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AN AMERICAN STATE-FEDERAL PERSPECTIVE ON THE PROPOSALS

By Hugh H. Makens*

I. INTRODUCTION

State securities or "Blue Sky" laws date back to the passage of the first such law in the State of Kansas in 1911. These laws were designed to prevent promoters from selling "useless chunks of blue sky" in lieu of valuable interests in viable enterprises. Following the Kansas example, adoption of such laws quickly occurred in virtually all of the states throughout the United States and in Canada. The U.S. federal government was far slower in reacting to national patterns of pervasive fraud. It took an international depression to trigger Congressional action in the form of the Securities Act of 1933 and the family of related laws adopted through 1940.

Most state securities laws are designed to provide full disclosure of all material facts in conjunction with the offer or sale of securities to a prospective investor and to ensure the fairness of the terms of the underlying offering. The regulatory coverage of state laws is primarily directed to the initial offering of securities as opposed to after-market activity. The jurisdictional reach of such laws encompasses both securities sold within the state and those sold from the state. This system is comparable in some respects to the Canadian provincial laws. The practical limitation is the ability of the state to meaningfully affect activity that arises outside of that particular state's boundaries. This limited jurisdictional reach is particularly crucial where securities are sold outside of the prescribed regulatory framework.

In addition, the "Blue Sky" laws customarily regulate the activities of broker-dealers and several address the activities of investment advisers. None

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1 The Kansas Securities Act, Kan. L. 1911, c. 133.


regulates securities exchanges; nor do the “Blue Sky” laws contain extensive provisions regulating the daily operations of either broker-dealers or investment advisers. Rather, the regulations promulgated by the states rely on a minimum of identification, disclosure, capitalization and broad record-keeping paralleling the federal requirements and often adopting them by reference.

Perhaps the most common lament that one hears from practising securities attorneys in the United States is the concern over the necessity of dealing with “fifty different jurisdictions.” The implication of such statements is that the states constitute an amorphous mass with no sense of unity or organization. In fact, that is not the case. The states in recent years have acted together to develop a number of common policies, procedures and forms, as well as to share educational, enforcement and management information. The Canadian provincial commissions have co-operated in a similar fashion with each other. All of the states, as well as all of the Canadian provinces and territories, are members of the North American Securities Administrators Association (NASAA). The objective of this organization is the development of uniform policies. NASAA has produced common policies in a number of areas, including the regulation of oil and gas, real estate and stock offerings. For corporate offerings, the states adhere to the format established by the Securities and Exchange Commission (SEC) forms S-1 through S-18. Registration is initiated by using a uniform national application form. As a consequence of these efforts and co-ordination with the SEC, the format for disclosure is the same in virtually every state in the United States.9

There are currently about twenty-seven states which possess the statutory authority to impose “fair, just and equitable” requirements on offerings filed within these states.10 If the administrator deems an offering unfair due to excessive compensation to promoters, conflicts of interest arising from transactions with affiliates or problems in the backgrounds of the promoters or inadequate promoters’ capital contributions, permission to sell securities in the state may be denied. The fairness requirements in these “merit regulatory states” are likewise virtually identical. The major differences in state regulation are a function of staff experience, staff size and professional qualifications for staff selection. These same factors must be considered when viewing potential problems with securities regulation in the Canadian provinces.

In the design of the Securities Act of 1933, the American Congress did not provide merit regulatory authority to the SEC. The existence of merit

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8 California withdrew as a member apparently due to the personal pique of its Commissioner in September, 1980. It is likely that California will return to NASAA when a new Corporations Commissioner is selected in that state.

9 The states presently use a uniform registration document, Form U-1, as found in 1 Blue Sky L. Rep. (C.C.H.) ¶5103 and a Uniform Consent to Service of Process, Form U-2, ¶5113.

regulatory authority in the states, coupled with the potential impact of power of such magnitude being vested in a federal agency, was sufficient to deter Congress from endowing the SEC with merit regulatory authority.11

The SEC has been characterized by slow but steady growth during its forty-nine year history. As with almost all government agencies, it has striven continually to expand its regulatory boundaries, size and influence. In doing so, it has too frequently acted introspectively, either by ignoring the states, or by giving the states’ concerns superficial attention. The SEC has too often provided, at best, a light cosmetic treatment to a relationship that, until ten years ago, was almost non-existent. The relationship is now in a state of progressive evolution and significant strides have been made, but there remains a wide gulf between the current relationship and an effective co-operative model.

II. INTERGOVERNMENTAL CO-OPERATION

The concept of effective government is easy to define. Taxpayers pay for services, not agencies nor specific people, not intergovernmental bickering, not personal power for administrators and not agency prestige. The taxpayer has one view of the statutory authority vested in an agency. He asks that the agency fulfill its statutory task effectively and efficiently. The task of securities agencies is to ensure full disclosure to investors to prevent fraud. It is impossible to eliminate fraud or to obtain perfect filing compliance or fully accurate disclosure, but with federal and state or provincial governments acting in concert, progress toward that goal will be far greater.

An ideal co-operative system should have certain characteristics:

1. In matters of common concern, joint policy development should occur regularly, encompassing the ambit of all mutual responsibilities.
2. Free and open information sharing should occur, particularly in the areas of economic impact, management and administrative systems, training and statutory implementation.
3. The language used should be compatible and the interpretation should also be uniform.
4. There should be a minimal duplication of effort, and unnecessary regulation should be identified and eliminated at both levels.
5. All agencies should be responsive to each other and the public in a timely and a reasonably competent manner.
6. Mutual trust should be the keystone of the relationship. Hence, integrity of information, patience, understanding and a desire to perform professionally should characterize exchanges. Candor in communication must exist.
7. Each agency should be willing to recognize the expertise of the other and whether through that realization, by analysis of its own resources or by an

informal comity, should periodically defer using its power in order to pre-
serve the balance of the relationship.

8. There should also be an adequate balance of statutory authority among
the parties. Section 28(a) of the Securities Exchange Act of 1934 makes it
clear that the states' "Blue Sky" laws are not pre-empted by the federal laws
unless they are in conflict with the provisions of that Act or the rules promul-
gated thereunder. Section 18 of the Securities Act of 1933 provides that
nothing in that Act affects the jurisdiction of the states. The NASAA en-
dorsement of the Proposed Federal Securities Code is indicative of state
willingness to co-operate in this manner with the Commission.

An illustration of the problems arising when the system breaks down is
found in the takeover litigation between the various states and the SEC. The
SEC has wasted enormous amounts of man-hours struggling with state
tender offer laws when, by reacting co-operatively six years ago, most of the
current problems could have been avoided. The SEC was more preoccupied
with the theory of pre-emption than with solving the underlying problem.
Now, some states and the Commission are locked in litigation over the issue.
This is a ridiculous waste of taxpayers' money.

To illustrate the problems and potential solutions, it is useful to consider
the opportunities for co-operation and conflict that arise out of the relation-
ship between the states and the SEC.

III. ENFORCEMENT

Obtaining credit for the successful termination of any activity that vio-
lates the law is an essential element for any governmental body with an
enforcement obligation. To justify its existence before its legislative creator,
a securities agency must show a reasonable level of success in criminal, civil
and administrative actions. If it does not show this success, the agency's
budget may be drastically cut. The primary reason for the creation of a secu-
rities administrative agency is the prevention of fraud. Without a successful
record, the justification for the continuation of that agency may be called
into question. Thus, each law enforcement agency strives to maximize its
credit for preventing or punishing fraud.

While the SEC and the states are making progress in developing systems
to more effectively respond to the tremendous volume of fraudulent activity,
the ability to combat securities fraud is drastically impaired by the lack of

14 See Pozen and Lamb, Rule 14j-2(b) under the Securities Exchange Act and the
State Law Regulation of take-over bids, (pp 287-400) and Shapiro, "State Takeover Laws,"
in Twelfth Annual Institute on Securities Regulation, Course Handbook Series 348 (Insti-
tute of Securities Regulation, 1980) at 401-448.
15 The message conveyed by the states' takeover legislation was relatively simple:
the existing federal system was failing dramatically. If the Commission had reacted by
treating the problems rather than fiercely guarding its pre-emptive authority, then perhaps
many of the state laws would have been enacted.
investigative staff in virtually every securities agency. This staffing problem is as real at the SEC as it is in even the smallest of the states or provinces. The only means of addressing this problem is "selective" enforcement; cases with some promise of visual impact and substantial threshold economic levels dictate the allocation of investigative resources. In determining the appropriate state-federal allocation of resources there are a variety of factors that enter into the picture.

A. Communication

The first consideration is that of effective communication. Unfortunately, fraud cases and even registration violations are not necessarily obvious upon initial inspection. As a consequence, it is vital to obtain information relating to the scope and nature of a particular scam before an evaluation can be made to determine if it is suitable for enforcement action. The potential communication problem between the states and the SEC is met in a variety of ways. Three or four times annually, key members of the SEC staff meet with state administrators and discuss current cases and investigations. The preponderance of information at such meetings customarily comes from the states. This is only appropriate in that the states, because of their proximity to the action, are far more likely to initially detect the presence of a fraudulent scheme, unless a multi-national corporation is the perpetrator. At these meetings the states actively encourage the SEC to become involved in multi-state fraud investigations, and the SEC staff may encourage state action on a particular fraud or type of fraud.

The SEC has divided its operational offices throughout the United States into regions. The Regional Administrator for each SEC office serves as a contact point for the states to report and react to fraudulent activity occurring within their region. Through periodic meetings and regular communications, enforcement information is exchanged on a continuing basis. The SEC also maintains two extremely helpful enforcement tools. The Securities Violators Bulletin is a periodically updated publication, prepared by the SEC, which lists alphabetically all of the persons that have been named in any formal proceedings commenced by the SEC or by the state agencies. The states can obtain copies of the "SV" book and use it as a quick reference to determine if an investigative suspect has been involved in other securities activities which gave rise to enforcement action elsewhere in the United States. Second, the SEC maintains computerized enforcement information, particularly pertaining to past and current subjects. Thus, it is possible for the states, through a regional office, to obtain access to the names and schemes

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17 See id. at 603-15, generally on investigations. See also Canada Securities Market Act, [hereinafter Draft Act], in 1 Proposals, s. 14.01 et seq.; Commentary to Part 14, Anisman et al., 2 Proposals for a Securities Market Law for Canada (Ottawa: Minister of Supply and Services, 1979) [hereinafter 2 Proposals] at 303-28.
18 The SEC is located in Washington with regional offices in Boston, New York, Atlanta, Fort Worth, Chicago, Denver, Los Angeles and Seattle.
of past and potential securities law violators in the computer. State investiga-
tive information is not included within the computer banks, but state enforce-
ment actions are included to the extent that the states report them.

In spite of the levels of communication described herein, a major failing
of the state-federal system is the inability to identify investigative matters of
mutual interest in sufficient time to prevent substantial public harm. Untold
millions of dollars have been lost because of the failure to centralize informa-
tion effectively as a means of detecting potentially fraudulent activity.\(^{19}\)

B. Co-operation

Joint investigations are also a vital element in effective enforcement.
Once a fraudulent scheme is detected, it is frequently essential to maximize
available manpower for a brief period of time in order to develop sufficient
information to commence a proceeding. The pooling of resources is obviously
the most effective means of achieving this goal. Hence, for example, an in-
vestigation in Detroit, which affects activities in other parts of the United
States and in Ontario, might involve co-operative efforts by the Ontario Se-
curities Commission, the Securities and Exchange Commission and the Michi-
gan Corporation and Securities Bureau.

During the investigation, one agency is likely to emerge as the “lead”
agency for the purposes of developing the proceeding. While, in this hypo-
thetical situation, all three agencies would have the power to commence a
proceeding, it is likely that only one or two would do so to avoid the duplica-
tion of effort, but all would assist in the investigation. If criminal action
is appropriate, it is more probable that a state or provincial action is in order,
while if injunctive action is desirable, the SEC may take the lead.\(^{20}\) Further,
if the preponderance of the illegal activity has occurred beyond the boun-
daries of the state or province, it is more likely that the matter would be left
to the SEC. On the other hand, if the preponderance of the activity takes
place within either the province or the state, other jurisdictions are likely to
defeer to that local entity. Finally, if the matter involves less than a million
dollars or less than one hundred people, the SEC is far more likely to defer
to the state or province because of the lack of federal impact of the matter.

Another consideration in determining the appropriate agency to take the
lead is the potential impact or prophylactic effect of an action upon others
who may engage in similar conduct. The SEC in recent years has been aggres-
sive in tackling novel securities situations.\(^{21}\) The ability to warn investors
nationwide, combined with the ability to warn promoters that the particular
scheme is not suitable for further exploration, is an appealing concept to the
states and the SEC.

\(^{19}\) The Draft Act, s. 15.12 mandates a co-operative level that should become the
model language for the federal and state statutes in the United States.

\(^{20}\) The Commission's ability to seek injunctive relief on a nationwide basis is obviously
a superior remedy to an injunction in a single state. While the states might seek standing
in a federal court on a parens patriae basis, this has rarely been sought.

\(^{21}\) E.g., worm farms, movies and records.
Finally, if speed is essential, the state or province will likely take the lead, since a criminal reference processed through the SEC and the Department of Justice moves more slowly.

C. **Mutual Trust**

Efficient law enforcement requires the existence of mutual trust between co-operating agencies. That trust has not always been present between the SEC and the states and is unlikely to always be present between the Canadian provinces and the federal government. The process of selecting government officials has its occasional flaws, as evidenced by the periodic resignations under pressure of various state and federal officials over the last fifty years. The SEC may not wish to share information about a politically sensitive issue in a state when other public officials of that state are participants in the scam. Another area of difficulty arises when there is a lack of confidence that information will be provided on a two-way basis. No agency is likely to provide information if it feels that there will not be reasonable reciprocity.

Historically, there has been a high level of co-operation between Canadian provincial authorities, the SEC and the state regulatory agencies. Regulators from both countries exchange ideas and information as members of NASAA.

Co-operation with the Royal Canadian Mounted Police has also been excellent over the years.

D. **Recognition**

Individuals tend to respond favourably toward affirmative recognition. The same is true of government agencies. The SEC, when it participates with state agencies in investigations, generally recognizes those agencies, and their co-operation and assistance, in its press release. Because of the wide-spread dissemination of SEC press releases, states certainly appreciate the favourable reference and this recognition probably provides a slight additional incentive to co-operate.

E. **Competence**

For agencies to co-operate, a common level of professionalism is necessary. This competence is obtained most easily through joint training and the sharing of enforcement techniques. The SEC conducts an annual training seminar that representatives from both the states and Canadian provinces attend. In addition, several of the SEC Regional Offices host jointly-prepared programmes by state and federal officials on current enforcement techniques and recent developments in the enforcement field. Enforcement training remains open to improvement, however, because of the lack of depth and limited nature of the existing training.

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22 The turnover of personnel, conflicting personalities, excessive pride and many other human problems will contribute to the partial breakdown of the system. The problem with ideal models is that they must be implemented by people.
IV. CORPORATION FINANCE

If there is an area where liaison between the states and the SEC has historically been singularly lacking, it is in the co-ordination of the regulation of business financing. The process starts well. In a public offering of securities that is to be registered in multiple states, as well as with the SEC, the registrant may file simultaneously with the SEC and the states. All states may use the U-1 Registration by Coordination form. At this point in time, the liaison between the SEC and the states has broken down quite frequently.

When the SEC promulgates a registration policy or disclosure format, it does not consult in advance with the states regarding the contents of such a form or policy. As a consequence, it is not unusual for the SEC to move away from the direction taken by most state statutes or by a policy that has been developed by NASAA. Recently, the dialogue between the SEC and the states has improved somewhat in this area, but it is worth noting that Rule 146 (private offerings), Rule 147 (intra-state offerings), Rule 240 (very small corporate offerings) and Rule 242 (small business corporate offerings) were all developed without the active participation of the states in the planning stage. Since the states have an impact that is equal to, and frequently greater than, the SEC in these areas of regulation, it is little short of amazing that a more diligent form of co-ordination of effort was not pursued.

Most recently, signs of significant progress in improvement of the state-federal relationship were exhibited in the development of Proposed Regulation D, the revision and consolidation of Rules 146, 240 and 242. A NASAA committee conferred and exchanged drafts with the SEC staff. State input in final development of the regulation seems highly likely and the regulation may serve as a touchstone for development of a uniform state exemption encompassing all, or a portion, of the regulation. The SEC Release 33-6339 of August 7, 1981, contained specific reference to the state liaison and co-operation. The states and the SEC have not yet moved to true co-operative policy development, but this represents a major step in that direction.

In the development of a national oil and gas registration policy for limited partnerships, the states and the SEC engaged in a significant dialogue which led to both a greater uniformity and a policy that was acceptable to both the SEC and the states. In contrast, when the SEC adopted Guide relating to real estate programmes, none of that co-operation and co-ordination

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23 Supra note 9.
28 S.E.C. guide 60, 17 C.F.R. 231.5465. The states and the Commission are currently working cooperatively to revise Guide 60 with a view toward establishing common state and Federal disclosure guidelines.
was present; rather, the SEC acted in splendid isolation.\(^{29}\)

Likewise, the SEC's cursory review policy was adopted by the commission without consulting with the states, despite the fact that state approval in most instances was essential to meaningful implementation of that policy. It sometimes appears to the state administrators that the SEC acts arbitrarily and capriciously in policy development. That conclusion is probably well merited.

Traditionally, the securities laws are thought of as having their justification in preventing fraud. In the registration and exemption context, however, this certainly is not the case. The principal objective of the registration provisions of the 1933 Act and "Blue Sky" laws is to provide an investor with adequate information to enable him to make an informed investment decision. The issue is not primarily fraud, but rather the identification of business risk and the dissemination of that information regarding actual or prospective operations in such a manner that the investor can be fully informed when evaluating the merits of the securities offering.

Many states have the power to deny an issuer the right to sell securities in the event of unfairness of the terms of the offering or because of inadequate disclosure. In analyzing an offering, the states will frequently exchange comments, either through a centralized clearing facility located in one state, or on a courtesy basis between examiners. As a consequence, there is substantial, though probably insufficient, uniformity in many states' comments on a registration application. The SEC, for a number of years, followed the practice of contacting the home state of a registrant prior to declaring a registration effective. The securities administrator in that state then had the opportunity to apprise the SEC of information that was locally known, but that would not be readily available to an SEC examiner. This practice would periodically result in the SEC being alerted to prospective problems not disclosed in the offering material that related to either the project or the promoter. This practice is not followed uniformly, probably to the detriment of the investing public.

Other examples of this lack of co-operation and co-ordination are found in the interpretation of common statutory terms. Both the states and the SEC have been negligent in advising each other about positions taken on certain issues or in discussing common fundamental concepts between the state and federal statutes. For instance, even though the *Uniform Securities Act* and

\(^{29}\) NASAA presently has the following policy statements:

a) *Publication or Distribution of Preliminary Prospectuses and Preliminary Summary Prospectuses*, Oct. 9, 1957, as found in 1 Blue Sky L. Rep. (C.C.H.) ¶5151;

b) *Qualification or Registration of Securities*, May 24, 1945, ¶5201;

c) *Options and Warrants*, Oct. 7, 1971, ¶5211;

d) *Registration of Oil and Gas Programs*, Oct. 31, 1979, ¶5222;


f) *Open-end Investment Company Regulations*, Jan. 1, 1953, ¶5272;

g) *Uniform Reporting and Application Form for Investment Companies*, May 1974, ¶5291;

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the 1933 Act have substantially identical language, the states and the SEC do not have a common definition of the term "security." While the co-ordination of such questions may periodically be impractical or not subject to completion in a reasonable time frame, these issues are of sufficient magnitude to merit co-ordination at least between the SEC and NASAA, if not between the individual states. Clearly, it is appropriate that a better information sharing system be developed to ensure that such interpretative data is readily available to both parties. The principal failure in this regard has been on the part of the states where the circulation of "no action" and interpretative opinions on a broad scale is relatively rare. Apart from providing such information through the publication of a newsletter, it is rare for that kind of information to be readily available even to agencies with common concerns, let alone to the public.

V. REVIEW OF A CANADIAN PERSPECTIVE

A. The Proposals Vis-à-Vis The State/Federal System

Howard, in "Securities Regulation: Structure and Process," reviews the American securities regulatory experience in the context of developing a model federal system. He notes that the major disadvantage of a dual system is that it "institutionalizes multiple statute systems, making practical administration and compliance with the law both complex and costly." He points out the need to develop uniform laws. His opinion is that the concern is with "indirect microlevel mechanisms that attempt to minimize market imperfections engendered by government policies to protect investors through cartel-like structures conspicuously designed to give the objectives of stability and investor security priority over market efficiency," and he summarizes by saying "we are concerned not with displacing the market but with making a constrained market work better."

One conclusion that Howard reaches is that

the provinces tended from the outset to follow the U.S. state models which presuppose that the securities industry is a kind of public utility and therefore that an external government regulatory body should have broad powers to regulate market entry, conduct and commission rates, subject to full consideration of industry views and to judicial review of the administrative process.

It appears that Howard underestimates the access that investors have to state commissioners and legislatures and the concomitant awareness by such officials of potential investor problems. He also overestimates industry power

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31 3 Proposals, at 1607.

32 Id. at 1617.

33 Id. at 1617-18.

34 Id. at 1625.

35 Id.

36 Id. at 1641, 1646.
and participation in the analogy to public utilities. The analogy is appropri-
ate, however, in its attempt to define the scope of state securities law power.\textsuperscript{37} The thrust of his article is then presented: "The central problem therefore is to determine what institutions of federal-provincial cooperation will best enable the government of Canada to contribute to this objective, which involves consideration of the existing framework of federal-provincial relations and the alternative coordinating mechanisms that can realistically be employed within it."\textsuperscript{38} The goal is, within the context of the prevailing general economic policies, to allocate capital to enterprises that can make optimum use of it and to achieve efficiency in the sense that capital can flow from savers to users with a minimum of unnecessary cost.

The article attempts to define the role of the state/federal system in the United States.

As already pointed out, when it enacted the Securities Act of 1933 and the Securities Exchange Act of 1934 the U.S. Congress deliberately maintained a dual or two-tier regulatory system based on disclosure and self-regulation at the federal level and broad administrative discretion at the state level, thus assuring a broad, minimum national standard and at the same time permitting more stringent state standards. It follows, therefore, that in connection with each public distribution of securities a prospectus must be qualified at the federal level and in each state where the securities are to be distributed, a policy that is continued in the \textit{ALI Federal Securities Code} on the ground that the dual system is required to empower the states to enact laws which better reflect local capital market conditions and which give regulators broader, more subjective discretion to deal with local market actors. Starting from this premise, law reform in the United States has therefore been directed not at federal pre-emption or federal-state uniformity but instead at federal-state coordination and state law uniformity.\textsuperscript{39}

One can easily agree with the conclusions, except that the pressure for a co-ordinated state-federal relationship has come primarily from the state administrators and a few key contributors from the SEC, the National Association of Securities Dealers (NASD) and the NYSE. Until passage of the 1980 amendments to the 1933 Act there was little legislative pressure to attain that objective.\textsuperscript{40}

If this otherwise excellent article is to be faulted, it is for its next conclusion:

In the federal Securities Act of 1933 coordination is achieved largely through the intrastate exemption, which in effect excepts from the application of the federal law any securities distribution that is confined to a state or a state and certain defined contiguous areas. At the state level, coordination is commonly achieved by automatic qualification of a prospectus that has already been cleared at the federal level, obviating repeated scrutiny in several jurisdictions.\textsuperscript{41}

\begin{itemize}
\item \textsuperscript{37} Id. at 1677.
\item \textsuperscript{38} Id.
\item \textsuperscript{39} Id. at 1680.
\item \textsuperscript{40} The \textit{Small Business Investment Incentive Act of 1980}, Pub. L. No. 96-477, 94 Stat. 2275, Title V, §505, amended 15 U.S.C. §77s to mandate an annual meeting between the SEC and the states to discuss small business financing and to develop common implementation procedures.
\item \textsuperscript{41} Howard, \textit{supra} note 31, at 1680.
\end{itemize}
This conclusion fails to recognize that essential difference between state and SEC regulation, i.e., the application of “fair, just and equitable” or “merit” standards. The states rarely disagree with an SEC disclosure position, but will attack the areas of promoter compensation and conflict of interest with a vengeance, despite clearance at the SEC.

Is the state or the federal system best? Is a combination most effective? Professor Loss of Harvard University, author of the Uniform Securities Act and reporter for the Federal Securities Code concluded that the dual system of federal and state regulation was too deeply entrenched in the United States to make federal pre-emption practicable there. Loss now concludes that “the only hope for simplification lies in uniformity and federal-state coordination.” Howard defines that as the uniformity of statutory provisions and the co-ordination of statutory systems, administrative forms and administrative procedures. There are more factors than just comparable paper provisions that lead to uniformity. Mutual need, mutual respect and mutual effort at co-operation are the bases for uniformity, not uniformity mandated by legislation. Ironically this latter approach can often be more divisive than beneficial.

Howard comments that the “Uniform Securities Act sponsored by the National Conference of Commissioners on Uniform State Laws [has been] influential [but] has not been able to overcome the predilection of local legislatures to attempt to improve policy through subtle drafting changes to substantive provisions and of administrators to develop different procedures.” He notes:

Fortunately, the coordination of statutory systems through the intrastate exemption technique has proved to be a slightly fruitful approach because it permits a state to express local values in its laws and at the same time to subordinate those laws to federal laws and so give priority to interstate distributions that comply substantially with the local laws.

It is not the intra-state exemption that makes the system work, although it is far more helpful than most commentators realize. It is a combination of common state action when dealing with national problems, or in many states short of staff and funds, the inaction coupled with the review of stronger sister states. The strength of the dual system in the United States is not the application of local standards to local issues, but rather the imposition of national fairness standards to sift out the poorer quality offerings that would

44 See Comment to §1904, id. at 966.
45 Loss and Cowett, Blue Sky Law (Boston: Little, Brown, 1958) at 238. In drafting the proposed Federal Securities Code, Professor Loss worked actively with NASAA to develop a more effective co-operative federal-state system. Unfortunately, the SEC was unwilling to participate in a dialogue on the Code's contents until it had been completed. Once completed, the SEC did not invite NASAA to participate in its discussion which changed some of the requirements that NASAA had supported.
46 Howard, supra note 31, at 1685.
47 Id.
otherwise pass through SEC review by disclosing, in the peculiar gibberish of prospectuses, the bad points of the offering. Without reasonable fairness standards, the disclosure system would be a disastrous failure.\(^4^8\)

In his conclusion, Howard points out that the converse of the American state-federal disagreement exists in Canada.

Thus, although there is no consensus [sic] in Canada about an acceptable means of federal involvement in securities regulation, there is a widely-held view that for these reasons alone Canada should not adopt a dual system that would superimpose a second, federal level of regulation on top of the existing provincial system.\(^4^9\)

If there is to be a federal system, however, the unique chance to write on a clean slate provides a chance to avoid many of the problems of the American system.

With this overview of American relations to frame the perspective, there are some concerns that merit consideration in discussing the Proposals For a Securities Market Law For Canada (Proposals).

B. The Scheme of the Proposals

The Proposals clearly set forth the desired interrelationship between the provincial and federal authorities. "[I]t is hoped that they [the Proposals] will provide a basis for discussion not only with interested citizens but also with provincial governments that will ultimately lead to a coordinated and cooperative legislative scheme for the regulation of all aspects of the Canadian securities market."\(^5^0\)

That premise is of such magnitude that its inclusion in the statement of policy in the Act is vital to avoid the weaknesses that have been discussed arising out of the present federal-state system in the United States. A major contributing factor to the problems in the United States has been the absence of a legislative, executive or self-imposed mandate among securities regulatory agencies to maximize co-operative efforts. The mandate for federal-provincial co-operation should, therefore, be clearly and unequivocally stated at the beginning of the Act. In fact, the draft Canada Securities Market Act [Draft Act] does expressly state that the purposes specified in it "can best be accomplished by the creation of a Canadian Securities Commission" to regulate the Canadian securities market... in cooperation with similar provincial and foreign public authorities.\(^5^1\) The section thus includes federal-provincial co-operation only as a means rather than as one of the purposes of the Act and should be amended so that co-operation is expressed as a goal. Subsection 1.02(f) now states that "national enforcement mechanisms are necessary" to deal

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\(^4^8\) See Draft Act, s. 5.09. See also Commentary, 2 Proposals, at 82-85. The Proposals, at 82-85. The Proposals support a national merit system.

\(^4^9\) Howard, supra note 31, at 1684.

\(^5^0\) "Preface," 1 Proposals, at ix. The Proposals, however, does not adopt the details of the Howard scheme, but rather, it provides a more flexible structure to permit government negotiation.

\(^5^1\) Id., s. 1.02.
with improper conduct "in light of the interprovincial and international character of modern securities markets and of fraudulent securities schemes which necessitate cooperation between Canadian law enforcement agencies and those of other nations." The desired result might be accomplished by a minor amendment to make clear that co-operation between federal and provincial agencies is also necessitated.

Two of the essential characteristics outlined above for an ideal co-operative system are the avoidance of unnecessary duplication of effort and of elimination of regulatory burdens imposed on those subject to the legislation. It is unnecessary to deal with this subject here for Professor Anisman, in his "Brief Submitted to the Parliamentary Task Force on Regulatory Reform," provides an excellent overview of the techniques used in the Draft Act to avoid overlap and duplication.

Three areas of responsibility form the backbone of an effective co-ordinated securities regulatory system—securities registration and exemption, brokerage regulation and enforcement. The Draft Act generally addresses these areas effectively.

Section 5.09 contains provisions for a "merit" review of securities offerings similar to the authority presently possessed by the provincial commissions and by many of the states. Since the SEC does not possess this authority, new issues of co-ordination and interpretation would arise between the federal and provincial agencies. This "merit" authority, exercised in isolation, can cause extraordinary expense to issuers without correlative value to the investing public. Perhaps a mandate to jointly develop merit review standards would ease the transitional effects of phasing in a federal system that includes merit regulation. Joint hearings which are contemplated in general terms in the Draft Act, would be the most effective means of developing common merit standards.\footnote{Brief dated Oct. 27, 1980 [hereinafter Brief].}

The Draft Act has many features which will ensure a more effective joint regulatory system. Section 5.10, for instance, requires that the Commission accept a prospectus filed in connection with an interprovincial distribution for use in any province that has accepted it. The Commentary to section 5.10 makes it clear that a provincial government may establish the standards of investor protection for all distributions in the province and that "no conflict exists between Part 5 [of the Draft Act] and any provincial prospectus provisions that continue in force even if they impose less stringent requirements than the Draft Act."\footnote{Draft Act, s. 15.07; see also Commentary, 2 Proposals, at 334-35; Brief, at 24.} To provide national protection, the Commission may refuse to issue a receipt on a national basis. The Commission must, however, issue a receipt for any province where the distribution has been accepted by the provincial administrator, but the receipt will be limited

\footnote{Commentary, 2 Proposals, at 85.}
to the province in which the distribution has been approved, and the securities may be sold only in that province.\textsuperscript{55} The \textit{Commentary} notes that:

\begin{quote}
[i]t is likely that the section will rarely, if ever, have any effect because the provincial commissions will probably coordinate their vetoing of a prospectus with the Commission's and because they will probably be reluctant to permit a distribution that has been refused by the Commission, after a hearing, pursuant to the standards specified for the exercise of its blue sky discretion.\textsuperscript{56}
\end{quote}

There is no comparable provision in the state-federal system.

There has been no attempt in this paper to compare the provincial exemptions with those of the \textit{Draft Act}.\textsuperscript{57} It is worth stating, however, that for exemptions to be effective in providing a reduction of unneeded regulation, they must parallel the provincial exemptions. The cost and confusion of this, as shown by the failure of the SEC and the states to co-ordinate exemptions, is staggering and largely unnecessary.

The \textit{Draft Act} does retain an intra-provincial exemption similar to the intra-state offering used in the United States.\textsuperscript{58} This exemption places the sole authority in the provinces over matters pertaining to the distributions made in a single province. This exemption is used for most small offerings made in the United States.\textsuperscript{59} The fault of both the intra-state and intra-provincial exemption is the failure to recognize an exemption for contiguous geographical areas such as Ottawa and Hull, located in different provinces. A distribution regulated by the provinces of Quebec and Ontario would not raise a significant federal concern and likewise would warrant an exemption. The \textit{Commentary} recognizes that “difficulties will inevitably occur” in such circumstances and states that while the exemption “may not be available... the Commission will probably develop policies and regulations to deal with such cases” under its general exempting powers.\textsuperscript{60}

Part 8, relating to “Market Actors,” fails to contain a complete system for co-ordinating the broker-dealer requirements of the provinces and the federal government. Considering the agony that was experienced over the years spent in the United States in attempting to bring about such co-ordination, inclusion of an effective system for uniformity adopting forms and procedures is an absolute necessity. Section 8.03 provides for the acceptance of a filing made in a province, but it can be limited to that province. The mandate to develop uniform forms would be a simple addition to the proposed Part 8.

This part does provide an exemption for broker-dealer firms that carry on business exclusively within one province.\textsuperscript{61} “[C]oordination with the pro-

\begin{footnotes}
\item[55] \textit{Draft Act}, s. 5.10. See also s. 6.05 and \textit{Commentary}, at 104-106.
\item[56] \textit{Commentary}, 2 \textit{Proposals}, at 86.
\item[57] See Parts 3, “Exemptions,” and 6, “Exemptions from Prospectus Requirements,” and the \textit{Commentary} on these Parts, 2 \textit{Proposals}, at 45-58 and 106 respectively.
\item[58] \textit{Draft Act}, s. 6.05 and \textit{Commentary}, 2 \textit{Proposals}, at 104-106.
\item[60] \textit{Commentary}, 2 \textit{Proposals}, at 105.
\item[61] \textit{Draft Act}, s. 8.07.
\end{footnotes}
The relationship of the NASD and the various stock exchanges with the states in the United States is generally good, both sides could benefit from more effective co-ordination in these areas. The provision recognizing the provincial registration of SROs may be modified to attain this objective as well as to ensure the "grandfathering" of existing SROs.

Enforcement regulation is covered in Part 14. The powers and procedures follow very closely those found in both the federal and state systems in the United States. The Draft Act, however, contains a number of improvements. Section 14.01 contemplates the possibility of appointing provincial authorities in the capacity of investigators for the Commission. This authority is clear when read in conjunction with sections 15.09 and 15.10.

Section 14.02 contemplates the Commission conducting an inquiry to aid in the development of new policy. Sections 15.09 and 15.10 make provisions for joint hearings with the provincial authorities. The Draft Act also contemplates the possibility of the Commission designating provincial authorities to hold such hearings within each province. By this means of local contact, far more meaningful and complete commentaries can be obtained on matters of national impact.

C. The Commission

The Canadian Securities Commission (CSC) should include representatives of the provincial securities agencies and of the associations of such agencies. This would be a unique opportunity to avoid the bifurcated policy formulation characterizing the present American system while preserving the "laboratory" value of provincial regulation. Section 15.01, which establishes the composition of the CSC, should provide specifically for provincial "seats," combining elements of the CANSEC proposal. While this suggestion is

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62 Commentary to Part 8, 2 Proposals, at 129.
63 See Draft Act, s. 9.01; 2 Proposals, at 150.
64 See Draft Act, s. 9.04; 2 Proposals, at 154-55.
66 Draft Act, s. 15.09; 2 Proposals, at 338-39.
contained in the Commentary to section 15.01, it is suggested that a specific statutory mandate would be preferable.

The contract approach advocated in section 15.06, whereby an agreement may be negotiated between a provincial government and the federal government to permit the provincial government to assume all or a portion of the powers and responsibilities of the federal government within the province or, alternatively, whereby the province could delegate such powers under its provincial statute to the federal government, offers a unique opportunity to fill the enforcement void existing in a few of the provinces presently. Somehow the number of offenders always seems to exceed the staff and resources of law enforcement. Based on conversations with provincial commissioners, it is believed that this is presently the case across Canada, as it is in the United States.

Any such contract should be carefully drawn to ensure that policies developed by one unit of government are not inadvertently undercut by the other through precipitous conduct. Co-operative rather than unilateral action should characterize the relationship, at least at the decisional stage. Bear in mind, however, that the keystone of such a relationship will be timely responsiveness. Nothing will more quickly reduce co-operation than a system that permits the diligence of one body to be rendered moot by the dalliance of another.

The contract approach would also serve to eliminate some of the information sharing limitations which have grown out of the American Freedom of Information Act and Privacy Act. In the rush for open government and individual privacy, the American Congress has significantly and unnecessarily hampered law enforcement. State legislatures have likewise enacted similar provisions. An internally co-ordinated system eliminates the need for treating sister agencies as trespassers in the halls of justice. Section 15.23(2) of the Draft Act addresses this question well as between agencies, but not as to the use of such information, for example the use of such information in a subsequent proceeding.

The Commentary to section 15.06 suggests substantial flexibility is provided in the establishment of federal-provincial relationships. Such a co-operative environment is to emerge from negotiations between the government units rather than as a result of a mandate from the federal government. This has two significant advantages: first, that no legislative body can possess the in-depth knowledge necessary to form such a system efficiently, given the

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68 See Commentary, 2 Proposals, at 332.
71 Commentary, 2 Proposals, at 334.
provincial regulatory history and its absence on the federal level; and second, that the system must be as flexible and adaptive as the changing securities markets. Providing specific statutory guidance through common substantive requirements and leaving the administrative system to emerge with an efficient, yet fluid, market control mechanism appears the wisest approach.

Perhaps the major failing of the federal system in the United States is the inability to provide meaningful dual policy development between the SEC and the states. Section 15.07, which permits a provincial body to participate in hearings, provides one mechanism to achieve policy participation, especially if the initial stage of rule-making proceedings are contemplated by this section. To the extent that a provincial administrator is vested with authority in an investigation, the provinces likewise have enhanced policy power.

Section 15.09 might be read as a limitation on the power of provinces to participate in the regulation promulgation process, or merely as an expression of the fact that regulation must emanate from the body empowered by statute to create regulation. It would be beneficial if the provinces were specifically permitted to participate in the regulation formation process. The Commentary does not address this crucial issue. Sections 15.07 and 15.10 could, however, be used for this purpose.

Section 15.11 appears on its face to be one of the most routine of statutory provisions, mandating an annual report to the Minister and Parliament. It can, however, serve as the basis for establishing a measuring stick of cooperative progress. The reporting requirements should be amended to include an overall report on the status of federal-provincial relations and specifically to enumerate joint enforcement actions and common policies and procedures developed or in formation.

Section 15.12 provides the heart of a joint programme. It mandates that the Commission shall co-operate with the provincial securities commissions and other persons responsible for the administration of a securities act “in order to minimize duplication of effort and maximize the protection afforded investors in Canada.” If the spirit of this provision does not get lost in a bureaucratic maze or an individual’s quest for personal power, this is the seed from which an effective dual system can grow. It is important that the direction be primarily from the federal system toward the provinces, rather than from the reverse direction, since the federal system will in all probability be better funded and clearly can act on a unitary basis when approaching the provincial administrators.

Section 15.12(4) could be narrowly read to limit the level of co-operation with “intergovernmental, national or international organizations” to securities markets. A far better choice of words would be the more expansive securities “regulation.” The provincial participation in the North American Securities Commissioners Association has resulted in substantial benefits for both the Canadian and American participants and such a restrictive inter-

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72 Although the section permits the Commission to participate in the work of “organizations dealing with the regulation of securities markets,” [emphasis added] a narrow reading might, improperly, emphasize “markets” rather than their regulation.
pretation could impair the ability of the federal government to join in such an organization. Either the *Draft Act* or the *Commentary* should reflect this thought.

Section 15.15 permits the Commission to make regulations governing a wide spectrum of securities activities. Such regulation should be done in co-operation with the provinces, preferably prior to publication as prescribed in section 15.15.

Flexibility and discretion are not the adversaries of business when properly implemented by a governmental agency. Section 15.16 provides that the Commission may issue special orders relating to almost any matter encompassed by the *Draft Act*, thus ensuring an open and flexible regulatory environment. Prior to effectiveness of such orders, the provinces should have an opportunity to comment on any orders concerning applicants from their provinces in the manner contemplated in section 15.17 on self-regulatory organizations.

A shelter from civil proceedings is provided in section 15.22 for a commissioner, employee or agent of the Commission acting in good faith. Persons acting under sections 15.06 or 15.09 should be specifically included in that grant.

VI CONCLUSION

It is difficult to write this type of article, since there is the basis for a full-length article or more on any of the topics discussed, hence the narrowness of the scope of the response.

If there is one message to convey to the drafters of the legislation which may emerge from this Herculean project undertaken by Professor Anisman with the help of Messrs. Grover, Howard and Williamson and the many individuals who assisted them, it is that effective regulation does not require total uniformity but rather a system which is goal rather than product oriented. The *Canada Securities Market Act* will be measured, not by its clarity (though this obviously is an important objective), nor by its comprehensiveness, but rather by the ability of those who administer it to meet the objectives of investor protection and the enhancement of the capital markets. Uniformity cannot be achieved at the price of imaginative solutions; economy cannot be attained at the cost of impairment of necessary investor protections. No world has been made perfect by law.

Given sufficient latitude to operate and a true spirit of co-operation between federal and provincial authorities, this *Draft Act* is drafted in a manner that will substantially enhance investor protection in Canada. To develop a successful joint venture requires that each side have significant bargaining power in dealing with the other and that both are clearly directed toward a common objective. The *Draft Act* falls short of that goal for the reasons set out. The changes required to attain a workable draft, however, do not appear difficult to achieve.

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