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Corporate Gatekeeper Liability in Canada

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STEPHANIE BEN-ISHAI

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I. INTRODUCTION

A series of significant reforms with respect to the legal treatment of corporate gatekeepers have taken place over the last five years in a number of countries around the world. This article serves as a taking-stock exercise of the current gatekeeper liability regime in Canada, supplemented by an examination of the options for dealing with corporate gatekeepers presented in other jurisdictions, most notably the United States and the United Kingdom. The two primary forms of liability in the Canadian system are civil liability, through both common law and statutes, and administrative liability, found in various regulatory regimes for the different types of gatekeepers. There is also the possibility of criminal or quasi-criminal liability for many gatekeepers. This article suggests that the polycentric system in which there are multiple sources of liability for gatekeepers is effective in a Canadian context. While there is an international trend towards increased streamlined government regulation of gatekeepers, as demonstrated in the U.S. and U.K., it is not a system that should be adopted by Canada. Ultimately, though the Canadian system is imperfect, this article concludes that the current Canadian regime is best suited to provide gatekeepers with guidance and incentives to perform their gatekeeping function while facilitating the competitiveness of Canadian capital markets. The key challenges with the current model center on the legitimacy and independence of the sources of liability.

For the purpose of this article, corporate gatekeepers are defined as third parties who can disrupt misconduct by withholding support. The categories of corporate gatekeeper considered in this article are directors, lawyers, auditors, underwriters, credit rating agencies (CRAs), financial analysts, and retail investment advisors (RIAs). In this article, gatekeeper liability includes civil, administrative, and criminal sanctions that can be imposed on gatekeepers who fail to withhold support. This includes rules that can be enforced by public regulators and also rules that can be enforced by private parties like investors. The sources of law reviewed are statute (corporate and securities), common law, self-regulatory organizations' (SROs) rules, and rules of professional conduct set by industry bodies. The focus of this article is on gatekeepers of public companies.

Part II provides a theoretical framework of corporate gatekeeper liability, through a survey of previous academic writing on the subject. For example, the works of Reinier Kraakman and John C. Coffee Jr. are considered in this section. Part III examines the sources of corporate gatekeeper liability at common law in Canada, including civil liability, statutory liability, and other regulatory regimes such as those put into place by provincial law societies. In Part IV, the author deals with each category of gatekeeper separately and suggests reforms to improve the Canadian system. A comparison with the United States and United Kingdom informs this analysis. Part V concludes.
II. CORPORATE GATEKEEPER LIABILITY THEORY

In the 1980s, Reinier Kraakman published two articles that expanded on the concept of “gatekeeper liability,” which he defined as liability imposed on private parties who are able to disrupt misconduct by withholding their support from wrongdoers. This support—which might include a specialized good, service, or form of certification that is essential for a wrongdoer to succeed—is the ‘gate’ that the gatekeeper keeps. True gatekeeper liability is designed to enlist the support of outside participants in the firm when controlling managers commit offences; the first requisite for gatekeeper liability is an outsider who can influence controlling managers to forgo offences. As outsiders to the firm, these professionals are less likely to risk their reputations over fraudulent or suspicious transactions. Kraakman identified outside directors, accountants, lawyers, and underwriters as potential targets for gatekeeper liability strategies: they each have access to information about firm misconduct, they already perform a private monitoring service on behalf of the capital markets, and they face incentives that differ from those of managers (that is, they are likely to have less to gain and more to lose from firm misconduct than inside managers). Like other liability regimes, gatekeeping imposes costs; Kraakman examines whether legal rules can induce gatekeepers to prevent misconduct at an “acceptable price.”

After outlining possible costs of a gatekeeping model, Kraakman suggests ways to adjust these costs, such as limiting penalties that gatekeepers face for breach of duty or selecting prescribed duties for gatekeepers to undertake. Finally, Kraakman canvasses other enforcement strategies and concludes that gatekeepers’ response to misconduct, by withholding support, has significant advantages over other third-party enforcement duties.

For Kraakman, legal duties should be imposed on intermediaries to act as gatekeepers in certain markets, due to defects in the ability of parties to contract or ascertain the reputation of different intermediaries. Stephen Choi, however, argues that Kraakman’s argument “fails to take into account the impact of different screening accuracies in the market, the incentives of intermediaries to invest in accuracy, the ex ante response of producers to the possibility of certification, and potential market defects.” Choi argues that “gatekeeper liability is too heavy-handed a response” and instead advocates for less intervention through a system of self-tailored liability, a regime where “lawmakers may allow intermediaries to choose for themselves the specific duties that they will be held accountable . . . .”

2. Kraakman, Gatekeepers, supra note 1, at 54.
3. Kraakman, Corporate Liability, supra note 1, at 890.
4. Id. at 891.
5. Kraakman, Gatekeepers, supra note 1, at 75.
6. Id. at 79-81.
7. Id. at 85.
8. Id. at 93-100.
10. Id.
11. Id. at 951.
More recently, John C. Coffee, Jr. has popularized Kraakman’s concept in the aftermath of Enron and other corporate scandals. Coffee has blamed such scandals on the failure of gatekeepers, who, he asserts, allowed management to engage in fraud.\(^\text{12}\) Coffee has defined gatekeepers as independent professionals who act as reputational intermediaries, providing verification or certification services to investors.\(^\text{13}\) Gatekeepers have less incentive to deceive; therefore, the market views gatekeepers’ assurances as more credible. Their credibility also stems from the fact that gatekeepers pledge their reputational capital.\(^\text{14}\) Theoretically, a gatekeeper would not sacrifice the reputational capital built up over many years of performing services for a single client or a modest fee. However, there are instances where reliance on gatekeepers may be misplaced, such as: where there is a sudden decline in the deterrent threat facing gatekeepers and they are thus more willing to take risks; where greater inducements are offered to gatekeepers to breach their duties; or where certain market scenarios lessen injury to a gatekeeper’s reputation.\(^\text{15}\) Included amongst Coffee’s list of gatekeepers are auditors, credit rating agencies, securities analysts, investment bankers, and securities lawyers.\(^\text{16}\) Coffee concludes that the creation of excessive liability might cause the market for gatekeeping services to fail; instead, he advocates a shift towards stricter liability standards with a ceiling on gatekeeper liability adequate to deter misconduct.\(^\text{17}\)

Whereas Coffee’s proposed system is essentially regulatory, Frank Partnoy advocates a contractual system based on a percentage of the issuer’s liability.\(^\text{18}\) Under Partnoy’s proposed regime, gatekeepers would be strictly liable for any of the issuer’s securities fraud damages pursuant to a settlement or judgment.\(^\text{19}\) Although gatekeepers would not have available to them due diligence defenses, they could limit their liability by agreeing to and disclosing a percentage limitation on the scope of their liability.\(^\text{20}\) Authors such as Larry Ribstein oppose mandatory personal liability for professionals as a relatively ineffective way to encourage professional firms to perform their duties to clients and others.\(^\text{21}\) Ribstein argues that this liability is based on “an attenuated notion of responsibility and unrealistic assumptions about


14. Id. at 13.


17. Id. at 67-68.


20. Id.

firm members' ability to monitor." Furthermore, he suggests, imposing personal liability on professionals may increase agency costs between professionals and their clients; affect professional firm size, structure and scope; and reduce desirable liability of the firm. In relation to auditors, Lawrence Cunningham prescribes a framework that uses financial statement insurance as an alternative to financial statement auditing backed by auditor liability. In his proposed framework, companies could opt for either model, subject to investor approval. Financial statement insurance policies would cover damages arising from audit failure—damages due to financial misstatements that auditors did not discover—replacing auditor and issuer liability.

In the broader context of the regulation of gatekeepers, Richard Painter stresses the balancing act that this type of regulation entails. Gatekeeper regulation, he argues, is pointless if it impairs information flow to gatekeepers: "Any improvement in gatekeeper response to risk that comes from these rules has to be weighed against potential reduction in gatekeeper information and consequent impairment of gatekeeper evaluation of risk." In order to optimize the regulation of gatekeepers, he suggests that experimentation with divergent rules—for example, American and European rules for auditor and lawyer intervention, rather than convergence of legal rules, will facilitate the learning process.

III. THE CANADIAN SYSTEM

The Canadian model for gatekeeper liability reflects Painter's suggestion for resisting a convergence of legal rules, as there remains a high degree of divergence in the nature of the liability for each corporate gatekeeper. In addition, Choi and others' concerns with an excessively heavy-handed or interventionist liability scheme have been largely limited in the Canadian context. Rather, relying heavily on self-regulation, but resisting the contractual and insurance models proposed by Choi and Cunningham, the Canadian system has attempted to achieve the balance called for by Coffee.

Under the current Canadian regime, corporate gatekeepers are open to civil liability, but in practice, investors' ability to impose civil liability on corporate gatekeepers is quite limited. Both substantive and procedural obstacles limit common law civil liability. The application of the business judgment rule and a range of statutory defences, in addition to procedural obstacles, limit statutory (corporate and securities) civil liability, including the new secondary market civil liability regime found in Ontario's securities legislation. The rules of professional conduct provided by gatekeepers' Self-Regulatory Organizations (SROs) or industry

22. Id.
23. Id.
25. Id.
26. Id. at 415.
28. Id. at 407.
29. Id. at 425.
bodies either do not provide for or are unlikely to result in liability to third parties. Taken together, the Canadian approach to civil liability for corporate gatekeepers is consistent with the U.S. and U.K. models, to the extent that it has been informed by concerns relating to the promotion of investor confidence in the fairness of the market. The harm perpetrated against individual investors has been seen as a matter of secondary importance.

A. Common Law

A traditional source of civil liability for many gatekeepers, including directors and auditors, is common law. Under common law, investors are able to bring an action against directors for a breach of fiduciary duty and duty of care, as well as seek remedies in contract and tort. However, these causes of action have generally been supplanted by securities and corporate legislation as the common law remedies have more onerous substantive and procedural requirements to be met.

In order to bring a common law action forward against a lawyer, investors must meet the standard set forth in Filipovic v. Upshall, which established that “the [lawyers] stood in a sufficient relationship of proximity with the plaintiffs to engender a duty of care on their part . . . . It required the defendants to carry out their duties as corporate lawyers in a reasonably professional and competent manner and with the utmost good faith.” In CCL Dedicated Enterprise Fund v. Fisherman, the court held that a prima facie duty of care exists when a lawyer makes representations to the investing public for the purpose of furthering the investments in their client. This duty will only be negated through policy considerations if the factual situation shows no reasonable alternative action by the lawyer that would not bias the client. The motion also holds that this duty may be breached through a failure to prevent misrepresentations by the client or failure to withdraw services in the face of fraudulent activities. However, while CCL and Filipovic do allow the possibility that a lawyer may be found to owe a fiduciary duty of care to investors, it is difficult for investors to establish that duty, and once established, the courts are relatively unlikely to find negligence or breach of duty of care giving rise to damages.

Against auditors, there is the possibility of relief for shareholders in tort, as the Supreme Court of Canada held in Hercules that it is reasonable for a corporation’s shareholders to make investment decisions relying on the correctness of the corporation’s audited financial statements. However, that decision largely curtailed the potential scope of liability under the second stage of the Anns/Kamloops test, which addresses policy considerations. The primary concern is that the defendant might be exposed to indeterminate liability from an indeterminate class, and in Hercules the Court held that a duty of care for negligence only arises when the claimants are known to the defendant as a clearly defined class, and that their usage of the representation is for the primary purpose for which the representation was

30. Filipovic v. Upshall, No. 2256, 1998 O.J.
34. Id. at paras. 44-46.
created. In that case, it was held that the corporations’ auditors did not have a duty of care to the shareholders and investors. Beyond tort, shareholders cannot sue auditors under contracts, because the courts have consistently held that auditors enter into a contract with a corporation and not its shareholders.

In contrast, a common law action for negligent misrepresentation by the investment advisor may be possible, as an investment advisor will likely be found to owe a duty of care to the investor through application of the Anns/Kamloops test. The investment advisor’s relationship with the client generally indicates a provision of professional services in accordance with industry practice and standards. There may also be a contractual relationship between the client and the investment advisor, with any claim of liability dependent on the written and unwritten terms of such a contract. As well, since the investment advisor’s relationship with his or her client is one of agency, the investment advisor owes a fiduciary duty to the client. Accordingly, to the extent that investment advisors are required by their fiduciary relationship, their contracts, and industry practise and standards to suggest and sell suitable products to their clients, those advisors may also be performing a gatekeeping function. However, the case law does not suggest that this is the focus of litigation in this area.

The other three categories of gatekeepers—underwriters, credit reporting agencies, and financial analysts—are even less likely to be held liable under common law. For underwriters, common law is largely irrelevant; their primary source of civil liability is statutory. Like auditors, credit reporting agencies also use the second stage of the Anns/Kamloops test to avoid liability to shareholders in tort actions. Finally, financial analysts can sometimes be liable for negligent misrepresentation, but that type of action is only likely to be pursued in very extreme cases.

35. Id. at para. 46; see also Bow Valley Huskey (Bermuda) Ltd. v. Saint John Shipbuilding Ltd., 3 S.C.R. 1210, para. 62 (1997).

36. Although Hercules limits the common law right against auditors for negligent misrepresentation, this limit only reaches so far. In Kripps v. Touche Ross, 6 W.W.R. 421 (1997), 33 B.C.L.R. (3d) 254 (C.A.) (leave to appeal refused 225 N.R. 236n (S.C.C. 1997)) (note: although Kripps was decided before the Hercules case, leave to appeal was denied after Hercules), investors who purchased debentures issued by a mortgage company that went bankrupt sued the auditors. The investors claimed the auditor’s report was a negligent misrepresentation since the financial statements had not accurately reflected the company’s financial position. The plaintiff investors argued that they had relied on the auditor’s report and the auditors should have been aware that the investors would rely on the auditor’s certification that the mortgage company’s financial statements were accurate. Unlike in Hercules, the British Columbia Court of Appeal held that the auditor was liable. Although the auditors complied with applicable accounting and auditing rules, they allowed the company to understate its losses in a fashion that could mislead investors. At the time of the events in Kripps, there was no statutory civil liability for auditors under the British Columbia Securities Act. In contrast, in Hercules, since financial statements were only part of the company’s annual financial disclosure then, for policy reasons, the auditors were not held liable for negligent misrepresentation.


39. Id. The Gowlings memorandum provides an excellent overview of the case law in this area.

B. Statutory Liability

i. Corporate Statutes

The gatekeepers most heavily regulated by statute are directors. They owe a fiduciary duty to the corporation under section 122(1)(a) of the *Canada Business Corporations Act* (CBCA) (and the equivalent sections of the provincial acts) to “act honestly and in good faith with a view to the best interests of the corporation.”\(^{41}\) If they breach that fiduciary duty to the detriment of the company, stakeholders can bring forward a suit using section 239 of the CBCA, which allows derivative actions by complainants on behalf of the corporation.\(^{42}\) Section 238 of the CBCA defines complainants and includes “any other person who, in the discretion of a court, is a proper person to make an application under this Part.”\(^{43}\) However, in the recent case of *Peoples Department Stores Inc. v. Wise*, the Supreme Court of Canada held that the fiduciary duty of directors does not extend beyond the corporation directly to its creditors.\(^{44}\) The Court stated that “in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, among other things, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.”\(^{45}\)

Thus, one argument available to directors is that they were balancing multiple interests, or acting in “the best interests of the corporation” in the discharge of their fiduciary duty.\(^{46}\) Directors can also use other principles including the “business judgment rule” to help defend against allegations of breach of duty.\(^{47}\) The business judgment rule holds that directors are not obliged to give continuous attention to the company’s affairs but their duties are awakened when information and events that require further investigation become known to them.\(^{48}\) This rule is utilized by the judiciary to “protect[] Boards and directors from those that might second-guess their


\(^{42}\) CBCA, supra note 41; see also OBCA, supra note 41, § 246; BCBCA, supra note 41, § 232; ABCA, supra note 41, § 240; MCA, supra note 41, § 232; SBCA, supra note 41, § 232; NBBCA, supra note 41, § 164; NFCA, supra note 41, § 369; YBCA, supra note 41, § 241; NWTBCA, supra note 41, § 241; and Companies Act, R.S.N.S., ch. 81 Third Schedule, § 4 (1989) [hereinafter NSCA].

\(^{43}\) CBCA, supra note 41; see also OBCA, supra note 41, § 245; BCBCA, supra note 41, § 232; ABCA, supra note 41, § 239; MCA, supra note 41, § 231; SBCA, supra note 41, § 231; NBBCA, supra note 41, § 163; NFCA, supra note 41, § 368; YBCA, supra note 41, § 240; NWTBCA, supra note 41, § 240; NSCA, supra note 41, Third Schedule, § 1.

\(^{44}\) Peoples Dep’t Stores, Inc. v. Wise, [2004] 3 S.C.R. 461, para. 43.

\(^{45}\) Id. para. 42.


\(^{47}\) Id. paras. 152-56.

\(^{48}\) Id. para. 126.
To apply the rule, the courts must find that the directors were “scrupulous in their deliberations and demonstrate diligence in arriving at decisions.”

The other major defence available to directors is that of due diligence or good faith reliance. Directors can be relieved of any liability if they relied in good faith on financial statements produced by an officer or auditor of the corporation or a report of a professional. A number of provinces offer directors both a good faith reliance and due diligence defence similar to section 123(4) of the CBCA. These defences have meant that, in practice, the application of the statutory duty of care has been extremely limited.

Individual investors can move beyond the statutes mentioned above, and seek to use the oppression remedy against directors who have failed in their gatekeeping role. Using that statutory remedy contained in the CBCA and most provincial statutes, a “complainant” may apply to the court for relief if the business of the corporation or the powers of the directors have been exercised in a manner that is “oppressive or unfairly prejudicial to or that unfairly disregards the interests” of any security holder, creditor, director or officer. In Peoples, the Court’s reasoning suggests that in future cases the oppression remedy analysis will not require a determination of whether directors have breached their fiduciary duties and that it may be possible to use the oppression remedy to hold directors accountable to individual stakeholders. However, neither position is new and the above statement can be taken as obiter as the case itself did not concern an oppression action. This highlights one of the difficulties in assessing the oppression remedy, as there are relatively few oppression actions in the courts each year. As a result, the judicial treatment of the oppression remedy has frequently drawn from the case law on breach of statutory duties, importing concepts such as the “best interests of the corporation” and the “business judgment rule.” The notion that a director’s
fiduciary duty includes an obligation to balance a number of interests has also been considered by courts applying the oppression remedy, as in *Re Ferguson and Imax Systems Corp.*, wherein the Court of Appeal for Ontario held that it was imperative that the oppression remedy be applied in a manner that balances the protection of stakeholders and the ability of management to conduct business in an efficient manner.

ii. Securities Statutes

While directors are the primary gatekeepers regulated under the CBCA, all corporate gatekeepers are, to some degree, subject to securities statutes. The statutes differ from province to province, but here, the discussion will focus on the *Ontario Securities Act* (OSA). While many of its provisions are similar to those of other provinces, Ontario is noteworthy as it is the only province to impose secondary market liability on some corporate gatekeepers.

Under securities legislation, directors may be liable to persons who acquire securities in a corporation during the period of distribution while there are uncorrected misrepresentations in a prospectus. The purchaser need not show reliance on the misrepresentation for liability to attach. The onus shifts to the defendant to show that any depreciation in the value of the securities was not the result of the misrepresentation. The plaintiff has no claim if he or she knew of the

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57. 43 O.R. 2d 128, 137 (C.A. 1983). This was an appeal after the application for relief was dismissed under s. 234 of the *Canada Business Corporations Act*. S.C., c. 33 (1974-5). The appellant claimed that the corporation and the directors had, by organizing a special meeting to vote on a resolution to amend its articles to reorganize its capital, acted in a manner that was oppressive, unfairly prejudicial, or unfairly disregarded her interests as a security holder. On appeal, Brooke J.A. found for the appellant and granted her relief for oppression.

58. British Columbia has proposed legislation (Bill 38) implementing a similar regime, but the implementation of this legislation has been put on hold. See BC Securities Commission, http://www.bsc.bc.ca/instruments.asp?id=1894#moving and http://www.bsc.bc.ca/release.asp?id=2944 for details.


60. OSA, supra note 59, § 130(1); BCSA, supra note 59, § 131(1)(a); ASA, supra note 59, § 203(1); SSA, supra note 59, § 137(1); NBSA, supra note 59, § 149(1); NSSA, supra note 59, § 137(1); PEISA, supra note 59, § 16(1); NLSA, supra note 59, § 130(1); but see QSA, supra note 59, §§ 217-219 (where there is no specific reference to deemed reliance, although non-reliance is not a listed defence under § 217 or § 220); MSA, supra note 59. This act makes no specific reference to deemed reliance, although non-reliance is not a listed defence under § 65. The right to rescission under § 65 applies only to the issuer. See also NWTSA and YSA, supra note 59 (Under these acts, like the MSA, the right to rescission applies only against the issuer and there is no specific mention of deemed reliance).

61. ASA, supra note 59, § 203(9); BCSA, supra note 59, § 131(10); OSA, supra note 59, § 130(7); SSA, supra note 59, § 137(8); NBSA, supra note 59, § 149(8); NSSA, supra note 59, § 137(7); PEISA, supra note 59, § 16(7); NLSA, supra note 59, § 130(7).
representation. Directors, along with the issuer, underwriter, an expert who has filed a consent, and anyone else who has signed the prospectus, are jointly and severally liable.

Liability for a prospectus misrepresentation is generally only alleviated if the prospectus was filed without the director's consent, the director withdrew consent within a reasonable period of time upon discovery of a misrepresentation, or the director exercised due diligence but failed to ascertain the existence of the misrepresentation (other defences are not relevant to the gatekeeping function).

Most recently, in Kerr v. Danier Leather Inc., the first class action to be litigated to the final stages by shareholders for a prospectus misrepresentation under section 130 of the OSA, the Court of Appeal for Ontario used the business judgment rule to protect directors from personal liability. The decision suggests that the business judgment rule will serve as an important shield for directors in future litigation using the statutory liability provisions for misrepresentation found in the provincial securities acts, including the new secondary market civil liability regime in Ontario discussed below. The liability for initial disclosure documents in general does not appear to be consistent across Canada, though generally, the scope of damages for a misrepresentation in the primary markets is limited to the price at which the securities were offered to the public.

Quebec, which does not appear to have a specific clause limiting damages, is the exception.

The Ontario Securities Commission (OSC) is also limited in its authority to deal with lawyers. While it can exercise some control over lawyers practicing within its area of jurisdiction, according to the Court of Appeal for Ontario, solicitor-client privilege must be maintained. It must be noted that the power of the securities commissions to sanction and reprimand lawyers does not necessarily extend to the ability to place remedial sanctions limiting lawyers' ability to practice in the securities area in the future; this would bring the commission into the role of regulating the practice of law, an area reserved for the law societies.

Still, section 130(1) of the OSA applies to lawyers, including their statements in a category of "expert" opinions to which liability may be attributed for misrepresentations. A misrepresentation that triggers this section will create joint and several liability with any other party listed in section 130(1). The defenses for experts like lawyers, auditors, and other gatekeepers discussed below include: filing of the prospectus without consent, withdrawal of consent upon discovery of a misrepresentation,

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62. ASA, supra note 59, § 203(4); BCSA, supra note 59, § 131(4); OSA, supra note 59, § 130(2); SSA, supra note 59, § 137(3); NBSA, supra note 59, § 149(3); NSSA, supra note 59, § 137(2); PEISA, supra note 59, § 16(2); NLSA, supra note 59, § 130(2).
63. See MSA, supra note 59, § 97.
64. Kerr v. Danier Leather Inc., [2005] O.J. No. 5388; [2005] LEXIS 6560.[Ruth, the only version we are able to get is the LEXIS version because Tarlton stopped getting the printed cases, Andy].
65. OSA, supra note 59, § 130(9); BCSA, supra note 59, § 131(13); ASA, supra note 59, § 203(13); SSA, supra note 59, § 138(11); NBSA, supra note 59, § 149(11); NSSA, supra note 59, § 137(9); PEISA, supra note 59, § 16(9); NFSA, supra note 59, § 130(9). NWT, Yukon, and Manitoba appear to only provide a right of rescission, which would preclude a need to limit damages to the price at offering.
66. RSQ, supra note 60 § 214 (discussing damages, but not indicating any limitations).
69. OSA, supra note 60, §130(1).
70. Id.
notification of the securities commission and the public of the misrepresentation, and due diligence.71

Auditors are also covered under section 130(1) of the OSA as experts, and thus securities statutes are a source of liability for them.72 However, because the Supreme Court of Canada in *Hercules* found that auditors owe a duty of care to corporations and not shareholders, for shareholders to bring an action using a corporate statute against an auditor, they would need to use the derivative action discussed above in the context of directors.73 Another similarity between auditors and directors is that the oppression remedy may possibly be used against auditors though it is far more limited in that context, as an attempt to use oppression action in Ontario was rejected because it is the “corporation or any of its affiliates” that must have acted oppressively and auditors were found to fall outside of this realm.74

Securities statutes provide a source of liability for underwriters as well as lawyers and directors. The OSA requires underwriters to provide a signed certificate for inclusion with the prospectus with respect to the securities offered by the prospectus that:

[T]o the best of their knowledge, information and belief, the foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part XV of the Securities Act and the regulations thereunder.75

Underwriters who certify the prospectus are exposed to statutory civil liability to any purchaser for damages or rescission where such purchaser buys a security offered pursuant to a prospectus during the distribution period.76 However, where an underwriter is a defendant, the underwriter’s maximum liability is generally the portion of the distribution underwritten by the underwriter (this limitation of liability does not exist in Quebec).77

Credit rating agencies, financial analysts and retail investment advisors are all subject to section 130(1) of the OSA. However, as section 130 applies to civil liability for misrepresentation, these groups would only be included as possible defendants under paragraph (d) if their consent had been filed pursuant to a requirement of the regulation with respect to reports, opinions, or statements that had been made by them, or, under paragraph (e), if the CRA actually signed the prospectus or amendment to the prospectus.78 The scope of civil liability stemming from securities statutes is smaller for these gatekeepers than the liability of those discussed above.

72. Id. § 130(1).
73. *Hercules*, *supra* note 33, at 171-72.
74. Budd v. Gentra, B102/95, [1996] O.J. 3515 QUICKLAW (Gen. Div.), [1996] 12 O.T.C. 117, aff’d [1998] 43 B.R. (3d) 27 (Ont. C.A.). In the appeal decision, the oppression claim against the officers and directors was also struck because it contained no allegation of specific acts they had done.
76. OSA, *supra* note 60, §§ 59 and 130(1)(b); see also QSA, *supra* note 59.
77. Id.
78. Id. § 130(1).
iii. Secondary Market Liability

*Pearson v. Boliden Ltd.* confirms that to take advantage of the above statutory provisions creating civil liability for primary market misrepresentations, the purchaser must have purchased the securities directly from the issuer rather than in the secondary market. However, in Ontario, the recent proclamation of the “Keeping the Promise for a Strong Economy Act” which went into effect on December 31, 2005, has introduced a statutory regime of civil liability for secondary market disclosures through the introduction of part XXIII.1 to the OSA. The amendments extend the civil liability regime beyond primary market disclosures, and they apply to all Ontario reporting issuers and to any company with publicly traded securities that has a real and substantial connection to Ontario. The amendments also open the door for class action lawsuits that allege misrepresentations by creating a statutory right of action without regard to whether the purchaser or seller of securities relied on the alleged misrepresentation or delay in disclosure. Improper continuous disclosure can include a misrepresentation in a document or other communication, which would reasonably be expected to affect the share price, or a failure to make timely disclosure of material changes.

It is important to note that in order to proceed with an action for damages under the new secondary market liability scheme, an investor must obtain leave of the court. Each defendant must receive notice of the motion for leave to proceed. The court will grant leave only if it is satisfied that the investor is bringing the action in good faith, and there is a reasonable possibility that the action will be resolved at trial in favour of the investor. The plaintiff must have bought the securities while the misrepresentation was uncorrected and without knowledge of the misrepresentation, but need not show reliance on the misrepresentation.

Directors can defend themselves with any of the following arguments: (1) the change in the value of the securities is not related to the misrepresentation (onus on defendant to show); (2) the defendant relied on an expert report; (3) the defendant relied on another publicly filed report; (4) the defendant conducted a reasonable investigation, or, for a failure to make timely disclosure, if the defendant can prove he did not know of the change; and (5) an exemption on misrepresentation of “forward-looking” information, provided that the document or public oral statement contains cautionary language relating to the forward-looking information.

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81. OSA, supra note 59, § 138.3. The distinction between “material fact” and “material change,” also found in § 130 of the OSA (and defined in § 1 of the OSA), was critical to the appellate ruling in *Kerr v. Danier*, supra note 64, where the court confirmed that “material fact” is intended to be defined more broadly than “material change” in the Act. The Court of Appeal agreed with the trial court that the impact of unseasonably warm weather did not constitute a “material change” in Danier’s business or operations.
82. OSA, supra note 60, § 138.8(1).
83. Id. § 138.8(1)(a)-(b).
84. Id. § 138.8(1).
85. Id. §138.4(7)(f).
86. Id. § 138.5(3).
87. Id. § 138.4(11).
88. OSA, supra note 60, § 138.4(14).
89. Id. § 138.4(6).
information, identifies material factors that could cause actual results to differ materially, and states the material factors or assumptions that were applied in making a forecast or projection in the forward-looking information.\textsuperscript{90} There is also a whistleblowing defence available if the following criteria are satisfied: the contravention was made without that defendant's knowledge or consent; upon becoming aware of the misrepresentation the defendant promptly notified the board of directors of the issuer of the matter, and, if no correction or subsequent disclosure was made, the defendant promptly provided the Ontario Securities Commission (OSC) with written notification of the misrepresentation.\textsuperscript{91}

Secondary market liability also applies to lawyers, auditors and financial analysts as experts under section 138.1 of the OSA if their report, contains misrepresentations used in a public statement (written or oral).\textsuperscript{92} An investor can sue an "expert" if the misrepresentation is also contained in a report, statement or opinion made by the expert (Expert Report); if the document or statement includes, summarizes or quotes from the Expert Report; and the expert consented in writing to the use of the Expert Report in a document released or statement made by someone other than the expert.\textsuperscript{93} Experts are able to use the same defences as directors, listed above, and their liability is limited to the greater of $1 million or the amount of revenue raised from the responsible issuer within the last 12 months.\textsuperscript{94} Unlike the other groups of gatekeepers, underwriters are not included in section 138.3(1), and credit rating agencies are explicitly excluded from secondary market liability in section 138.1(1) of the OSA. It is not immediately clear from the legislation if retail investment advisors are included under this section.

Because secondary market liability is quite new to Ontario, there has been little jurisprudence, so it is unclear how much protection these defences will afford directors and other gatekeepers, and how much success shareholders will have in holding failed gatekeepers liable.

C. Other Regulatory Regimes

i. Provincial Securities Commissions

Provincial securities commissions have broad powers to enforce securities laws through the imposition of administrative orders in the public interest. Included among the long list of possible administrative sanctions is the ability of commissions to impose a penalty, if it is determined at the hearing that a person or company has contravened—or failed to comply with—any provision of the securities legislation.\textsuperscript{95}

\begin{itemize}
  \item \textsuperscript{90} \textit{Id.} § 138.4(9).
  \item \textsuperscript{91} \textit{Id.} § 138.4(15).
  \item \textsuperscript{92} \textit{Id.} § 138.3.
  \item \textsuperscript{93} \textit{Id.} § 138.4(12).
  \item \textsuperscript{94} OSA, supra note 60, § 138.1.
  \item \textsuperscript{95} \textit{Id.} § 127(1)10 (imposing a penalty of up to $1 million); BCSA, supra note 59, § 162 (up to $250,000 for individuals and $500,000 for persons who are not individuals); ASA, supra note 59, § 199 (up to $1 million); MSA, supra note 59, § 148 (up to $100,000 for an individual and $500,000 for persons who are not individuals); SSA, supra note 59, § 135 (up to $100,000); QSA, supra note 59, §273 (up to $1 million); NBSA, supra note 59, § 186 (up to $750,000); NSSA, supra note 59, § 135 (up to $100,000).  
\end{itemize}
In addition, the securities commissions can apply to the court for a declaration that a person or company has not complied with a provision of the securities act. On application by a commission, the court may make an order imposing a penalty or requiring current directors or officers to be removed and replaced, requiring a person or company to compensate or make restitution to an aggrieved person or company, requiring a person or company to pay general or punitive damages, or requiring a person or company to pay the Provincial Treasurer any amounts obtained as a result of non-compliance with any provision of the securities act. These judicial and administrative sanctions apply to all of the corporate gatekeepers under consideration.

For directors specifically, the OSC can seek administrative sanctions if the financial information contained in the company's press release was materially misleading and that the directors therefore acted contrary to the public interest by not making sufficient inquiries before releasing the interim financial results, as in Standard Trustco Ltd. In that case, the OSC criticized the directors for inappropriately approving financial statements and disseminating the information publicly. It also noted that directors who are members of the audit committee should bear more responsibility than other directors for a compliance deficiency in the corporation's financial statements.

The securities commissions do not appear to have successfully extended liability to lawyers acting merely in their role as gatekeeper: something more is required for liability to attach. For example, in Re Orsini, a lawyer prepared a financing scheme that breached various provisions of the OSA; the lawyer was involved directly in developing the scheme, and benefited materially from the sale of shares. In contrast, Henderson v. Alberta (Securities Commission) involved a situation where a lawyer had met with potential investors and did not deliver them the required documentation; despite the initial finding of the trial court against the lawyer, the Alberta Court of Appeal held that he had made his dealings in good faith, and reversed the trial judgment. These two cases suggest that innocent—though nonetheless negligent—failure to prevent a client from committing a violation of securities law does not create a violation giving rise to administrative sanctions against lawyers. Sanctions will not be imposed unless the lawyer personally performed an action which triggers an offence.

Underwriters are treated somewhat uniquely by provincial securities commissions, as their role is to be not only a gatekeeper but also a devil’s advocate, as per the OSC’s regulatory proceeding, YBM Magnex International Inc. (Re).
Re A.E. Ames & Co. Ltd, the OSC held that as gatekeeper, there is a duty upon the underwriter to uncover all the facts. While in Feit v. Leasco Data Processing Equipment Corp. the OSC recognized limits of the underwriter’s role because of more limited access to information, as devil’s advocates, underwriters must challenge the issuer’s disclosure with respect to any misconduct, otherwise they may be subject to administrative sanctions in addition to civil liability as discussed above.

Underwriters, financial analysts, and retail investment advisors must all register under provincial securities legislation, as firms that engage in securities underwriting, investment firms, and all securities firms and their employees who provide trading and advising services, respectively. As a result of the mandatory registration requirement, the provincial securities commissions have the power to suspend or revoke the registration of a wayward registrant, which may include situations where the firm fails to properly supervise the analysts (employees) at the firm.

ii. Market Regulation Services Inc.

Market Regulation Services Inc. (RS) is a SRO recognized by the securities commissions in Alberta, British Columbia, Manitoba, Ontario and Quebec as a market regulation provider for the trade exchanges and trading systems in Canada. RS administers the Universal Market Integrity Rules (UMIR), which apply to directors and lawyers as corporate gatekeepers. 10.16 of UMIR provides a set of reporting obligations for directors as gatekeepers of market participants. Directors of market participants are obligated to report trading violations to the compliance department of the participant. Section 10.3 of UMIR allows for a finding of liability for a market participant through the actions of their directors, officers, partners, or employees. Similarly, a director or partner may be found liable for the actions of the firm and face personal sanctions, while a lawyer hired by a market participant can be liable under this section as the employee of a market participant.

Section 10.5 of UMIR provides a broad power to the market regulator to impose sanctions for violations of UMIR. Sanctions include a reprimand, a fine of up to one million dollars or the amount equal to triple the financial benefit which accrued to the person as a result of committing the violation, or any other remedy deemed appropriate under the circumstances.

105. OSA, supra note 59, § 25(1); BCSA, supra note 59, § 34; ASA, supra note 59, § 75; MSA, supra note 59, § 6; SSA, supra note 59, § 27; QSA, supra note 59, § 148; NBSA, supra note 59, § 45; NSSA, supra note 59, § 31; PEISA, supra note 59, § 2; NLSA, supra note 59, § 26; YSA, supra note 59, § 3; NWTS, supra note 59, § 4.
106. OSA, supra note 59, § 25(1); BCSA, supra note 59, § 34; ASA, supra note 59, § 75; MSA, supra note 59, § 6; SSA, supra note 59, § 27; QSA, supra note 59, § 148; NBSA, supra note 59, § 45; NSSA, supra note 59, § 31; PEISA, supra note 59, § 2; NLSA, supra note 59, § 26; YSA, supra note 59, § 3; NWTS, supra note 59, § 4.
108. UMIR §10.16.
109. Id. §10.3.
110. Id. §10.5.
111. Id. §10.5(1).
iii. Professional Regulatory Bodies

Beyond the common sources of liability discussed above, many corporate gatekeepers are also regulated by their own professional groups. Lawyers are accountable to their provincial law societies; underwriters, financial analysts, and retail investment advisors to the Investment Dealers Association of Canada (IDA); auditors are accountable to provincial institutes of chartered accountants; and credit rating agencies are accountable to the International Organization of Securities Commission.

a. Provincial Law Societies

In Ontario, lawyers are regulated by the Law Society of Upper Canada. The Society's Rules of Professional Conduct Rule 2.02(5) holds that lawyers cannot knowingly assist in or encourage any dishonesty or crime, or tell their client how to violate the law and avoid punishment. The comments to this rule indicate that a lawyer has an obligation to investigate any suspicions both prior to and during a retainer. Other provinces have similar rules, although Ontario is the only province to require "up the ladder" reporting; that is, lawyers must inform representatives of the organization up through the board of directors if it is known that the client is, has previously, or will engage in dishonest, fraudulent, or illegal conduct. In Ontario, lawyers must also withdraw from acting in the matter should corrective action not be taken.

Even with this obligation for lawyers, every province recognizes the confidential nature of the solicitor-client relationship. Ontario Rules of Professional Conduct Rule 2.03 governs confidentiality. Generally confidentiality is protected across the board, meaning there is little room for whistleblowing. Rule 2.03(2) and (3) outline the areas of justified disclosure in Ontario. The commentary confirms that when a lawyer becomes aware that a client that may commit a fraudulent, criminal, dishonest, or illegal act, he or she is prevented from passing any confidential information to the correct authorities, though he or she must follow the procedures outlined above in Rule 2.02. The confidential information provisions in all other provinces except Alberta and Saskatchewan also prevent lawyers from whistleblowing on corporate wrongdoing. As whistleblowing is not often an option for lawyers, most jurisdictions either allow or oblige lawyers to withdraw from a case where the client persists in instructing the lawyer to breach ethics. For corporate counsel, withdrawal means refusing to implement the client's instructions in that matter, while continuing to advise the corporation or government in other respects—including, in certain cases, resigning.

112. LAW SOCIETY OF UPPER CANADA, RULES OF PROF'L CONDUCT R. 2.02(5) cmt. (2005), R. 2.02(5.1), R. 2.02(5.2) cmt. (2004).
113. Id. R. 2.02(5) cmt.
114. Id. R. 2.02(5.1).
115. Id., R. 2.02(5.1), R. 2.02(5.2), and R. 2.02(5.2) cmt. (2004).
116. Id. R. 2.03.
117. Id. R. 2.02.
118. LAW SOCIETY OF ALBERTA, CODE OF PROF'L CONDUCT HANDBOOK, ch. 5.
If a lawyer does not fulfill his or her gatekeeper function, he or she could be disbarred, reprimanded, suspended, or face other conditions on practicing. Some law societies can issue any order they deem appropriate for breaches of professional conduct, which opens up the possibility for fines and/or payments to third parties. Fines are rarely imposed as penalties, and the author has found no evidence of payments to third parties being ordered. Some provinces do not give law societies the ability to impose sanctions beyond disbarment, reprimand, suspensions, or conditions.

b. Investment Dealers Association of Canada

Underwriters, financial analysts, and retail investment advisors all fall under the scope of the Investment Dealers Association of Canada (IDA). The IDA’s mission is to protect investors and enhance the efficiency and competitiveness of Canadian capital markets. The IDA enforces rules and regulations regarding the sales, business, and financial practices of its Member firms and its Approved Persons, investigates complaints, and disciplines Members and Approved Persons.

One IDA By-Law, No. 29, deals with ethics and business conduct, charging its members to “observe high standards of ethics” and to “not engage in any business conduct or practice which is unbecoming or detrimental to the public interest.” Policy No. 5 provides an elaboration on the By-Law, and provides in section 4.1 that its members have a duty to deal fairly and “act fairly, honestly and in good faith”; section 4.2 provides that the public interest is held in high regard; and section 4.5 states that members shall ensure that their trading does not contravene any criminal and regulatory laws. Most importantly, with regard to withholding support and services from clients engaging in misconduct, if underwriters fail to act properly, they may be held liable under section 4.6 with regard to misrepresentation and false remarks. The sanctions if the standard of business conduct falls below the standard set by the policy and by-laws are contained in section 5 of IDA Policy No. 5, including fines of up to $1 million per offence or (in the case of a Member) triple the amount of the benefit from the breach, reprimands, suspension or termination of approval, or expulsion.
Retail investment advisors are generally employed by investment firms which, like underwriters, are regulated by the IDA and must adhere to its by-laws, rules, and regulations. In addition, investment advisors themselves must personally register as a Registered Representative (RR) or Investment Representative (IR). An RR has full authority to deal with the public and can advise on trades. An IR cannot advise on trades although he or she can take unsolicited client orders. For both types of registration an individual must successfully complete the Canadian Securities Course, the Conduct and Practices Handbook Exam, and a training program offered by his or her firm. For IRs, the length of the training course is 30 days, and for RRs, the length of the training course is 90 days. After registration, six months of extra internal supervision is required. RRs must then go on to complete an additional course (the Professional Financial Planning Course or Investment Management Techniques Course) within 30 months of registration. Along with the registration, the IDA imposes an obligation on RRs to take “reasonable precautions to ensure that any transaction in which he or she is involved is transacted to the benefit of and best interests of his or her client.”

The IDA regulates investment firms that employ financial analysts, and IDA members have a supervisory responsibility over their employees. While they are subject to the same rules as other firm employees, financial analysts are not required to be registered. However, senior analysts are usually officers and/or directors of Member firms, and therefore subject to additional liability. The IDA provisions that govern objectivity and accuracy do not specifically relate to analysts, but rules like 2(b), which ensures a level of objectivity and accuracy of information, can be applied. There is also an explicit duty for analysts to prevent any potential conflicts of interests in rule 11, and rule 17 obliges them to uphold the Chartered Financial Analyst (CFA) Institute’s Code of Ethics and Standards of Professional Conduct. Breach of IDA Rules will lead to investigation for all gatekeepers subject to them, and if the investigation leads to a need for further action, a disciplinary hearing will be held. The IDA can impose penalties on both registered employees and Member firms, including: a reprimand, fines, suspension, prohibitions, termination, and expulsion of membership.

Even without the IDA obligation, many financial analysts are subject to the Code of Ethics and Standards of Professional Conduct. The CFA does not cover all securities analysts, since membership in the organization is not a requirement according to provincial securities legislation. However, those that are must adhere

130. Id.
131. Id.
133. Securities Industry Committee, supra note 40, at 37.
134. IDA Policy No. 11, Research Restrictions and Disclosure Requirements, R. 2(b).
135. Id. R. 11 and R. 17.
to the Code of Ethics, which obliges its members to act with integrity and in an ethical manner.\textsuperscript{138} The Standards of Professional Conduct sets out a guideline that "members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities."\textsuperscript{139} The guideline on misconduct states that "members and Candidates must not engage in any professional misconduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence."\textsuperscript{140} Violation of the Code results in loss of membership, but as it is not a requirement for industry participation, this sanction has limited force.

c. Provincial Institutes of Chartered Accountants

The Provincial Institutes of Chartered Accountants Rules of Professional Conduct (Rules) forms the professional obligations of CAs that perform audits.\textsuperscript{141} With the exception of the Quebec Code of Ethics, the Rules are substantively equivalent across all provinces.\textsuperscript{142} Most importantly, Rule 213 of the Rules of Professional Conduct, explicitly states "a member, student or firm shall not knowingly associate with any unlawful activity."\textsuperscript{143} As such, upon detection of client misconduct, an auditor may be explicitly obligated to withhold support and services.

However, often client misconduct falls into a grey area, and may not be considered outright unlawful. As such, other rules which pertain to the auditor’s liability as gatekeeper include the following: Rule 201.1 provides, “a member, student or firm shall act at all times in a manner which will maintain the good reputation of the profession and its ability to serve the public interest”; Rule 202 provides, “a member, student or firm shall perform professional services with integrity and due care”; and Rule 205 provides, “a member, student, or firm shall not sign or make false or misleading documents and oral representations.”\textsuperscript{144} In particular Rule 204.1, which pertains to maintaining independence in any accounting engagement, provides that any member of a firm who participates in an engagement shall be and remain free of any influence impairing the professional judgment or objectivity of the member, or which a reasonable observer thinks might impair the member.\textsuperscript{145} Rule 206 deals with professional standards, and carries an ethical

\begin{footnotes}
138. Id.
139. Id. R. I(c).
140. Id. R. I(d).
142. Id.
143. Id.
144. Id.; see also Québec, id. R. 5, 23, and 34.
145. Id.; see also Québec, id., R. 36.4.
\end{footnotes}
standard of conduct not found in provincial securities legislation or the corporate statutes.\textsuperscript{146}

The Professional Conduct Committee investigates all written complaints received about Institute members, students, and firms for violations of the Institute's rules of professional conduct, regulations, or bylaws. When the Professional Conduct Committee lays a charge or charges of professional misconduct against a member, student or firm, a formal hearing is held in front of the Institute's disciplinary committee; if a finding of guilt is made, the disciplinary committee has the power to order that the member, student or firm be: reprimanded; fined; charged the costs of the investigation and hearing; suspended from the Institute; struck off the register of students; or expelled from membership in the Institute.\textsuperscript{147} The CGA and the CMA regulatory bodies also have their own sets of rules of professional conduct that are similar to the Rules outlined above. A detailed examination of these rules is not necessary as the Canadian Public Accountability Board and accompanying legislation in most instances require members to follow the Rules.

Auditors are also regulated under the Canadian Public Accounting Board (CPAB).\textsuperscript{148} National Instrument 52-108 requires auditors of reporting issuers to be members in good standing with the CPAB, a new independent public oversight system that includes regular and rigorous inspections of auditors of Canada's public companies.\textsuperscript{149} Section 300 of the CPAB Rules sets out the professional standards that audit firms must adhere to, which generally echoes the ethical standards imposed by the professional regulatory bodies that have jurisdiction over them.\textsuperscript{150} If a violation occurs, sanctions are prescribed on the audit firm under CPAB Rules section 601 including: additional professional education for some or all of the designated professionals of a participating audit firm; the design, adoption or implementation of policies by a participating audit firm to ensure its compliance with the CPAB Rules; and appointment of an independent monitor, subject to the approval of the Board, to observe and report to the Board on a participating audit firm's compliance with the CPAB Rules.\textsuperscript{151}

d. International Organization of Securities Commission

Unlike CPAB and other regulatory bodies, the International Organization of Securities Commission's (IOSCO) Code of Conduct Fundamentals (IOSCO Code)\textsuperscript{152} does not act as a code of conduct to which CRAs are expected to adhere. Instead it contains a set of provisions that the IOSCO expects all CRAs will incorporate and give full effect to in their codes of conduct. The IOSCO Code addresses issues including how CRAs should avoid or mitigate potential conflicts of interest, improve

\textsuperscript{146} Id.; see also Québec, id. R. 19.
\textsuperscript{147} See generally Institute of Chartered Accountants, supra note 141 and accompanying text.
\textsuperscript{150} CPAB Rules, § 303(a) and (b).
\textsuperscript{151} Id. § 601.
\textsuperscript{152} International Organization of Securities Commissions, Code of Conduct Fundamentals (Dec. 2004) [hereinafter IOSCO Code].
the transparency of the ratings process, and protect their integrity and independence while dealing fairly with issuers, investors, and other market participants. The liabilities of CRAs for failing to withhold their support and services upon detection of misconduct are primarily implicit. Rule 1.6 of the IOSCO Code deals with the quality of the rating process, and states that "the CRA and its analysts should take steps to avoid issuing any credit analyses or reports that contain misrepresentations or are otherwise misleading as to the general creditworthiness of an issuer or obligation." While the IOSCO Code provides indications on how CRAs should conduct their business, it should be noted that currently there is no mandatory disclosure of CRAs' codes of conduct under any provincial securities legislation, and no explicit sanctions for non-compliance.

D. Criminal and Quasi-Criminal Liability

The potential for criminal and quasi-criminal liability can be demonstrated through an examination of provisions that can apply to many gatekeepers. For example, under provincial securities law, anyone who authorizes, permits, or acquiesces in a contravention of the provincial securities acts may be liable for a fine of not more than $5 million and/or imprisonment for a period of up to five years less one day in Ontario, British Columbia, and Alberta. The penalties vary by province, but the underlying behaviour triggering the offence is the same. Also, it is important to note that this behaviour is only quasi-criminal, since the legislation is provincial, thus the mens rea requirement for this offence is one of strict liability. Only a due diligence defence will be afforded a director who has authorized, permitted, or acquiesced to the company's violation of securities law.

There is also federal legislation with quasi-criminal effects. Under the CBCA and parallel provincial corporate law statutes, § 250(1) states:

a person who makes or assists in making a report, return, notice, or other document required by this Act or the regulations to be sent to . . . any person that

(a) contains an untrue statement of a material fact, or

(b) omits to state a material fact required therein or necessary to make a statement contained therein not misleading in the light of the circumstances in which it was made . . .

154. IOSCO Code, supra note 152, r.1.6.
155. OSA, supra note 59, § 122(3); ASA, supra note 59, § 194(3); BCSC, supra note 59, § 155(3). In Ontario, for example, § 122 of the OSA makes it an offence to make a materially misleading or untrue statement or material omission in any document required to be filed or furnished under Ontario securities legislation.
is guilty of an offence and liable on summary conviction to a fine not exceeding $5000 or to imprisonment for a term not exceeding six months or to both.\textsuperscript{157}

In addition, if the corporation itself does any of the above, any director or officer of the corporation who knowingly authorized, permitted or acquiesced in the commission of the offence is a party to and guilty of the offence and is liable on summary conviction to the same penalties as listed above.\textsuperscript{158} A due diligence defence is provided under the corporate statutes such that no person is guilty of a quasi-criminal offence "if the person did not know, and in the exercise of reasonable diligence could not have known, of the untrue statement or omission."\textsuperscript{159}

Along with quasi-criminal liability, directors can be held criminally liable through various sections of the \textit{Criminal Code of Canada} (CC), including section 400, under which it is an offence to make, circulate, or publish a prospectus that is known to be false in a material particular with intent

(a) to induce persons to become shareholders or partners in a company,

(b) to deceive or defraud the members, shareholders or creditors ... of a company, or

(c) to induce any person to

(i) entrust or advance anything to a company, or

(ii) enter into any security for the benefit of a company ... \textsuperscript{160}

Other applicable sections include section 382, which creates an indictable offence liable to imprisonment for a term not exceeding 10 years for entering transactions that create false or misleading appearances of market activity or a misleading appearance as to the market price of a security,\textsuperscript{161} and 380(2) which extends the prohibition against fraud to any deceit, falsehood or fraudulent practice that affects the public market price of stocks or shares and creates an indictable offence liable to

\textsuperscript{157} CBCA, \textit{supra} note 41, § 250; ABCA, \textit{supra} note 41, § 251; SBCA, \textit{supra} note 35, § 300; NBBCA, \textit{supra} note 41, § 175; NFCA, \textit{supra} note 4135, s.§ 504; YBCA, \textit{supra} note 41, at § 251; NWTBCA, \textit{supra} note 41, § 252. \textit{See also} OBCA, \textit{supra} note 41, § 256 (liability in Ontario is $2,000 or imprisonment for 1 year, or $25,000 for a corporate body); BCBCA, \textit{supra} note 41, §§ 427-428 (liability in B.C. is $10,000 for an individual, or $25,000 if not an individual). \textit{Note that} \textit{Companies Act}, R.S.Q. c. C-38, §§ 108 and 201, \textit{creates liability for untrue entries in the corporate books $100 per entry and liability for damages and} \textit{Companies Act}, R.S.P.E.I., c. C-14, § 54 (1988) \textit{creates liability for damages stemming from misrepresentations in the corporate books. There does not appear to be quasi-criminal liability under the NSCA, \textit{supra} note 42.}

\textsuperscript{158} NSCA, \textit{supra} note 42.

\textsuperscript{159} \textit{Id.}


\textsuperscript{161} \textit{Id.} § 382
imprisonment for a term not exceeding 14 years.\textsuperscript{162} Even when the directors are not the party for actually committing the offence, they may also be liable for aiding and abetting,\textsuperscript{163} as exemplified in the case of \textit{R. v. Fell}.\textsuperscript{164}

Section 380.1 was introduced in March 2004, establishing four aggravating circumstances that a court can consider when imposing a sentence for market fraud offences.\textsuperscript{165} A court can impose tougher penalties if:

(a) the value of the fraud committed exceeded one million dollars;

(b) the offence adversely affected, or had the potential to adversely affect, the stability of the Canadian economy or financial system or any financial market in Canada or investor confidence in such a financial market;

(c) the offence involved a large number of victims; and

(d) in committing the offence, the offender took advantage the high regard in which the offender was held in the community.\textsuperscript{166}

These provisions apply equally to other corporate gatekeepers, including lawyers. Lawyers face quasi-criminal liability through the Ontario \textit{Provincial Offences Act} under sections 77 and 78, which make a lawyer party to an offence under provincial securities or corporate legislation if he or she did or omitted to do anything to aid or abet a client in committing an offence, or if he or she counseled another person to commit an offence.\textsuperscript{167} Some other provinces have similar legislation.

There are a number of examples where lawyers have become liable for a criminal action under the CC through their actions on behalf of a corporation, which may be characterized as a failure in performing their gatekeeping function. In one example, \textit{R. v. Sahaidak}, a lawyer was held criminally liable for a fraudulent stock scheme, despite being neither the “creator” nor the “driving force” behind the scheme.\textsuperscript{168} However, the judge noted that “there are offences . . . that need lawyers in order to be committed” and found the lawyer to have been “an active participant in each of the frauds and an important participant.”\textsuperscript{169} In another example, \textit{R. v. Shead}, a lawyer was held liable for several counts of fraud for making negligent disclosures to investors.\textsuperscript{170} This case suggests a requirement of subjective knowledge of the facts to draw a legal conclusion of fraud (i.e., objectively dishonest conduct and deprivation caused by the dishonest act) and an action to aid in the commission of the crime, which is a high mens rea threshold to be met. A lawyer is generally unable to control a corporate client from engaging in the dishonest act unless the dishonest act is reliant upon an action by the lawyer. Thus, in general, the withholding of consent should be sufficient to prevent a fraudulent act; intentionally aiding a client when there is knowledge of a criminal action will constitute aiding and abetting under the CC.

\textsuperscript{162} \textit{Id.} § 380(2).
\textsuperscript{163} \textit{Id.} § 21(1).
\textsuperscript{165} Criminal Code, \textit{supra} note 160, § 380.1.
\textsuperscript{166} \textit{Id.}
\textsuperscript{169} \textit{Id.}
All categories of corporate gatekeepers can be exposed to criminal liability under the CC, depending on the degree of misconduct. Auditors, credit rating agencies, financial analysts, and retail investment advisors are all also liable to quasi-criminal charges under securities and corporate legislation. Underwriters and CRAs, through the adoption of Bill C-45, can be held liable as an “organization, which includes a law firm, based on criminal activity of senior officers of the organization.”

IV. LOCATING THE CANADIAN SYSTEM IN AN INTERNATIONAL CONTEXT

A. Directors

In the United States, the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) imposes increased responsibilities on directors, without direct legal penalties for directors who breach those responsibilities.172 In the United Kingdom, there have been recent amendments to company law which have relaxed the provisions protecting directors and other company officers from liability.173 Amongst these changes is the introduction of director liability to third parties, under sections 19 and 20 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (C(AICE)).174 The current Canadian gatekeeper liability regime for directors is in line with the U.S. model, but has not gone the U.K. route of attaching additional liability to the additional responsibilities now placed upon directors, and particularly independent directors, as gatekeepers.

The academic literature suggests that the exact nature of the gatekeeping role that directors should play remains unclear. For example, James Kirkbride and Steve Letza suggest that non-executive directors might serve as internal monitors of CEO behaviour because they have access to privileged information about firm operations, which is inaccessible to public enforcement officials.175 However, they outline some of the problems associated with imposing gatekeeper liability, including the cost element; if gatekeepers cannot shift their liability risks, they will charge higher premiums.176 This suggests that imposing increased liability on directors as gatekeepers does not necessarily contribute to a more effective gatekeeper liability regime.

Indeed, public opinion does not support an increase in sources of director liability.177 Instead, increasing transparency and disclosure about directors’ salaries

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171. For a more detailed discussion see Darcy L. MacPherson, Extending Corporate Criminal Liability?: Some Thoughts on Bill C-45, 30 MAN. L.J. 253 (2004).
174. Id.
176. Id.
177. The Ditchley Foundation Conference, Confidence, Control and Compensation: Questions for the Modern Corporation (Sept. 5-7, 2003), at http://www.ditchley.co.uk/page/175/modern-corporation.htm.
may help allay general concerns. The sharp rise in directors' salaries relative to the salaries of the average employee was cited as a major problem by many Ditchley Foundation conference participants, including business people, regulators, and politicians. Further demonstrating the problem with directors' salaries, the Ontario Teachers' Pension Plan released a report in June of 2006 showing little correlation between CEO pay and total stock return. To combat the public perception problems with directors' compensation, the Canadian Coalition for Good Governance has suggested transparency guidelines and assists in their implementation.

Additionally, the recent introduction of the secondary market civil liability scheme in Ontario presents an opportunity to evaluate the impact of increased gatekeeper liability for directors and at the same time examine the judiciary's role in applying such a regime. Further amendments are not recommended until this experience has been fully evaluated in the Canadian context. Following an evaluation of the current regime, further consideration should be given to attaching increased liability to the added responsibilities placed on directors, and in particular, independent directors.

B. Lawyers

In Canada, the United States, and the United Kingdom, lawyers are regulated both by law societies and securities statutes. Under section 307 of Sarbanes-Oxley, the SEC has developed rules of professional conduct for lawyers, and those who violate the rules are subject to all remedies and sanctions available to the SEC for the violation of federal securities laws. Lawyers are also regulated by their state bar association, many of which have adopted the American Bar Association's Model Rules of Professional Conduct (Model Rules), though it is up to each state bar association to develop its own rules and standards. In the U.K., the Law Society sets out The Guide to the Professional Conduct of Solicitors. Lawyers in the U.K. are also regulated under the Financial Services and Markets Act 2000 (FSMA 2000).

Unlike the U.S. model and more akin to the U.K. model, the Canadian model for gatekeeper liability for lawyers clearly assigns the key regulatory function to the provincial law societies. The benefit of this model is that the problem of conflicting standards that exists in the U.S. between the Rules of Professional Conduct, set by each state Bar Association and the SEC rules does not arise. It is also the case that the law societies are keenly aware of the competing tensions between lawyers' gatekeeping function and the confidentiality requirements that are required.

178. Id.
generally of all lawyers. However, there is variation among the law societies to the extent they have created specific rules to address lawyers’ gatekeeping function. Ontario appears to have created the model most similar to the U.S. model, striking a balance between lawyers’ roles as gatekeepers and advocates.

To improve the competitiveness of Canadian capital markets, it is recommended that each law society give consideration to adopting a similar set of rules—with the input of each provincial securities commission. A more uniform and comprehensive set of rules of professional conduct will simplify the existing system and at the same time ease investors’ concerns about the role that lawyers are playing in Canadian capital markets. Following a provincial consultation process, it may be helpful to form a national working group to develop a uniform set of rules of professional conduct.

C. Auditors

After the financial collapse of Enron, there was very little public confidence in auditors and accountants. While it was an American corporation, seventy-three percent of Canadians doubted their public protections, and believed an Enron-like scandal would take place there as well.184 Further, inconsistencies between the Canadian and American systems have since been highlighted by Al Rosen, founder of the forensic accounting firm Rosen & Associates Ltd.185 He contends that in 2003, two-thirds of Canadian companies would have lower reported profits if American accounting rules were used in place of their Canadian counterparts.186 Recent Canadian reforms, detailed below, have helped to address these concerns, and this article offers additional suggestions to increase public confidence in auditors further.

In the U.S., Sarbanes-Oxley imposed extensive federal regulation on the accounting profession.187 The act created the Public Company Accounting Oversight Board (PCAOB) to oversee the audit of public companies.188 Accounting firms must register with the PCAOB which has broad powers to promulgate binding rules and standards, conduct investigations, and impose discipline; by shifting control of the accounting profession to a new body, the PCAOB aims to address the problem of accounting irregularities by establishing auditing standards and imposing professional discipline.189

The U.K.’s counterpart to the PCOAB is the Financial Reporting Council (FRC), an independent regulator for corporate reporting and governance, created in April 2004 under the authority of the C(AICE) Act.190 The functions of the FRC include: establishing, monitoring, and enforcing accounting and auditing standards;

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186. Id.
189. See Coffee Gatekeeper Failure and Reform, supra note 12, at 50.
regulating auditors; operating an independent investigation and disciplinary scheme for public interest cases; overseeing the regulatory activities of professional accountancy bodies; and promoting high standards of corporate governance.\textsuperscript{191}

Drawing on the U.S. and the U.K. models, the author believes that consideration should be given to conferring SRO status on the Canadian CPAB, subject to oversight by each of the securities regulators; the development of the CPAB provides an opportunity to improve the current gatekeeper liability regime for auditors. The current model, in which the CPAB relies on the ethical standards imposed by the industry bodies that have jurisdiction over auditors is consistent with the current Canadian self-regulatory approach. However, the status of the CPAB, as a creature of contract, is distinct from other similar organizations, creating issues concerning legitimacy, fairness and effectiveness. Currently, three SROs are recognized by the OSC and most other provincial securities regulators. The SROs currently recognized by the OSC are the Investment Dealers Association of Canada (IDA), the Mutual Fund Dealers Association of Canada (MFDA), and Market Regulation Services Inc. (RS). An SRO is an entity that represents registrants and is organized for the purpose of regulating the operations, standards of practice, and business conduct of its members and their representatives, with a view toward promoting the protection of investors and the public interest. It is recommended that the CPAB be accorded SRO status. This will improve investor confidence in both the CPAB, as regulator, and auditors, as gatekeepers, because their chief regulator—the provincial securities commission—will be perceived to be more legitimate and fair. At the same time this change will bring the Canadian position more in line with the U.S. and U.K. positions. In its capacity as an SRO, the CPAB will be in a better position to work with the industry bodies that regulate the accounting profession, thereby ensuring that the ideal level and form of gatekeeper liability for auditors is in place.

The recent reforms and the changes proposed still leave the “two master problem” unresolved: auditors are still asked to treat the public as master, but continue to be paid by the corporation.\textsuperscript{192} While this is recognized as an issue for gatekeepers, there is insufficient evidence to suggest that the current Canadian system needs to be completely overhauled at this time. Much has happened in Canada, the U.S., and the U.K. in the context of oversight of auditors over the last five years, and at this point, it is justifiable to resist making further changes and to allow the current system to develop while continuing to monitor it. In particular, the recent expansion of the number of accountants who may perform public audits should be observed.\textsuperscript{193} The role that increased competition may play will be a factor in future regulatory decisions.

D. Credit Rating Agencies

Commentators such as Frank Partnoy see CRAs as possessing little informational value. That is, while initial credit ratings provide guidance on purchases, it is unclear whether they provide any information beyond that already reflected in the "price talk" before a fixed instrument is issued. Building on this critique, the best reforms should create incentives for CRAs to generate greater informational value while reducing the impact of ratings on markets. In the current American context, Partnoy argues that CRAs are important not because they offer valuable information, but because they grant issuers "regulatory licenses"—that is, a good rating entitles the issuer to certain advantages related to regulation.

The effectiveness of CRA's gatekeeping role remains an open question. However, both the public perception and academic writing suggest that the existing liability regime does not instill confidence in capital markets and that there is room for modernizing Canadian securities legislation to improve the current situation. Accordingly, reforms to the current regime should focus on creating incentives for CRAs to generate informational value while reducing the market impact of ratings from a small group of CRAs.

Given the uncertainty around CRAs' role and that there is no Canadian SRO or industry body charged with regulating CRAs, the securities commissions could play a critical role. Securities legislation should be amended to create a mandatory registration requirement for all CRAs and the provincial securities commissions should have the power to revoke or suspend registration of a wayward registrant. The disclosure obligations formulated by the IOSCO should be a condition to registration with the provincial securities commissions. The registration requirement would bring the treatment of CRAs more in line with the spirit of Canadian securities legislation as it relates to oversight of corporate gatekeepers. Registration would also create a threat of liability for rating malfeasance. Given concerns with imposing civil liability on CRAs, the ideal gatekeeper liability scheme should focus on administrative liability. The IOSCO Code, which CRAs have already generally adopted, presents a good model for imposing liability on CRAs.

E. Financial Analysts

Because of their unique intermediary role in capital markets, conflicts often arise between an analyst's duty to provide independent, objective advice to investor clients and pressures to support investment banking revenues. In the current

195. Id. n.13.
196. Id.
197. Id. at 28.
context, buy-side pressures on financial analysts are increasing in significance. For example, there is incentive for a mutual fund with large holdings in a stock to persuade an analyst not to put a "sell" recommendation on the stock that might contribute to a decline in its price. Following the SICAS Report, the IDA has taken significant measures to address the gatekeeping role played by analysts. However, given the recent reforms in the U.S. and the U.K. to bolster confidence in analysts function as gatekeepers, analysts should require more detailed disclosure by analysts, with accompanying liability for failure to disclose.

U.S. reforms include SEC Regulation AC (Analyst Certification), effective April 2003, which requires that when a broker, dealer, or covered person furnishes research prepared by a research analyst, the research must include a statement by the research analyst that the research truly reflects the analyst's opinion, and disclose whether or not an analyst received compensation in connection with his or her specific recommendations or views. Penalties under the Securities Act (or rules or regulations promulgated under the act, such as Regulation AC) may amount to fines of up to $10,000, or imprisonment of up to five years.

The U.K.'s attempt to raise confidence in analysts' function is found in the Financial Services Authority's (FSA) Conduct of Business Sourcebook, section 7.17, which imposes "fair presentation" and disclosure requirements on analysts. Since July 2004, firms that publish impartial research must have implemented a policy on identifying and managing conflicts to ensure analysts' impartiality. The FSA's rules set out minimum standards for conflict management processes and procedures.

In Canada, IDA Policy No. 11 should be amended to require: 1) a statement by the analyst that the research truly reflects the analyst's opinion; and 2) a prohibition on the investment banking department supervising or controlling analysts. Currently, Rule 2(b) requires that members disclose their system for ratings. More specific disclosure requirements, including identification of the analyst responsible for the production, dissemination of the research, and a statement by the analyst that the research truly reflects the analyst's opinion would bolster investors' confidence in the information that is provided. This reform will address both sell-side and buy-side pressures facing financial analysts. In addition, members should not only set policies and procedures under IDA Rule 11 to avoid conflicts of interest, but also put in place controls and maintain records of supervision of analysts, and explicitly prohibit supervision and control of analysts by the investment banking

203. EMILIOS E. AVGOULEAS, MECHANICS AND REGULATION OF MARKET ABUSE: A LEGAL AND ECONOMIC ANALYSIS 366 (2005). Note that COB 7.17 was adopted in compliance with Article 6(5) of the MAD.
department. While such measures may appear to be outdated to the American reader given that similar measures were introduced in the U.S. in 2003 following Eliot Spitzer's investigation of conflicts of interest at Wall Street investment firms, they are not outdated in the Canadian context. These measures will bring the Canadian approach to gatekeeper liability for analysts more in line with the U.S. and the U.K. approaches, while maintaining the Canadian self-regulatory model.

F. Retail Investment Advisors

Recent reform efforts regarding the liability of investment advisors in Canada have not focused on their role as corporate gatekeepers. Rather, the focus has been on establishing consumer protection mechanisms to address power imbalances in investment advisors' relationships with customers. The evidence suggests that consumer protection issues are the most pressing concern in the Canadian context. In certain instances, there is an overlap between liability introduced for more general consumer protection purposes and liability for failure to perform a corporate gatekeeping function. However, recent U.S. and U.K. reform efforts demonstrate that similar issues arise with respect to the role of analysts and investment advisors as corporate gatekeepers and accordingly, similar gatekeeper liability regimes (specific to the role of each gatekeeper) are justified and should be put into place. In the U.S., a full service investment advisor is obligated to recommend to a customer only those securities that match the customer's financial needs and goals (the "suitability obligation"), which is imposed on NASD members through Rules of Fair Practice (Conduct Rule 2310). Similar consumer protection issues arise in the American context, as breach of the suitability obligation has grown into the most commonly alleged basis of investor recovery against investment advisors.

To a certain extent, the corporate gatekeeping role of investment advisors in Canada has been underestimated. The IDA, as a national SRO, is ideally suited to develop and implement a parallel policy to Policy No. 11, which is specific to the role of investment advisors. In particular, like Policy No. 11, the policy for investment advisors should build on the existing requirements in securities legislation for disclosure of possible conflicts resulting from the firm's relationships to issuers and clients. The new policy should respond to issues created by relationships in the firm, in the same way as Policy No. 11 seeks to respond to relationships between analysts and investment bankers.


G. Underwriters

Recent reforms in the U.S. have not focused on imposing or modifying the liability to which underwriters are subject as gatekeepers. For example, Choi writes that underwriters face strong incentives to act as certifiers; if they can provide credible assurances that an issuer's disclosures are truthful, investors will be willing to pay more for the issuer's securities. The issuer will then pay more for the underwriter's certification service. There is less need for underwriter liability if they are incentivized to become more independent, and arguably better gatekeepers, by the market for independent certifiers. This argument applies to the Canadian context, suggesting that, like in the U.S., underwriters do not need to be subjected to additional liability.

The reforms introduced by National Instrument 33-105 help promote this model in Canada, and are consistent with the recent and proposed reforms in the U.S. and the U.K. to improve the effectiveness of underwriters' role as gatekeepers. The current regime does subject underwriters to civil, administrative and criminal liability for failure to perform their gatekeeping role. However, the focus is on disclosure of conflicts rather than on enlarging the instances and possibility for gatekeeper liability. In this way, the current regime is consistent with the model that Choi advocates. There is insufficient evidence to suggest that increasing or modifying the gatekeeper liability regime to which underwriters are currently subject will contribute to more competitive Canadian capital markets. At the same time, time constraint issues related to fast track offerings and the implications for the ability of underwriters to conduct adequate due diligence should continue to be monitored.

V. CONCLUSION

The analysis of the academic literature and the comparative context suggest that developing a streamlined approach to amending the gatekeeper liability scheme in Canada, which comes closer to the U.S. and the U.K. models, is not desirable. Overall, the polycentric legal environment for gatekeeper liability in Canada appears to be developing in a manner that gives gatekeepers guidelines on how to perform their functions, as well as adequate reason to do so. This can be demonstrated by indexes such as the Rotman School of Management's Board Shareholder Confidence Index, which found that governance scores, designed to reflect the degree to which elements of good governance are implemented by a company, have improved every year since 2003.

In examining the existing Canadian model where the boundaries between law and professional practice are somewhat blurred and subsystems of liability that apply to various gatekeepers differ both from gatekeeper to gatekeeper and also geographically, it became apparent that participants in the market and other

209. Choi, supra note 9, at 962.
210. BCSA, supra note 59, § 33-10.
members of the public may not be aware of the extent of the existing corporate
gatekeeper liability regime in Canada. Awareness of the liability scheme plays a key
role in developing confidence in Canadian capital markets. Accordingly, a final
recommendation is made with regards to the widespread dissemination and
availability of papers that seek to map out the existing gatekeeper liability regime in
Canada and situate it in the context of recent academic literature and reforms in
comparable jurisdictions.