaps more conscious of the real risks involved in the business." In contrast, the banks are very bureaucratic, with a mandarin level that acts as a buffer between lines of production and decisions, said Bandeen. The banks are supposed to be well regulated deposit institutions, and so they have shut the junior issuers out of their retail systems to avoid reputational risk. As a result, Bandeen said he was beginning to think that it might have been a fundamental regulatory error to allow the takeover of these I-banks.

The banks are used to oversight from OFSI, and so they have the resources and experience to handle the increasing levels of regulation, said Bandeen. For the little company, compliance is much more onerous. Bandeen said that he has been in heated arguments with those, usually now part of the big banks, who say that juniors are currently in a cyclical down market, that the weak will be weeded out, and that new stars will emerge when markets recover. Bandeen thinks this might not be true. The increased regulatory compliance is material. I hear of people spending 30% of their operating expenses on compliance, often resulting in little or no profits, said

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Bandeen. This does not bode well for the junior or early stage companies, he said. White said he doesn't believe that the current financing downtrend is because there are not enough accredited investors; rather, it's because fewer want to invest at this time because the junior resource market is cyclical. The offering memorandum exemption should be looked at, but White doesn't think it will suddenly open the gates for more investment.

There are new OSC capital and reporting requirements which many EMDs find unnecessary, said Prill. For example, often the investors are introduced to the EMD by the issuer in order to close a specific private placement. The EMD may have no previous contact with the investors and, once the transaction is closed, no continuing relationship. However, the EMD is required to maintain an ongoing reporting relationship with each investor. There is a sense that the OSC is imposing the attributes of a retail broker (who has a continuing relationship with the investor) on an EMD (who, in many cases, does not). If the OSC wishes to change this fundamental business relationship, then yes, Prill says we need better education. But the education should be more in the nature of a dialogue, where both regulator and regulated listen to each other.

I asked White to comment on the regulatory changes imposed on EMDs, and he described how his firm IBK Capital has been conducting business along these lines for many years, such as a healthy buffer of capital, insurance, and self-imposed proficiency requirements. The real change for the industry, according to White, is that the OSC now requires each EMD to emphasize its duty to protect the investor rather than to raise funds for the issuer, even though the investor does not pay the EMD for these services nor does the EMD usually hold any securities for the

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investor. According to an OSC survey[456], many EMDs do not protect investors and focus only on closing the trade to get their commission, said White. In IBK's case, it is ultimately the client who decides whether or not to invest but IBK must decide if the trade is suitable. Sometimes, we go back to the investor and say that the investment is not suitable based on our knowledge of the investor, the investment size and the risks of the investment, said White. We have to keep detailed logs, to be able to prove to the OSC that we know the investor and that the product and the trade are suitable.

But, said White, there is a mood among certain advocacy groups that investors are not being protected enough. If the focus were only to protect investors, then the best practice would be to avoid any high-risk stock. The big banks and large brokerage houses won't sell their retail clients anything other than blue chips, said White. Many people think that bigger companies are less risky, but that's not necessarily true—many large companies have imploded, and the potential for fraud exists in all quarters. For many investors, a well-rounded portfolio can include a mix of junior issuers. The greatest potential for growth is in the junior market. To name a few successes: Goldcorp, Barrick, First Quantum, Wheaton River, New Gold, Detour and Osisko were all once high-risk penny stocks that depended on the junior markets to execute their business plans, and are now some of the most profitable mining companies in Canada. There will be successes and failures in the junior market and investors need to know they can lose their entire investment. So, it is good policy to require EMDs to know their investors and the

[456] See footnote 457.

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suitability of the investment and IBK Capital has done this for years. But ultimately, the investor has to be responsible for deciding what level of risk to assume and the EMD can only advise. If the regulators expect more than this from EMDs, they will leave the private placement junior market, which could make it very difficult to raise funds for emerging industries. The OSC should understand this.

The OSC is again in a difficult position, being statutorily mandated to protect investors, but also being asked by many in the industry to loosen the rules to allow for easier financings. Section 13.3(2) of OSC Rule 31-103 does allow, as noted by White, that ultimately the investor is responsible for deciding the level of risk. The rule states that: "If a client instructs a registrant to buy, sell or hold a security and in the registrant's reasonable opinion following the instruction would not be suitable for the client, the registrant must inform the client of the registrant's opinion and must not buy or sell the security *unless the client instructs the registrant to proceed nonetheless."*[emphasis added]. In a recent "compliance sweep" of over 85 Ontario EMDs, the OSC found that in 22% of cases, EMDs had poor documentation practices to demonstrate the suitability advice given and 15% sold unsuitable investments to some clients. Furthermore, 18% improperly relied on the accredited investor exemption when distributing prospectus-exempt securities to investors.[457]

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[457] OSC Staff Notice 33-740, May 30, 2013 <http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20130531_33-740_rpt-results-kyc-kyp.htm>

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Should there be mandatory continuing education?

I asked Workman whether or not mandatory continuing education for the managers of venture issuers would be a good idea, and he said that managers ought to be continuing their education for their own self-interest. However, there will always be those who flout the regulations, so enforcement is important. Some have had the attitude that "I'll do it my way and I'll pay the fine if I get caught", said Workman.

I asked Bandeen about a CPD education requirement for directors of venture issuers, and he said that one kind of education would be to beef up enforcement so that people clearly understand what is considered bad behaviour and that there are tangible, significant, costs to conduct one's business inappropriately. One problem with CPD, he said, is that it would just feed the business schools, which are very expensive. But maybe it's not a bad idea, he said, as long as it doesn't become perfunctory. For example, most people wrongly think that that their only obligation is to the shareholders, rather than the broader stakeholder groups, said Bandeen.

I asked Prill whether or not a continuing education requirement would help the industry, and Prill said that he didn't think it would make much difference for the managers of venture issuers, but it could help EMD firms which are the gatekeepers. Traditionally, EMDs (formerly "broker dealers") saw their client only as the issuer, since the issuer pays their commission. They would sell the security, describing its prospects in the best light, subject to all disclosure rules, and leave it to the investor to assess its suitability for their own financial plan. It is comparable to

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how one would expect a real estate agent for the vendor of a house to act—disclose what is required by law, but emphasize all of the positive aspects of the house, leaving it to the purchaser or the purchaser's agent to decide what is suitable. Canadian regulators have imposed a primary fiduciary obligation to the investor, even though EMDs continue to collect their fees from the issuer.

I asked Thompson if there should there be a CPD requirement for the directors and managers of venture issuers, and he said that it might help for some of the new areas, such as corporate responsibility. He noted that governments and regulators have placed more social responsibility obligations on companies than they used to. One of the problems with imposing education, said Thompson, is that the directors of junior companies usually don't get paid, and they will want to be paid if they have to pursue further education. Any requirement will add to the issuer's cost and reduce the amount of money spent on exploration.

In the following chapter, I argue that a continuing education requirement should be imposed.

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Chapter 7: Summary, Recommendations and Areas for Further Inquiry

Summary

This paper addresses whether or not the securities regulation of Ontario venture issuers should be based primarily on rules or principles. Those who advocate rules-based regulation argue that it makes law predictable, less discretionary, and easier to enforce. Principles–based regulation is grounded on the philosophy that when an activity is complex, such as securities regulation, detailed rules can evolve into a confusing web, obscuring core values and discouraging creative solutions. As described in chapter one, the OSC shifted towards rules in 1995 in response to the Ainsley case, and again in 2004 in response to US Sarbanes Oxley regulations. The BC Commission proposed a principles–based *Securities Act* in 2004, with a simplified, plain language rulebook with an overarching "Code of Conduct" of twenty–eight general principles.

Chapter one reviewed the regulations affecting junior issuers, the cost of securities regulation and competition with foreign jurisdictions for listing issuers. Reference was made to the restrictions introduced on junior mining financings in Ontario in the 1970s and how many juniors left the Toronto exchange to list on the Vancouver stock exchange. A number of securities law reports were reviewed in chapter one. The 2006 Crawford Panel recommended principles-based regulation with plain language, and the 2009 Expert Panel argued that principles–based regulation would better achieve regulatory outcomes since it would give businesses greater flexibility to adapt compliance practices to the latest innovations in the capital markets. However, any shift to principles-based regulation must be balanced against the regulatory risks

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of the Ontario venture market. Chapter one discussed these risks, including industry concentration, controlling shareholders, and how junior mining ventures are susceptible to market manipulation in three ways: (i) spreading false information in an offering document, circular or news release; (ii) withholding material information from investors, and (iii) creating a false impression of the value of a security by spreading false rumours and manipulating the market.

Chapter two reviewed the rules approach and the principles approach, and discussed regulatory compliance theories—why do people comply with the law? Is it because they are self–interested and will comply if the amount and probability of the penalty is greater than the illegal gain (deterrence theory)? Are other motives in play? Many of the respondents to the survey said that venture issuer managers are usually honest and will comply with the principles if given the opportunity, as did the expert Thompson, who said that most are involved for the long-term and he usually assumes that they are upright and will do a fair deal. This corresponds with the reason-drive motive, the social identity motive, the justice motive and the citizenship motive. However, 73% of respondents said that the most important motive of promoters is share price over the next 12 months, rather than the long term value of the business or a reputation for ethical business practice (Table 20). Thompson agreed that a lot of promoters are opportunists who look for the short term, promoting mining when mining is hot and high-tech when high-tech is hot. It would seem, therefore, that promoters need to be regulated by the incentive motive, including specific and general deterrence. Deterrence is best enforced by rules-based regulations since infractions and punishments are clearly prescribed *ex ante* to deter future behaviour.

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New governance theory was discussed in chapter two. It is a more collaborative relationship between regulator and regulated. It gives the regulated greater autonomy to design processes to meet principled objectives, with mechanisms for transparency and accountability. It emphasizes problem solving and experimentation in the design of regulatory strategies. Also discussed in chapter two were comparisons with other regulated activities, including income tax compliance, accounting standards, and the Australian Competition and Consumer Act. The purpose of these comparisons was to glean factors to assess whether rules-based or principles-based regulation would be more effective for a particular field of regulation.

Chapter three described eight factors to assess whether rules or principles would be more effective, chapters four and five applied these factors to venture issuers with a survey, and chapter six discussed these factors with open-ended consultations with six experts in the industry. The answer to the research question is not a simple choice of all principles or all rules.

Analysis

(a) Where on the rules/principles continuum do Ontario securities regulations currently lie?

Table 1 compares Ontario securities regulations with other regulations, including US Sarbanes Oxley. Although the Ontario Securities Act is of average complexity, the rules of the OSC have a large number of words per sentence, exceeding that of Sarbanes Oxley and approaching the complexity of the notoriously complex *Income Tax Act*. The Ontario Securities Act, and the Rules and Policies of the OSC, comprise a book of over 3,000 pages of small print, of which 156

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pages are for the Securities Act passed by the legislature and 25 pages are for the General Regulation; thus, there are over 2,500 pages of OSC rules in small print.[458] The Securities Act sets out its fundamental principles in section 2.1, with the primary means for achieving these purposes to include "requirements for timely, accurate and efficient disclosure of information, restrictions on fraudulent and unfair market practices and procedures, and requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants." These are high-level directives. Section 127 of the Securities Act gives the OSC power to make various orders if in its opinion it is the public interest to do so, and, as stated by the Supreme Court of Canada, in exercising its discretion, the OSC should consider the protection of investors and the efficiency of, and public confidence in, capital markets generally.[459] Again, these are high-level directives.

It would seem, therefore, that Ontario regulations are a combination of principles-based legislation and detailed OSC rules.

(b) Should OSC regulations be more principles-based?

The industry expert Workman said that principles are needed in that they provide general guidelines for individuals and companies to understand the rules, but they should be used as a

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[458] *Consolidated Ontario Securities Act, Regulations and Rules*. Paul Findlay, Carswell, 2013. Approximately 3,350 pages

[459] Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission) [2001] 2 S.C.R. 132

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preamble to establish the context that surrounds a rule, since principles on their own are often soft and fuzzy. The industry expert Prill agreed: the problem with principles on their own is that the regulator may have in mind what they should mean, but the business community may operate on a different understanding for years, and then face major adjustments and possibly enforcement proceedings after-the-fact. These comments are similar to those of David Brown, former Chair of the OSC, as quoted above (page 70): "To force investors to interpret a set of principles and to make a judgement as to whether their application by an issuer or registrant is adequate is neither efficient nor would it inspire confidence." Braithwaite also argues that vague principles are "a common affliction of regulatory standards, especially those that rely on such open–ended terms as 'in the public interest', 'feasible', or 'reasonable' (see above, page 70)

Some aspects of securities regulation should be principles-based and other aspects should be rules-based. Applying Diver's analysis to securities regulation (above, page 78), licensing market participants, such as brokers and public accountants, should be principles-based, with discretion to consider the many factors comprising "good character" before granting a licence. Similarly, the expert Ellingham noted that when the TSX used principles to determine which companies could be listed on the exchange, it was more able to adapt to foreign listings, technology listings and unusual listings such as Amica Homes (see page 252). Enforcement regulations, however, should be rules–based, precise and transparent, to enhance predictability, says Divers. This is echoed by the expert Prill, who said that precision is essential, since no solicitor wants their client to be a poster child for a 20:20 OSC interpretation. Without clear

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rules, market participants may become too cautious and experimentation and diversity may be overly constrained.

(c) Better organization of principles and rules in OSC regulations

As Braithwaite said, laws can be written by setting down binding principles, with detailed rules to illustrate how the principles should be applied to perhaps a dozen common concrete commercial arrangements (above, page 92). As Wood notes, rules may increase or decrease task complexity, depending on the circumstances, but an implementation guideline that sequences the decisions necessary to implement a standard, or adding an index that better relates existing rules and precedents, can lower complexity (above, page 73).

The Law Society of Upper Canada regulates 40,000 lawyers in Ontario.[460] It would seem that the training, fiduciary obligations (including holding trust funds for clients), mortgage transactions, client confidentiality issues, and conflicts of interests that lawyers face are as complex as they are for market intermediaries regulated by the OSC. Many of the securities disclosure documents for issuers are drafted by lawyers, who face the risk of a negligence claim

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[460] 41,022 as of May 6, 2010 with 21,107 in private practice; 11,843 otherwise employed (education, government, etc.); 8,072 not employed in Ontario (retired, outside of Ontario, etc.) In addition, the Law Society regulates 2,892 paralegals. See: <http://www.lsuc.on.ca/faq.aspx?id=1275#q1266>

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if their due diligence fails to disclose a material fact. According to Table 1, the bylaws of the Law Society (or at least bylaws 1 to 3) and the Rules of Professional Conduct have fewer words per sentence than OSC Rules. The Rules of Professional Conduct are written in the style advocated by Braithwaite—binding principles are set out, with explanatory plain language comments describing how they should be applied in typical situations. With comments, they are a total of 95 pages (136 pages, including Bibliography, Table of Concordance and Index). The bylaws of the Law Society, which regulate all other matters dealing with Ontario lawyers, including practice management, and the election of benchers, are a total of 321 pages of rather large print. This is considerably less text than the regulations in the securities industry.

(d) Better education to promote principles

One of the factors in assessing rules or principles is—is there a shared understanding of regulatory principles? The survey suggests a misunderstanding among many respondents of the purposes of securities regulation, though further review of the explanations given shows that some recognized which principles applied but disagreed about their application to the facts.

The experts Thompson, Workman and White all noted that the junior resource industry in Ontario has evolved in the past thirty years from a location for financing exploration among North Americans and West Europeans to the pre-eminent location to raise funds for mineral exploration around the world. Funds are raised in Canadian markets, and in the TSX and TSX-V

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in particular, from investors from many different cultures, for projects in many different locations, including Central America, South America, Africa, the Middle East, etc. The more culturally diverse market players become, the less we can assume that there is a shared understanding of business ethics and regulatory principles. As discussed above under the topic Rules or Principles—Comparison with other Regulated Activities, from page 146, different cultures may have different notions of fair play in business and regulation, so the evolving nature of the venture market must be considered.

Better education of the managers of venture issuers about securities principles may assist. For example, commencing January 1, 2011, lawyers and paralegals in Ontario must complete in each calendar year at least 12 hours of continuing professional development in eligible educational activities. No less than 3 of the 12 hours must be on topics related to professional responsibility, ethics and practice management ("professionalism"). The required 3 hours related to professionalism must be accredited by the Law Society.[461] Similarly, since January 1, 2004, the Chartered Accountants of Ontario requires that members in public accounting complete a minimum 20 hours per calendar year, with at least half this of verifiable learning, and a minimum 120 hours in each 3-year period.[462] Ontario professional engineers must maintain a rolling total of at least 240 continuing professional development hours for any continuous three year period. Members must have a minimum number of 5 hours in at least three of the six

[461] (Law Society of Upper Canada 2011)

[462] (Chartered Accountants of Ontario 2011)

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categories in any three-year period; professional practices, formal training, other educational activity, participation, presentations and contributions to knowledge.[463]

In contrast, the TSX-V and the Ontario Securities Commission have no continuing education requirements for directors of venture issuers. TSX-V Policy 3-1 section 5.10 states that "Management, Directors and Officers must have: (a) adequate experience and technical expertise relevant to the issuer's business and industry; and (b) adequate reporting issuer experience in Canada or a similar jurisdiction." These twin considerations are further itemized in sections 5.11 and 5.12 of Policy 3-1, but these are initial requirements in order to be approved by the TSX-V to become a director. The TMX Learning Academy (for both TSX Venture issuers and the more senior TSX issuers) is an educational platform that provides educational materials and tools for TSX-V issuers, and the TSX-V does host a number of workshops with helpful information on the various aspects of being a public company.[464] However, these are voluntary courses. Given that there appears to be a deep level misunderstanding of the principles of securities regulation among many respondents, and that, in many cases the directors and officers disagree about the application of disclosure principles to their particular facts, consideration should be given to a mandatory continuing education program. Courses could be offered by the TSX-V Learning Academy, universities, colleges, or private educational resources (including web-based seminars). Continuing education could enhance the reputation of Ontario venture issuers

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[463] (Professional Engineers and Geoscientists of BC 2011)

[464] (TSX Venture Exchange 2011)

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worldwide. Such requirements may discourage part-time or semi-retired directors from remaining in their position, many of whom have years of experience to contribute, and so, consideration should be given to grandfathering provisions. The experts Bandeen, Workman and Thompson were tentatively in favour of mandatory continuing education, subject to cost. However, the best approach may be a gradual introduction of education, with incentives rather than punishments, such as reduced regulatory fees for issuers which have managers who complete approved education programs.

(e) Enforcement strategies based on compliance motives

Some of the respondents to the survey argued that venture issuer managers are usually honest and will comply with regulatory principles if given the opportunity.[465] This was echoed by Thompson, who has been in the industry for 50+ years, and who finds that most people in the industry are in it for the long-term, upright and will do a fair deal. Some respondents said that principles are too vague and that managers will twist principles to suit their own purposes.[466] All of the experts including Thompson agreed that, no matter what regulations you may have, there will always be some who will mislead or commit fraud. Many respondents agreed that

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[465] Table 27 lines 26, 41 and 62; Table 40 line 40.

[466] Table 26 lines 22, 23; Table 40 lines 6, 47, 52

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enforcement was important to level the playing field and insure consistency.[467] As the expert Prill said, honest business people can believe that they are in compliance with the principles, and then face major adjustments and possibly enforcement proceedings after-the-fact.

Chapter two discussed various theories of why the regulated do (or do not) comply—(i) the "incentive" motive, i.e. the cost-benefit calculation of rewards and punishment; (ii) the "reason-driven" motive, where the regulated look to the law for convincing policy reasons for doing (or not doing) certain things; (iii) the need for "social identity" and to join the right community and to adopt its norms; (iv) the desire for justice and morality; and (v) the "citizenship-oriented" motive, i.e., those who choose to comply simply because it is the law.

Addressing the "reason motive" would seem to be an effective strategy for respondents. As Parker suggests, regulators must convince people that the law represents shared values. Regulators must avoid the "compliance trap"— i.e. where compliance becomes difficult to improve because the values underlying compliance are contested.[468] A significant number of respondents failed to apply the law against insider trading and a significant number failed to apply the law of fiduciary duty when receiving confidential information. The desire for justice and morality should be considered as motivating factors for respondents, however, since many gave detailed explanations for their answers, evidencing interest in the ethical correctness of their

[467] Table 26, lines 1, 2, 9; Table 29, lines 4, 5; Table 27 line 1, 24, 27; Table 40 lines 2, 3

[468] (C. Parker, The Compliance Trap - The Moral Message in Responsive Regulatory Enforcement 2006) at 34.

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views. If the population of venture managers in general care as much about ethics as many respondents did, enforcement proceedings should be based on justice and the OSC should publish plain language reasons and welcome industry comment for their enforcement and settlement proceedings.

A "regulatory pyramid" should be developed, with an educational, dialogue approach, with informal rewards such as praise, rather than sanctions ("soft words before hard") at the base of the pyramid. Ascending strategies (such as penalties) could be invoked for serious or repeat non–compliance. As enforcement moves up the enforcement pyramid, the "incentive" motive, i.e. the cost-benefit calculation of rewards and punishment, could be the basis for compliance. An ascending pyramid with punishment as an option seems necessary, since the survey found that most respondents believe that promoters are motivated by short-term interests rather than by the long term value of their business or their reputation for ethical business practice.

(f) Accept analogous solutions and foster collaboration with regulators

The third factor is to improve problem solving by accepting analogous solutions. The expert Prill referred to the 5% *de minimus* test for audit committees, and suggested that the same should apply to the "connected issuer" principle in 31-103. If principles are to work, regulators should accept analogous interpretations unless they clearly do not apply. For example, when interpreting a financial disclosure principle, issuers should be allowed to draw from analogous

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tax accounting issues. When faced with a conflict of interest question, issuers should be allowed to draw from the analogous situation of a trustee buying property from a trust—in trust law, a trustee can seek court approval on notice to interested persons for a transaction in the face of a conflict of interest. In some cases, a director who wishes to enter into a transaction while in a conflict of interest should be able to obtain approval from OSC staff, on public notice to the shareholders and the market, without necessarily triggering all of the valuation and minority approval requirements in Multilateral Instrument 61-101.[469] Staff of the OSC and TSX-V should accept analogous solutions unless they are clearly inapplicable.

The survey found a diverse range of expertise on the boards of most respondents. A board with a range of experience will more likely find solutions to business issues, including compliance issues, than a board composed of like-minded individuals with identical backgrounds. The experts Thompson and Workman both referred to the benefits of a board with experience in the new areas of corporate responsibility, including environmental compliance and local community participation. Such diversity of relevant experience should be encouraged, given the importance of cooperation with Aboriginal communities under the new Mining Act and given the internationalization of the junior resource market in Ontario.

The fourth factor to improve is regulatory collaboration. The experts Thompson, White and Workman all described a shift of relations with OSC staff, from one of direct communication and meetings, to one of indirect email communication through lawyers. All three saw this as a

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[469] See the topic "Regulation of Ontario venture issuers" from p.13 above.

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negative trend, increasing the cost of disclosure. The expert Ellingham described how principles-based regulation and direct contact is more effective for the regulator when dealing with new situations and different parties.

One suggestion to increase communication is to adopt a policy similar to the Practice Management Helpline available for Ontario lawyers. This lawyer helpline provides confidential telephone assistance to interpret their obligations under the Rules of Professional Conduct or the Paralegal Rules of Conduct.[470] For the managers of venture issuers, a TSX-V disclosure helpline could be provided. Managers who are in disagreement about disclosure issuers (which apparently is quite often—see the results of Table 22), could receive independent assistance from a group of experts. Of course, the directors of the issuer cannot simply unload their responsibilities on an outside body and say “this is what the experts told us to disclose”, because the directors have primary responsibility for insuring compliance. However, discussing disclosure with independent experts could enhance the quality of the debate among the directors of the corporation, leading to faster and better disclosure. It should be a voluntary decision, as it is with the lawyer’s helpline.

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[470] (Law Society of Upper Canada 2011) As a lawyer in private practice, I have personally accessed this resource when facing difficult ethical issues and I found the service excellent.

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*(g) **Rules for historical transactions and principles for ongoing and future disclosure***

In simple systems, with known results, clearly stated rules allow participants to focus on matters other than compliance. This parallels Divers discussion about prioritizing the transparency, accessibility and congruence of rules—regulations which require predictability and transparency should be rules-based.[471] Ford argues that periodic and prospectus securities disclosure should be rules–based, with uniform document presentation, so that investors can efficiently compare similar circumstances.[472] The majority of respondents to the survey who answered that choosing rules or principles depend on the kind of information that should be disclosed (Table 25) said that property evaluation opinions and related party transactions, which are essentially historical or scientific assessments, should be regulated by rules. This parallels Mahoney's comments regarding historical costs and how bright-line rules allow investors to better measure a promoter's compensation and self-interest (above, page 142).

Future predictions and ongoing disclosure should be regulated by principles. (This is what most respondents thought—see Table 28). This is because the considerations which can affect forecasting are numerous and have to be weighed; in a sense, like predicting the weather. However, the Canadian Securities Regulators in Staff Notice 51-330 require that cautionary statements be included in any forward looking statement, including any forward statement in an

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[471] Above, p.194

[472] See above, note 3

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Annual Information Form, Management Discussion and Analysis, news release or investor presentations archived on company websites. Issuers must identify and incorporate by reference material risk factors, material factors or assumptions in any forecast, avoid "boilerplate" disclosure, and use tables and other methods of presentation that clearly link specific material risk factors and material factors and assumptions. These requirements appropriately caution investors of the risks of forecasts. However, because of the numerous factors which can affect future events, forecasts should be principles-based.

(h) Simplify private placement disclosure

Over the last three years, 19% of the funds raised by respondents were private placements from close friends or family of management, 25% were private placements from existing business contacts of management, and 41% were private placements (usually accredited investors) introduced by an arm's length broker, agent or finder. Only 15% of the funds raised were from a prospectus, capital pool or take-over (Table 16).

Respondents said that close friends and family and existing business contacts rely more on management's reputation for honesty and past business success than they do on evidence about the issuer's assets and prospects (Table 17). The expert Thompson, who has been in the business for 50+ years, said that he subscribes to a number of private placements each year, with virtually no paper disclosure, but based on the people involved. The expert White observed that most

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private investors look at the people involved, who's running the company and chat about the opportunities. The people involved are 90% of the decision making process and detailed disclosure documents are not worth the cost. As the expert Bandeen said, hardly anyone reads the disclosure documents. Most people who want to learn will Google the business, read about management, and search with a few provocative words to check out the negatives. What they really want is timely financials, material risks, a summary of the product, and a summary of the managers and principals involved.

Given the expensive costs of a prospectus for most venture issuers, consideration should be given to a principles-based, investor document for funds raised from accredited investors. In British Columbia, New Brunswick, Nova Scotia and Newfoundland/Labrador, the prospectus requirement does not apply to a distribution by an issuer of a security of its own issue to a purchaser if the purchaser purchases the security as principal, the issuer delivers an offering memorandum to the purchaser in compliance with the rules, and the investor signs a risk acknowledgement in compliance with the rules. In Ontario, there is no corresponding exemption. As Sarra notes, proportionate disclosure should be based on what is relevant to investors.[473] See also the comments by Deaves[474], who wrote a report for the Task Force—he suggests that investors can suffer from "information overload" and that greater attention should be given to the form, rather than the content, of disclosure.

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[473] *Supra*, note 99

[474] (Deaves 2006)

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To make the private placement rules accessible, the OSC should refrain from amending them so frequently. See Table 2 at page 74—it seems as though every six months the private placement rules are being tinkered with, making it difficult for managers to comply without consulting expensive securities lawyers. It is hard to understand why the rule should be amended at all, since the regulatory concerns remain the same over time.

(i) Questions raised by the experts but beyond the scope of research

Some of the issues raised by experts were important but beyond the scope of research in this paper. For example, the question as to whether Exempt Market Dealers should have a primary fiduciary obligation to the investor, rather than to the issuer which pays their fee, is important and will affect the market profoundly over the years. Similarly, the question about who is sophisticated enough to be an "accredited" investor (someone who can invest without a prospectus), and the observation that the banks have become too dominant in the industry and that their conservative blue chip investment strategies have crowded out risk-financing for the juniors, are important but beyond the scope of this research.

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Conclusions

Ontario securities regulations are a combination of principles-based legislation and detailed OSC rules. The Securities Act, with its broadly worded public interest powers, lies on the principles end of the rules/principles continuum; in contrast, the OSC instruments most frequently accessed by venture issuers lie on the rules end of the continuum. Some aspects of securities regulation should be principles-based. For example, licensing market participants, such as brokers and public accountants, and listing companies on an exchange such as the TSX-V or the CSNQ, should be principles-based, with discretion so the regulator can consider many factors before deciding to approve an applicant. Other aspects should be rules-based. For example, enforcement rules should be precise and transparent, to enhance predictability.

For those areas which should be principles-based, instruments should be written in the style of the Rules of Professional Conduct for Ontario lawyers. Binding principles should be stated, followed with examples to illustrate how those principles should be applied to perhaps a dozen common situations. Plain language commentary should be included. For those areas which should be rules-based, task complexity should be reduced by indexing rules according to subject, plain language should be used, and amendments should be infrequent.

The OSC should encourage greater diversity of related experience on the boards of venture issuers, to increase the possibility of finding analogous solutions. Workman and Thompson described the benefits of boards with experience in the new areas of corporate responsibility, including environmental compliance and local community participation.

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Better collaboration with the regulator would assist, with direct contact between staff of the OSC and the issuer, rather than email correspondence through lawyers. To make this effective, managers of venture issuers should have continuing education requirements, so that they understand the principles and can cooperate directly with OSC staff. The junior resource market in Ontario is becoming internationalized. Different cultures will have different attitudes and may not understand the purposes of Ontario securities regulation, and so, greater education requirements could benefit both venture issuers and their investors.

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Appendix A: Venture Issuer Survey

Table 7 In what capacity do you currently work for a venture issuer?

In what capacity do you currently work for a venture issuer? (Check all that apply)						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
Director	61%	66	57%	40	61%	106
Officer	71%	77	67%	42	68%	119
Employee	23%	25	18%	14	22%	39
Professional consultant (e.g. lawyer, accountant, geologist, scientist)	18%	19	22%	13	18%	32
		108		66		174

Table 8 How many years have you worked for a venture issuer?

How many years have you worked for a venture issuer? (for any venture issuer and in any capacity; not necessarily your current one)						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
Less than 1 year	2%	2	2%	1	2%	3
1 or more but less than 5 years	25%	27	16%	14	23%	41
5 or more but less than 10 years	33%	36	37%	24	34%	60
10 or more but less than 20 years	24%	26	24%	16	24%	42
20 years or more	16%	17	20%	12	17%	29
		108		**67**		**175**

Table 9 How many venture issuers do you currently work for?

How many venture issuers do you currently work for?						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
1	56%	60	50%	31	53%	91
2	15%	16	19%	14	17%	30
3	11%	12	21%	14	15%	26
4 or more	18%	19	10%	7	15%	26
		107		**66**		**173**

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Table 10 How many days per week do you currently work for all venture issuer(s)?

On average, how many days per week do you currently work for all venture issuer(s)?						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
Less than 1 day	2%	2	2%	3	3%	5
1 day	6%	6	0%	0	3%	6
2 days	4%	4	4%	4	5%	8
3-4 days	14%	15	20%	11	15%	26
5 or more days	75%	81	74%	46	74%	127
		108		**64**		**172**

Table 11 Do you expect to leave the venture issuer industry in the next three years?

Do you expect to leave the venture issuer industry in the next three years?						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
Yes	12%	13	17%	9	13%	22
No	66%	71	64%	41	65%	112
Not sure	21%	23	19%	15	22%	38
		107		**65**		**172**

Table 12 What formal education have you completed?

What formal education have you completed? (check all that apply)						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
Community College	14%	14	22%	11	16%	25
Undergraduate university degree	54%	55	46%	26	51%	81
Professional degree (Engineering, Law, Medicine, etc.)	36%	37	44%	23	38%	60
Masters degree	27%	28	41%	20	30%	48
Doctoral degree	2%	2	2%	4	4%	6
		102		**56**		**158**

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Table 13 What formal education has your Chief Executive Officer completed?

What formal education has your Chief Executive Officer completed? (check all that apply, and answer for your largest venture issuer)						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
I am the CEO and I answered the last question	40%	39	37%	24	40%	63
Community College	2%	2	12%	5	4%	7
Undergraduate university degree	26%	25	30%	16	26%	41
Professional degree (Engineering, Law, Medicine, etc.)	24%	24	19%	9	21%	33
Masters degree	19%	19	19%	9	18%	28
Doctoral degree	2%	2	5%	7	6%	9
		98		**59**		**157**

Table 14 Which of the following skills does your board of directors include?

Which of the following skills does your board of directors include? (check all that apply, and answer for the board of your largest venture issuer)						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
Engineer	53%	56	49%	30	52%	86
Scientist—e.g., a geologist, computer scientist, biologist or medical scientist	62%	66	70%	40	64%	106
Director with personal experience managing the kind of property the company owns	73%	77	70%	42	72%	119
Finance expert—e.g, broker, financial adviser, financial analyst	63%	67	67%	40	65%	107
Chartered or certified management accountant	62%	66	53%	31	59%	97
Lawyer	57%	60	47%	25	52%	85
		106		**59**		**165**

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Table 15 Market capitalization of the largest venture issuer you work for?

What is the current market capitalization of the largest venture issuer you work for? ("Market capitalization" equals the number of shares outstanding multiplied by the current market price of the shares. Do not include outstanding warrants or options.)						
		2011		**2012**		**Total**
Response	Percent	Count	Percent	Count	Percent	Count
Less than $5 million	29%	28	14%	10	24%	38
$5 million or more but less than $15 million	20%	20	35%	17	23%	37
$15 million or more but less than $25 million	10%	10	7%	4	9%	14
$25 million or more but less than $50 million	17%	17	23%	14	20%	31
$50 million or more but less than $100 million	9%	9	9%	5	9%	14
$100 million or more	14%	14	12%	9	15%	23
Not sure	0%	0	0%	1	1%	1
		98		**60**		**158**

Table 16 Percentage of equity funding raised from the following?

Over the last three years, what percentage of your venture issuer's equity funding was raised from the following? (include debt that is convertible to equity, and answer for your largest venture issuer.)						
	2011	**Mean**	**2012**	**Mean**	**Total**	**Mean**
Close friends or family of management	2042	21%	745	15%	2787	19%
Existing business contacts of management	2500	26%	1287	25%	3787	25%
Private investors introduced by arm's length broker, agent or finder	3668	37%	2468	48%	6136	41%
Other (eg. prospectus, capital pool, take-over)	1590	16%	600	12%	2190	15%
Total	9800*	100%	5100*	100%	14900	100%

*represents the sum of percentages and the next column divided the sum by the number of respondents.

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Table 17 Close friends and family of management

For venture issuers, please rank the order of importance you think that investors who are close friends and family of management place on the following.								
	1st importance		**2nd importance**		**3rd importance**		**Total**	
2011								
Management's reputation for honesty	66	73%	19	21%	6	7%	91	100%
Management's past success in business	20	21%	59	63%	15	16%	94	100%
Evidence about the issuer's assets and prospects	7	8%	15	16%	71	76%	93	100%
2012								
Management's reputation for honesty	36	67%	13	24%	5	9%	54	100%
Management's past success in business	14	26%	30	57%	9	17%	53	100%
Evidence about the issuer's assets and prospects	5	9%	11	21%	37	70%	53	100%
Total								
Management's reputation for honesty	102	70%	32	22%	11	8%	145	100%
Management's past success in business	34	23%	89	61%	24	16%	147	100%
Evidence about the issuer's assets and prospects	12	8%	26	18%	108	74%	146	100%

Table 18 Existing business contacts of management

For venture issuers, please rank the order of importance you think that investors who are existing business contacts of management place on the following.								
	1st importance		**2nd importance**		**3rd importance**		**Total**	
2011								
Management's reputation for honesty	40	43%	33	35%	20	22%	93	100%
Management's past success in business	40	43%	31	34%	21	23%	92	100%
Evidence about the issuer's assets and prospects	13	14%	29	31%	51	55%	93	100%

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2012								
Management's reputation for honesty	24	47%	17	33%	10	20%	51	100%
Management's past success in business	22	42%	16	30%	15	28%	53	100%
Evidence about the issuer's assets and prospects	8	15%	20	38%	25	47%	53	100%
Total								
Management's reputation for honesty	64	44%	50	35%	30	21%	144	100%
Management's past success in business	62	43%	47	32%	36	25%	145	100%
Evidence about the issuer's assets and prospects	21	14%	49	34%	76	52%	146	100%

Table 19 Introduced by an arm's length broker

For venture issuers, please rank the order of importance you think that investors who are introduced by an arm's length broker, agent or finder place on the following.								
	1st importance		**2nd importance**		**3rd importance**		**Total**	
2011								
Management's reputation for honesty	15	17%	32	36%	43	48%	90	100%
Management's past success in business	33	36%	30	33%	29	32%	92	100%
Evidence about the issuer's assets and prospects	45	48%	30	32%	18	19%	93	100%
2012								
Management's reputation for honesty	11	21%	21	40%	20	38%	52	100%
Management's past success in business	19	36%	19	36%	15	28%	53	100%
Evidence about the issuer's assets and prospects	25	46%	13	24%	16	30%	54	100%
Total								
Management's reputation for honesty	26	18%	53	37%	63	44%	142	100%
Management's past success in business	52	36%	49	34%	44	30%	145	100%
Evidence about the issuer's assets and prospects	70	48%	43	29%	34	23%	147	100%

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Table 20 Promoters

For venture issuers, please rank the order of importance you think that promoters place on the following.							
	1st importance		**2nd importance**		**3rd importance**		**Total**
2011							
Share price over the next 12 months	62	68%	17	19%	12	13%	91
Long term value of the business	26	28%	57	61%	10	11%	93
Reputation for ethical business practice	5	5%	18	20%	69	75%	92
2012							
Share price over the next 12 months	43	81%	4	8%	6	11%	53
Long term value of the business	9	17%	31	60%	12	23%	52
Reputation for ethical business practice	3	5%	17	31%	35	64%	55
Total							
Share price over the next 12 months	105	73%	21	15%	18	13%	144
Long term value of the business	35	24%	88	61%	22	15%	145
Reputation for ethical business practice	8	5%	35	24%	104	71%	147

Table 21 Disclosure debates

How frequently do the directors of your venture issuer debate among themselves about when or which information should be press-released? (answer for your largest venture issuer)						
		2011		**2012**		**Total**
Response	Percentage	Count	Percentage	Count	Percentage	Count
Never	6%	6	5%	2	5%	8
Rarely	20%	19	29%	15	23%	34
Sometimes	29%	27	27%	15	29%	42
Often	32%	30	27%	17	32%	47
Always	12%	11	12%	6	12%	17
		93		**54**		147

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Table 22 How frequently do your directors consult on continuous disclosure issues?

How frequently do your directors consult with the following on continuous disclosure or press-release questions? (answer for your largest venture issuer)										
	Never		**Rarely**		**Sometimes**		**Often**		**Very Often**		**Total**
2011										
Geologist or other scientist	25	27%	8	9%	15	16%	15	16%	29	32%	92
Lawyer	4	4%	5	5%	31	34%	31	34%	21	23%	92
Auditor or accountant	7	8%	24	26%	38	42%	10	11%	12	13%	91
Securities analyst	35	38%	32	35%	18	20%	5	5%	1	1%	91
2012										
Geologist or other scientist	11	20%	7	13%	6	11%	17	31%	14	25%	55
Lawyer	2	4%	7	13%	12	22%	19	35%	15	27%	55
Auditor or accountant	5	9%	15	28%	17	31%	11	20%	6	11%	54
Securities analyst	25	48%	13	25%	9	17%	3	6%	2	4%	52
Total										
Geologist or other scientist	36	24%	15	10%	21	14%	32	22%	43	29%	147
Lawyer	6	4%	12	8%	43	29%	50	34%	36	24%	147
Auditor or accountant	12	8%	39	27%	55	38%	21	14%	18	12%	145
Securities analyst	60	42%	45	31%	27	19%	8	6%	3	2%	143

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Table 23 How often has your issuer communicated with staff of the TSX-V and OSC?

In the past 12 months, how often has your issuer communicated with staff of the TSX-V and staff of the Ontario Securities Commission? (do not include just filing forms,and answer for your largest venture issuer)										
	Never		**1 -4 times**		**5 - 10 times**		**11 - 20 times**		**more than 20 times**		**Total**
2011											
Staff of TSX-V	4	4%	53	59%	21	23%	7	8%	5	6%	90
Staff of OSC	52	62%	27	32%	3	4%	1	1%	1	1%	84
2012											
Staff of TSX-V	6	11%	31	55%	13	23%	5	9%	1	2%	56
Staff of OSC	37	70%	13	25%	2	4%	1	2%	0	0%	53
Total											
Staff of TSX-V	10	7%	84	58%	34	23%	12	8%	6	4%	146
Staff of OSC	89	65%	40	29%	5	4%	2	1%	1	1%	137

Table 24 How helpful has staff been?

How helpful has staff of the TSX-V and OSC been in terms of explaining or assisting your issuer with compliance issues?									
	No opinion		**Not helpful**		**Somewhat helpful**		**Very helpful**		**Total**
2011									
Staff of TSX-V	9	10%	5	5%	36	39%	42	46%	92
Staff of the OSC	50	62%	3	4%	14	17%	14	17%	81
2012									
Staff of TSX-V	12	21%	2	4%	23	41%	19	34%	56
Staff of the OSC	38	73%	4	8%	6	12%	4	8%	52
Total									
Staff of TSX-V	21	14%	7	5%	59	40%	61	41%	148
Staff of the OSC	88	66%	7	5%	20	15%	18	14%	133

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Table 25 How should regulations be drafted?

To improve public disclosure for venture issuers, how do you think securities regulations should be drafted?		
Response	**Percentage**	**Count**
2011		
Detailed disclosure rules, describing exactly what should be disclosed and when.	27%	24
Broad principles, with examples of good disclosure in particular cases as guidance	43%	38
It depends on what kind of information is to be disclosed.	29%	26
No opinion	1%	1
2012		
Detailed disclosure rules, describing exactly what should be disclosed and when.	7%	4
Broad principles, with examples of good disclosure in particular cases as guidance	67%	37
It depends on what kind of information is to be disclosed.	24%	13
No opinion	2%	1
		55
Total		
Detailed disclosure rules, describing exactly what should be disclosed and when.	19%	28
Broad principles, with examples of good disclosure in particular cases as guidance	52%	75
It depends on what kind of information is to be disclosed.	27%	39
No opinion	1%	2
		144

In the last question, you chose detailed disclosure rules. Please explain why. (Minor grammatical mistakes corrected.)

Table 26 Explanations - detailed rules

#	Explanations – detailed rules
	2011
1	The rules don't seem to be followed by all issuers on what has to be disclosed or how truthful that disclosure must be and it presents a competitive disadvantage to the group that provides accurate timely disclosure today.

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2	1 - Staff of venture issuers come from many backgrounds. Rules help to standardize required and put all participants on a level playing field. 2 - Allows exchanges and commissions to give follow up which is to the point. 3 - Reduces the amount of boiler plate, which is reproduced over and over.
3	They should know what they want disclosed and what they are looking for specifically. There are too many gray areas now.
4	Standard forms as used by the SEC are a great idea. Makes compliance simple because there is essentially a check list that drives the disclosure. Makes the regulators job easier too.
5	The OSC considers that every event and every news release requires an MCR (Material Change Report). It is a $50 per tax grab. All news release are now available to all regulators on SEDAR.
6	No- I noted that it depends on the issues. In some cases "principle" based regulation is preferable, but for certain regulations that is not going to get the result the regulators are trying to achieve.
7	Leaves no doubt as to the rules of conduct.
8	Small venture issuers do not have the luxury of resources (time and money) to have professional staff in the company or have advisors and consult with them as cost effectively and efficiently as an actual "rulebook" might provide.
9	Too many promoters tend to play hard and fast with the rules.
10	We need to know and we need examples.
11	The less judgement involved the better.
12	Smaller firms need specific guidance. If there are broad and/or loose rules, there may be increased demand for the services of a securities lawyer to interpret the rules or provide guidance. Smaller firms have a propensity to use legal services only when they need them, due to budget constraints.
13	SO that there is no ambiguity.
14	To provide black & white guidelines whenever possible.
15	For the purpose of clarity, precise rules are preferred.
16	To assure timely and complete disclosure.
17	To make it easier for each issuer to comply.
18	For clarity.
19	Every company should have a detailed list for disclosure - just makes it easier to be consistent.
20	The rules and policies are vague when it comes to disclosure rules and what qualifies as needing to be disclosed. The TSX-V now offers 1/2 day seminars. One of the seminars is on Disclosure. This is a great idea!
21	Full disclosure, good and bad, is good for the industry overall. The 43-101 rules, for example, while clunky and inconvenient, have straightened out the industry, especially the stock broker side of the industry.

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	2012
22	The current broad coverage is in many cases too vague and is open to interpretation which the TSX interprets to their best interest and the Company interprets to its easiest interest and then can get in trouble with the TSX as to whether something should have been filed or not. (particularly in regard to assets sales and acquisitions).
23	I believe that when rules are ambiguous it allows for interpretations that may not be entirely ethical. If the rules are specific there can be no excuse.

In the last question, you chose broad principles. Please explain why. (Minor grammatical mistakes corrected.)

Table 27 Explanations - broad principles

#	Explanations – broad principles
	2011
1	One size often does not fit all. In mining the prescriptive part of technical disclosure is NI 43-101 which also regulates quality and competence of preparers as well. Other areas of disclosure can be deficient if hard and fast rules are set because much of the financial and MD&A disclosure at the SME level is landed on the accounting staff who like to follow precedents and templates and quote peers. This would be easier with highly specific rules, but not as much thought would go into it (in an ideal world).
2	Strict rules are too constricting and don't allow flexibility for companies of various sizes and controlling positions, to pursue growth plans.
3	We have a head office staff of six. None of us are lawyers, and legal costs run around $30000 per year. Much of that cost is to ensure that very specific information is declared.
4	There are many different types of venture issuers, from Capital Pool Companies to mining operating companies, etc. Having specific rules for all Venture issuers does not allow for the flexibility that some Venture issuers may require.
5	The directors clearly understand their public responsibility and clearly understand the meaning of a material issue.
6	Management of most firms understand responsibilities in this regard. However regulators do subtly move requirements, so that ongoing indication of expectations could be helpful, particularly for less experienced participants.
7	Because each Company or for that matter each individual will have their own style of news release.
8	We should have something along the lines of GAAP.
9	Materiality is often subjective, to a large degree, and management can best determine which news is material. Also, oftentimes news which is not necessarily material would best serve the shareholders if released.
10	The Board must have a detailed policy of disclosure that shall state what and when to be disclose. The policy shall be

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	published with the annual report and proxies and revised by the OSC or other provincial jurisdiction
11	Governance, in Canada, is mostly principles-based systems allowing the application of the business judgement rule and while exercising the duties owed to the corporation. For smaller issuers, who need access to capital this is a must. The more American style "rules-based" system creates much higher costs and harms a smaller issuers ability to be and remain a public company. In fact, the SEC, this summer will likely alleviate the SOX requirements for NYSE issuers who are smaller cap- moving towards a Canadian principles-based system.
12	Very important to review each public disclosure on a case-by-case basis.
13	Better than having too many rules to cover the many scenarios that can arise.
14	It is impossible to detail all possible examples so the only way to effectively indicate what should be disclosed is through examples covering the broad principles.
15	Legislator and bus. Community
16	I don't like detailed, ruled based systems. The get ever longer and more complex as they try and deal with every eventuality, which increases compliance costs and you never can deal with every eventuality. You have to trust people to work sensibly. Yes you will get people who cheat and find ways around the rules, but they will do that anyway. More complex rules do not stop that sort of behaviour. So draft the rules for use by reasonable people.
17	Markets work more efficiently when participants understand the rules and can focus on running their businesses. Detailed rules often force participants to look for ways around the rules when they are too proscribed.
18	As a mineral exploration company we are dealing with nature and complex geological issues and defining what is material is complex. We cannot have rules for every eventuality this just creates non productive bureaucracy, we NEED COMMON SENSE. After all we should be intelligent to understand/interpret what is needed from broad principles. In today's litigious society there is no escape as no one is responsible for anything anymore as exemplified by politicians, judges, police, bureaucrats.
19	Only broad principles can cover all the different types of industries listed in Venture and I feel there are already too much disclosure requirements. As most venture issuers are starting new business, the time and money spent on meeting the continuous disclosure requirements would be better spent on developing the business, after all investors for Venture stock is looking for potential of the company, not the present value of the company.
20	The nature of our business does not always lend itself to specificity. Also, once one gets into a rules-based scenario more time is spent trying to stay between the posts (or bending the posts) than observing the intent, and that can be counterproductive to the disclosure process; indeed, it is quite prone to misinformation.
21	There is a lot of "exceptions" when growing a small business and lack of sophistication. Broad rules permit more leeway to tailor disclosure to the investor audience.
22	Disclosure should be made for all items that are material to a company, but materiality differs greatly from company to company, industry to industry. Too much detail can cause disclosure to become strictly rules-based at the expense of the intent to provide material information to the shareholder.
23	So there are no "grey areas".
24	Helps to see what like companies are doing.

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25	Reducing the number of pages required to disclose regulatory requirements is useful. A guideline takes up much less room, and requires less sorting through each time there is a question or conflict about the regulations. Subsections and too many references make it very difficult to comply, and to know we are in compliance for sure.
26	I am assuming that the regulatory functions will operate reasonably effectively as gatekeepers in allowing junior company management access to the public's funding. That being the case, I also assume that management will generally be honest, and sufficiently competent and experienced in carrying out their functions as to be able to rely on their knowledge, experience and, yes, even wisdom in conducting the affairs of the issuer. Statements of broad principle, combined with some examples, should provide adequate guidance.
27	There are too many "exceptions" because there is a broad range of business types (foreign, domestic, small, large, early exploration, production).
28	To provide guidelines based upon past experiences.
29	Specific situations are hard to define and anticipate. General principles provide better guidance.
30	Too detailed an explanation would leave more questions than it would answer.
31	Different industries require different disclosures. Also shell companies and CPC's [Capital Pool Companies] have not much to disclose - so exacting rules would be overkill.
32	""Intention" not "rule following" is key to the "Canadian advantage" - without that Canada is just a different version of America and it loses that advantage for venture based companies.
33	In most cases it is a judgment call, so it is much better to have general rules because it is simply impossible to cover all cases.
34	The industry has a core of well respected individuals with years of success that are held in high regard. The principals that established their track record should be used as the "cookie cutter" for other companies. As it is, I feel we get bogged down in very costly regulatory rules that are established and implemented by people with very little practical experience in the industry. It never fails to surprise me that in order to do one simple act for the benefit of all shareholders it may cost many thousands of dollars to do it. The costs of doing something that would be a benefit for all, based on principle, becomes impossible because of the regulatory cost involved. Sometimes it makes me wonder who they are trying to protect.
35	Specific situations that cannot be covered exist. It is better to have a "principle" based policy that can accommodate the many situations that arise.
36	It is too difficult for the regulatory bodies to try and define and put parameters around every situation. Instead, broad guidelines are required for material disclosures then each issuer needs to assess what is material and execute timely disclosure.
	2012
37	you will never select each and every possible case that can happen if you go to detailed.
38	We should be principled based regulation. Securities industry is complicated and may need explanation. Rules-based is dogmatic and does not always allow for the detail needed for full disclosure
39	We should avoid being over regulated, that creates an environment where regulators turn into traffic cops trying to penalize issuers. Using broad principles creates flexibility (which some issuers abuse). There are often grey areas

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	around disclosure and companies should have the latitude to manage this. The exchange and IIROC are good resources for companies to use in dealing with these grey areas.
40	Very difficult to have definitive rules to cover all public companies - would need different sets of rules for each industry, which is not practical.
41	TSX-V listings are junior companies that have limited access to people who are willing to be on the Board of a junior mining company. This can hamper skill level on a Board and the BoD have to rely on expertise from their network to fill in the gaps. Having a strict set of rules means that when a square peg doesn't fit in the round hole, the regulators would need to get involved in solving disclosure issues. That is not the best thing for Venture issuers and there would be big delays getting replies to issues. Principle- based regulations gives the fair mindedness that most all issuers have good ethics and morals and that they will do their best for shareholders given limited resources. I believe this is the case and most people in junior mining are trying their best and have good ethics. Regulator driven rules means that we will move toward the US style of securities where companies look to their lawyers to find loopholes in the rules rather than reporting based on principles. This means the regulators distrust people who manage junior companies and that distrust becomes two sided and also delays decision making processes when junior companies need to be nimble. Education of Boards and their duties and responsibilities is a better means to better disclosure and transparency. Education is the means to get directors to make better decisions in a principle based reporting system
42	There should be an assumption that management knows its business and what aspects are material for purposes of disclosure to the market. Not a hard and fast list of items mandated for disclosure which often will have no relevance to the market based on the size and activity level of the issuer.
43	There is no way that anybody could write enough rules to cover disclosure. The more rules there are, there are more ways to get around them. Disclosure has already gone overboard and a great deal of time is wasted trying to decide what will and will not require disclosure. A litmus test will do.
44	There are far too many complexities in different forms of transactions to be addressed by rules
45	The wide variety of issuers with different business focuses requires broad limits with respect to principles.
46	The rules and regulations have become so complicated that regular investors have no idea what is going on. Out of 100 investors if one reads a prospectus i would be shocked. You have high costs for Venture issues and the regular investor does not understand the information that is being issued by Issuer.
47	So many variables to try and write a one fits all guideline it is impractical and in my opinion probably will not be particularly helpful. Admittedly there are some areas that a specific definition such as what market value should be used to determine the exercise or strike price of an awarding a stock option - day awarded or closing day before, if day awarded is it the high, low or close that should be used???
48	Rules obtain exact compliance, Principles and objectives of fair full disclosure encourage disclosing material information within the context of a situation. Recent accounting and now IFRS is an example of massive disclosure to the point that no one reads any of it. Placer operations can no longer meet disclosure rules so virtually all of the successful ones if not in a large company stay private because the rules of 43-101 cannot be met. Integrity and judgement result in better disclosure than rule compliance. If there is misleading or dishonest behavior prosecute that to the point of severe pain for the guilty. SOX reporting is the perfect example of over regulation that was unnecessary, the guilty were prosecuted successfully under existing laws but saddled managements and investors with huge costs for useless activities

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49	Rules-based approach cannot foresee every circumstance, so at some point you need to rely on principals. Rules are too rigid when a principal can take into account all of the facts of the situation.
50	Provides more flexibility to deal with individual circumstances.
51	Not every company is the same and if you use broad principles they can count for all types of companies instead of just some.
52	No set of rules can be comprehensive enough to include all possibilities in the junior mining business. Inevitably the set of rules keeps expanding in a futile attempt to cover more and more of those possibilities. The system becomes driven by policy and procedures rather than by business merit. This results in greater and greater expenditures on lawyers and accountants to generate ever increasing amounts of paper with useless detail and the original purpose of the business becomes less and less relevant. I believe that a principles-based approach is much more efficient and much more effective.
53	Many times the detailed principles have no relevance
54	Less regulation is better. More detailed rules makes increases costs.
55	Left to their own devices, they will soon create/have created, a regimen of rules that require a full time staff to interpret/comply with. This is a TSX "Venture" company...not Bell Canada.
56	I believe the conduct of business should be left to those with the experience remembering they have already qualified with the TSX-V as fit directors or qualified persons. Fixed rules can never be comprehensive enough to master human ingenuity.
57	For small venture issuers, generally there are not many significant material changes to the business. Using a principles-based approach would allow less meaningless disclosure.
58	Every circumstance cannot be anticipated by regulators.
59	Each issuer has its own unique circumstances to navigate - detailed disclosure requirements may actually work against investor interests. Take two issuers that sign a large, material contract. In one case, it may make sense to disclose all of the pertinent details, perhaps even the contract itself. In the other case, such disclosure may seriously compromise the issuer's competitive position, which hurts shareholder value. Detailed rules cannot be relied upon to always work to the shareholders' advantage - management must have some discretion to protect the company's value in specific circumstances.
60	Detailed rules inherently result in something being missed, and the various security commission then try to apply a principles-based approach based on the rules they wrote. It seems much more practical to just start with a principles-based approach.
61	Detailed disclosure rules can never cover all the bases or special circumstances.
62	Can never deal with all the details to provide strict rules for each situation and (I can see it now - strict rules can be found at www.big-site-where-you-never-find-anything-and-designed-by-gov.com) do we really need another one of these? besides I don't have any confidence that the regulator could provide these accurately or efficiently neither through motive nor intellect. Keep it broad, most people are honest and you'll always have to weed out the few undesirables no matter what you implement. Most important..... Educate the investor how to ask the right questions. Most investors I know have been around the block to know to ask the hard questions and that's either because they are savvy and/or they have learned the hard way.

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63	Broad - Understandable and covering key concepts. Too much detail defeats understanding of spirit of directive. Example - helps issuer craft a good document
64	Because there are far too many variables/scenarios to be specific. Compliance would be a regulatory and counterproductive nightmare.
65	because reference is to be made to case histories.
66	Because most of the disclosure in our business will relate to drill hole results and in some cases they are material and in others they are not. Having broad disclosure principles will allow the Board to release results that actually are material to the share price and the shareholders while not releasing results that can be misleading or misconstrued.
67	Because it would be impractical, or, nearly impossible to provide rule-based guidelines that would cover every possible situation.
68	The current broad coverage is in many cases too vague and is open to interpretation which the TSX interprets to their best interest and the Company interprets to its easiest interest and then can get in trouble with the TSX as to whether something should have been filed or not. (particularily in regard to assets sales and acquisitions).
69	I believe that when rules are ambiguous it allows for interpretations that may not be entirely ethical. If the rules are specific there can be no excuse.
70	It depends on what kind of information is to be disclosed.

This question was only answered by those who answered "It depends on what kind of information is to be disclosed" in Table 25

Table 28 Detailed rules or broad principles?

Which of the following do you think should be regulated with detailed rules and which should be regulated with broad principles ?									
	Detailed rules		Broad principles		Mixture of both		No opinion		Total
2011									
Mineral and oil and gas reserves	10	42%	2	8%	9	38%	3	13%	24
Related party transactions	11	46%	4	17%	9	38%	0	0%	24
Other conflicts of interest	12	50%	5	21%	6	25%	1	4%	24
Executive compensation	8	33%	10	42%	6	25%	0	0%	24
Business forecasting	1	4%	11	46%	11	46%	1	4%	24
Ongoing disclosure about material facts	4	17%	10	42%	9	38%	1	4%	24
2012									
Mineral and oil and gas reserves	8	62%	2	15%	2	15%	1	8%	13
Related party transactions	10	77%	2	15%	1	8%	0	0%	13

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Other conflicts of interest	7	54%	5	38%	1	8%	0	0%	13
Executive compensation	7	54%	6	46%	0	0%	0	0%	13
Business forecasting	1	8%	11	85%	1	8%	0	0%	13
Ongoing disclosure about material facts	5	38%	8	62%	0	0%	0	0%	13
Total									
Mineral and oil and gas reserves	18	49%	4	11%	11	30%	4	11%	37
Related party transactions	21	57%	6	16%	10	27%	0	0%	37
Other conflicts of interest	19	51%	10	27%	7	19%	1	3%	37
Executive compensation	15	41%	16	43%	6	16%	0	0%	37
Business forecasting	2	5%	22	59%	12	32%	1	3%	37
Ongoing disclosure about material facts	9	24%	18	49%	9	24%	1	3%	37

Please give reasons for your answer. (Minor grammatical mistakes corrected.)

Table 29 Explanations to rules or principles

	Explanations
	2011
1	I believe in full, open dialogue. However, there are instances whereby it is in the interests of the company and / or the shareholder to use broad principles over detailed rules, to allow the company room to facilitate business. All of this, of course, should be at the discretion of the governing bodies and as such, should they should have final right to approve/disapprove dissemination of information. It's a tough nut to crack, how much information is too much and how much is not enough. IIROC does a tremendous job as it is today, overseeing the market - any more work and they may become ineffective.
2	I feel the market is over regulated in some respects with many rules and regulations that are not enforced in practical terms but at the same time blatant pump and dump schemes abound. The dealing with a security commissions and TSX is very similar to security at the airport. Many rules and regulations administered by under-achievers who catch nobody but burden the process of doing business with useless costs. Accounting costs are staggering for the small issuer.
3	People who are conflicted or who stand to gain personally from a transaction should have to explain their actions. Rules provide loopholes while principles capture intent. Forecasting and compensation are decision-based - principles apply as well as metrics. A mixture of regulation is needed to ensure both are reported. Material facts are facts, they can be codified. Do so.
4	Even playing field for all.
5	This seems self-evident to me. Mineral and Oil and gas reserves are matters of measurement. The standards by which these measurements are to be performed should be well defined to ensure consistency between projects. Leaving these open to interpretation encourages exaggeration. Related party transactions are the means by which public money is used for personal interests. It's something that has to happen, but oversight must be strict to ensure that the shareholders' interests are being taken care of, and not just the interests of the related party. Companies who unfairly compensate executives for poor performance should be punished by the shareholders, rather than regulators.

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	Conversely, letter-of-law limits on executive compensation limits the potential for executives to be properly compensated. Forecasts are someone's best guess. I'd rather not engage in it if I can help it. It seems irresponsible. Materiality is always going to be subject to interpretation, especially in mining. Certain things, however, are material or are not.
6	It is not possible to predict all fact situations. Common law is better than civil.
7	Broad principles are useful for smaller companies that struggle with excessive red tape that is generated for large companies who can afford it. Unfortunately, the people who take advantage of loopholes in broad principles will use them to the detriment of unwary and unsophisticated investors. Reputation does matter although it is unrecognized in various rules. As for TSX-V, they seem more interested in creating a large bureaucracy that is completely out of whack with junior mineral exploration. Some detailed rules are obviously needed but how many is a very specific question to answer.
8	The way stock prices move in the junior market there is need to have detailed disclosure of the people involved I have seen stock go up significantly before news. Our group is appalled by markets moving up or down before news- we are very tight lipped and disclose fully on our releases, i.e. drill results, when others are very vague
9	Disclosure laws need a proper balance; they should not be overly cumbersome on the corporation but also should obviously disclose relevant material information to protect investors.
	2012
10	Too much detail already that no one understands but experts
11	They are my opinion
12	The first two are capable of having detailed rules made and enforced when necessary...for the latter it is hard to make detailed rules covering all possible situations...that is where general 'best practice' principles are best applied, but of course the interpretation and application of those principles is quite subjective, and subjective rules are much more difficult to enforce.
13	Generally, the more guidance the better, except where it becomes too difficult to cover every eventuality.
14	1) Reserves fall under 43-101 (which needs clarification here, and an overhaul is required- I think it has become too limiting and a cash cow for consultants) 2) RPT- require detailed rules; without which, there are too many sharp business people who find ways around that... 3) same as above 4)same as above 5/6)Forward looking statements are easily understood by public market- principles can apply

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Table 30 Factors to make principles work

How important do you think the following factors are, in order to make principles-based regulation understandable and effective for venture issuers?											
	Very Important		**Important**		**Neutral**		**Somewhat Important**		**Not at all Important**		**Total**
2011											
Issuers and staff of the OSC and TSX-V should have a shared understanding about what makes the market fair and efficient	49	57%	31	36%	4	5%	2	2%	0	0%	86
Issuers and staff of the OSC and TSX-V should agree about which principles are the most important	34	40%	43	50%	7	8%	0	0%	2	2%	86
Issuers and staff of the OSC and TSX-V should collaborate and have regular communication	31	36%	32	37%	15	17%	5	6%	3	3%	86
Enforcement should be balanced and fair	51	60%	29	34%	5	6%	0	0%	0	0%	85
2012											
Issuers and staff of the OSC and TSX-V should have a shared understanding about what makes the market fair and efficient	28	54%	18	35%	5	10%	1	2%	0	0%	52
Issuers and staff of the OSC and TSX-V should agree about which principles are the most important	26	50%	22	42%	4	8%	0	0%	0	0%	52
Issuers and staff of the OSC and TSX-V should collaborate and have regular communication	23	44%	19	37%	8	15%	2	4%	0	0%	52
Enforcement should be balanced and fair	38	75%	11	22%	1	2%	1	2%	0	0%	51
Total											
Issuers and staff of the OSC and TSX-V should have a shared understanding about what makes the market fair and efficient	77	56%	49	36%	9	7%	3	2%	0	0%	138
Issuers and staff of the OSC and TSX-V should agree about	60	43%	65	47%	11	8%	0	0%	2	1%	138

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which principles are the most important											
Issuers and staff of the OSC and TSX-V should collaborate and have regular communication	54	39%	51	37%	23	17%	7	5%	3	2%	138
Enforcement should be balanced and fair	89	65%	40	29%	6	4%	1	1%	0	0%	136

What other factors do you think are important, to make principles-based regulation work for venture issuers? (Minor grammatical errors corrected.)

Table 31 Other factors for principles-based regulation

	Other factors for principles-based regulation
2011	
1	OSC has to harmonize for TSX-V issuers with at least ASC and BCSC too. Issuers have to know that regulators in fact have the resources to monitor and provide guidance that is useful have top level enforcement responsibility and not just leave it to the courts and class action lawyers to enforce their principles. You will never get agreement amongst all issuers so in some ways a rigid rules system would make better goal posts if this does not work.
2	1 - Principles are open to interpretation and so require someone to decide if they have been interpreted as they were intended to be interpreted. 2 - Principles require an appeal process, if issuers don't agree with the exchanges interpretation. 3 - The move to IFRS is a move away from principles and professional judgement, which I think is right because it reduces the subjectivity that comes from national or cultural bias.
3	I live in Quebec, which seems not to be your focus. The AMF here in Quebec is much more intrusive in Venture matters than other securities commissions. For example, the AMF is the only securities commission that has NOT delegated complete responsibility to the TSX-V for implementation of the TSX-V Policy 2.4 (Capital Pool Companies).
4	Markets should be regulated by OSC and not TSX. TSX is a public company operating for profit and should also be regulated by the OSC.
5	The regulators should do enough background work on the issuer and the issuers people so that they are in a position to accept the disclosure or answers the issuer puts forward.(ie. you should not be treated as bad or guilty until proven to be so). The existing regulatory environment for the TSX-V is adversarial. The issuer is treated like a liar and a thief by the TSX-V staff in particular. They also do not read the continuous disclosure information provided by the issuer in their own files. Every new submission to them is like starting from square one. Issuers are automatically deemed to be guilty of something. Further "Tier One" TSX-V issuers are supposed to be regulated under the TSX rules. It doesn't happen. The regulatory environment is equivalent to a nasty parent. Totally patriarchal.
6	The less regulation the better.
7	Not sure I can think of any.
8	Who said they work?

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9	Venture issues are risky, and venture investors understand this. The regulator needs to assist the process, not stand in the way. The regulator shouldn't pass judgment, but instead ensure that the process is transparent. Investors and companies are not morons and don't need nannying - they need clear communication.
10	Fair and open communication; OSC and TSX-V staff that have relevant public company experience.
11	Allow pre-marketing of an IPO, to avoid the costs of $1 million and a failed IPO. IPO's are private companies and so there is no risk of information leakage. The current system is a barrier for firms to go public and the CPC process is a good start but that is showing cracks in the type and size of companies going public. The larger SPACS, for Canada, have never happened, not one, to date. So CPC and Spac's are not a good answer. Pre-marketing under green sheets, with dealers should be allowed for IPO, and then the IPO documents can be drafted if there is an order book. The street never buys from an IPO document anyway. Strict compliance with existing rules can be maintained and the issuers can have confidence in trying an IPO, if the initial costs can be deferred until there is an order book...
12	Some of these regulations need to be economically sound .... OSC is disconnected from real economic impact of some of their regulations or requirements.
13	Professional judgement on the part of the OSC in applying the spirit of the rules as opposed to the letter of the rules, and, actually following their own rules as set out in NI.
14	Principles? This is the stock market! The quality of the directors is paramount.
15	Because it can be so complex, case stories (i.e. examples) of enforcement should be publicized or communicated to issuers (on an anonymous basis of course)
16	Regulators lack real world experience. TSX-V must hire more outsiders to compensate for this weakness.
17	Penalties for failing the follow the broad rules should be severe and publicized.
18	A practical experience working in TSX-Venture companies should be a pre-requisite for any regulator not a 26 year old lawyer wet behind the ears.
19	For the most part, I am not impressed with the staff of the TSX-V. They show minimal understanding or empathy for the pressures and exigencies experienced by the business side of things. Their regard for the time constraints of the issuers are deplorable. Their reviews of Technical Reports are, for the most part, petty (e.g. move the sentence on p. 3 to p. 17, etc., etc.) and seldom go the substance, and that just requires a lot more time to address their idiotic BS. Typical bureaucrats!
20	Some common sense and tailoring regulations/fees etc. to the current economy and conditions. The fundamental problem is applying regs/structures suited to international co's to small issuers, who struggle just to do their work, with ever-expanding requirements/fees/rules that have virtually no benefit to shareholders of ethical companies. Many regulatory bodies have a strong desire to 'empire build', because they have no reason to streamline or reduce fees, as it's contrary to their existence. The regulators' staff should have mandatory job placements in TSX-V issuers to get a better understanding of how their regs etc. impact people working in the industry, and how useful they are.
21	The factor that is most important is the how similar TSX-V policies are to OSC rules.
22	Regulations need to be determined and agreed upon by the various Securities Commissions, and NOT by the exchanges, as the latter are for profit businesses. What benefits the shareholders of the exchange is often at odds with what benefits the shareholders of the companies that list upon them.

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23	Regulatory staff should be sufficiently experienced and balanced in their views to allow them to assess the apparent integrity and demonstrated track records of management. If these factors support the initiatives proposed by management, the attitude of regulators should be "Is there any reason not to say 'Yes'?" rather than "What hoops should we make these guys jump through?".
24	Consistent application of the rules. Some companies bend over backwards to comply and the "bad guys" go on reporting information (I am thinking mostly technical) in misleading formats
25	Prompt feedback from regulators on submissions and a willingness to be flexible.
26	Thorough investigation of possible infractions and strict, punitive, well publicized enforcement and punishment.
27	Fair and transparent and equitable exercise of the rules
28	Very difficult to align regulators and issuers. Generally viewpoints are very divergent simply based on what side of the industry you choose to work on. Regulators tend to want strict rules under which to prosecute the perpetrators of the illegal. Issuers operating in the arena of the TSX-V tend to be entrepreneurs trying to build a successful company with as little staff as necessary - often precluding expertise in the regulatory sector.
29	I think there is a lot of grey area with principle-based regulation since a regulator could interpret situations differently and the absence of clear cut rules could be a major problem.
30	A well-educated regulatory staff.
31	I deal with the BC Securities Commission and they are interested only in regulations which bring income to the Province - regulation is done for the regulation's sake - not fairness - their propensity to issue fines seems to be their incentive. Money rules with the BC Securities Commission
32	Clear guidelines in laymen terms Workshops, seminars and webinars to define and education issuers Regular updates and newsletters Chat or online access to OSC or TSX-V staff to query on issues
2012	
33	Who would not agree with the apple pie above?? Start by asking for each regulation...Does this REALLY help level the playing field for investors and maintain market integrity ?? I think there is a lot of stuff that we have to do that does not really help the investor. Put more effort in managing what brokers are allowed to do ...those rules would help the market.
34	Unfortunately the regulators seem divorced from what is important to investors, Too much "law" and too little common sense.
35	They have a nasty habit of changing their own rules if they don't like the answers they're getting, or, something out of the SEC is suddenly "Flavour of the month". Principles-based reduces that ability.
36	The TSX rules are arbitrary inforced. They tend to investigate the small player while ignoring the larger co0mpanies. They are just counting scalps not uniform investigating fraud at all levels.
37	The staff at OSC and TSVX must make decisions job number one when asked about disclosure.
38	The securities commissions should try to be more collaborative with issuers
39	Staff at the OSC and TSX-V need to have some flexibility to consider unique circumstances - policy doesn't always

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	protect shareholders. It is my opinion that policy presently rules over common sense - even when staff at securities regulators or the TSX-V may agree with the issuer's position they are powerless deviate from policy directives.
40	OSC and TSX-V officials need a basic understanding of capitalism - filling a market need. They need to come from the prospective that risk capital is investing based upon a gamble that the directors and executives can fill the projected market need profitably.
41	OSC and TSX-V consultation with BCSC, ASC, etc.
42	No comment
43	Maybe you should generalize to say principal regulator rather than OSC
44	It is important that issuers and regulators agree on the goals of regulation. (ie - the goal is not the regulation of the rules, the goal is fair and open disclosure). The system often causes inappropriate disclose for the sake of following a rule - a company may be caused to file a material change report because of a change in trading volume or price that itself will cause further swings, in the absence of no real material change in the business...silliness ensues for the sake of following a "rule".
45	integrity to follow - by the issuer
46	If principles are to be the prime objective of market oversight, then it will cost more to issuers for OSC TSX-V to keep a lid on it. Principles will, on the other hand, allow more freedom for creative business practices (which may be a good thing to stimulate productivity), but could allow more abuse....??
47	I think you have mandatory courses for Directors' Officers in regards to principal based regulation - and frequent seminars - think tank meeting between issuers and TSX - Securities Commission
48	accessibility of regulators. regular communication - electronic and I would suggest seminars/workshops on issues either regulators (as a group) or company managements (as a group as determined by requests to regulators) might think are topical.
49	ENFORCEMENT SEEMS TO BE MAINLY FOR THE LITTLE GUY WHO MISSSED A FILING BY A DAY WHEREAS BIG RIP OFFS RARELY GO ANYWHEERE EXCEPT for a LONG DRAWN OUT COURT CASE!!!! REGULATORS usually OVERREACT by MIXING FRAUD WITH GENUINE MISTAKES
50	- Keep it simple - Regulators should consult business as to what may work rather than implementing their idea which is often based in less than the real world. - Market self regulates to some degree. Educate the consumer more to help self-regulation. Do you constantly over promise and under deliver? Educate investors, have them conduct due diligence. - No matter what you have issuers disclose, investors will still lose money and make money, please do not make this another idiot proof design reducing us all that much further towards being idiots ourselves.

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Table 32 Ethics question 1

Suppose that the buyer of a mining claim discovers from independent research (and without involving any trespass on the claim) that the claim follows the line of an adjacent mineral vein, and so the claim is far more valuable than the seller realizes. Should the buyer be legally required to advise the seller about this information before purchasing the claim?							
		2011		**2012**		**Total**	
Response		**Percentage**	**Count**	**Percentage**	**Count**	**Percentage**	**Count**
Yes		12%	10	5%	2	9%	12
No		74%	62	84%	41	76%	103
Not sure		14%	12	11%	9	15%	21
			84		52		136

Table 33 Explanations for ethics question 1

	Explanations for ethics question 1
Those who answered "Yes"—the buyer should be legally required to advise the seller about this information before purchasing the claim.	
2011	
1	There is legal precedent in Canada regarding this issue.
2	It is the "right" thing to do!!
3	Ethics - however, I'm biased as a claim holder. We've been over-staked contrary to AOI *[added by John Allen – the "area of mutual interest" in a joint venture agreement"*] provisions and had many other co's/geo's visit our claims without permission, to get 'an edge'. I think it could partly depend on how ethically the information was attained, and who was acquiring. It doesn't seem right that the seller doesn't benefit from non-disclosure of a material fact.
4	Yes, because it's fair.
5	This applies if the buyer owns the adjacent claim (i.e. area of interest issue). I don't think it applies if good "intelligence" or other intellectual capacity (i.e. interpretation of airborne geophysics) leads to the conclusion that a claim is more valuable than the seller thinks.
6	To maintain the honesty and integrity of management.

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7	I think that should the buyer not disclose the discovery, it is unethical and just opening up a potential future litigation.
2012	
8	Common practice
Those who answered "No"—the buyer should not be legally required to advise the seller about this information before purchasing the claim.	
2011	
9	I am assuming that you mean it lies in the path of the known vein elsewhere and not that the buyer has trespassed on the property to observe it (or used information from someone who has). If he has then it should be disclosed. If he has not it may be a simple geometric extrapolation or result of complex geological analysis.
10	If the seller did their own research, they could find the same information.
11	Many products can be put to non-intended uses, which make them more valuable. There is no obligation to inform the seller. In sugar growing areas molasses is a by-product of refining and is often poured back onto fields as a fertilizer. The pharmaceutical industry can prepare very expensive drugs from molasses. Should they, a purchaser of raw molasses from a refinery, be obliged to say that he has a customer who is in the pharmaceutical industry?
12	As long as the buyer is not using illegally obtained information, and the seller has the right to obtain the same information. As well, veins are not straight, and do not last forever.
13	If the buyer has done - and presumably paid for - his own independent research, he should benefit from that. Also, it has not been proven that the claims are more valuable. It will likely require more drilling, anyway.
14	Buyer beware applies to seller too.
15	The buyer and the seller both have a duty to do what is in the best interest of their respective shareholders and have a duty to understand the assets that each is trading (due diligence). Each party has its own interpretation of the value of the asset and accordingly, the price at which the exchange/trade is to take place. If one party sees value that the other does not, that is part of the process.
16	When we are the buyer or Optionee of the property our internal due diligence checks all information provided by seller or Optionor as we assume it is all data regarding property. If we discover a material deficiency we can choose to discuss or discontinue acquisition plan. We do not feel an obligation to inform the Optionor the reason why we discontinued. Your example above is common, as most mineral occurrences are structurally controlled and the structural setting is most important in our due diligence. If the Optionor is not aware of this common geological fact we feel no responsibility in its education.
17	Everyone has the right, opportunity, and duty to conduct research. We do not function in a socialist environment (as yet).
18	That information is not public information and is therefore meant to be a competitive advantage to the buyer. Sharing it with the seller would enable the seller to seek a higher bidder who had no prior knowledge

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	of the adjacent mineral vein.
19	It is not the obligation of a buyer to correct the perception a seller has about a given asset. Caveat emptor is the key concept in the purchase of any asset.
20	The outcome of due diligence is the property of the person that did it, not the market. The "market" is made up of individuals, each of whom is responsible for and benefits from the outcome of their own efforts. It's not a commune.
21	"If the seller has not done their due diligence on their OWN property, but the buyer has, that reflects the seller's incompetence. If someone is selling an old piece of furniture but does not realize the true value of it, but I, as a buyer, do, I am under no obligation to tell them the true value. The seller should have their asset appraised by a third party."
22	If the buyer, found this knowledge through no breach of a confidentiality agreement with the seller and not through the seller but through independent third party due diligence done or paid for by the buyer- then this information belongs to the buyer, it is the buyer's property.
23	It is the seller's responsibility to determine the value of the asset they sell and not the buyer's. The seller should look to ensure in its legal agreements that compensation for the claim would encompass additional payments if the claim value proves more financially rewarding than originally thought just as the buyer looks to protect itself that it does not overpay for the claim.
24	The seller should not get the benefit of the adjacent owner's geologic investigations, because he did not pay for the data.
25	Both parties are able to do their own independent research. The vendor is either selling his property with representation or "as is". If the vendor makes representation, then he is liable for those representations. In either case, it is up to the purchaser to evaluate the property and to assess its potential. As such, the purchaser is the one who should benefit from his assessment.
26	The value of a property is always a judgment call where the seller and buyer make their decision without any guaranty of success and they are on equal basis in that respect.
27	It is up to the seller to value his property, it is not the duty of a buyer to tell him what it is worth.
28	The question assumes the seller could have discovered the same facts with a bit of work or if the seller had better management. There is no reason to force the buyer to share the fruits of its labours.
29	There is no basis in law to require the buyer to voluntarily disclose information acquired in those circumstances.
30	It is not his property, so not entitled to provide info outside of that.
31	It is not a fact that the vein exists under the claim until drilled or explored, the TSX-Venture is littered with properties like this that never amounted to a hill of beans. We humans are so arrogant that we underestimate Mother Nature. The seller is selling land and should have conducted his own due diligence or hired an independent geologist before offering for sale.
32	It is the seller's responsibility to do the due diligence if somebody shows interest in buying his claim.

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33	Caveat emptor applies to buyers and sellers alike. As long as the information was acquired legally I see no reason to disclose.
34	This is a business issue, not a securities issue.
35	This fact is a private commercial matter and in the normal course of business. It should not be governed by securities rules or TSX-V policy. If it was, public companies would be at a distinct disadvantage relative to private companies.
36	If the information that made the claim more valuable is publicly available, then the person who discovers it is entitled to reap the rewards, not the seller who didn't find the information.
37	Ignorance should not be rewarded.
38	First, so long as the buyer broke no laws obtaining his information, or in no way impaired the seller from obtaining this information, this is the essence of free enterprise - searching for a competitive advantage. Second, there is no way to guarantee that the buyer's information is more accurate until the mine is exploited it is simply the buyer's informed opinion.
39	The information that the buyer obtained was done so by using its own resources and should be considered proprietary.
40	A buyer isn't required to tell the seller of a company, or a car, that the item is more valuable than they expect because of information they don't know yet. It is caveat emptor - the buyer has done more research, and information is lopsided, which is how value is ultimately determined in any market.
41	An ancient business principle is 'caveat emptor'. It seems totally fitting that 'caveat vendor' should equally apply. If this question were reversed, such that the vendor knew of information which diminished the marketability of the claim, our entire business system is surely based on the vendor NOT being required to disclose that information.
42	The seller has equal opportunity to undertake due diligence on their claim. Neglecting to undertake such due diligence should not place that burden on the buyer.
43	The seller has access to attaining the same information.
44	Nothing/nobody misleading in the transaction.
45	"Veins do not go in straight lines and are not necessarily following separate direction, Can veer, dip, stop. Just because it looks like it might be on your ground no reason to be true until it is tested".
46	Caveat emptor and vice versa.
47	Buyer (and Seller) beware. Each has responsibility for their own due diligence.
48	You are assuming that the vein extends onto the claim in question - which is indeterminable until it is developed. You also assume (possibly very incorrectly) that the seller does not know about the possibility of potential value and in his research, has very little chance of actually extending onto the claim. If both sides are happy in their decision to buy/sell - stay out of the deal!
49	Pretty simple: the increase value comes essentially from the buyer's due diligence. Why would he share it with the seller?

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50	Buyers and sellers are responsible for their own due diligence. If they were not then what would prevent any seller to make claims on the buyer in the future. The seller would sell to the buyer but always have the right to make claim at anytime in the future?
51	The seller had access to the same information as the buyer.
52	Perhaps the seller is aware of the information and has discounted it.
53	The directors of a company are mandated to get the best result for its shareholders, and it is up to a seller and a buyer to do their own analysis in choosing to price an asset. Your assertion that perhaps ethics should drive a company to disclose that a seller is selling cheaply is ludicrous.
2012	
54	You are not in business to protect the interest of a seller who has not done their own due diligence on their own asset. This is the seller's problem.
55	You are kidding right?
56	Why should the buyer offer an advantage to the seller if the buyer was the one who did research on the properties surrounding the claim. Who is to say that the claim is more valuable - you could have two geologists give three different opinions. It is still going to cost millions to prove out the theory - nothing is guaranteed in geology.
57	There is no duty owned by the buyer to the seller. Our whole legal system is premised on 'buyer beware'... which means that the vendor is not obliged to inform the buyer but may not misrepresent to the buyer...the converse is also true. If you sell a painting that you hate and I buy it for an agreed price, the fact that I knew in advance that it was by a little known but valuable artist does not change the deal. Same goes for jewelery...if you sell me a ring thinking it is paste but it is in fact a diamond and I recognize it as such does not alter the binding buy-sell contract...think if a flea market or swap meet scenario. Mineral claims are not different. Large mining concerns do sell properties that they, for one reason or another, fail to recognize the potential and someone else comes along seeing the project differently and good things results...that is how it is.
58	There are never any guarantees of how far a vein will run
59	The whole premise of 'markets' is different parties with different knowledge. If each participant had perfect knowledge, trades would nearly never occur. Assuming it was legally obtained, contract law does not have any broad requirement to for parties to disclose privately obtained research to their counterparts in negotiation. Extending such a requirement solely to TSX-V issuers would put them at a competitive disadvantage and discourage listing.
60	The seller should have done the same technical work as the buyer to realize the value of his asset. If the seller did not bother to do this they are negligent.
61	the seller should have done his research. after all he is the owner...
62	The seller is obligated to do his own research and if his neglect on that front allows him to sell his claims for less than they are worth, then so be it.
63	thats just crazy talk. of course not. business is competitive- keep it that way.

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64	It is the seller's responsibility to understand and inform themselves of the value of their property. The buyer has no duty of care to the seller.
65	Same rules need to apply to both sellers and buyers.
66	Places undue burden on potential buyer. Seller may claim later that the buyer knew about something that was really unknown to buyer, but later discovered.
67	It is the responsibility of the purchaser to make a fair and reasonable deal in the first place. In this day and age it is hard to imagine that a vendor would not be aware of the the 'area code' value of his claim before he offers it for sale in the first place.
68	It is the responsibility of the seller to set their price. If I offer to buy a car at a certain price based on my knowledge of the market for that type of car, I am under no obligation to inform the seller that he should be charging me a higher price or, for instance, that he/she has not noticed that all that is required for a substantial increase in the value is a simple and inexpensive repair.
69	It is speculation until proven. Seller needs to investigate motive of buyer and arrange in a sales agreement sufficient protection against something that turns out to be prior knowledge on the part of the buyer which was unreasonably or illegally obtained.
70	Information advantages gained through honest research, diligence, and hard work should be for the benefit the party that has acquired that advantage. In this scenario, to legally require the buyer to disclose the information they hold is the same as requiring the buyer to relinquishing a competitive advantage gained within the confines of the law - that's tantamount to requiring poker players to show each other their hands prior to making bets - it just doesn't make sense. Buyers and sellers all have to take responsibility for themselves, otherwise there's no motivation to exercise your own diligence - you can be lazy and negligent and simply exploit the other party's hard work to your advantage. That is blatantly unfair.
71	If the seller is to lazy to do his/her own homework, than that's to bad. There's a big difference between this scenario + selling something that you know is encumbered/faulty.
72	If the buyer uses independent means, not in any way from the Company or its management, then that is the seller’s problem that they didn't discover this on their own.
73	If one does independent research, the fruits of that research should be his. (the same information found by one one person may not lead to the same conclusion if found by another. So the decision to disclose goes beyond the information. The reason for the decision would depend on how the information is interpreted and that should be proprietary.
74	He found out from independent research, doing his due diligence before proceeding to buy. The seller has every opportunity to do his own research and if he is negligent in doing so, the buyer should not be the one to have to pay for that.
75	Did the buyer spend resources to get this research...did the seller have the opportunity to get the same research? I think you see where I am going...
76	Definitely not, are we to now conduct due diligence for others? This is the same as staking ground - if we have a discovery adjacent to a property using a theory we have developed about mineral occurrences in an area, do we sit on our discovery and wait to test them on our neighbor when the property becomes available and staked by us or do we disclose this information to our neighbor so they may make a discovery? If required to do this you are taking the B out of Business. Hmmm, perhaps I should then be required to

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	disclose where the good fishing is??? On the other hand, if the sellor were to require this disclosure in a contract of sale, then the buyer is obliged.
77	caveat emptor in reverse
78	Caveat emptor - from a seller viewpoint
79	capitalism. This is an arm's length transaction - buyer owes no duty of care to seller.
80	Buyers and sellers all have different views and due diligence. The buyer did his homework, the seller did not.
81	Assuming that the information is freely available to all, the Buyer did his due diligence and the Seller did not.
82	as long as the critical information was equally available to either party using legal means of acquiring same.
83	As is. If you r that dumb you shouldn't be in the business game
84	A good and fair rule should benefit the hard working and smart people. The seller in this case should figure out the value of his claim himself.
Those who answered "Not Sure"	
2011	
85	It depends where the information came from.
86	Would need more depth on the question; on the surface - not really how often in real estate is property bought KNOWING that the value will increase with the implementation of a new road/rail/bridge access??!! So, not sure is the only answer I can give.
87	I am not in mining area - ethically it should be disclosed but the seller has set a price based on their knowledge and the buyer is willing to pay - the ultimate value is irrelevant.
88	This sounds like a question for counsel. It's also a half-baked question. Has the adjacent ground been staked? Are we talking about a claim that has already been purchased? (We're talking about a "buyer" rather than a "potential buyer") Is the seller looking for an area of interest as part of an option agreement? This largely depends, I think, on whether or not a deal has been consummated, and what the terms were. Feel free to get back to me with this one once it's cooked.
89	I suppose it depends on the facts. Ethically the buyer should advise the seller if the property is far more valuable. That said, if the same information is available to the seller and the seller has not taken the time to complete its own independent research, then the obligation should not all rest upon the buyer. Also, it is difficult to really get an idea of how valuable a mineral claim is until you are on the property, drilling and reviewing the results.
90	Depends on whether the information obtained was in the public domain or not. The seller should be aware of the value of the property and hence the knowledge that the adjacent mineral vein was potentially present. The buyer should know what is on his property or is potentially on it.

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2012	
91	We presume the seller of the claim had originally acquired the claim because of its location, that being proximal to a mineral vein. A property acquisition process in the exploration trade known as "tying on ground" in anticipation of creating value based on "closeology". Owners of tie-on ground are traditionally looking to make a quick profit, knowing that the chances of finding a mine along strike from a mineralized vein are about one in one hundred. If, in the highly unlikely event that the independent research had identified a mineral deposit that had economic viability, the purchaser should not legally, but morally offer the seller an underlying royalty that would, if the property came to production, be of significant value.
92	Unlike most venture issuers I have no idea what you are talking about. I am not a mining guy. But, in general, if a buyer sees more value in an asset than the seller, this would be indeed rare, and not likely the obligation of the buyer to disclose to the seller.
93	Depends on who dealing with and deal. Answer is yes if dealing with prospector and no if dealing with major company.
94	Depends on the circumstances of the purchase. If it is "tendered" out to several potential buyers, then it is a competitive system and would not need to be pointed out. To the benefit of the buyer. If it is a transaction where the seller is still involved financially or based on a royalty involvement through the purchase (e.g NSR or NPI or similar) then they need to be informed but obviously the buyer should be able to benefit somewhat on pointing out the oversight.

Table 34 Ethics question 2

You answered "no" to the last question. What if some of the valuable information came from an employee of the seller? – an employee who volunteers information to the buyer without realizing its importance and without telling his or her superiors. Should the buyer be legally required to advise the seller about this information before purchasing the claim ?							
		2011		**2012**		**Total**	
Response		**Percentage**	**Count**	**Percentage**	**Count**	**Percentage**	**Count**
Yes		35%	22	28%	13	34%	35
No		47%	29	50%	19	47%	48
Not sure		18%	11	22%	9	19%	20
			62		41		103

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Table 35 Explanations for ethics question 2

	Explanations for ethics question 2
Those who responded with "Yes", they would change their answer and say that that the buyer must disclose	
2011	
1	If he does not disclose and the vendor discovers the special knowledge and advantage after-the-fact then likely he would try to sue anyway.
2	The buyer has gained an unfair edge from the seller through the tipped information.
3	This information was obtained by the seller.
4	The employee has an obligation to his employer, and this information came to the buyer technically from the seller. This should be discussed with the seller.
5	Obvious conflict of interest
6	In this situation the information actually belongs to the seller.
7	It's selective disclosure and can be influenced by money. That's a breach of trust, not due diligence.
8	This information is now not from an independent source and there should be at least disclosure to the seller of where the information originated.
9	Because the buyer is acting on information from an employee of the seller (who is appears to be in a conflict of interest - even though they do not know they are)...and the buyer did not generate the information on its own.
10	The employee has inside info and therefore should be disclosed
11	The employee has given privileged information and it cannot be used without permission
12	The information came from the seller (directly or indirectly).
2012	
13	Yes because the employee works for the seller...
14	This is now a clear conflict interest
15	The information came from the seller's camp and materially affects the value of the transaction
16	That is a very clear conflict of interest on the part of the sellers employee.
17	It's inside information, regardless of its importance.

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18	In this case, the valuable information belongs to the seller. It is not legal to steal it from his employee.
19	If this proprietary information was leaked by an employee of the seller, you would if effect be in possession of material undisclosed information, provided you could confirm the information (not just misinformation floated to influence buyers).
20	Breach of potentially confidential information.
Those who responded with "No", they would not change their answer and continue to say that the buyer need not disclose to the seller.	
2011	
21	The flaw in this question is your use of the word "valuable" as meaning positive. Valuable information to us is knowledge and information that is negative as well. The employee is an agent of the seller and we assume his job is to assist in the sale of the property and that the Company knowledge = employee knowledge. We are able and accept the responsibility that we can tell what is positive and what is negative from any agent of the company regardless of the fact that he may something that the Company doesn't (which is unlikely) and then decide if the property has value. Overall negative = no purchase and no reason is given.
22	Again, the buyer has no obligation nor should he/she have, to do anything for the seller other than pay for the asset on the agreed upon terms.
23	How would an employee know the true value and not the owner? Again, the owner is being painted as being incompetent. The owner should know the true value of their asset; that is the owner's (or seller's) responsibility.
24	The Seller should fully understand the merits of the property which he's selling. Smart employees should be sharing this valuable information with their respective management team.
25	There should be an onus on the seller to do their homework both internally and externally. If the employee knowingly withholds information from its employer this would be illegal.
26	"Ethics should not be set in law. The purchaser would be wise to investigate the information volunteered from the employee. Once again, if the property is being sold with representation, then only the representations of the vendor should be relied upon. In such a case, if an employee of the vendor disclosed information, he would be an agent for the vendor and as such, the purchaser should inquire to the vendor as to the truth of such claim. In either case, if the purchaser believes the employee has withheld information from the vendor, the purchaser should inform the vendor. That would be ethical. "
27	Same as before. The buyer and seller are making business decisions both assuming that they will benefit from the transaction.
28	Again, no. It appears management of the buyer is smarter / better educated than that of the seller. Why penalize the buyer?
29	The information was not acquired through any act or omission that contravenes a law. The buyer is still not obligated to disclose.
30	The seller would have its remedy against the discloser. Furthermore, the information could be wrong; the buyer has to make a decision regarding source and accuracy (or if it was deliberate misinformation). On the other hand, if the discloser stole the info from his employer, that would be another story.

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31	It is the employee's responsibility to act according to corporate principles or ethics. The buyer may or may not use the information provided.
32	If the information was gained during a sanctioned site visit with insufficient supervision to oversee employees with valuable information; then too bad for the seller. If the employee brought the information forward in an unethical communication then yes, it should be brought to the attention of the seller.
33	Ignorance and stupidity should not be rewarded
34	The employee may be liable to his employer for breaching confidentiality, or securities legislation about material matters, but that is not the responsibility of the buyer of the property.
35	This question refers closely to the factum of the 'Navidad' claims in Argentina. Cdn litigation on this matter has made its determination, with which I disagree, based on my >30 years' experience in mineral exploration. Given the legal precedent, I realize that following my own advice may pose some risks to me - which I am prepared to assume.
36	If the employee had valuable information, it is incumbent on the employee to divulge that to the seller.
37	The seller is still responsible for the choice they make
38	Nothing misleading; employee is an agent of the seller
39	"Definitely not . .. there is no way the buyer should be required to tell the seller something they should already know exception - If the employee tells the buyer that they are intentionally hiding the information from the seller that would be clearly intention to defraud"
40	As before, each bears their own responsibility for due diligence.
41	"How do you determine the accuracy of the ""inside"" information? also how would the employee get this information without the company knowing? Perhaps this is just a false information plant to make the buyer want to buy without proper due diligence. For every theoretical possibility, there are two sides. It will be difficult to regulate knowledge and requirements on both sides of the buy/sell equation."
42	The employee who provided the buyer with such information should be telling his employer - the seller.
43	Same as prior.
2012	
44	Tough luck for seller. Again, seller may assert an employee disclosed information before the sale, but how can it be proven? Leaves the door open for frivolous lawsuits.
45	this issue is one between the seller and its employees. Management of the seller needs to be clear to whom buyers can speak with, and sellers' should always have c/a's with its employees (usually do- I do).
46	This is one point - there may be several negatives that the seller has not exposed or maybe the employee is wrong.
47	The unsolicited actions and/or statements of the seller's employees are the responsibility of the seller, not the buyer.

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48	The seller and buyer need to have access to the same information. If the seller ignores their access, the buyer should not be punished
49	the same rules as "buyer beware" apply to the seller
50	The responsibility for proper disclosure lies with the issuer. Directors are elected by the shareholders - one of their primary roles is to ensure appropriate and effective governance and oversight is dispensed. If the shareholders elect sloppy or under-qualified directors, they should ultimately suffer the consequences! Regulation should not be a substitute for good governance.
51	The buyer owes no duty of care to the seller. The seller has issues with their employee. Why would the employee not make this information known to their employer in the first place, this does not make sense. If the seller believes they have sustained a loss, they may have a case against their employee for breach of contract or breach of confidentiality.
52	The buyer is not responsible for controlling the employees of the seller. (I am assuming nothing nefarious between the employee and the buyer, just an inadvertent employee making a casual comment)
53	same answer
54	providing there is no coercion (financial or otherwise) the same principle as above applies.
55	Often employees may think providing information would help in the sale so it may be innocent comment. More to the point why not disclose the information if it will help the sale and further withholding information could lead to litigation. The buyer is only doing his due diligence in collecting information, as he should.
56	Legally...no, as long as the contact with the employee was above board. Ethically, not sure.
57	It goes back to my previous answer - it would still cost millions to prove out the idea - and the employee would be a geologist and I would assume he would inform the board of his theories and it is their option to accept it. A secretary is not going to have information that the president doesn't already know. A geologist would have told his superiors what his opinion of the property is. I thought it was the job of a company did get the best deal it can for its shareholders (that includes buying claims)
58	I believe the company is responsible for its internal relations and if they handle information without caution or pick poor employees, that are their issue. If that employee asks for consideration for this information then they may be breaking a law to which the purchaser is obliged to inform or be an accomplice.
Those who responded with "Not Sure" and gave reasons	
	2011
59	This sounds like insider trading which is not accepted, but which authorities have much difficulty stopping and proving when suspected.
60	"This is NOT the old ""theft"" of information. Much Supreme Court of Canada precedents on this, make this very clear, this is not theft or misappropriation. The only issue would be what is the exact wording of the confidentiality agreement. It would come down to what

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	that agreement actually states."
61	It is another form of buyer beware again because we are dealing with information from the loose tongue employee of the seller who has NO INTENT to harm his employer. Again it is not the responsibility of the buyer to legally protect the seller.
62	This is a criminal act of betrayal by the seller's employees and the acceptance of the illegal information by the buyer, the transaction would be void by the court, anyway.
63	It depends on whether the employee was coerced into providing the information, and whether the information was obtained legally. If the employee volunteered the information or let slip uncoerced then any issue the seller may have should be with the employee. If the information was not obtained legally, or the employee was coerced, then the buyer should disclose.
64	I find this to be quite grey - the seller should be aware of all information with regards to the property that they own and if they had information that showed that it was completely worthless - would they be required to provide that information? I think that is something that the courts would settle after the fact- buyer & seller beware.
65	it should be treated as inside information and as such i would not get involved.
	2012
66	This is where you get advice from a lawyer.
67	Not sure if he's legally required to mention it, but ethically I would say yes.
68	Not enough information given to answer. The answer could be influenced by the nature of the information, the jurisdiction of the seller, any confidentiality agreements in place, etc. In any event, this is the type of situation that is best disposed of according to law. Introducing regulatory requirements in situations like this could actually complicate the matter by creating multiple regimes to comply with (legal and regulatory in multiple jurisdictions) - regimes which may conflict in certain circumstances thus putting the issuer in a position where it cannot avoid non-compliance.
69	need more facts - employee's are bound by rules of confidentiality and generally if an employee knows "information" so should the employer. from the question sounds like a junior employee who would not normally be expected to have more information than management.
70	Depends on the circumstances; is it an opinion or is it a set of facts. If it is facts then I believe the employee is basically committing fraud for some reason and as a buyer I would disclose the information to the seller. If it is a subjective opinion that is something the employer was not interested in or the buyer placed more emphasis on than the seller in which case as long as the seller had given permission to talk to the employee I think that is simply a difference of opinion leading up to a deal being possible
71	Assuming that the information was freely disclosed (no payments or other coercion by the Company towards the employee), same answer.
72	As per prior answer, seller needs to protect itself and take legal action if necessary

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Table 36 Ethics question 3

Suppose an investor is buying shares of a company trading on a stock exchange. The investor discovers from independent research that the company is far more valuable than the public realizes. Should the investor be legally required to disclose this research to the public before purchasing the shares on the exchange?							
		2011		**2012**		**Total**	
Response		**Percent**	**Count**	**Percent**	**Count**	**Percent**	**Count**
Yes		5%	4	3%	1	4%	5
No		93%	78	89%	46	91%	124
Not sure		2%	2	8%	5	5%	7
			84		**52**		136

Table 37 Explanations for ethics question 3

	Explanations for ethics question 3
Those who answered "No", the investor should not be legally required to disclose this research before trading.	
	2011
1	Investors, unless in possession of undisclosed material information that belongs to an issuer, should be able to analyze and conclude how to handle their risk capital as long as they use their own (or public) information and brains. They can use any "black box" system they like and take their chances.
2	There is no obligation unless they are insiders
3	Buyer has no disclosure obligation.
4	Private research is an expensive product. If the exchange is interested in having private research disclosed, it should pay for it and then transfer it to the public domain.
5	Every share is bought by someone who thinks the company is worth more than it is traded at. Attempting to have everyone disclose this information would become a nightmare. Half the time they are wrong.
6	Independent research will likely tell you that 80% of the TSX Venture stocks are worth more than the public is valuing them. It would be ludicrous and impractical for such an investor to disclose such information. Besides, this research would likely express an opinion regarding value, not an absolute "truth" regarding value.
7	This does not sound probable. Are you talking about insider trading?

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8	If you mean a positive evaluation from independent research as "his own" research it is difficult to understand how the information could have material value unless there's an inside connection to the information, which would rule out "independence." If the independent research is purchased as proprietary by the investor and the research generator is independent of the Company, and a material value change in the shares of the company is predicted, no problem.
9	Independent research implies publicly available info.
10	There is no black box formula to arrive at the correct share price of a company. It is an open free market where the price is what someone is willing to pay, no more and no less.
11	Not his place to do anything if the research he has done is indeed independent.
12	People do independent research all the time to try and find undervalued situations. It is part of what makes a Market.
13	"Why? An investor is looking to maximize the value of his/her investment which in the case of an institution may be finances from a number of individuals. By disclosing their perceived inherent value it may increase the value of the stock, lowering their ability to generate the returns to their investors. Equally, scam artists have been pulling this trick for years... claim value on stock that doesn't exist."
14	Private initiative should be rewarded.
15	I answered this already. The due diligence results are the proprietary intellectual property of the person that performed them. They should not be compelled to give up their rights. Furthermore, they might be wrong. After all, values are in the eye of the beholder - they're just an opinion.
16	"If the investor does independent research that any member of the public can do themselves, they are doing their due diligence. Why would they disclose what they have found? Does Warren Buffett disclose that he has found undervalued companies? No, he invests, then discloses. And even then, he does not have to. Are suggesting some level of socialism here? Do you understand what a free market is?"
17	Prices traded on exchange are market value. The ultimate value is only what is paid and so the investor is still taking risk until the investor can unlock any other value.
18	No inside information, all available in public domain.
19	That's the real value of completing your research and conducting meaningful due diligence.
20	It is a public market. Investors are entitled/obliged to do their own homework from whatever sources they deem advisable.
21	My concern would be whether or not this information was material and available to management.
22	It's not an investor's role to educate the public on his investment decisions.
23	He has discovered the information on his own and has no fiduciary obligation to the public.
24	As long as the company is complying with its continuous disclosure obligations, then all investors should have access to the same accurate information. It seems all too common these days that the share price of companies does not

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	accurately reflect the true value of such companies.
25	If he is right, and if he acquired the information legally, he should benefit from his research work!
26	It is up to the market (i.e. individuals in that marketplace) to value the company. The purchaser is not obliged to tell the market what a company is worth.
27	If this is so, then you just put the entire money management industry out of work.
28	The investor has no duty to anyone else to disclose the fruits of his own labour in acquiring the information. to do so would place an unreasonable expectation on every participant in public markets.
29	Onus is on company to divulge that.
30	The investor should be rewarded for appropriate due diligence.
31	"If the information is freely available then the investor is legally entitled to benefit from the fruits of his labour. Should a lawyer be obliged to disclose to a policeman when a policeman makes an error in processing that will benefit the lawyers client???? What is good for the goose is good for the gander"
32	It is personal opinion. What happen if the independent research company makes a mistake?
33	It's a difference of opinion that makes a horse race interesting. Unless selling for reasons unrelated to perceived value, buyers and sellers of stock always have a difference of opinion about value. Anyone who determines that a stock is undervalued (or overvalued), for whatever reason, provided that that determination is arrived at independently, should be entitled to act accordingly.
34	As long as the information is derived from a fully independent source, there is no requirement to inform the public.
35	The investor is doing due diligence for his/her own purposes.
36	The value of a company is subjective. All material information is to be in the public domain, and as such, no investor may have an unfair and distinct advantage over another. It is legal for an investor to derive a conclusion through mosaic theory.
37	The person / company that uncovers any publicly available information that the company or general public is unaware of should be the one who benefits.
38	Individual initiative within the law should always be rewarded. The investing public would have access to the same information as the investor with initiative. Investing for profit is not a communal activity. Lazy "investors" deserve nothing.
39	This is the point of independent research. As long as the investor did not have insider information that was not available to the general public he should not be punished for doing a superior job of analysis than other investors.
40	I consider this proprietary information because the investor used his own resources to come to his conclusion and was not paid by the public for the research.
41	The investor did his homework aka due diligence. He isn't paid to help others realize this.

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42	Definitely not. Arbitrage is powered by lopsided information. Profit can be realized any time someone knows more than someone else.
43	Reaching insights such as this is one of the purposes of conducting independent research. It is at the heart of capitalism - and of free markets.
44	Huh? Are you saying that the investor has inside information that other investors don't have? Otherwise this doesn't make sense to me.
45	Provided that the independent research carried out did not involve inside information and was readily available to all investors that cared to research it is information that is available to everyone.
46	Investor is not an insider of the company.
47	The company is responsible for the public disclosure of any pertinent information.
48	The market supposedly represents values; they are established by buyers and sellers.
49	Independent research should be done by all before investing if he found something he can act not inside information only
50	"Absolutely not . . .why do independent research if it's of no monetary value? Lack of independent research will lead to more insider advantage and hurt the long term knowledge in the marketplace. PS - just asking this type question demonstrates the ignorance of the questioner or those pressuring him or her to ask the question"
51	"What if the research (completely contrary to general knowledge) is significantly flawed? You could have just caused a run on the market where significant numbers of people could get hurt. This is a silly argument."
52	It comes exclusively from its own due diligence. Why would he share it with others?
53	Independent research is the cornerstone of good investing. If the info used is in the public domain then good investors will use it, and should, to their advantage. This is what separates good managers from the others.
54	There are many companies that trade below their value. It is not an individual investor’s role to ensure the public is aware of the value.
55	The public is never fully informed nor can they be. It is possible even in the simplest transaction to overwhelm the public. e.g., ask yourself how the Black Scholes pricing model on options works and how it affects a junior's share price. Not one in 10,000 can answer this, yet virtually all juniors issue options.
56	Stupid question.
	2012
57	With the very large assumption that the individual has no connection to the Company, and the data obtained is not from an insider, no. Differing amounts of knowledge is part of the market.

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58	Why? Let the public do their own research.
59	Value is a matter of opinion, not a matter of fact. Investors should be able to act however they want when acting on their own research - no one else should be entitled to benefit from the investor's hard work and analysis.
60	U don't know if it's true
61	Too subjective. Investor may be using different criteria than other investors.
62	This would prejudice the the right of an investor to keep proprietary information to himself. If this right is not protected every acquisition would attract litigation or no research would be done if the reward is taken away.
63	This is capitalism - remove this and it takes away from what our economy and system is all based on.
64	The same research information is available to everybody
65	The same as with the mining claim. Anyone buying shares on the open market has the ability to do the research for him or herself.
66	The investor owes no duty of care to the public in relation to this matter. The company may be doing a poor job of disclosure.
67	The buyer has done their own research to formulate their opinion of the value of the asset and should be allowed to act on that analysis.
68	So long as the research was legal and did not include any insider information! The company should have been able to do the same and therefore disclosed it - see previous answer.
69	So long as no inside information is gained, buyers should not be required to educate anyone with information they spend time, money or energy obtaining. So long as the information is legally obtained.
70	Should the Company, for internal strategic reasons such as negotiating terms of additional asset acquisitions, may not believe it to be in the best interest of its shareholders to disclose corporate strategy yet to be consummated. Forcing the investor to be legally required to disclose results of his research could impair the company's market capitalization and shareholder value. Further to which subsequent litigation could have far-reaching effects.
71	same answer
72	No. Independent research could (1) be wrong, (2) not bear fruit, (3) be internal to the buyer, (4) depend on faactors out of control of either the seller or the buyer.
73	It is public information, no obligation to force feed people; one would have to wonder about the competence of management and the board though.
74	Isn't that the whole purpose of research, trying to identify an opportunity before others.
75	Investors that do their own or hire others to do research is fair ball. theoretically, any investor could do similar research.
76	Investor needs to be rewarded for his effort
77	If the information is in the public domain, the investor has no responsibility to disclose this information to the public

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78	If investor prepared to do own research he should benefit from it and have no obligation to the general public
79	If he is basing his opinion on publicly available information, there is no need to publish his work product.
80	I wish we had more shareholders like this!
81	I am sure if he published what he knows he would be crushed by the securities commission - he would be asked to provide independent studies from what he found out - he would be forced to prove to the Company, TSX, and securities commission his public statements (making him libel). My guess is his safest bet it to keep his mouth shout - you never know - his research could be wrong and he loses all his money
82	He should not be legally required to do so if he is not an insider and get it from his independent research. He might not be sure whether his opinion is right or wrong. His purchase might be highly risky.
83	He should be rewarsed for his research.
84	From the investor's own analysis of publicly available knowledge, the investor has determined that the shares are undervalued. He/she are under no obligation to give away this analysis and no-one has a right to demand it.
85	due diligence
86	crazy talk. arm's length investor can do what it wishes.
87	Cmon, that's a ridiculous question.
88	as long as the investor is only utilizing public info and is not himself an insider or control person.
89	As long as no laws have been broken in acquiring the information there is no obligation to tell anyone else about your personally researched information.
90	Again requires investor to disclose what may or may not be material. How is he or she to decide? Again places undue burden on investor and opens him or her to frivolous lawsuits.
91	again capitalism - this is how market efficiency works. investors analysts etc. compete to outwit and find temporary inefficiencies.
Those who responded "Not Sure"	
91	"Yes to disclose if the information came not from some public source. No if the information was available for all who cared to do some basic research."
92	In this situation I think I would need to know specific circumstances such as why the company is so undervalued in the first place.
	2012
93	The research is not the Company's copyright.

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Those who respondent "Yes"	
	2012
94	If he is gaining the information from insider information, then yes. If he has done analysis and valuation and has found out there is more value to the Company that is his benefit. If he is going to finance the issuer, then he should disclose this to the management.

Table 38 Ethics question 4

You answered "no" to the last question. Would your answer change if the source of the information is from an employee of the company who volunteers information to the investor without realizing its importance? Should the investor be legally required to wait for the information to be disclosed to the public before purchasing the shares on the exchange?							
		2011		**2012**		**Total**	
Response		**Percent**	**Count**	**Percent**	**Count**	**Percent**	**Count**
Yes		64%	49	72%	31	67%	80
No		18%	14	22%	10	20%	24
Not sure		17%	13	6%	3	13%	16
			76		**44**		120

Table 39 Explanations for ethics question 4

	Explanations to ethics question 4
Those who responded that "Yes", their answers would change and the investor should wait for the information to be disclosed.	
	2011
1	I think this is in fact the law regarding material undisclosed information. An employee is responsible to his company and therefore not allowed to give out proprietary information on his or her own.
2	The buyer now has material undisclosed info, so cannot trade.
3	Obvious.
4	That is by definition insider trading (trading on information known to insiders of the company and not the public).

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5	He has come into possession of "insider" information and knows that it is insider info.
6	That would be classed as insider information.
7	This is insider trading, is it not? Is this information material non-public information?
8	Tipping is illegal – period.
9	Insider information, makes the buyer a tippee.. against securities laws.
10	That situation refers to insider information ... and should never be tolerated.
11	"Yes---because otherwise he would be trading on insider information."
12	Trading on insider information is not only unfair, but illegal.
13	It is insider trading pure and simple. It is illegal again common sense.
14	It is inside trading.
15	Yes - this is now in the realm of tipping, or insider information.
16	That is a company disclosure issue.
17	It's insider information.
18	If the investor does not wait then they are acting on insider information.
19	That would make it insider trading which is illegal.
20	If the information is material, it should be publicly disclosed before an employee is allowed to talk about it to the general public. Otherwise, this is a securities violation.
21	My answer changes because the information now becomes material information not generally disclosed to the markets - the recipient is either a "tippee" or dangerously close to being one - as defined by insider trading laws.
22	Relates to previous comment. I can see where you are going now...
23	That would be insider trading therefore it should not be acted upon.
24	This becomes insider information.
25	In this case the investor should inform the company or the regulator.
26	Tougher decision, but limited disclosure is a "no--no". The employee represents the company, no matter how stupid he or she may be.
27	He should not buy the shares; he's got insider info.
28	Insider information was disclosed.

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29	I think they are already required to do that....it is called tipping and would put the buyer off side with insider trading rules.
30	It would become insider trading.
31	Inside information is inside information.
32	Absolutely! All employees need to be aware of insider information and be reminded by the company that sharing information that is not publicly available to anyone outside the company.
33	The source is non-public and material. It must be disclosed.
	2012
34	Yes - then he has received insider information from inside the Company - have now idea how you in force that - and inform the public about it - don't think there is a lot of that insider trading going on - more important insider trading going on with press release being leaked before being disseminated - would be a waste of time and resources to go after the accidental leak (don't see it as rampant as other insider trading issues)
35	this sounds like deliberate tipping
36	this really is an issue between issuer and its employees. the employee is liable in my opinion, not the issuer.
37	This is now inside information and must be treated as such.
38	Then it is not entirely independent.
39	The investor would be in possession of material undisclosed information.
40	The information is now likely an insider tip, and the individual should not trade until it is public. This is a reasonable limit on the market given the range of investors.
41	That's inside information whether intentional or not.
42	That is a clear conflict of interest on the employee's part, and insider trading on the investors part.
43	sounds like "tipping" and there are rules covering this already which should be known.
44	It's an investment decision made on the basis of inside information.
45	It is insider information and it does not matter how it was obtained or by whom.
46	Investor becomes party to insider information.
47	information should be of full disclosure to all to have everyone on the same playing field
48	if material inside information, that is essentially current practice and law.
49	If it is "insider" information then the buyer must ensure it is public prior to buying shares.

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50	If he is trading on material undisclosed information, he is guilty of insider trading.
51	I do not think the person should buy shares as he is now privy to inside information even if the employee does not recognize its significance. I would phone a director and stress the need to disclose asap
52	Employee information is inside information in my opinion
53	Arguably falls into "special relationship"
54	Any person trading on the basis of undisclosed material information might be guilty of insider trading.
Those who responded that "No", their answers would not change.	
	2011
55	It is the issuer's duty to make sure that employees do not disclose confidential information and is the officers of the listed to make sure that data that could influence purchases is not readily available to employees who do not know of those restrictions.
56	Does the employee know the difference between "important" information and "material" information? Does the investor know? If the investor acts on the information and it turns out it was "material" this could be a problem, but we do not think there is an obligation on the part of the investor for public disclosure. His decision is to buy or short the shares or not based on his analysis of the information and his awareness of what is material and what can significantly change the value of a company (up or down).
57	"The onus isn't on the investor here; it's on the employee (and possibly his supervisors) to know what's public and what isn't, and to keep his mouth shut. Did the investor even know if it was public information? He could have figured, by virtue of the fact that he was being told, that it was public."
58	If anyone had access to the same employee but failed to ask the right questions, then no, this investor ought to be able to benefit from his own superior due diligence efforts.
59	The information was not acquired under false pretenses. It is the responsibility of the issuer to advise its employees on confidentiality policy.
60	Yes if the information is material. No if it is immaterial.
61	Anti-insider knowledge rules hurt in the long term .. . this is not even an insider knowledge situation being described . . . sorry but trying to make legal activity illegal just does not make sense . . if there is collusion or fraud .. . that's different . .but the above describes neither.
62	"If you are judging whether to buy shares based on employee's information, I suspect you will be disappointed in the long run. However, if your information is coming from an officer or director of the company, you are de facto an ""insider"" and are already precluded from buying, just as the other insiders are."

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	2012
63	The investor would not necessarily be in a position to determine whether such information is material and non-public. Sophisticated investors are well versed on what they can and cannot do with misappropriated information and already have standards they have to adhere to (i.e. CFA charter holders have a code of ethics covering this). It would be blatantly unfair to hold the general investing public to the same standards when they do not have the information and education to adhere to those standards.
64	Same answer as before.
65	same
66	Owner should have a disclosure policy for employees. The employee needs to sign off and be aware of the chance of prosecution for breach
67	It is the responsibility of the issuer to ensure inside information remains inside. Again - investors should not be made responsible for someone else's poor oversight or governance practices. More emphasis should be on penalizing the directors/officers that allowed this to happen.
68	If any employee discloses confidential information, that is already addressed. If it is not confidential information but does provide strategic benefit, the acquirer should not be obligated to wait for the information to go public. Very often the information one gets does not meet the materially test and does not meet disclosure requirements. If it does, it should be held as confidential and not disclosed by employees.
69	Ethically yes, he should wait. The employer should educate the employees about the importance to keep certain things quiet until it is publicly disclosed. If they have been educated the person should lose their job.
70	All of which is too difficult to define, regulate and enforce. A marketplace would not exist if there was a common sharing of opinion based on disclosure to the public.
71	Again, the actions/statements of an employee regarding the business are the responsibility of his/her employer. If you do not want your employees giving away potentially valuable proprietary information, then give them instructions not to volunteer information. If they do not appear to have the necessary judgement, then do not hire them in the first place.
Those who responded that "Not Sure" if their answers would change	
	2011
72	"Do you mean buying insider information? Disclosure before purchase would be an admission of intent to do inside trading."
73	Depends on the status of the information and the nature of the information.
74	It depends what kind of information this is. If the information is material, non-public information that could have a material impact on value or share price, then yes. If the investor is in possession of such material, non-public information, then he should make this information public before buying.
75	I think it should be disclosed - but then it depends on the nature - I don't know.

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76	Would depend upon the context of the employee divulging such information.
77	I answered "no" to the last question assuming that the company was compliant in its continuous disclosure obligations. While it seems unethical for the investor to purchase securities in this fact pattern, I think the onus should be on the company to have staff that are knowledgeable and skilled in the company's business and also to disclose any material information once received. Management should consider implementing black-out periods and reviewing confidentiality concerns with employees if material information is pending. The arm's length investor should not be put in this position in the first place.
78	If he is not an insider himself he should be allowed to benefit from his "research" efforts. However, the company that let insider information be released could be in trouble...
79	"It's complicated! We have a Question of disclosure from management ... "
80	Again complex and depends on a variety of factors.
81	The question is too broad - it would depend on some of the circumstances. Generally, any information, however obtained, provided that it is not illegal to listen to it, should be OK to act upon. It is the management of the company itself which is in error in that it does not appreciate its asset value. Fire the management.
82	Question for securities lawyers.
83	The test should be whether the information is inside information. A classic example, highlighted years ago by Peter Lynch, is Chrysler corporation in the '80s. If an employee noticed that the 1 millionth magic wagon rolled off the assembly line in record time, and concluded that this should lead to record profits and a corporate turnaround, the employee or investor to whom he relayed this information is just making an astute investment to buy. However, if the employee disclosed the actual financial results, this is insider information and the investor/employee should not be legally able to buy. In the first scenario it is not certain to the buyer that Chrysler will have superior results, it is an assumption, in the latter scenario it is certain.
	2012
84	The correct answer is actually 'not clear' rather than 'not sure'. I think that legally there has been no illegal tipping by the employee, but there is still a question of insider trading on the part of the investor...and it might turn on whether or not the investor knew that the information was insider knowledge.
85	Nothing is pure black and white. Your question is coming into a gray area. I would keep saying "no" if the investor make his own analysis and draw his own conclusions after discussing with the employee of the company about its pulic information. I will change my answer to "yes" if some material and factual information such as new assay grade, interval, thickness, tonnage is provided by an employee to the investor before they are disclosed to the public. In brief, the key issue is how to define the source of the information, personal understanding/opinion or factual data.

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"What other factors do you think influence whether or not principles-based regulation would be effective for venture issuers?"

Table 40 Other factors

	Responses
1	There will be people who try to take advantage of it either by pushing the envelope or even as a framework for fraud. Principles are in some ways harder that detailed rules, although if properly adhered to would be more useful. Arguments against would be lack of comparability even if more accurate and higher costs of both compliance and enforcement in all likelihood.
2	There is inconsistent application by TSX-V and OSC of regulations.
3	They must promote transparency and a level playing field for all issuers.
4	I don't think principles are the road to take. Take a look at the rules-based systems that were required to get civilization to where it is today - Hammurabi Code, Justinian Institutes, Civil Codes. Then in the common law world - Criminal Codes, Family Codes and the Uniform Commercial Code.
5	Compliance enforcement and a strong regulatory body
6	1) Can issuers be held accountable to principles? 2) Do issuers have principles?
7	You will need to sensitize officers and directors to such principles. This will be a culture change for many.
8	We already view the relationship in this way in that the board of venture issuers has to determine what is material and when to disclose it. The investor has to know what to base its decision of owning venture issuers shares or not and be responsible for that.
9	Pragmatically, look at the mess in the US under its penalty-based system, rather than principles-based.
10	Principles vary by cultures and rules that vary by culture would be absurd.
11	Well, in Japan it is expected that people trade on insider information. I like our system better.
12	I am not sure; I would have to look at the concept with more clarity than I have.
13	Venture issuers are inherently risky. Investors should be protected from fraud and misrepresentation, not from risk. It's an uncertain world in the venture market - regulation shouldn't attempt to reduce that risk, only present it for what it is. Rules-based regulation inherently creates filters that the unscrupulous presenters can use to hide important information from the market. Principle-based regulation is more robust, although it's more difficult to enforce.
14	Principles-based regulation will achieve benefits for consumers by fostering a more innovative and competitive financial services industry. Principles-based regulation also offers effective protection as senior managers drive the changes necessary for their firms to meet the Principles.
15	The rules should be more adaptable to the specific situation of a company.

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16	Those are bad examples of principle based governance; they are all governed by securities laws and rules. You need better examples of governance systems, for example: a) M&A b) Material facts c) Press release and "Spins" d) Future events e) Accounting Policies and IFRS vs. GAAP f) Mining reports 43-101 etc, etc...
17	Principles-based regulation works fine so long as everyone involved has principles. That's a tough thing to govern.
18	Don't know.
19	Degree of compliance, clarity of regulations, manner of corrective measures, means of disciplinary action available.
20	The actual honesty and business practices of the management of the company in question
21	Small issuers have not the same budget to staff its disclosure team! Principles-based should be enough ... shareholder should decide to buy or not if they are not satisfy with the disclosed info - compared with the standard in the industry
22	None.
23	Exact location of claim boundaries, especially when there is a discovery, then they should be surveyed.
24	The principles have to reflect the real world. The regulators have to get out of the board room and let the directors do their job. The Founder's Policy from Dec 2007 is one example of a horrible regulation that cripples boards and undermines transactions.
25	Public confidence in such an approach would be improved if the regulatory authorities impose severe penalties including substantial fines and lifetime bans from the public markets of those caught in breach.
26	Would it be a Material change or not is the factor
27	Basic rules published in simple English not legal BS that can be understood by all.
28	Investors/shareholders are entitled to material or relevant information on a timely basis: that principle I agree with unequivocally. Principles, in my opinion, do not readily lend themselves to specific rules. The rule drafters are always going to miss something. No one is smart enough to contemplate every possible contingency or permutation.
29	Not sure.
30	Enforceability Interpretation Impact on public - depends on what the issue is, some are less sensitive than others. Cost - should have a 'streamlining' effect that would be welcomed by many issuers. There comes a point where the camel's back breaks.
31	Size of the firm, in terms of market capitalization, total net tangible assets or other measures.
32	No comment.
33	N/A
34	It is my belief that persons investing in the capital markets must take responsibility for their decisions - and that this is especially so in the "high risk / potentially high reward" world of junior resource markets. Enforcement of principles-based regulation, to prosecute and obtain disgorgement of ill-gotten gains from transgressors, is the way to go to

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	discourage the predatory players in this industry. But we do NOT need "super-Nannies".
35	There are over 1700 mining companies alone on the TSX-V and policing them is a task that is currently underfunded. Working with anything other than a principal based system would be more expensive than companies or investors would be willing to accept. Not sure how a merger with the LSE is going to help the individual investor and it is certainly going to cost companies more money.
36	Each and every situation is different in some way or other which is why I believe guidelines of past experiences lend themselves to the guidance for the future.
37	I don't see how principles-based regulation can be sufficiently described/defined/documented/enforced to assure an effective and fair market place.
38	The speed of the regulation being enforced and transparency of the transactions.
39	Cost/benefit analysis costs of compliance and costs of policing would kill the goose.
40	I believe that most issuers are honest and work for the benefit of the shareholders and the interested public. However, the few percent that are not get all the press. This distorts the actual reality and causes the regulators to react - possibly with more posturing than required. I still think it is better to quietly maintain a position of auditing a limited number of issuers and prosecuting those that don't comply with the rules.
41	I think the practical application of principles-based regulation would definitely cause some confusion for venture issuers since the standards would be so broad and it does not seem to be clear to me as to how such principles would be measured or enforced.
42	Streamlined listing process that will be far less costly for the investing public. Although, this may come at a cost of regulatory jobs, I believe entrepreneurialism should be encouraged, on broad levels, as opposed to punish by unnecessary costs.
43	Probably many I can't consider now.
44	We already have 'principled based disclosure'. It's called a 43-101. To implement regulation along the lines suggested by this questionnaire would be preposterous.
45	Not sure.
	2012
46	what are the costs to the issuer to do this? ie) legal costs, exchange costs (passed back to the issuer), etc. would it be more or less costly overall?
47	Unfortunately, you will not be able to remove all of the rouge people who would cut corners and not give proper disclosure.
48	Too much legalese will become indecipherable to non-legal experts and hence principles should be outlined. A smart issuer, knowing the principles, will seek proper legal advice for the detail but will be aware of the general principles.
49	The volume of information that any issuer must sift through with respect to compliance is very expensive. In theory, principles-based regulations should be more cost effective than extensive, restrictive policies. With small venture issuers with limited cash positions and management resources, it could actually be detrimental to shareholders if venture issuers have to devote too much management time and money to compliance rather than working on the

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	venture issuer's business objectives.
50	The regulator also has to understand that decisions made in real time must be reviewed in light of the circumstances at the time the decision was made and based on what a reasonable person would be likely to conclude in those circumstances.
51	The knowledge and integrity of management.
52	The fact that being ethical and honest does not seem to matter anymore when money is involved. You can't do business on a handshake anymore. When the bottom line is in danger, principles get thrown by the wayside. May be cynical but alas we've had to change the way we do things because the old way of doing things just doesn't work anymore.
53	The ability of the various SCs to apply them fairly.
54	Strict enforcement for those issuers that violate exchange regulations.
55	Speed and flexibility for juniors Project by project basis for discipline or investigation by regulators Ability for limited skilled boards inherent in junior companies to do the best they can to meet disclosure rules Principles-based is easier to educate people on. Rules-based is easier for lawyers to work on and directors and management never gain experience and education because the lawyers are doing all the work and companies only learn from mistakes (which would be very costly) compared to the cost of education for Boards.
56	see previous answers
57	Regulators like rules to follow and enforce, judgement is hard to regulate and is shades of grey, but that usually resulted in more meaningful disclosure
58	Regular reviews of issuer disclosure under principles-based regulation would help compliant issues improve disclosure and give the regulating authority a better idea of who to review more often.
59	Quality of regulatory and TSX-V staff. training, etc. it is a big change from current practice.
60	Principles-based regulation cannot be applied to a market place functioning on risk capital investment. The existing regulatory environment for TSX-V is more than adequate and has been so since its conception. Another layer of "regulation" imposed by authorities who do not understand the necessity of risk capital investment would hasten the demise of a financial institution that has created real wealth not only for Canada, but many other parts of the world.
61	principles-based regulation sounds like the best policy but a mixture of both would provide a fairer market since principles can be broadly interpreted.
62	Principles are a personal thing and rules are meant to level the playing field. This means that the exchange should be very cognizant of the principles of individuals allowed to act as Directors etc. if it is principle based. I feel that this was lacking in the 08 meltdown all the way up the highest levels. Rules didn't help.
63	No comment
64	It is more in keeping with the nature and capabilities of a Venture Issuer
65	In order to be effective needs lots of communication between regulators and issuers. Need to have a joint discussion with the regulators and Issuers. Also need mandatory courses.

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66	Impartially
67	If everyone acted within their stated parameters such as: This survey is estimated to take 4 minutes of your time when in fact it takes much longer than that for me, am I average, best case or worst case? - Has the issuer of the survey actually tested this time determination? if so with whom? Where is this disclosed? - Perhaps the issuer is acting from the best case scenario which is just that, the best case, what about the average case, or worst case, what about a range, for instance, this survey will take between 4 minutes and 30 minutes. - Maybe it's just a matter of interest in contributing to this and if I were to do my due diligence to find that it actually takes on average 30 minutes then I can draw my own conclusions to contribute or not. - Perhaps the issuer of the survey should be required to construct a website divulging the survey in its entirety prior to the survey beginning it and provide an opportunity for the predecessors to comment. - Perhaps next time I see a survey like this I'll say to myself, nope, it is way too much time. I hope that you may be able to see a parallel here. Thanks
68	Focusing on the big rip offs and show some leniency for the juniors, especially first time offenders.
69	Everything is dependent upon the issuers good intentions, i.e. that they WANT to be good corporate citizen
70	Ethics, skill and experience of management. Demonstrated performance of the Company.
71	continuous disclosure and corporate governance in place for pubco
72	Any thing that makes sense.

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Appendix B – Expert interviews

Ian Bandeen

Bandeen believes that, in comparison to the US, securities regulation in Canada is very much principles-based. Directors of public companies have a fiduciary obligation to operate in the public interest; rules are not exhaustive but are applications in specific cases. This is different than in the US, where rules are typically seen as limits and market participants will hire lawyers and accountants to skirt them, often with seemingly no care to underlying principles.

The Americans tend to be pioneers in financial matters, according to Bandeen—for example, securitization, multiple market trading, and high frequency trading. Financial pioneers create new kinds of markets, and then the old guard starts demanding reviews about "unfair trading practices", forcing regulators to embark on time-consuming, consensus-building, exercises. This is partly why US rules are a nightmare. They don't start from first principles, but react to new products after-the-fact, and so the evolution of US regulations are difficult to navigate and often seemingly circular. Generally speaking, Canadian regulators have the luxury of coming to the game later, can see what happens in other jurisdictions, and can structure our markets to adopt the best and avoid the worst practices.

The banks have had a disproportionate effect on the markets in Ontario, according to Bandeen. They and their agents have the resources to dedicate time to write comments, gather a consensus, and storm the Bastille. Physically, their head offices are near the OSC. They will be at the table, 85-90% of the time. I have seen instances where OSC staff say that they've received 28

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comments that said one thing and 2 comments that said the other, so they've assumed the majority of comments reflect the industry; but often, it's just because smaller issuers don't have the resources to follow the regulations and make comments.

Bandeen worked at McLeod Young Weir and Burns Fry before they were absorbed by the banks in the late 1980s and early 1990s, and he described the cultural shifts that happened. I-banks were very independent, said Bandeen. "It was your own capital; decisions were made swiftly on the right basis, with the level of risk management that a prudent owner of capital would employ. The IDA was your own club, and the presidents of various investment clubs were rotating chairs, so it was a different world, more clubby, but also perhaps more conscious of the real risks involved in the business." In contrast, the banks are very bureaucratic, with a mandarin level that acts as a buffer between lines of production and decisions, said Bandeen. The banks are supposed to be well regulated deposit institutions, and so they have shut the junior issuers out of their retail systems to avoid reputational risk. As a result, Bandeen said he was beginning to think that it might have been a fundamental regulatory error to allow the takeover of these I-banks.

The banks are used to oversight from OFSI, and so they have the resources and experience to handle the increasing levels of regulation, said Bandeen. For the little company, compliance is much more onerous. Bandeen said that he has been in heated arguments with those, usually now part of the big banks, who say that juniors are currently in a cyclical down market, that the weak will be weeded out, and that new stars will emerge when markets recover. Bandeen thinks this might not be true. The increased regulatory compliance is material. I hear of people spending

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30% of their operating expenses on compliance, often resulting in little or no profits, said Bandeen. This does not bode well for the junior or early stage companies, he said.

The regulators have said in public that they wish to re-visit the whole subject of disclosure, said Bandeen. There is a school of thought that the prospectus model is broken and that the disclosure process has become lawyered up with reams of unread material. We have to modernize the rules to reflect how the world works, which is a wired, connected, global place, said Bandeen. People have access to a large amount of information. Hardly anyone reads the disclosure documents. Most people who want to learn will Google the business, read about management, and search with a few provocative words to check out the negatives. What they really want is timely financials, material risks, a summary of the product, and a summary of the managers and principals involved. It should be in an accessible language. CSNX is a model with meaningful transparency. We did away with the hundreds of pages of often conflicting prescribed rules such as you would see with the TSXV and went instead for simple to read forms and rules.

The accredited investor concept is outdated and very elitist and paternalistic, according to Bandeen. Just because someone has money, doesn't mean they are sophisticated. Bandeen would rather focus on meaningful disclosure and transparency, and have qualified advisors review for suitability. Younger kids, of 20s and 30s, are more sophisticated about technology businesses. If they want to invest $5,000 in a company that they think will catch on, why do we think that the regulator knows better? At the end of the day, who are you protecting? People

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should understand that it is a risky venture and that they could lose all their money. The advisor should sign off that the client understands. Suitability rules should be principles-based.

I asked Bandeen about a CPD education requirement for directors of venture issuers, and he said that one kind of education would be to beef up enforcement so that people clearly understand what is considered bad behaviour and that there are tangible, significant, costs to conduct one's business inappropriately. One problem with CPD, he said, is that it would just feed the business schools, which are very expensive. But maybe it's not a bad idea, he said, as long as it doesn't become perfunctory. For example, most people wrongly think that that their only obligation is to the shareholders, rather than the broader stakeholder groups, said Bandeen.

Elaine Ellingham

Prior to demutualization in 2002, the TSX accepted listings in a discretionary, principles-based manner, said Ellingham. For example, the foreign company listing policy used to be unwritten, so the TSX imposed requirements without any specific rules—eg. at least two Canadian directors, broker sponsorship, a sufficient distribution of shareholders in Canada, or an office or an investment relations person located in Canada. A larger issuer with noteworthy management, with more ties in Canada, could be listed more easily. If some of the managers had been involved in companies that had imploded, an independent director would be required. Similarly, when the technology boom happened in the late 1990s, technology companies that didn't have any revenues were listed, on an exceptional basis, by the application of underlying principles. It was in some ways an old boys' network, according to Ellingham—a lot depended on reputation and who you knew, but underlying this was a principles-based application of precedent—if we

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granted an exemption for this one, we should do it for that one, depending on the underlying principle of investor protection. 50% of TSX management were lawyers who understood this precedent-based application of principles.

When the TSX was demutualized in 2000 and became a for-profit business, there was a major paradigm change, said Ellingham. The TSX looked at where its revenues were coming from and no longer saw itself as a regulator, but as a business. TSX clients were the listed issuers, who paid our fees, and the more listings that the TSX could acquire and the greater their growth, the more profits there would be. The TSX had targets on the number of new listings, and so the focus changed from protecting investors to growing the TSX business.

The OSC had to decide how it was going to audit us, since the TSX was no longer seen as a partner protecting investors, said Ellingham. To meet this concern, the TSX adopted rules and standards, which could more easily be verified on audit, rather than to allow discretion. Though the TSX corporate manuals may not have changed much, the application of those standards changed profoundly, said Ellingham. The TSX also cut costs by hiring people with business, marketing and relationship management experience—MBA graduates who could apply standards to be verified on audit, rather than (more expensive) lawyers who could apply legal precedent.

The effect of moving to standards rather than discretion is that you don't always get a sense of what the company is trying to do, said Ellingham. For example, Ellingham was involved in the listing of Amica retirement homes, which started with the name Ishtar. The prospectus was very confusing: retirement homes, with gourmet food, etc. "It was, as it turned out, middle-eastern

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people who were immigrating and bringing their parents, and they saw that there were no high-end retirement homes, so they thought it would be a good business. It did become a good business and meeting the people and getting outside the strict application of rules was important."[475]

When dealing with the smaller issuers on the TSX-Venture exchange, where the management teams are often not as sophisticated as those listed on the TSX, rules may be preferable, said Ellingham. Of their 1800 listed TSX-V companies, Ellingham described how many are quite strange. The rules can help control them and avoid reputational risk to the TSX-V and TSX. This is why we have two tiers on the TSX-V, so issuers can graduate and move to the more principles-based TSX, said Ellingham.

Brian Prill

The problem with principles is that the regulator may have in mind what they should mean, but the business community may operate on a different understanding for years, said Prill. Honest business people can believe that they are in compliance with the principles, and then face major adjustments and possibly enforcement proceedings after-the-fact.

For example, Prill was providing the initial comment letters on Instrument 31-103 regarding Exempt Market Dealers. The conflict of interest disclosure required for an underwriter in 33-105

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[475] Amica Mature Lifestyles Inc. is now a leader in the management, marketing, design, development and ownership of luxury seniors residences. There are 23 Amica Wellness & Vitality™ Residences in operation in Ontario and British Columbia, Canada, with a market capitalization of about $260 million as of July 2013.

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is quite clear and rules-based—there is a 10% test for related issuer disclosure. But similar requirements for a "connected issuer" in 31-103 are principles-based and hard to assess, said Prill. If the connection is less than 2% of the outstanding securities, is it *de minimus*? The principles do not give guidance. By comparison, audit committee rules do have a *de minimus* test of 5%. As a solicitor, there is a tendency to be very conservative so that your client isn't the poster child for a 20:20 OSC interpretation, said Prill. Another example referred to by Prill is referral arrangements. Rule 31-103 requires disclosure, but it is unclear whether or not a trailer fee would be allowed among EMDs—it is permitted in the mutual fund industry. Prill has called staff of the OSC for guidance and was told: "We think that all the guidance is out there, and if you need more guidance, contact a solicitor. Well, I am a solicitor and some things need more guidance."

I asked Prill whether or not a continuing education requirement would help the industry, and Prill said that he didn't think it would make much difference for the managers of venture issuers, but it could help EMD firms which are the gatekeepers. Traditionally, EMDs (formerly "broker dealers") saw their client only as the issuer, since the issuer pays their commission. They would sell the security, describing its prospects in the best light, subject to all disclosure rules, and leave it to the investor to assess its suitability for their own financial plan. It is comparable to how one would expect a real estate agent for the vendor of a house to act—disclose what is required by law, but emphasize all of the positive aspects of the house, leaving it to the purchaser or the purchaser's agent to decide what is suitable. Canadian regulators have imposed a primary

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fiduciary obligation to the investor, even though EMDs continue to collect their fees from the issuer.

There are new OSC capital and reporting requirements which many EMDs find unnecessary, said Prill. For example, often the investors are introduced to the EMD by the issuer in order to close a specific private placement. The EMD may have no previous contact with the investors and, once the transaction is closed, no continuing relationship. However, the EMD is required to maintain an ongoing reporting relationship with each investor. There is a sense that the OSC is imposing the attributes of a retail broker (who has a continuing relationship with the investor) on an EMD (who, in many cases, does not). If the OSC wishes to change this fundamental business relationship, then yes, Prill says we need better education. But the education should be more in the nature of a dialogue, where both regulator and regulated listen to each other.

Ontario takes a very paternalistic view of securities regulation, according to Prill. The BC securities commission mission statement is "[t]o protect and promote the public interest by (i) fostering a securities market that is fair and warrants public confidence and (ii) a dynamic and competitive securities industry that provides investment opportunities and access to capital."[476] The OSC statutory mandate is "[t]o provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets."[477] The key difference, according to Prill, is that the BC mission expressly includes

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[476] See: <http://www.bcsc.bc.ca/about.asp> accessed October 2013.

[477] Section 1.1 of the Ontario *Securities Act*

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investment opportunities and access to capital. The OSC seems to focus more on investor protection, according to Prill. BC offers an olive branch to get you to comply. Ontario sees any non-compliance as a problem with integrity. We need to help those who are honestly trying to learn, and we should encourage education, said Prill.

Edward Thompson

Thompson notes that the Vancouver Stock Exchange started with guidelines and they were successful in raising money, but there were a few bad examples. Today, the regulators try for perfection and make 98% suffer to regulate the 2% who are bandits, said Thompson. If someone wants to commit fraud, they will do so no matter what your rules or regulations say. The regulators should be prepared for the odd bad case, said Thompson.

As to collaboration with the regulator, Thompson said that when he was running companies in the 1970s, he would often meet with OSC staff and discuss what was acceptable without involving lawyers. "You would explain what you were doing and if they had a problem, they would ask you. Now, the OSC doesn't want to talk with the CEO, just the lawyers. This drags the review on for months and months." It seems, according to Thompson, that the OSC staff has a lot of turnover, with employees who work there for just a few years, with a CYA attitude, and they want hard and fast rules so they don't have to exercise judgment. The industry needs experienced staff who we can work with.

Thompson does think there is a shared community: "I have dealt with people in the industry for 50+ years, most are involved for the long-term, and I usually assume that they are upright and

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will do a fair deal. Yes, a lot of promoters are opportunists who look for the short term, promoting mining when mining is hot and high-tech when high-tech is hot. In the last upturn, just about anybody could raise money, and so it attracted the fringe players. Canada has become the global place to finance resource exploration, and people from different cultures can think differently about business ethics."

I asked Thompson if there should there be a CPD requirement for the directors and managers of venture issuers, and he said that it might help for some of the new areas, such as corporate responsibility. He noted that governments and regulators have placed more social responsibility obligations on companies than they used to. One of the problems with imposing education, said Thompson, is that the directors of junior companies usually don't get paid, and they will want to be paid if they have to pursue further education. Any requirement will add to the issuer's cost and reduce the amount of money spent on exploration.

I asked Thompson what disclosure documents should be drafted for private placements introduced through a broker, and he said that he subscribes to a number of private placements each year, with virtually no paper disclosure, but based on the people involved: "Sometimes, they'll have some documents or a file and I will look at what exploration project they have." Thompson said that many of the juniors have insufficient finances and should consolidate, but the cost to generate the disclosure documents is about $300,000 and that is far too much. It should just be financial statements and the directors' recommendation—future projections, for example, are a waste of time and effort.

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Michael White

I asked White if he thought there was a shared understanding of regulatory principles among the brokers and issuers in the venture issuer community. White has been in the business since 1992 and his father and partner has been in the business for 45 years. White believes that when his father was younger and the street was smaller, principles worked well since everyone knew and trusted each other and reputation was everything. You couldn't become an investment banker unless you had been in the industry for at least 15 years, he said. You had to become part of the club, get to know everyone and build trust, and then you could move up in the business. Now people move around more, said White. If you don't know someone, it's difficult to trust them. I can see why rules are more required now, he said.

I asked White about collaboration with the regulator, and he said that there used to be more trust with the OSC when members of staff were in positions for a long time and people got to know each other. It used to be that an investment banker would work through a prospectus with a point man at the OSC and one could talk through situations directly, said White. Now, it is rare to have a working relationship with OSC staff and most dealings are conducted through lawyers. There is still, however, direct contact with the exchanges.

I asked White to comment on the regulatory changes imposed on EMDs, and he described how his firm IBK Capital has been conducting business along these lines for many years, such as a healthy buffer of capital, insurance, and self-imposed proficiency requirements. The real change for the industry, according to White, is that the OSC now requires each EMD to emphasize its duty to protect the investor rather than to raise funds for the issuer, even though the investor does

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not pay the EMD for these services nor does the EMD usually hold any securities for the investor. According to an OSC survey[478], many EMDs do not protect investors and focus only on closing the trade to get their commission, said White. In IBK's case, it is ultimately the client who decides whether or not to invest but IBK must decide if the trade is suitable. Sometimes, we go back to the investor and say that the investment is not suitable based on our knowledge of the investor, the investment size and the risks of the investment, said White. We have to keep detailed logs, to be able to prove to the OSC that we know the investor and that the product and the trade are suitable.

But, said White, there is a mood among certain advocacy groups that investors are not being protected enough. If the focus were only to protect investors, then the best practice would be to avoid any high-risk stock. The big banks and large brokerage houses won't sell their retail clients anything other than blue chips, said White. Many people think that bigger companies are less risky, but that's not necessarily true—many large companies have imploded, and the potential for fraud exists in all quarters. For many investors, a well-rounded portfolio can include a mix of junior issuers. The greatest potential for growth is in the junior market. To name a few successes: Goldcorp, Barrick, First Quantum, Wheaton River, New Gold, Detour and Osisko were all once high-risk penny stocks that depended on the junior markets to execute their business plans, and are now some of the most profitable mining companies in Canada. There will be successes and failures in the junior market and investors need to know they can lose their

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[478] See footnote 457.

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entire investment. So, it is good policy to require EMDs to know their investors and the suitability of the investment and IBK Capital has done this for years. But ultimately, the investor has to be responsible for deciding what level of risk to assume and the EMD can only advise. If the regulators expect more than this from EMDs, they will leave the private placement junior market, which could make it very difficult to raise funds for emerging industries. The OSC should understand this.

I also asked White what prospectus exemptions should be available for juniors to raise funds and what disclosure documents should be required. He said that the current private placements exemptions work well and that most of his investor clients look at the people involved, who are running the company, and chat about the opportunities. The people involved in the company are 90% of the decision making process and detailed disclosure documents are not worth the cost, said White. The investor needs to know that, with this type of high risk, management has the ability to make a return of such-and-such a magnitude but the investment could go to zero. White said he doesn't believe that the current financing downtrend is because there are not enough accredited investors; rather, it's because fewer want to invest at this time because the junior resource market is cyclical. The offering memorandum exemption should be looked at, but White doesn't think it will suddenly open the gates for more investment.

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Al Workman

Principles are needed in that provide general guidelines for individuals and companies to understand the rules, said Workman. Often, professionals will read the rules and are left wondering what they mean. Rules can be abstract. Principles should be used as a preamble to establish the context that surrounds a rule. Principles on their own, however, are often soft and fuzzy said Workman, and regulators can change them without the need for a legislative process and debate. So, principles help to interpret, but industry needs hard and fast rules. Otherwise, the law is defined by decisions through litigation. Industry needs both principles and rules, written in plain language.

For example, Workman was involved in a round table last April 2013 regarding the new Mining Act, which he says has become an unreadable assemblage of old articles and paragraphs, modified where needed by new articles and paragraphs, the entirety of which is heavily cross-referenced to other documents and appendices, said Workman. The regulations appear in multiple documents and many of the guiding principles are set forth in policy documents which can be changed without sufficient public comment. A professional in the mineral industry may be in breach of the policy without even knowing it. That leaves the company at the mercy of the courts to decide their particular case. Also, the mining regulations go into new territory regarding aboriginal issues that has so many qualifications. It should have been an entirely new document. We need a framework that encourages investment, but the law has become unreadable. The mining industry's leading advocate, the PDAC, was simply ignored when the mining code was finalized, said Workman.

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Whether you have principles or rules, those setting out to misinform investors will find a way, said Workman. Fairness opinions and valuations are an example, he said. The Ontario Business Corporations Act only mentions valuation once, in the context of transactions between corporations, where a company is going private, and a valuation is required. When talking of mergers and takeovers, the law is moot on valuations, so companies trot out fairness opinions, disclosing that they are not valuations in footnotes, but the public treats them as though they were valuations. In many cases, the company giving the fairness opinion is in a conflict of interest because the financial institution will receive a success fee if the transaction goes through. This is a problem, said Workman.

Workman has been in the resource industry for almost 40 years, in Yemen for four years, Indonesia for two years, and his firm has worked in over 140 countries, and so he has a broad range of experience. I asked him whether or not there is a community of shared values in the junior resource industry. He said there are a lot of players, and some come and go. Twenty or thirty years ago, the business was dominated by well-established Canadian, U.S. and European companies with a similar business culture. In the last few decades, the industry has become more cosmopolitan and culturally diverse because foreign companies are accessing Canadian markets. Canadian exchanges are the largest in the world for funding mineral projects—more than half of the money raised globally goes through the Canadian markets. He said: "There is a wide variety of business ethics on this planet, and there are some groups of individuals whom we have never had a good experience with, and there are some individuals out there, some cultures, that are always trying to deceive you and get a one-up on you. These companies or individuals

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have no scruples when it comes to circumventing rules or principles, including any sense of fair dealing." Workman said that when his firm does a 43-101 mining report, it requires complete disclosure and it is often the most expensive part of the project for a client. But, said Workman, for some companies and individuals, it's just not part of their culture to provide full disclosure.

I asked Workman if greater diversity on the boards of junior companies would allow them to better apply principles, and he said that most companies do try to get a board with a diverse background. A few companies, he said, have got into trouble because they didn't have the specific technical ability for their project. Issues of aboriginal rights, corporate social responsibility and environmental issues are becoming more important, said Workman. Twenty years ago, companies had open access under the mining law, as an essential right on Crown land and on private land subject to dealing with the (surface rights) land-owner. Sometimes, the negotiations relating to access would test the relationship, but the law was always on the company's side. Now, much more is required. A company's board should be much broader in terms of its abilities, since local communities can be very demanding and difficult to deal with.

I asked Workman if he thinks there is cooperation and collaboration with regulators, and he said there is, if you have a specific question. The regulators in Toronto and Vancouver have been quite responsive, according to Workman, and have been able to clarify what was required in a 43-101 report. But, in some instances, the feedback has often been very myopic, said Workman, in part because the reviewer for the regulator was not truly qualified in the subject matter. We have had to insert qualifying statements to the extreme, and in some cases the redundancy verges

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on overwhelming, leaving important non-technical aspects overlooked, such as how market forces may affect the viability of a project.

I asked Workman whether or not mandatory continuing education for the managers of venture issuers would be a good idea, and he said that managers ought to be continuing their education for their own self-interest. However, there will always be those who flout the regulations, so enforcement is important. Some have had the attitude that “I’ll do it my way and I’ll pay the fine if I get caught”, said Workman.

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