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Canadian federal corporate legislation contemplates that shares will be transferred by endorsement of paper share certificates. These provisions, now found in the Canada Business Corporations Act (CBCA) Part VII, were enacted in the mid-1970s to reflect the then current market practices. However, for the last two decades, the overwhelmingly prevalent commercial practice is to transfer shares by book entries without using paper certificates (such transfers taking place in what is called the "indirect holding system"). It is embarrassing to note that, despite the domination of the indirect holding system, until recently there have been no legislative provisions addressing this method of transferring securities.

Recent specific provincial legislation has addressed this practice by removing responsibility for securities transfers from provincial corporate legislation and placing it within legislation that deals exclusively with securities transfers. However, Canadian federal legislation has yet to respond to the ubiquitous indirect holding system for federal corporations. This article reviews the case law history regarding the current CBCA Part VII provisions and outlines the current prevailing methods of transferring securities. It then compares the operation of CBCA Part VII to general corporate law policy rationales. The impact of provincial securities legislations on the CBCA is evaluated and the future role of the CBCA Part VII provisions is analyzed by focusing on efficiency concerns. Finally, responses by the Canadian federal government are evaluated and two possible solutions are offered as rational and efficient responses under the current circumstances.

Les lois fédérales canadiennes sur les sociétés prévoient que les actions sont transférées par l'endossement de certificats d'actions papiers. Ces dispositions, qui figurent maintenant dans la Loi canadienne sur les sociétés par actions (LCSA), ont été adoptées dans le milieu des années 1970 afin de refléter les pratiques du marché alors en vigueur. Toutefois, au cours des deux dernières décennies, la pratique commerciale prédominante est de ne plus utiliser de certificats papiers, mais plutôt de transférer les actions au moyen d'inscriptions en compte auprès d'intermédiaires en valeurs mobilières (le « système de détention indirect »). Il est gênant de noter qu'en dépit de la prédominance

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du système de détention indirect, il n'y a eu, jusqu'à récemment, aucune disposition législative traitant de ce mode de transfert des valeurs mobilières.

Une loi provinciale récente traite de cette pratique à l'intérieur non pas d'une loi sur les sociétés mais dans une législation portant exclusivement sur le transfert de valeurs mobilières. La législation fédérale canadienne se doit de répondre au système de détention indirect, également omniprésent au sein des sociétés fédérales. Le présent article examine la jurisprudence concernant les dispositions actuelles de la Partie VII de la LCSA et fait ressortir les modes de transfert de valeurs mobilières qui prévalent actuellement. Il compare ensuite le fonctionnement de la Partie VII de la LCSA par rapport aux fondements des pratiques régissant le droit des sociétés en général. L'incidence des lois sur les valeurs mobilières provinciales sur la LCSA fait l'objet d'une évaluation par les auteurs et le rôle éventuel des dispositions de la Partie VII de la LCSA est analysé en mettant l'accent sur les questions d'efficience. Finalement, les réactions du gouvernement fédéral canadien sont évaluées et deux pistes de solution sont explorées relativement à ces réactions.

1. INTRODUCTION

The objectives of this article are threefold. First, it undertakes a brief historical overview of the present Canada Business Corporations Act (CBCA) Part VII provisions (enacted in the mid 1970s), including an overview of how the present provisions operate to create negotiable corporate securities as well as a summary of the case law decided under CBCA Part VII. Second, it analyzes the policy rationale of CBCA Part VII and compares this to both current security transfer practices as well as the latest provincial legislative initiatives regarding securities transfer. Based upon this, there is a critical analysis of CBCA Part VII in light of the CBCA policy rationales and the impact of provincial securities transfer legislation. From the critical analysis, the article suggests the role of CBCA Part VII for the future. Third, based upon the foregoing discussions, the article then makes recommendations regarding how the federal government might approach CBCA Part VII given some of the procedural obstacles and practical concerns that exist.

This article proceeds as follows. Part 2 reviews the history of the present CBCA Part VII provisions in light of the market practices at the time of their enactment and notes the particular influence that American legislative action had on the process. This part offers an overview of the provisions of CBCA Part VII with particular emphasis on how the negotiability provisions function to enhance the free flow of corporate securities. The case law relating to CBCA Part VII is reviewed and
analyzed and case law under Ontario's corporate statute is briefly compared.

Part 3 examines the policy rationale behind CBCA Part VII and proposes a bifurcated model whereby CBCA Part VII addresses two distinct sets of policy rationales of (a) supportive and administrative functions, and (b) market supporting and efficiency functions. In this part of the article, CBCA Part VII is also evaluated in light of current market practices relating to securities transfer. In particular, the prevailing indirect holding system is a focus of the article. Current provincial legislative initiatives regarding securities transfer are explored with a view to how they interact with CBCA Part VII. Finally, Part 3 conducts a critical analysis of CBCA Part VII as it relates to (a) the CBCA's policy rationales, and (b) the impact of provincial legislative initiatives. Part 3 also suggests a future role for CBCA Part VII.

Part 4 draws upon the analysis in Part 3 and reviews the various factors that facilitate or hinder changes to the CBCA. Based upon this, as well as an analysis of provincial initiatives, four possible options for amending the CBCA are presented. Of these four options, two are suggested as being optimal solutions for the CBCA. Part 5 concludes.

2. CBCA PART VII PROVISIONS – BRIEF HISTORY, SUMMARY OVERVIEW AND CASE LAW

(a) Brief History

The current CBCA Part VII provisions relate to the topic of security certificates, registers and transfers. These provisions were originally enacted in the mid-1970s and were intended to bring the CBCA into line with the then current market practices.

Prior to the current CBCA Part VII provisions, the share certificate itself was only a representation of what was written in the corporation's shareholder register. The definitive source of shareholder rights was the actual shareholder register and supporting documentation (usually contained in the corporation minute book and consisting of documents such

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1 These provisions were introduced in the Canada Corporations Act, R.S.C. 1970, C-32, which was the predecessor to the Canada Business Corporations Act, S.C. 1974-75-76, c. 33. Later, those provisions were re-enacted substantially in the same form in Canada Business Corporations Act, R.S.C. 1985, c. C-44 [CBCA].
as subscriptions for shares, and directors’ resolutions issuing or transferring shares). The important implication of all this is that share certificates could not be relied upon. If the shareholder register was different from the share certificate, then the shareholder register prevailed.²

Although the share certificate was merely a derivative piece of written evidence of what was contained in the shareholder register, in actual commercial practice, share certificates were treated as if they were negotiable instruments.³ Generally speaking, a negotiable instrument allows a person, known as a transferee, who acquires an instrument (e.g., a cheque or, in this case, a share certificate), to obtain potentially better title to the instrument than his/her predecessors. For example, if the transferor had a defect in his/her title to the instrument, the transferee could obtain clear title to the instrument if the transferee had (a) no notice of any defect, (b) given valuable consideration for the instrument, and (c) acted in good faith.

Accordingly, there was a clear conflict between “law on the books” and accepted commercial practice. Technically, according to the law at the time, share certificates were simply written evidence of shareholder register entries and nothing more. One could not rely upon them. However, in commercial practice, by treating share certificates as negotiable instruments, innocent transferees could in fact rely upon them.

Thus, Canadian federal corporate law was amended to account for generally accepted commercial practices. At the time of amendment, the Canadian government borrowed heavily from Article 8 of the Uniform Commercial Code (“UCC”). The UCC is a model piece of legislation in the United States and was developed by two private organizations, the National Conference of Commissioners on Uniform State Laws and the American Law Institute. Since the UCC was developed by private organizations, it does not officially have the force of law by itself. However, since it has been substantially adopted by the legislatures of virtually all of the states in the U.S.A., the UCC is often synonymous with the actual law of the state. Ever since the original 1952 edition of the

² For a more detailed historical account see Bruce Welling, Corporate Law in Canada, 2nd ed. (Toronto: Butterworths Canada Ltd., 1991) at 701-709.
³ Ibid., at 702. Welling cites case law establishing that, even though the share certificates were not actually negotiable instruments, the courts were willing to side with an innocent transferee. In effect then, this turned the share certificates into something like a negotiable instrument.
UCC, the UCC has evolved with amendments developed by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and the American Law Institute ("ALI").

The UCC consists of nine numbered articles and each article deals with a major substantive area of commercial law. Article 8 deals specifically with investment securities and it is this part of the UCC that the federal government borrowed heavily from when enacting the amendments to CBCA. The overall effect of Canadian federal corporate law amendments in the mid-1970s was "to confer upon the investment securities of a corporation a negotiable or (perhaps more accurately) quasi-negotiable character, so as to facilitate dealings in those securities in established securities exchanges and other markets." Those amendments were substantially re-enacted in 1985 and have remained the same up until the present.

(b) Overview of Part VII Provisions

Part VII of the CBCA consists of sections 48 to 81 inclusive. Although a comprehensive review of each section is beyond the scope of this article, Part VII can be effectively summarized. The general purpose of this part of the CBCA is to govern the transfer or transmission of a security. The definition of a security under the CBCA is fairly broad although restricted to instruments issued by a corporation. In

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4 Text of the UCC Articles can be accessed online: <http://www.law.cornell.edu/ucc/ucc.table.html>. In summary, the topics the UCC Articles relate to are Article 1 - General Provisions, Article 2 - Sales, Article 2A - Leases, Article 3 - Negotiable Instruments, Article 4 - Bank Deposits, Article 4A - Funds Transfers, Article 5 - Letters of Credit, Article 6 - Bulk Transfers and Bulk Sales, Article 7 - Warehouse Receipts, Bills of Lading and other documents of title, Article 8 - Investment Securities, and Article 9 - Secured Transactions.


6 *Supra*, n. 1.


8 CBCA, *supra*, n. 1, s. 48(1).

9 Section 48(2) of the CBCA, *ibid.*, states that a "security" or "security certificate" means an instrument issued by a corporation that is

(a) in bearer, order or registered form,
(b) of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment,
(c) one of a class or series or by its terms divisible into a class or series of instruments,
contrast, the definition of a security under the Securities Act (Ontario) is much broader and includes items as diverse as a document constituting evidence of an interest in scholarship or educational plan or trust.\textsuperscript{10}

Also related to Part VII are sections located in other parts of the CBCA that also deal with restrictions on transfer. These sections state if there are ownership, issue, or transfer restrictions then these are to be noted in the articles of incorporation\textsuperscript{11} and if the articles of incorporation are to be amended such that there is a change, addition, or deletion of such restrictions, then such an amendment requires a special resolution of the shareholders.\textsuperscript{12}

Essentially, Part VII of the CBCA is a self-contained set of transfer rules for corporate securities that has the effect of turning corporate securities into negotiable instruments (except where there are transfer restrictions noted on the security certificate).\textsuperscript{13} In addition, there are some general rules of an administrative nature regarding (a) the rights of a holder to have a security certificate or written acknowledgement of such a right, (b) the contents of a share certificate, restrictions noted on a certificate, and other formalities,\textsuperscript{14} and (c) the establishment of a securities register in which the names of shareholders and number of shares held are kept.\textsuperscript{15}

In the establishing this code of transfer rules, there are two key concepts: "adverse claim" and "bona fide purchaser."\textsuperscript{16} An adverse claim includes a claim that a transfer was or would be wrongful or that a particular adverse person has an interest in the security. A bona fide purchaser means as purchaser for value in good faith and without any notice of any adverse claim who takes delivery of a security in the proper form. The key idea here is that a bona fide purchaser takes a security free and clear of any adverse claims,\textsuperscript{17} subject to a few exceptions. This

\begin{itemize}
\item \textsuperscript{10} Securities Act, R.S.O. 1990, c. S5, s. 1 [OSA].
\item \textsuperscript{11} CBCA, supra, n. 1, s. 6(d).
\item \textsuperscript{12} Ibid., s. 174.
\item \textsuperscript{13} Ibid., s. 48(3).
\item \textsuperscript{14} Ibid., s. 49.
\item \textsuperscript{15} Ibid., s. 50.
\item \textsuperscript{16} Ibid., s. 48(2): these definitions are a key part of the negotiable nature of security certificates established under this part.
\item \textsuperscript{17} Ibid., s. 60.
\end{itemize}
concept allows for the freer flow of corporate securities by minimizing the number of inquiries that an innocent transferee must make regarding the corporate securities in question.

The CBCA sets up a number of more detailed rules that support the general concept of negotiability of corporate securities. Certain evidentiary presumptions, such as presumptions as to validity of signatures, are set out. Lack of a genuine certificate may defeat a bona fide purchaser and a bona fide purchaser may be deemed to have notice of an adverse claim under certain circumstances including where terms are noted on the security or where there are particular endorsements on the security. The CBCA also provides for warranties given to the purchaser and issuer as well as warranties given by intermediaries, pledges, and brokers.

There is also a set of rules regarding the types of endorsement that may be used to transfer a security (e.g., special endorsement, blank endorsement, etc.) as well as definitions of the appropriate persons who may make such endorsements (e.g., person specified on the security, or a person acting under an applicable power of attorney).

Another key idea that completes this self-contained transfer code is the concept of the issuer being under a duty to register a transfer. If all the formalities have been properly complied with (e.g., proper endorsement) and the transfer is rightful or to a bona fide purchaser, then the issuer is under a general obligation to register the transfer on the books. This important concept ties the security certificate (which is a negotiable instrument) to substantive rights. A bona fide purchaser can obtain a security certificate free and clear of adverse claims. In turn, as long as the proper procedures have been met, the bona fide purchaser can then require the issuer to register the transfer on the securities register.

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18 Ibid., s. 53.
19 Ibid., s. 55(3).
20 Ibid., s. 55(1).
21 Ibid., s. 61(1).
22 Ibid., s. 63.
23 Ibid., s. 65.
24 Ibid., s. 76(1). Note that the issuer may require reasonable assurance the endorsement is genuine. In addition, the issuer may deny the registration if it is under a duty to inquire into an adverse claim. Such duties to inquire are rather limited and found in s. 78 of the CBCA.
The above concept is important because, if the corporate security certificates are negotiable, then the issuer does not necessarily know who is the lawful holder of the corporate security certificate at any time. There may have been many endorsements and transfers of the security certificate, without any notice to the issuer. As far as the issuer is concerned, it only knows who it has listed on the securities register as a shareholder. Thus, if a bona fide purchaser for value desires to exercise the rights associated with the securities in question, then it needs to have the transfer registered on the securities register.

In addition to the administrative and negotiable instrument provisions, it should be noted that Part VII also plays an important role with respect to the transmission of corporate securities. Transmissions refer to a transfer of corporate securities that is founded primarily by operation by some rule of law as opposed to the voluntary and consensual agreement of two parties. Transmissions often arise in the case of deceased persons, infants, mentally incompetent persons, missing persons, or bankrupts. Under such circumstances, the CBCA allows particular persons to be the constructive registered holder.25

Thus, it is clear that Part VII of the CBCA contains a variety of provisions relating to security certificates. Although the amendments in the mid-1970s introduced provisions that gave legal recognition to the practice of treating corporate securities as negotiable instruments, Part VII contains more than that. It also contains the basic administrative provisions that support the creation of security certificates and security registries. In addition, Part VII also deals with the fairly important topic of transmission of securities. With respect to the negotiable nature of corporate securities, Part VII provides a fairly detailed and self-contained set of rules governing the transfer of corporate securities that include evidentiary presumptions, key definitions such as bona fide purchaser and adverse claim, rules regarding endorsement and appropriate signatures, warranties of various key persons, as well as rules regarding the duties of issuers and the registration of transfers.

25 Ibid., s. 51(2). Also see s. 51(7) which sets the procedural and evidentiary requirements in order for a person to become a constructive registered holder.
(c) Case Law Relating to Part VII of the CBCA

A search for cases where the courts had judicially considered the provisions of Part VII of the CBCA revealed that there have been very few court judgments that considered these provisions in a significant way. Relatively speaking, the number of reported cases is very few and there are approximately twenty court cases that made reference to the provisions of CBCA Part VII. The vast majority of those court cases make only cursory references to CBCA Part VII provisions and did not consider them in a significant way. Although there may be some differences of opinion as to how many cases substantively considered CBCA Part VII provisions, a fair estimate would be that about five or so cases have actually made significant reference to the CBCA Part VII provisions over the past thirty-one years. In contrast, other sections of the CBCA such as the oppression remedy (under s. 241 of the CBCA) have had much greater judicial scrutiny.26

Below, this article briefly discusses some of the more significant decisions relating to CBCA Part VII. An overall review of the case law reveals that the more mundane and administrative provisions relating to security certificates and transmissions have neither received much judicial attention nor have they been the subject of heated litigation. As could be expected, it has been the provisions regarding the negotiability of corporate securities that have received judicial consideration.

One leading case is Javelin International Ltd. (Receiver of) v. Hillier,27 which dealt with a person who had share certificates endorsed in blank and received them as a gift. The person had requested that the corporation register the transfer on the securities registry of the corporation. In this case, the court also dealt with the issue of the validity of shares issued for inadequate or improper consideration.

In Javelin, the court clearly laid down a number of firm statements with respect to share certificates and the negotiability principles of Part VII of the CBCA.

• A donee is a purchaser under the CBCA but is not the same as a "bona fide purchaser". In particular, a bona fide purchaser gives value for the security. This does not mean that a donee cannot have title to security. It simply means that, unlike a bona fide purchaser, a donee cannot acquire better title than the donor.

• It is possible for shares issued illegally or for inadequate / improper consideration to become a valid instrument where a purchaser for value obtains the share without notice of any defect going to its validity.

• More precisely, the CBCA has turned share certificates into negotiable instruments subject only to limitations where the restrictions are noted on the face of the share certificate itself.

• Even if the person in possession of the share certificate is a donee (i.e., not a bona fide purchaser), such a person may nevertheless require the transfer to be registered on the books if the transfer was rightful. However, rightful means more than "not wrongful". Viewing the CBCA as a whole, the court concluded that transfers should not be registered where to do so would be to ratify a known or apparent illegality / irregularity. In addition, where an adverse claim is known to exist, a transfer should not be registered. Thus, a transfer is rightful only if it is requested by person who had no knowledge of adverse claims and acquired the security in good faith from someone who had good title. Any knowledge of a defect in the transferor's title would not be good faith and would prevent a transfer from being registered.

In the Javelin case, the court found the testimony of the person requesting the transfer to be unreliable. A transfer could only be registered if either the person was a bona fide purchaser or if the transfer was rightful. The person in possession of the share certificates was not a bona fide purchaser for value (the person received the shares as a gift) and could not require on transfer on that basis. Under the circumstances, the court was unconvinced that this person took the share certificates without any notice of the defects, and as a result, this person also lacked the good faith required for a person requesting a registration of a rightful transfer.
In the case of *Csak v. Aumon*,\(^{28}\) the court affirmed the proposition that a share certificate is not actually the share itself. Invoking equitable principles, the court held that it is not necessary for share certificates to be issued for a person to be the beneficial owner of shares. In this case, the court found that the lack of legal title did not prevent beneficial owners from bringing applications under the oppression remedy provisions of the CBCA.

The case of *Ultramar Canada Inc. v. Montreal Pipe Line Ltd.*\(^{29}\) intertwines the transfer registry provisions with the duties of directors. The court held that, even where the articles of incorporation provided the directors with the discretion to refuse to register a transfer, the directors must exercise this discretion in good faith. Good faith in this context means that the directors should refuse only with a view to the best interests of the corporation. In this case, the court found that the directors refused to register the transfer in order to advance the interests of one group of shareholders over another and that such actions were a breach of the directors’ duties.

In *Verdun v. Toronto Dominion Bank*,\(^{30}\) the Supreme Court of Canada held that the corporation is entitled to treat the registered owner of the shares as the person entitled to vote to the exclusion of all other persons. The corollary result of this was that it was further held that an unregistered beneficial shareholder would not be entitled to vote or submit a shareholder proposal.

This case underscores the importance of registration of a transfer to a bona fide purchaser. In *Javelin*, registration of transfer is what the petitioner was seeking from the court, though it was ultimately denied for the reasons explained above. Further, in *Ultramar*, the directors were found to be in breach of their duties for wrongfully refusing to register a transfer. Finally, the *Verdun* case illustrates the important consequences flowing from registration on the securities register of the corporation.\(^{31}\)

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\(^{31}\) For an earlier case that mentions a similar principle, see *Trans-Mountain Pipeline Co. v.*
In passing, two other cases could be noted. First, in the case of *Heil v. T.E.N. Private Cable Systems Inc.*\(^{32}\) the court took a very broad and flexible interpretation of the definition of "transfer" under s. 48(2) of the CBCA in its evaluation of the meaning of "transferred after the record date" under s. 138(2) of the CBCA. The court noted the fact that the legislature provided a non-exhaustive definition of the term indicates that the word "transfer" was meant to be interpreted within the objects of any particular provision as a whole. Second, in the case of *LSI Logic Corp. of Canada Inc. v. Logani,*\(^{33}\) the court held that, pursuant to s. 49(15) and (16) of the CBCA, fractional shares may be acquired without shareholder consent.

In summary, a review of the significant case law reveals that the court cases have centered on key concepts such as the definition of adverse claim, bona fide purchaser, transfer, and the negotiable character of corporate securities. Other issues that have received focus include how the corporation deals with registered holders as well as the duty of the issuer to register a transfer. Some side issues that received attention include the flexible definition of transfer and the topic of fractional shares.\(^{34}\)

\(^{32}\) *Inland Natural Gas Co.* (1983), 49 B.C.L.R. 126, B.C. Corps. L.G. 78,214, 1983 CarswellBC 330, [1983] B.C.J. No. 1622 (B.C. C.A.), which held that so long as a person is listed on the securities register, such a person is entitled to any right given to it by law, including the right to request a meeting under the CBCA.


\(^{34}\) For an excellent digest of the leading cases in these areas, refer to Wayne Gray, ed., *The Annotated Canada Business Corporations Act* (Toronto: Carswell, c.2002-) and Wayne Gray, ed., *The Annotated Ontario Business Corporations Act* (Toronto: Carswell, c.2003-). Both of these works were consulted in researching this article. There were other cases that were reviewed in the statutes judicially considered search that have not been discussed here because they either (a) were deemed not to contribute in a significant way to the jurisprudence concerning the objects of the CBCA for the purposes of this discussion, or (b) had principles that were already well covered in cases that were discussed. Cases that were reviewed include the following: Besner c. J.A. Besner & Sons (Canada) Ltd., 15 B.L.R. (2d) 261, [1993] R.J.Q. 1759, 1993 CarswellQue 29, EYB 1993-84141 (Que. S.C.); EnCana Corp. v. Douglas (2005), 2005 ABCA 439, 2005 CarswellAlta 1872, [2006] 7 W.W.R. 59, 11 B.L.R. (4th) 198, 54 Alta. L.R. (4th) 130, 262 D.L.R. (4th) 279 (Alta. C.A.); Imperial Oil Ltd. v. Canada (Director appointed under the Canada Business Corporations Act) (1996), 11 C.C.L.S. 210, 1996 CarswellOnt 2315, [1996] O.J. No. 2380, 6 C.P.C. (4th) 170. (sub nom. *Imperial Oil Ltd., Re*) 6 O.T.C. 385 (Ont. Gen. Div. [Commercial List]);
It should be noted that the Ontario Business Corporations Act\textsuperscript{35} (OBCA), prior to its most recent amendments in 2006, had provisions that were very similar to the provisions under Part VII of the CBCA. For the purposes of comparison, a similar search was done for case law that had judicially considered the analogous OBCA provisions. The results were very similar to the search done for CBCA case law. Approximately twenty cases were identified as having referred to the relevant analogous OBCA provisions. Of these seventeen cases, roughly eight to ten of them could be considered as having meaningfully contributed to the jurisprudence for these provisions.\textsuperscript{36} The other cases were


\textsuperscript{35} Business Corporations Act, R.S.O. 1990 c. B.19 [OBCA]. The analogous provisions under the OBCA were found under ss. 53-91 and these sections were more or less analogous to CBCA Part VII, ss. 48-81. It is important to note that these provisions were recently amended in a significant way, as will be discussed later in this article.

still noted though their contribution to the jurisprudence was arguably of less value.\(^{37}\) Given the recent heavy amendments and deletions to the analogous OBCA provisions (to be discussed later in this article), the value of this OBCA case law to future jurisprudence is unclear. It is interesting to note that a jurisdiction with a high degree of commercial activity such as Ontario had few significant cases as well.

3. **ANALYSIS OF CBCA PART VII UNDER CURRENT CIRCUMSTANCES**

This part of the article analyzes the relevance of CBCA Part VII by drawing upon the previous discussion of its history, basic functions, and case law, and comparing that discussion to the present circumstance in the Canadian marketplace. In particular, emphasis will be placed upon (a) a discussion of the policy rationales of CBCA Part VII, (b) a review of the current market practices with respect to the transfer of securities, and

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(c) a review of the current changes being made to provincial corporate statutes with respect to security transfers, and (d) an analysis of the appropriate and desirable role of CBCA Part VII in light of the policy rationales of the CBCA as a whole as well as the foregoing points.

(a) Policy Rationale for CBCA Part VII

A close reading of CBCA Part VII reveals that the provisions of this part are actually operating at two distinct levels.

At one basic level, the administrative provisions of CBCA Part VII create the legal authority for the basic book-keeping necessary to a corporation. For example, the details regarding the creation of a securities register are clearly articulated\(^{38}\) and the important legal consequences of transfers noted on the securities register are set forth.\(^{39}\) There are also details about the form of share certificates.\(^{40}\) The provisions concerning transmission fulfill an important role by setting forth who may act as a registered holder in circumstances where the actual registered holder is unable to act (e.g., deceased, mentally incompetent, etc.).\(^{41}\) Thus, at this level, the CBCA Part VII provisions provide some of the required structure so that shareholders may exercise their rights under corporate law. In this sense, these provisions are supportive of the basic tenet that corporate law should assist the exercise of rights by shareholders.

However, the amendments to the Canada Corporations Act (the predecessor to the CBCA), in the mid-1970s, created a second dimension to the CBCA Part VII provisions, which inherited such amendments. As discussed above, these amendments were introduced to reflect the already ongoing market practice of treating security or share certificates as negotiable instruments.\(^{42}\) Turning share certificates into negotiable instruments had the effect of increasing the marketability of share certificates by allowing such instruments to flow more freely from one person to another. As long as one was a bona fide purchaser for value,

\(^{38}\) CBCA, supra, n. 1, s. 50(1).

\(^{39}\) Section 51(1) of the CBCA, ibid., states that, aside from a few exceptions, the corporation may treat the registered owner of a security as the person exclusively entitled to vote, to receive notices, to receive any interest, dividend, or other payments in respect of the security, and otherwise to exercise all the rights and powers of an owner of the security. This was illustrated in the Verdun case, supra, n. 30.

\(^{40}\) See s. 49 of the CBCA generally, ibid.

\(^{41}\) See s. 51(7) of the CBCA, ibid.

\(^{42}\) Supra, n. 2. Professor Welling notes that, in certain court cases, judges would also treat share certificates as negotiable instruments. Although the judges did not necessarily use the terminology of "negotiable instruments" they tended to favor the innocent transferee using available legal constructs to support such a result. The end result was that the share certificates had the same effect as if they were negotiable instruments. Welling notes, in particular, the case of Smith v. Rogers (1899), 30 O.R. 256 (Ont. C.A.).
one was relatively certain that one had obtained title to the security certificate.

A key point to note here is that the amendments were introduced to merely reflect market practices that were already in existence and generally well accepted by the financial community. As has been noted:

The purpose of the C.B.C.A. rules, and of Article 8 of the Uniform Commercial Code from which they were adapted, was to provide a legal basis for the existing market treatment of corporate securities. The rules were designed to permit reliable securities transactions with a minimum of effort wasted on title investigations, for these are conditions essential to a liquid securities market.\textsuperscript{43}

CBCA Part VII can be viewed as a set of legal provisions designed to support market efficiency by providing more legal certainty to widespread and prevailing market practices. This change was efficient, not only because the marketplace had adopted these practices, but also because the substantive practices themselves created a more fluid market for securities. The amendments were not viewed as an intrusive attempt by government to impose a regime of transacting. Rather, they were accepted with open arms as providing the necessary legal certainty to well-accepted market practices.

There are also two more reasons why the amendments could be viewed, at the time, as efficient and transaction enhancing. First, by borrowing heavily from UCC Article 8, the Canadian parliament made a significant step towards an attempt at harmonizing legislation with the United States, an important trade partner for Canada as well as one of the leading financial centres in the world. Second, the amendments assisted in detailing transfer provisions for corporate securities in one place and, in comparison to the prior state of affairs, provided a more manageable state of affairs. This is not to suggest that the present CBCA Part VII provisions are a comprehensive code or “one stop shop” for legal provisions relating to corporate securities. Indeed, it has been noted that, depending on the type of institution involved (e.g., bank, insurance company, loan and trust company, or cooperative credit associations), different sets of legislative rules may apply.\textsuperscript{44} However, relatively speak-

\textsuperscript{43} Ibid.
\textsuperscript{44} See B. Geva, “Legislative Power in Relation to Transfers of Securities: The Case for Provincial Jurisdiction in Canada” (2004) 19 B.F.L.R. 393 at 397, where Geva notes that “existing legislation is neither harmonious nor internally consistent, and its application is not always certain.”
ing, it could be regarded as efficient in comparison to the prior vacuum of law. In short, the amendments were efficiency-enhancing for the period albeit far short of establishing a comprehensive and uniform law for corporate securities.

Thus, the policy rationales for CBCA Part VII can actually be regarded as bifurcated given the fact that CBCA Part VII has two different functions – one relating to administrative support of the CBCA and the other relating to negotiability of corporate securities. With respect to the administrative provisions that provide some core functionality, the policy rationale is fairly simple. These provisions are supportive and establish the basic records which assist shareholder in exercising their rights. The negotiability provisions introduced in the mid-1970s have a number of policy rationales which can be summarized as:

- supporting and legitimizing accepted, sound, and widespread market practices;
- harmonizing with important trade partners and jurisdictions; and
- contributing to ease of legal reference by moving towards comprehensive provisions.

(b) Current Market Practices with Respect to the Transfer of Securities

In the current financial marketplace, there are two methods by which securities are held: the direct holding system and the indirect holding system. CBCA Part VII only contemplates a direct holding system for securities and does not have any provisions addressing the indirect holding system.

The direct holding system may be viewed as the "traditional method" of securities holding whereby securities were transferred by means of a physical certificate. Transfer of a security was accomplished when the owner of the security endorsed the certificate in blank (usually by signing on the back of the certificate without naming any particular transferee) and delivered physical possession of the endorsed certificate to the purchaser. The purchaser could easily resell the certificate by delivering the certificate to a subsequent purchaser. Since the certificate was still endorsed in blank, the purchaser could transfer it to the subsequent purchaser.
At any time, a purchaser could surrender the certificate to the issuer (i.e., the corporation) for a new certificate (usually issued to the purchaser and naming the purchaser on the front of the certificate). At the same time, the issuer would usually register the transfer on its securities register and the purchaser would now appear as the registered holder of the certificate. This is referred to as the “direct holding system” because the securities are directly held and the owners of the securities have a direct relationship with the issuer.

CBCA Part VII (and the old UCC Article 8 provisions upon which it was based) facilitated the direct holding system, as has been discussed, by providing a detailed set of rules regarding the transfer and negotiability of securities under such a system. Since the CBCA only addresses direct holdings, an underlying and unstated assumption is that the direct holding system is the method by which most securities transactions occur. However, this is not the case.

Presently, the dominant method for the holding of the vast volume of securities that are traded on the Canadian market is by the indirect holding system. In the indirect holding system, an investor’s proprietary interest in a security is recorded on the books of an intermediary. The intermediary is usually a licensed security broker, bank, or custodian. In turn, this intermediary may have its interests recorded on the books of another intermediary up the chain. This chain of intermediaries can continue upwards and ultimately ends in either one of two possibilities: either that the last intermediary (a) actually has physical possession the security certificates, or (b) is recorded by the issuer as being the registered holder of the security. Typically, this last intermediary at the top of the chain is a central securities depository.45

In Canada, the primary central securities depository is the Canadian Depository for Securities Limited (“CDS”)46 while in the U.S., it is the Depository Trust Company (“DTC”).47

The indirect holding system is considered much more efficient than the direct holding system. The actual physical delivery of certificates

46 See CDS online: <www.cds.ca>.
47 See DTC online: <www.dtc.org>.
contemplated by the direct holding system can be extremely costly given the large volume of trading that occurs in the marketplace. In contrast, the indirect holding system is much more efficient in that it does not rely on the physical delivery of certificates but, instead, relies on a book entry settlement system. The present reality is that most publicly traded securities are registered in the name of CDS & Co., which is the nominee for CDS. The result is that CDS is often the "last intermediary" holding the vast majority of publicly traded securities. The benefit of this practice is that transactions among lower tiered intermediaries can be accomplished by mere book entries to their CDS accounts as opposed to the tedious delivery of physical share certificates.

The indirect holding system's superior efficiency is evident by the number and value of trades generated. CDS presently holds over $27 trillion on deposit and handles over 77 million securities trades annually. The use of CDS seems to also be on rise. In 2004, CDS handled an average of 166,600 exchange trades per day. However, in 2005 the average was 218,000 trades per day representing a remarkable 31 per cent increase over 2004. Clearly, a quick glance at these CDS figures indicates the dominance of the indirect holding system in Canada.

Similarly, large numbers exist for the U.S. and indicate the widespread prevalence of the indirect holding system there. The U.S. did respond to the rise of the indirect holding system. In 1994, the ALI and NCCUSL approved a revised version of UCC Article 8 ("Rev. UCC Art. 8"), which provided a legal basis and infrastructure for the practice of indirect holding as well as made some minor adjustments to the direct holding system. In turn, these revisions were all accepted by most of the states and adopted. Rev. UCC Art. 8 was the product of extensive work over a five-year period including consultations with knowledgeable interest groups.

48 Spink, supra, n. 45.
49 CDS, supra, n. 46.
50 See CDS Annual Report 2005 at 4, available at CDS website, supra, n. 46. In addition, on 6 October 2005 there was a record breaking 387,360 exchange trades processed.
51 See DTCC Annual Report 2004 online: <http://www.dtcc.com/AboutUs/2004annual/DTCC---2004---Annual---Report.pdf>. In the U.S., the DTS is owned by the Depository Trust and Clearing Corporation (the "DTCC"). In 2004, the DTCC settled transactions valued at over $1.1 quadrillion, which is equivalent to approximately $4.5 trillion worth of transactions each day.
52 See J. S Rogers, "Policy perspectives on revised U.C.C. Article 8" (1996) 43 UCLA L.
Despite the fact the indirect holding system is dominant in Canada as well as in its major trading partner, the U.S., there are currently no federal Canadian statutory provisions that directly address, support, or legitimate this practice. Ontario did attempt a partial solution in its OBCA provisions analogous to CBCA Part VII. In 1986, Ontario tried to reconcile the indirect holding system within its own OBCA statutory provisions by creating the concept of "constructive delivery". In essence, s. 85 of the OBCA states that once the appropriate entry has been made in the records of the applicable clearing agency, such a book entry transfer is deemed to have the same effect as the actual physical delivery of the share certificate. For all practical purposes, "applicable clearing agency" means the CDS. However, this solution is incomplete since it only contemplates those intermediaries who are directly listed as holders within the books of CDS. It does not address the many other intermediaries and investors that exist below this top-tier of intermediaries.

Ontario has recently enacted legislation, the Securities Transfer Act ("STA"), in light of the inadequacies of s. 85 of the OBCA in handling the concept of indirect holding. The implications of the Ontario

Rev. 1435 for an excellent overview of the process that took place in the U.S. Rogers notes that meetings were arranged with individual securities firms, banks, transfer agents, lenders, as well as with large industry organizations. Moreover, representatives of the Securities Exchange Commission, the Department of Treasury, the Board of Governors of the Federal Reserve System, and many other important government institutions attended each drafting session.

53 OBCA, supra, n. 35, s. 85(1). This section states:
If a security shown in the records of a clearing agency is evidenced by,
(a) a security certificate in the custody of the clearing agency or a custodian or of a nominee of either, subject to the instructions of the clearing agency, and is in bearer form or endorsed in blank by an appropriate person or registered in the name of the clearing agency or a custodian or of a nominee of either; or
(b) an uncertificated security registered or recorded in records maintained by or on behalf of the issuer in the name of the clearing agency or a custodian or of a nominee of either, subject to the instructions of the clearing agency,
then, in addition to other methods, a transfer or pledge of the security or any interest therein may be effected by the making of an appropriate entry in the records of the clearing agency.

54 OBCA, ibid., s. 85(3) states: "A transfer or pledge under this section has the effect of a delivery of a security in bearer form or duly endorsed in blank representing the amount of the obligation or the number of shares or rights transferred or pledged."

55 Securities Transfer Act, S.O. 2006, c. 8 [Ontario STA]. As of the time of the writing of this article, this legislation has been passed in Ontario though it is not yet in force. The new legislation will be discussed in the next part of this article.
STA, which has been enacted though not yet in force, will be discussed in the next part of this article.

The present situation is somewhat ironic, given the original underlying rationales for the current version of CBCA Part VII – to establish a statutory regime that reflected efficient market practices, harmonize with the major financial jurisdictions, and move towards a more unified set of rules for corporate securities. In fairness, at the time the current CBCA Part VII provisions were enacted, these rationales could have been fairly said to have been reasonably fulfilled given the circumstances of the time. However, in the three decades that have passed since CBCA Part VII was enacted, the market practices in Canada and in other major jurisdictions such as the U.S. have moved on.

The result is that the original underlying rationales have become disconnected with the present commercial realities. Given the fact that the CBCA Part VII provisions do not address the dominant indirect holding system in Canada, they neither reflect current commercial practices in Canada nor harmonize with the major financial jurisdiction of the U.S. Lastly, rather than move towards a more unified set of rules for corporate securities, the present CBCA Part VII provisions run the hazard of either unnecessarily duplicating or interacting in an uncertain way with remedial provincial legislation aimed at addressing indirect holding.

The current situation is strangely reminiscent of Canadian federal corporate law prior to the amendments of the mid-1970s. During that time period, the legislation awaited amendments to bring it in line with market practices of negotiability. Similarly, the present CBCA awaits a response to the modern commercial realities of indirect holding.

(c) Current Developments with Provincial Corporate Statutes

The Ontario STA was recently passed by the Ontario legislature (May 2006) though it is not yet in force and awaits proclamation by Lieutenant Governor of Ontario. Similarly, Alberta has passed its own Securities Transfer Act66 and, it too, is not yet in force. Both the Ontario STA and Alberta STA have virtually identical provisions. Ontario and Alberta have delayed bringing their respective statutes into force (for

about six to eight months) in the hopes of allowing other provinces the opportunity to harmonize their legislation with the Ontario / Alberta versions.

Both the Ontario and Alberta statutes were heavily influenced by the model "Uniform Securities Transfer Act" ("USTA") prepared by the Canadian Securities Administrators (CSA). The CSA is a non-legislative forum without the formal authority to enact any laws that allows the thirteen provincial and territorial securities regulators to coordinate and harmonize Canada's capital markets regulation. Similar to the ALI and NCCUSL, the CSA is a very influential organization that consults regularly with relevant government and industry bodies regarding relevant issues. The analogy between the CSA and the ALI and NCCUSL is somewhat appropriate given how the USTA was very strongly based on the provisions of Rev. UCC Art. 8 (which itself was drafted by the ALI and NCCUSL). The fact that the USTA drew so heavily on Rev. UCC Art. 8 is not inconsistent with prior Canadian experiences given that the mid-1970s amendments to the CBCA were also drawn from the UCC. In the final result, both the Ontario and Alberta statutes have incorporated substantially all of the recommendations of the USTA.

A more detailed discussion of the policy rationales and thinking behind the USTA can be found in the USTA Consultation paper entitled "Proposal for a Modernized Uniform Law in Canada Governing the Holding, Transfer and Pledging of Securities" ("USTA Consultation Paper"). The USTA is intended to modernize the law of securities transfer in Canada.

In attempting to modernize the law of securities transfer in Canada, the USTA proposes changes not only to corporate statutes but also to a variety of other statutes including statutes dealing with personal property security interests. It is beyond the scope of this article to discuss in any detail those changes but it should be noted that such changes are intended to bring greater certainty in the manner in which a security interest is


granted in corporate shares or related securities (i.e., pledging corporate shares as collateral).

In terms of methodology, the USTA Consultation Paper proposes to remove the direct holding provisions from provincial corporate statutes and place them, with slight modifications, within the USTA. With respect to indirect holding, a new set of provisions will be implemented. Both the direct and indirect holding provisions in the USTA are substantially founded upon Rev. UCC Art. 8.

(i) **Direct holding system**

The basic tenets of the direct holding system are not substantially changed by the USTA. For example, the provisions in Part VI of the OBCA (which is analogous to Part VII of the CBCA) regarding the direct holding system are to be deleted and will be re-enacted in a functionally similar fashion in the Ontario STA.\(^{59}\) Not all provisions of OBCA Part VI will be deleted. The administrative provisions dealing with securities registers, issuance of certificates, and transmission of securities will all remain in the OBCA as these are regarded as squarely within the domain of corporate law.

There will be one substantive change to the direct holding provisions. The USTA replaces the concept of a bona fide purchaser (or good faith purchaser) with the concept of a "protected purchaser". Similar to the older concept of a "good faith purchaser", the protected purchaser, "in addition to acquiring the rights of a purchaser, also acquires the purchaser's interest in the security free of any adverse claim."\(^{60}\) The important difference with the new concept of the "protected purchaser" is that the protected purchaser does not need to demonstrate good faith in order to take advantage of the protections offered under the STA.

In addition, an entitlement holder may not bring a legal action against any purchaser of a financial asset where the purchaser has given value, taken possession or control of the security, and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations.\(^{61}\) The term "in collusion" is defined to mean

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59 These direct holding provisions can be found in ss. 29-32 (endorsements, instructions, and entitlement orders), ss. 33-40 (warranties applicable to direct holdings), and interspersed through Parts III, IV, and V of the Ontario STA, supra, n. 55.

60 Ontario STA, ibid., s. 70.

61 Ibid., s. 97(7).
"in concert, by conspiratorial arrangement or by agreement for the purpose of violating a person’s right in respect of a financial asset."62

The apparent net effect of such changes appears to be to provide greater protection to a transferee of securities. The requirement that an entitlement holder prove that the purchaser actively acted in collusion to deprive the entitlement holder of its rights is arguably a much higher evidentiary hurdle to surpass than the previous benchmarks of lack of "good faith" or of "actual notice". Presumably the intent of such a change is to enhance the free flow of securities by providing an even higher level of protection to a transferee of securities.

(ii) "Indirect holding system"

The USTA provisions relating to indirect holding systems represent a significant change to Canadian legislative approaches for the transfer of securities. However, this is not alarming given that the indirect holding system is widespread in practice in both Canada and the U.S.

The fundamental concept underpinning the indirect holding system under the USTA is the idea of a "security entitlement". The USTA rejects the idea that a beneficial owner of a book-based security has any direct rights against the issuer. After all, the issuer may have no knowledge whatsoever of the alleged beneficial owner’s entitlement, which, in an indirect holding system, is a book entry in the records of a security intermediary. Instead, the USTA provides that the beneficial owner of a book-based security has a bundle of rights that may only be exercised against the securities intermediary that holds the underlying securities or assets.

As Professor Geva succinctly explains:

[II]n the indirect holding system, an investor does not hold a security, does not have a property right in a specific security, and is not in a direct legal relationship with the security issuer. Rather, an investor in the indirect holding system is the holder of a securities entitlement, credited to a securities account kept with a securities intermediary. A security entitlement consists of a bundle of rights against the securities intermediary backed by financial assets held by the intermediary. Financial assets held by the intermediary may either actual securities or security entitlements backed by actual securities held by an upper-tier intermediary. Generally speaking, the entitlement holder has a proprietary right in a pool

62 Ibid., s. 1(1).
of financial assets, but not in any one particular asset among those of which the pool consists.\(^6\)

Under the Ontario STA, a security entitlement generally arises when a securities intermediary credits a financial asset to a person’s security account, receives a financial asset from a person, or is obligated by law to credit a financial asset to a person.\(^6\) The term “financial asset” has been broadly defined to include not only a security or share but also any type of obligation that is dealt in or traded in on markets or recognized as a medium for investment.\(^6\) Such a broad, neutral drafting approach ensures that the subject matter for what constitutes a financial asset is not closed due to lack of legislative foresight and can be properly reflected by the actual market. The Ontario STA then sets forth a regime whereby an entitlement holder’s rights may be asserted by the entitlement holder against its own security intermediary.\(^6\)

Interestingly, “security transfers” under the USTA provisions (or under the Ontario STA or Alberta STA) are not really transfers at all. In a common trade, security entitlements are created not through transfers per se, but by the creation of a book entry by a security intermediary (for the “transferee”) and the corresponding extinguishing of a security entitlement on the books of another intermediary (for the “transferor”). The key advantage of this is that it jettisons the old and inefficient idea of physically delivering certificates and replaces it with a legislative scheme that more accurately reflects the system of debits and credits that occurs on the books of securities intermediaries on a day-to-day basis.\(^6\)

Although the entitlement holder does not have a direct property interest in the underlying securities or a direct right of action against the issuer, the USTA provides that the entitlement holder will generally have functionally the same rights (e.g., interest, dividend, and voting rights) as a direct holder. This is accomplished by the entitlement holder

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\(^{63}\) Geva, supra, n. 44 at 394.

\(^{64}\) Ontario STA, supra, n. 55, s. 95(1).

\(^{65}\) Ibid., s. 1(1).

\(^{66}\) Generally, see Part VI of the Ontario STA which sets forth detailed provisions.

\(^{67}\) For an excellent and schematically illustrated description of this process, see Spink, supra, n. 45 at 362, where the author explains a hypothetical transaction that spans Canada and the U.S. In essence, the only real transfer that occurs is at the top tier, typically between CDS and DTC.
giving directions to the securities intermediary pursuant to the legislation.68

As a final note, the Ontario STA is substantially default/enable legislation and the parties may contract out of most of its provisions.69 However, given the prevalence of the indirect holding system, the ability to contract out is not likely to be invoked for publicly traded securities.

(d) Critical Analysis of the Role of CBCA Part VII in Light of Present Circumstances

The analysis of CBCA Part VII is conducted, in the context of the foregoing discussion, from both the perspective of (a) the policy rationales of the CBCA, as well as (b) the impact of provincial STAs. Finally, this analysis reflects upon the appropriate role of CBCA Part VII in the future.

(i) Context of CBCA policy rationales

Good corporate law is based upon sound policy goals. These policy goals, generally speaking, are:70

- enhancing economic efficiency;
- ensuring accountability of corporate managers, directors, and officers;
- protecting shareholders and other vulnerable parties;
- attracting business to the jurisdiction by inspiring confidence, supporting competitiveness, innovation, and growth; and
- responding effectively to the needs of larger widely held and smaller closely held businesses.

An evaluation of CBCA Part VII against these general policy goals yields slightly different results if one views these provisions as operating

68 See, e.g., Ontario STA, supra, n. 55, s. 100.
69 Ibid., s. 5. However, note that s. 5(2) contains some exceptions and specifically states: “The obligations of good faith, diligence, reasonableness and care imposed by this Act may not be disclaimed by agreement, but the parties may by agreement determine the standards by which the performance of such obligations is to be measured so long as such standards are not manifestly unreasonable.”
at two distinct levels as previously mentioned. The administrative provisions provide the fundamental documentary requirements and infrastructure. Although not nearly as powerful as the oppression remedy provisions, such basic provisions serve to protect shareholders by laying down a basic administrative structure that can later provide the evidentiary foundation for the exercise of shareholder rights.

In contrast, the current CBCA Part VII provisions relating direct holding / negotiability of corporate securities do not seem to directly further any of the above-stated policy goals of corporate law. The placement of negotiability provisions within the CBCA could be viewed as somewhat out of place when considered in the context of corporate law. Corporate law is generally concerned with the internal governance of the corporation and is primarily focused on the responsibilities, duties, and liabilities of directors and managers, and the rights of shareholders. The negotiability provisions do not seem to squarely address any of those concerns.

When viewed in historical context, one could persuasively argue that the present CBCA Part VII provisions did fulfill the corporate policy goal of economic efficiency back in the mid-1970s. The CBCA Part VII provisions filled a legal vacuum relating to the negotiability of corporate securities when the law did not keep up with market practice. By filling this legal vacuum with a comprehensive code modeled on the UCC, the CBCA Part VII provisions brought a significant increased degree of legal certainty, at least with regard to the direct holding of corporate securities, thereby making a contribution to economic efficiency.

In short, one could view the direct holding provisions of CBCA Part VII as an “awkward but necessary for the time” type of provision in the absence of any better solution. However, as noted above, times have changed since the mid-1970s. The rise of the indirect holding system, along with the corresponding changes to UCC Article 8 simply cannot be ignored. In addition, the rise of provincial securities transfer legislation, based upon the more modern Rev. UCC Art. 8, provides a

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71 See Poonam Puri, “A Rational Allocation of Responsibility between Corporate and Securities Laws in Canada,” prepared for Corporations Canada, Industry Canada, 2004, where it is noted that corporate statutes do contain a limited number of provisions that protect the rights of creditors and other stakeholders. For example, s. 42 of the CBCA protects shareholders in the context of directors declaring dividends. Similarly, s. 119 of the CBCA imposes personal liability on directors for employees’ unpaid wages.
potentially more economically efficient alternative to dealing with both direct and indirect holding that was not available during the mid-1970s.

(ii) Impact of provincial securities transfer legislation

In assessing the impact of provincial securities transfer legislation with respect to CBCA Part VII, it is useful to gauge the USTA policy objectives against those of the CBCA. The USTA has a number of stated policy objectives which include the following:72

- providing a sound legal system for existing securities holding and transfer practices, particularly the indirect holding system;
- harmonizing with Rev. UCC Art. 8;
- achieving uniformity within Canada by making the USTA a separate statute; and
- controlling systemic risk, achieving finality of settlement, and avoiding legal risk.

On a first cursory reading it does not appear that any of these policy objectives directly conflict with the CBCA. Indeed, some of them are complementary. Harmonizing with the American UCC can hardly be in conflict with the CBCA given the present CBCA provisions themselves were modeled on the prior UCC rules. Although Rev. UCC Art. 8 has had its modest share of criticism,73 the USTA Consultation Paper makes it clear that it considers Rev. UCC Art. 8 as generally recognized as the world’s most advanced securities transfer legislation.74 Furthermore, the USTA explicitly recognizes the fact that the U.S. and Canadian securities markets are becoming increasingly more integrated with the attendant result that harmonization is more desirable than ever.75

72 USTA Consultation Paper, supra, n. 58 at 22-27.
73 For example, see F. J Facciolo, “Father knows best: revised Article 8 and the individual investor” (Spring 2000) 27 Fla. St. U.L. Rev. 615, where the author criticizes revised UCC article 8 as having ignored the interests of the consumer investor and privileging the interests of upper tier securities intermediaries. One key criticism is that the consumer investor no longer has any direct right against the issuer but only an unsecured right against the intermediary. For a direct reply to such criticism, see C. W. J Mooney Jr., “The Roles of Individuals in UCC Reform: Is the Uniform Law Process a Potted Plant? The Case of Revised UCC Article 8” (Summer 2002) 27 Okla. City U.L. Rev. 553.
74 USTA Consultation Paper, supra, n. 58.
75 Ibid.
Although the current CBCA Part VII provisions were modeled on the prior UCC, there has been some criticism for not following the UCC more closely. It has been remarked that there are significant differences in wording between CBCA Part VII and the UCC provisions upon which it was modeled. "It is often unclear whether these changes in wording were intended to make some substantive alteration to the American rule or were motivated primarily by the idiosyncratic preferences of the Canadian draftsperson." On the other hand, the present USTA Consultation Paper makes it clear that the USTA seeks to avoid this form of confusion by relying and borrowing heavily on the wording from Rev. UCC Art. 8.

It is also worth noting that Rev. UCC Art. 8 also comes with an extensive set of official commentary (prepared by the NCCUSL and ALI) on each of its provisions. In the U.S., these commentaries are intended to act as an interpretive aid for the provisions of the UCC as enacted by each state. Although there is no firm Canadian tradition of the judiciary relying upon such commentaries, the authors of the USTA make reference to a few Canadian decisions that referred to the official comments of the UCC in interpreting Canadian legislation. To that end, the USTA itself comes with its own commentary. It is interesting to note that the USTA commentary, as might be expected, is substantially similar to the official commentary to Rev. UCC Art. 8. The similarity is to such an extent that the cover page notes that some of the commentary is quoted directly from the official commentary of Rev. UCC Art. 8 with the legal permission of ALI and NCCUSL.

Thus, the harmonization of the USTA with the American UCC is consistent with the prior history of the CBCA. In fact, the USTA goes further by borrowing more heavily from the wording of the UCC as well as implementing its own commentary, which in turn also borrows heavily from the UCC Official Comments.

The USTA goals of controlling systemic risk, achieving finality of settlement, and controlling legal risk are also consistent with the CBCA.

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76 McGuiness, supra, n. 5 at 587.
77 USTA Consultation Paper, supra, n. 58, at 35.
78 See UTSA with detailed comments (approved by the ULCC) and available online: Ontario Securities Commission <http://www.osc.gov.on.ca/MarketRegulation/SpecialProjects/usta/usta_20041112_task-force.pdf>.
rationale of achieving economic efficiency. All of the goals can fairly be said to be sub-variants of economic efficiency.

However, two of the goals of the USTA have the potential of being problematic in light of CBCA Part VII. At first glance, the USTA goals of providing a legal infrastructure for existing securities practices and for achieving unity in Canada could seem consistent with CBCA Part VII policy rationales. Arguably, they are consistent but lack of coordination between the CBCA and provincial STAs could be potentially problematic.

With respect to indirect holdings, there is no immediate problem since the CBCA does not address that matter. In this case, provincial legislation such as the Ontario STA and Alberta STA serves the useful function of filling a void in the legislation. However, if the CBCA is later amended to address indirect holdings, there is the potential for a confusing and duplicative array of legislation.

Even more immediate is the issue of direct holding. The Ontario STA applies to both direct and indirect holdings of securities. The Ontario STA states that if the issuer is incorporated under federal law, then the validity of the security is determined by the laws of Canada.79 However, for matters such as registration of transfer, whether an adverse claim may be asserted against a person, and other transfer issues, the Ontario STA states that the law that applies is the law of the issuer’s jurisdiction.80 In turn, it is stated that, in the case of an issuer incorporated under the law of Canada, the law of the issuer’s jurisdiction is the province or territory in which the issuer has its registered head office.81

Let us assume that a federally incorporated business corporation has its registered head office in Ontario. According to the Ontario STA, the governing law for the validity of the security is the CBCA, but the governing law for the transfer of the security would be that of Ontario (where the head office is located). However, the CBCA has its own transfer provisions for direct holdings. If it were a direct holding in question, then there would be potentially two different sets of rules to apply – the Ontario STA and the CBCA Part VII provisions.

79 Ontario STA, supra, n. 55, s. 44(1).
80 Ibid., s. 44(2).
81 Ibid., s. 44(5). Note that for Crown corporations, the governing law is that specified by the issuer.
This whole issue could be moot if both the Ontario STA and CBCA Part VII provisions were identical. However, as noted earlier in this article, the Ontario STA makes use of the new term “protected purchaser” while the CBCA Part VII provisions make use of the older concept of good faith or bona fide purchaser. This can be potentially problematic since the new term “protected purchaser” ostensibly provides more protection to the transferee. In contrast to this, as Part 2 of this article explored, the Javelin case\(^{82}\) was decided under the CBCA and made specific reference to the concept of a bona fide purchaser. The statutory provisions of the Ontario STA could potentially come into conflict with CBCA Part VII and the decided case law.

It is arguable that the likelihood that such a conflict would actually arise is quite remote (given the relatively low incidence of reported case law and the less frequent use of the direct holding system in comparison to the indirect holding system). One might also argue that, in fact, most cases could possibly have the same result regardless of whether one uses the protected purchaser standard or bona fide purchaser standard. Nevertheless, such uncertainty should be clearly addressed since it goes against the efficiency policy goals of both the USTA and CBCA. There must be a rational allocation of responsibility between the CBCA and USTA and this is the issue that is considered next.

(iii) **Future role of CBCA Part VII provisions**

An attempt to gauge the future role of the CBCA Part VII provisions can be taken from a variety of different perspectives. One tempting route would be to analyze the issue from a constitutional perspective and allocate the responsibility for corporate security transfers along lines of constitutional jurisdiction. This article takes no position on the constitutional question.\(^{83}\) It assumes, for the purposes of its analysis only, that both provincial and federal governments may competently legislate in

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\(^{82}\) *Supra*, n. 27.

\(^{83}\) At least one scholar has addressed this question directly and come to the conclusion that most security transfer matters are within the constitutional jurisdiction of the provinces with the exception of corporate securities that are bills or notes. Even with regard to such corporate securities, this respected scholar advocates that the federal government should voluntarily vacate the field for provincial legislation in the interests of greater efficiency and harmony. Thus, even a constitutional analysis may ultimately have to import efficiency-based conciliations. See Geva, *supra*, n. 44.
this area and then goes further in an attempt to discern which jurisdiction may legislate in the most efficient manner.

Previous discussions of the role of the USTA in relation to corporate statutes have tended to focus on a categorical analysis of the subject matter. The classic argument is that security transfer rules are not properly categorized as corporate law since they do not relate to fundamental corporate matters such as governance or protection of shareholder rights. The USTA Consultation Paper argues that "[t]he settlement of a typical market trade in corporate stock has almost nothing to do with corporate law. It is fundamentally a matter of property law." 84

While a categorical analysis has the allure of providing a definitive characterization of the issue with attendant consequences, it may not be quite so easy to pigeon-hole the issues. Corporate law can be regarded as an amalgam of various different categories of law. For instance, contract law can come into play as some have viewed the corporation as a nexus of contracts with the articles of incorporation sometimes being conceived metaphorically as a contract between ownership and management. Tort-like concepts are also found in corporate statutes such as the duty of care and fiduciary duties owed by directors to the corporation. 85 Arguably, fundamental corporate matters such as enabling provisions relating to pre-emptive rights 86 and options 87 relate to property rights. Rights attaching to shares are considered to be a fundamental corporate law concept yet one of those rights usually includes the right to receiving the remaining property of the corporation on dissolution 88 and may thus be conceived as also integrating property rights into the concept.

Taken to an extreme, a radical deconstruction of corporate law could potentially yield nothing but a handful of contract, tort, and property law concepts. While a categorical approach can yield some interesting observations, the critical juncture in the analysis would be where to exactly draw the line between corporate law and property law where

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84 USTA Consultation Paper, supra, n. 58 at 41. It also notes that, in the U.S., transfer rules have always been considered a matter of commercial property-transfer law.
85 Section 122 of the CBCA mandates such duties and even goes so far as to say that such duties cannot be contracted out of by the directors: CBCA, supra, n. 1.
86 Ibid., s. 28.
87 Ibid., s. 29.
88 Ibid., s. 24(3)(c).
aspects of both may appear to be significantly present. Where the line begins to become fuzzy, it is submitted that an efficiency analysis may assist in providing guidance.

With respect to the CBCA Part VII provisions, several efficiency matters may be considered:

- **Nature of the indirect holding system**: as outlined in Rev. UCC Art. 8, the fundamental concept of the indirect holding system is the security entitlement. In turn, an entitlement holder may only generally assert its rights against its own security intermediary. Clearly then, a great deal of risk and focus has been shifted towards the use of a security intermediary. There are a number of ways of mitigating against the risk of using a securities intermediary. For example, the Canadian Investor Protection Fund\(^9\) ("CIPF") provides insurance (of up to $1 million) against investment dealer bankruptcy for customers of its member investment dealers. As the CIPF notes, investment dealer bankruptcy is a relatively rare occurrence\(^9\) in part due to the regulatory requirements imposed by provincial securities commissions.

The fact that many securities intermediaries (*i.e.*, broker and dealers) are regulated closely by the provincial securities administrators is highly significant. Since the indirect holding provisions direct the entitlement holder exclusively to the securities intermediary with respect to its security entitlement rights, the manner in which such securities intermediaries are regulated will be of great interest to the entitlement holder. Despite the fact that security intermediary regulation is not technically one of the goals of securities transfer legislation, the interaction between the two subjects is so great under the indirect holding regime that it would be more efficient to have the two matters handled at the same level of government.

A general principle of economic efficiency is that, all other things being the same, responsibility should be delegated to lowest cost monitor. In this case, it would be redundant and cost inefficient

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\(^9\) See the Canadian Investor Protection Fund, online: <http://www.cipf.ca/c_home.htm>.

\(^{90}\) *Ibid.* The CIPF notes that, since its inception in 1969, a total of $35 million has been paid out to eligible customers of seventeen insolvent members.
to have the federal government monitor the actions of securities intermediaries when the same function is already being carried out by provincial security regulators. While it is theoretically possible to have the federal government legislate the indirect holding system and leave the monitoring to the provincial securities commissions, this too would be inefficient since there would be attendant information cost associated with the federal and provincial governments coordinating with each other.

The more efficient solution would be to have the indirect holding system governed by the entity that already governs the regulation of security intermediaries. Currently, that would be the provincial governments.

• **Direct and indirect holding system should be together:** Regardless of which jurisdiction governs the indirect holding system, both systems should be governed at the same level of government. Having two separate systems governed by different levels of government would unnecessarily confuse matters by requiring inquiry into two different statutes enacted by two different levels of government. If the direct and indirect holding systems are consolidated into a single code, the result is a higher degree of clarity and certainty.

• **Securities consist of more than just corporate securities.** If the CBCA Part VII provisions were amended to reflect the direct and indirect holding provisions of Rev. UCC Art. 8, there would still be problems and a gap to fill. Presumably, such purported CBCA amendments would only apply to corporate securities since the CBCA could only deal with federal corporate matters. It would not apply to provincial corporate securities. It would almost certainly not apply to securities issued by non-corporate entities such as limited partnerships and trusts. One need only look to the Ontario Securities Act\(^1\) definition of “security” to appreciate that the types of security traded on the market encompasses far more than just corporate shares or securities.

Therefore, even if the CBCA enacted provisions akin to Rev. UCC Art. 8, it would still be necessary for the provinces or federal

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\(^1\) *Supra*, n. 10.
government to enact similar legislation to cover all securities (i.e., not just federally incorporated corporate securities). This would lead to an unnecessary and inefficient duplication of legislation. This would also generate additional information costs since it would be necessary to coordinate both federal and provincial legislation so that federal corporate securities would be treated in a similar manner as all other securities in the marketplace. If federal corporate securities were to be treated in a different manner than other securities, this could lead to uncertainty and confusion as well as possible exploitation of differences in the legislation. In light of this potential problem, the more cost-effective solution would be to have the provincial legislatures address the issue entirely since they necessarily have to address the issues in any event at this time.

- **Personal Property Security Laws:** The USTA, Ontario STA, and Alberta STA, in addition to addressing the transfer of securities, have provisions regarding the pledging of securities as collateral. These provisions are intended to give greater certainty to lenders when securities are pledged as collateral for an obligation. In turn, it is intended that such enhanced legal certainty will promote the jurisdiction's competitiveness in the market and attract capital.

Although it is beyond the scope of this article to detail the exact mechanism by which such changes are accomplished,\(^92\) it is important to note that personal property security laws have always been the subject of provincial legislation.\(^93\) Therefore, the changes required to allow personal property security law to more effectively deal with book-based securities (i.e., in the indirect

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92 One of the key problems was that it was unclear how one could obtain an enforceable security interest in book-based securities. Lenders would often have to insist on a registration under the relevant personal property security statute and perhaps even require the delivery of physical certificates. Such extended procedures would often be costly and tedious. The USTA, Ontario STA, and Alberta STA handle this problem by creating the concept of “control”.

93 For example, Ontario has the *Personal Property Security Act*, R.S.O. 1990, c. P.10 [Ontario PPSA].
holding system) will have to be implemented at the provincial level.

For example, in the case of the Ontario STA there are changes not only to OBCA transfer provisions (most of which have been removed and placed wholly within the Ontario STA) but there are also significant changes enacted to the Ontario PPSA (which now allow for the aforementioned provisions relating to book-based securities). There is greater integration between both the Ontario STA and Ontario PPSA. Functionally this makes sense because the transfer of securities (governed by Ontario STA) and the pledging of securities as collateral (governed by Ontario PPSA) are two very common occurrences that can often appear in the same transaction. Having both transfers and pledges integrated in a legislative sense by the same level of government is efficient.

On the other hand, if corporate securities transfers were governed by the CBCA, then it would be necessary to review how such transfer legislation would be integrated with provincial personal property legislation. The additional information costs incurred would then be multiplied since the federal legislation would have to coordinate with not just one, but all of the provinces' personal property legislation. Again, given the added information costs and time consuming process of federal/provincial coordination, it seems the more efficient solution is to allow the provinces to handle the issue of security transfers entirely since they would already have to coordinate it with their personal property legislation in any event.

- **Harmonization with UCC model:** If the goal is to harmonize Canadian legislation with the UCC model, then in addition to closely following substantive provisions (as the USTA has already done in both its proposed statute as well as its commentary), it would be wise to follow the general overall scheme as well. In the UCC model, Rev. UCC Art. 8 is adopted by each state as a separate piece of legislation, rather than integrating it into a state corporate statute. In the mid-1970s, the direct holding / negotiability concepts of the UCC model of the time were integrated directly into the CBCA, presumably because, in part,
there was no separate provincial statute within which to place such provisions.

As has been noted before in this article, the CBCA amendments of the mid-1970s were probably the best and most pragmatic solution available at the time in light of those circumstances. However, they did have the consequence of significantly departing from the UCC model that they were trying to follow. While the UCC model contemplated a separate self-contained piece of legislation at the state (i.e., provincial) level, the amendments of the mid 1970s embedded the provisions within an existing corporate statute at the federal, rather than provincial, level.

In retrospect, the hazards of importing UCC Art. 8 provisions without also implementing such provisions in the same general overall schema become starkly apparent. Since CBCA Part VII was enacted at the federal level, coordinating with all provincial legislatures on closely related matters such as regulation of securities intermediaries and personal property security law would become necessary sooner or later. Similarly, since CBCA Part VII can only deal with corporate securities, there will necessarily be a large void relating to all other types of securities that would likely have to be filled by the provinces, thus requiring further coordination between both levels of government.

As a final passing note, if one of the goals is confidence building by adopting what some believe to be the most advanced securities transfer system in the world (i.e., Rev. UCC Art. 8), then it would be important to adopt not only its wording, but to also implement it within the same general framework. Since the Rev. UCC Art. 8 is implemented as a self-contained piece of legislation at the state level, in the interests of harmony, it would be prudent to follow the same general structure. A provincial securities transfer statute such as the Ontario STA would best fulfill such a role.

An efficiency-based analysis of CBCA Part VII results in the general conclusion that securities transfers are most rationally allocated to provincial legislatures. The intensified focus on securities intermediaries

94 USTA Consultation Paper, supra, n. 58.
in the indirect holding system brings renewed attention to the regulation of such intermediaries. Regulation of security intermediaries is currently accomplished at the provincial level so that it currently makes sense to integrate it with the provinces. Similarly, closely related issues such as personal property security law are regulated and legislated at the provincial level. If indirect holdings are to be regulated at the provincial level, then efficiency dictates that direct holdings would be best regulated at the provincial level as well so as to result in a single comprehensive code of security transfer rather than an uncertain bifurcated one. At best, CBCA Part VII would address only corporate securities and leave all other securities to the provinces. Such a situation would result in unnecessarily duplicative legislation. Finally, if the goal of harmonization is to be more accurately realized, then it is necessary to import not only the wording of the UCC but also the general framework in which it is implemented. All of these considerations generally suggest that the most efficient allocation of responsibility is to the provinces. From a historical perspective, it seems that the CBCA Part VII provisions were intended to fill a void left due to the lack of relevant provincial legislation at the time. Now that relevant and more efficient provincial legislation is soon to be in place, it may be no longer necessary for the CBCA to fill that void.

4. RECOMMENDATIONS ON FUTURE ACTION FOR CBCA

The foregoing analysis has come to the conclusion that it is more efficient for CBCA to allocate responsibility for securities transfers to provincial legislatures. In the analysis of how such a move might be accomplished, certain factors may either facilitate or complicate the allocation of securities transfer rules from the CBCA to provincial legislatures.

(a) Factors Facilitating the Allocation to Provinces

The first factor facilitating the allocation provincial legislatures is the ease of severance of the current provisions from the CBCA. As discussed, the current CBCA Part VII provisions operate at two distinct levels: administrative provisions and direct holding / negotiability provisions. The policy rationale behind the administrative provisions is merely to provide support to the infrastructure that assists shareholders in evidencing their ownership interest and exercising their rights. The
policy rationale with respect to the direct holding / negotiability provisions is to enhance economic efficiency by legitimizing existing market practices, thereby increasing certainty.

The differing policy rationales behind these provisions suggest that they address different goals and are thus easily severable from each other since they do not depend on each other. Indeed, prior to the amendments in the mid-1970s, the Canadian federal corporate law statutes did in fact exist without the provisions to be severed. Removing the direct holding / negotiability provisions will not be the removal of inextricably intertwined provisions in the CBCA. The transfer provisions of the CBCA comprise a fairly self-contained code that exists to promote market efficiencies, a rationale that is quite far removed from the more standard corporate rationales in the rest of the statute. In essence, removing the present direct holding provisions from the CBCA merely reverses the amendments of the mid-1970s. These amendments have since been superseded by potentially more modern mechanisms of promoting efficient market trades. As was analyzed earlier in this article, the relatively small amount of case law surrounding these provisions suggests that they are not the subject of high volume litigation. This further affirms the notion that their removal will not necessarily have a huge negative impact on the actual market.95

The second factor facilitating the allocation of responsibility to the provinces is the fact that the indirect holding system, including its co-existence with the direct holding system, is nothing new. The indirect holding system and book-based securities are a commercial reality and have been so for quite some time now. In addition, the current provincial securities transfer legislation are all based on the USTA, which in turn is based on Rev. UCC Art. 8. Rev. UCC Art. 8 has been in place since the mid-1990s and was specifically drafted to handle the issue of indirect holdings. The prevalence of indirect holding as an established commercial practice along with a proven, reputable system of legislation should provide the federal government with a strong degree of comfort that the transfer of corporate securities will be handled well by the new provincial legislation.

95 However, it is worth remembering that the new direct holding provisions under the Ontario STA uses the term “protected purchaser” as opposed to “bona fide purchaser”. Thus, the new statutory provisions potentially render the previously decided case law obsolete.
Third, based on the dominance of the indirect holding system and the comments of the securities industry, it is clear that there is high demand for legislation relating to the transfer of book-based securities. This is highly significant given how the USTA is essentially an attempt to transplant U.S. law into Canada. Some scholarly studies suggest that the effectiveness of a legal transplant is strongly determined by whether or not the recipient jurisdiction is familiar and receptive to the imported legal concepts:

Our key argument is that legality is largely a function of the demand for law. Only if demand for law is high, will there be voluntary compliance and will a society invest in the legal institutions necessary for upholding the public legal order [. . .] Laws that are compatible with the preexisting social norms are more likely to be well received and thus effectuated. We therefore suggest that transplants may work, if they are adapted, or if the population is already well familiar with the basic principles of these laws.\(^9\)

Since the Canadian market is already quite familiar with the indirect holding system (which is the basis of the vast volume of its publicly traded securities) and demand for legislation is fairly high, the above scholarly study suggests that transplantation of Rev. UCC Art. 8 to the Canadian legal system is likely to have a high probability of success.

(b) Factors Complicating the Allocation to Provinces

It is clear enough that CBCA Part VII provisions addressing the administrative infrastructure (e.g., providing for a shareholder register, etc.) should be left in the CBCA because such provisions do not relate to the issues of securities transfer (i.e., direct and indirect holdings). The question is what one must do to address the potential conflict between direct holding systems and whether one addresses the lack of any indirect holding provisions at the federal level.

The single most important factor that complicates the allocation of securities transfer responsibility is the fact that the provinces and territories have not all implemented or enacted securities transfer legislation. This inconsistency among provinces and territories places the CBCA Part VII provisions in a fairly difficult position at the moment. If the CBCA were to remove its direct holding provisions and allow the Ontario STA and Alberta STA to handle the issue, a gap would exist for

the provinces and territories that have no securities transfer legislation. In other words, the provinces and territories that have no version of the USTA enacted would now also have no direct holding provisions with respect to federal business corporations because the CBCA would have repealed them.

On the other hand, if the CBCA does not remove its current direct holding provisions, then there is the possibility of duplicative and conflicting laws with the Ontario STA and Alberta STA, since these provinces deal with direct holding as well within their securities transfer legislation. In short, there would be two sets of direct holding provisions, one federal and one provincial.

(c) Options and Recommendations

The next part of this article will discuss the various options for allocating securities transfer responsibility in light of the complications mentioned above. It is assumed that the administrative provisions of CBCA Part VII will remain in the CBCA as these provisions properly support CBCA policy rationales. The options below relate to possible courses of action regarding direct and indirect holding issues. The possible options include the following:

• Option 1: Enact a federal STA, with provincial exemptions if equivalent in place. In this scenario, the federal government would enact a federal version of the USTA. This would ensure that the provinces that had not yet enacted securities transfer legislation would at least have a comprehensive code for both indirect and direct holding of federal corporate securities (though there would still be no legislation dealing with non-federal corporate securities in the province). The federal STA could also state that if the province had a substantially similar piece of securities transfer legislation in place, then the provincial legislation would prevail. Eventually, if all the provinces and territories harmonized their legislation to the USTA, the federal STA provisions would be moot and could be repealed altogether.

This general stratagem of using federal law to cover provincial gaps and generally receding in favour of provinces is not an entirely unfamiliar concept. The recently enacted federal privacy legislation, _Personal Information Privacy and Electronic Doc-
Personal Information Privacy and Electronic Documents Act77 ("PIPEDA"), makes use of a similar, though not exactly same, concept. PIPEDA has a number of important provisions that protect the privacy of individuals.

However, PIPEDA also states that the Governor in Council, may, "if satisfied that legislation of a province that is substantially similar to this Part applies to an organization, a class of organizations, an activity or a class of activities, exempt the organization, activity or class from the application of this Part in respect of the collection, use or disclosure of personal information that occurs within that province."88 In short, if the federal government is satisfied that the province has privacy legislation that is substantially similar to that of PIPEDA, then it may exempt the province from a substantive number of PIPEDA’s provisions.

To date, this provision has already been invoked by the federal government. The general privacy legislation of both Alberta and British Columbia has already been deemed by the federal government to be “substantially similar”.99 The main difference between PIPEDA and the option of a federal STA is that PIPEDA does not contemplate completely vacating the privacy area while the federal STA may actually welcome such an action, if part of the rationale to implement it is to fill the gap left by provinces without securities transfer legislation.

The disadvantage to this option is that it requires extensive legislation by the federal government. The CBCA Part VII provisions would have to be removed and the federal STA would have to be enacted. One comfort is that the federal STA would already have the pre-existing model of the USTA to draw upon and it is unlikely that any substantial deviations would be required. However, unlike the provincial securities transfer legislation, the federal STA would have the added complexity of drafting and implementing the transition and exemption clauses mentioned above.

77 Personal Information Privacy and Electronic Documents Act, S.C. 2000, c. 5 [PIPEDA].
88 Ibid., s. 26(2)(b).
99 See the Canadian Privacy Commissioner, online: <http://www.privcom.gc.ca/legislation/ss_index_e.asp> citing the relevant issues of the Canada Gazette where the proclamations were made.
The advantage to this option is that it provides maximum coverage of direct and indirect holdings for corporate securities of CBCA companies as well as securities of other business organizations. It could be fairly said that this reasonably represents the most the federal government could do in the face of incomplete provincial harmonization. There have been many proposals for a single securities regulator with a single securities act for the entire country. (For the most recent discussion, see the Wise Persons Committee Report 2003). If this were to occur then one could contemplate a larger merger and coordination of all provincial STAs and the federal STA enacted under this option. Ideally, this would result in efficient synergies between both levels of governments.

- **Option 2: Leave CBCA Part VII with provincial exemption if equivalent in place.** This scenario envisions that the current direct holding provisions of the CBCA Part VII will continue to govern unless the province has addressed direct holdings, in a manner similar to the USTA, in its own provincial securities transfer legislation. This option solves the problem of having conflicting direct holding provisions between the CBCA and the Ontario / Alberta STAs. However, if a province has not enacted any securities transfer legislation, then there will be no gap for federal corporate securities since the CBCA Part VII provisions will continue to exist for those provinces.

The disadvantage to this option is that it provides no solution for the indirect holdings of federal corporate securities in provinces that have not enacted any securities legislation. Arguably, this does not deviate from the status quo since, until the Ontario and Alberta STAs are in force, there currently is no regime for indirect holding securities in any province.

The advantage to this option is that it requires minimal legislative action. The provisions of the CBCA are neither being removed nor is another separate piece of legislation being drafted. The current CBCA would simply make the qualifications mentioned above. Furthermore, one might argue that this option is very non-

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100 Committee to Review the Structure of Securities Regulation in Canada, *It's Time* (Ottawa: Department of Finance, 2003).
interventionalist since it does not attempt to impose a federal STA upon a province.

- **Option 3: Wait for provincial harmonization.** This scenario contemplates that the federal government do nothing until such time that all of the provinces have implemented securities transfer legislation similar to the USTA. At that point, the federal government would be in a position to completely repeal the CBCA Part VII transfer provisions. The advantage to this option is that there are no gaps in legislation. The main disadvantage is that it may be overly optimistic. If one assumes that the provinces will harmonize very quickly then this option is likely best. However, complete provincial harmonization of legislation would be an unprecedented occurrence in Canadian legal history. Thus, apprehension over whether this would likely occur in the short term may be well founded. If provincial harmonization is not forthcoming, then there is again the problem of duplication and potential conflict between the legislation of provinces that have enacted securities transfer legislation and the direct holding provisions of the CBCA.

- **Option 4: Completely repeal the CBCA transfer provisions without reference to provinces.** This scenario envisages the federal completely vacating the field of securities transfer for the provincial legislatures. Ostensibly, this would simply bring the CBCA, with respect to securities transfers, to its pre mid-1970s state. There are several significant disadvantages to this approach. First, it is unclear what effect the repeal would have on federal corporate securities certificates already in existence. Issues of retroactivity would have to be addressed. Second, it would leave a complete legal vacuum with respect to direct holdings of federal corporate securities in provinces that have not enacted any securities transfer legislation. This could lead to uncertainty and work against the very economic efficiencies that prompted the federal government to move in this direction in the first place.

The advantage of this option is that it is relatively easy to implement since it only requires repeal of the current CBCA Part VII transfer provisions. However, if the issue of retroactivity and
other ancillary issues are addressed in the CBCA amendments, then even this advantage could quickly evaporate. Arguably, the creation of a legal vacuum may prompt and provide incentive to provincial legislatures to enact securities transfer legislation. However, this is a risky strategy particularly for provinces where trade in securities is not a priority and may, in fact, backfire.

It is suggested that the optimal choices are options 1 and 2 above. The approach of waiting for complete provincial harmonization (option 3) may be far too optimistic and would leave potentially conflicting legislation in place. Completely repealing all of the CBCA Part VII transfer provisions (option 4), without regard to the provinces, may be simply too drastic a step given the confusion that it can generate.

Enacting a federal STA with provincial exemptions (option 1) is arguably the most complete and comprehensive solution. It ensures that there is no conflict with the Ontario STA and the Alberta STA while providing a complete code of securities transfer (direct and indirect) for provinces that have no securities transfer legislation. Whether or not it is ultimately chosen will depend heavily upon the federal government’s willingness to legislate a comprehensive securities transfer statute with intricate provincial exemption provisions.

On the other hand, leaving the direct holding provisions of CBCA Part VII in place with provincial exemption (option 2) is an easier and less intrusive than option 1, though less comprehensive. This option requires only minimal legislative action in the form of drafting a provincial exemption for CBCA Part VII. It is also the most flexible of all the options since it easily allows the federal government the freedom to pursue other options in the future. Whether or not this option is chosen will depend on the federal government’s willingness to tolerate an incomplete though flexible measure.

5. SUMMARY AND CONCLUSION

The current provisions of Part VII of the CBCA have an interesting history. Their enactment in the mid-1970s was a response to the market practice of treating corporate security certificates as negotiable instruments. These provisions were heavily based on UCC Art. 8, though they differed slightly in wording. CBCA Part VII has a comprehensive set of provisions regarding the negotiability of federal corporate securities with
integrated concepts such as "bona fide purchaser". A review of the case law reveals that there have not been many significant judicial considerations of these provisions (both at the federal level and of analogous Ontario corporate statute provisions).

CBCA Part VII operates at two policy rationale levels. At one level, CBCA Part VII contains provisions that are administrative and supportive in nature. These provisions provide the infrastructure that assists shareholders in exercising their rights. At another level, CBCA Part VII has negotiability provisions that, in the mid-1970s, supported existing market practices, harmonized with important trading partners and helped move the law towards a comprehensive code for securities transfer.

Although CBCA Part VII may have been a pragmatic solution at the time of its enactment, it has not kept up with modern times. CBCA Part VII only deals with the direct holding system. Currently, the dominant market practice for the transfer of securities is the indirect holding system. The indirect holding system is far more efficient since it deals with book-based entries rather than the more tedious practice of delivering physical security certificates. The indirect holding system is, by far, the manner in which the vast majority of publicly traded shares are held in Canada (as well as the U.S.).

The U.S. has addressed the dominant practice of indirect holding in Rev. UCC Art. 8. Until recently, no Canadian legislation addressed indirect holding. However, the CSA drafted the USTA in an attempt to address the indirect holding system and to modernize the Canadian system. Both Ontario and Alberta have enacted virtually identical securities transfer legislation (which have received royal assent but are not yet in force) based upon the USTA. The Ontario STA removes the direct holding provisions in the OBCA (analogous to CBCA Part VII) and places them within the STA. The direct holding provisions are similar but the concept of bona fide purchaser is replaced with the concept of protected purchaser (which arguably provides more protection to the transferee). With respect to indirect holdings, the Ontario STA creates a regime whereby indirect holdings are recognized as a security entitlement against a security intermediary. Security transfers are conducted by the creation of a security entitlement on one security intermediary's books and the elimination of a security entitlement on another security
intermediary's books. An entitlement holder, generally speaking, can only assert its security rights against its own intermediary.

Although the administrative provisions of CBCA Part VII fulfill the corporate policy rationale of supporting shareholder rights (by assisting in the creation of an evidentiary scheme), the negotiability provisions do not seem to fulfill any of the traditional goals of corporate law. In a broad abstract sense, the negotiability provisions arguably promoted the corporate goal of economic efficiency back in the mid-1970s by legitimating a common market practice. However, if that was the case, then that rationale is no longer present since CBCA Part VII has not kept up with the dominant indirect holding system.

The goals of the Ontario / Alberta STAs may seem to be complementary to those of the CBCA. Both the Ontario / Albert STAs have the goal of harmonizing with the U.S. as well as controlling systemic and legal risk. This would be consistent with the efficiency goals of the CBCA. However, there is the potential for conflict. The CBCA has direct holding provisions and the Ontario STA also has direct holding provisions (which purport to apply to all securities). Since the Ontario STA has introduced new concepts such as "protected purchaser" to its legislation, this has the potential of conflicting with older traditional concepts in CBCA Part VII.

In assessing the future role of CBCA Part VII, there are many perspectives one could take. Rather than using a constitutional or categorical analysis, this article proceeds with an efficiency analysis. It concludes that the CBCA ought to allow the provinces to legislate in relation to both direct and indirect holdings of securities. Indirect holding schemes based on Rev. UCC Art. 8 emphasize that the entitlement holder may only assert rights against the security intermediary. As a result, the jurisdiction that regulates security intermediaries is the most efficient one to handle the related issue of indirect holdings. Presently, that would be the provincial governments. Similarly, the issue of pledging securities as collateral is handled by the provincial government. Since security transfers and pledges are closely related issues, again it would be more efficient to have a single level of government deal with them together. On the other hand, current CBCA Part VII provisions that deal only with the administrative issues and not with direct / indirect holding issues
should be left in the CBCA as these provisions properly provide the infrastructure for corporate law matters.

Moreover, securities consist of more than just corporate securities of federally incorporated companies. They consist of provincial corporate securities as well as non-corporate securities. Thus, any federal attempt to legislate regarding indirect holdings would necessarily be incomplete because presumably a hypothetical CBCA indirect holding scheme would only apply to federal corporate securities. This would necessitate that the provinces legislate a parallel statute dealing with all other types of securities. This would lead to confusing and unnecessarily duplicative legislation. Finally, if the goal is harmonization with the UCC model, then it would be advisable to follow not only the same wording but also the same framework. The UCC contemplated a separate and self-contained securities transfer code enacted at the state level. Instead, Canada enacted it at the federal level and integrated it within its corporate statute. In time, this departure from the original framework would become apparent as integration with the provinces on key issues and dealing with non-corporate security issues became more difficult.

Presently, allocating responsibility for securities transfer to the provinces is difficult because not all of the provinces have enacted securities transfer legislation. If the CBCA removes its direct holding provisions, then there may be a gap for provinces without securities transfer legislation. On the other hand, if the CBCA leaves its direct holding provisions as is, then there may be potential conflict with provinces that have enacted securities transfer legislation.

There are four suggested options:

- enact a federal STA (based on USTA) with provincial exemptions for provinces with functional equivalent of federal STA;
- leave CBCA Part VII direct holding with provincial exemptions for provinces with direct holding provisions similar to USTA;
- do nothing and wait until all provinces harmonize; or
- remove all CBCA Part VII direct holding provisions.

The latter two options are not very appealing. Waiting for the provinces to harmonize may be too optimistic and can result in conflicting legislation in the interim. Removing all CBCA Part VII direct holding provisions may be too drastic and could lead to uncertainty. The two
former options are optimal. Enacting a federal STA is the most comprehensive solution with no gaps though it requires the willingness to commit to a detailed legislative solution. Leaving the CBCA direct holding provisions with a provincial exemption is the least committal solution and has the advantage of being flexible and leaving choices to the provinces. It is easier to implement and requires the willingness to tolerate an incomplete solution in exchange for future flexibility. In either event, both these options at least address the situation in balanced manner founded on what is relatively speaking, an efficient approach.

POSTSCRIPT
Since this article was written, both the Securities Act (Ontario) and Securities Act (Alberta) have been enacted and are now in force.