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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

Attention: The Secretary, Ontario Securities Commission and Me Philippe Lebel, Corporate Secretary and Executive Director, Autorité des marchés financiers

Dear Sir/Madam,

Re: CSA Consultation Paper 25-403 – Activist Short Selling

We are providing the submissions below to address certain Consultation Questions ("**Questions**") raised in the December 3, 2020 CSA Consultation Paper 25-403 - *Activist Short Selling* (the "**Consultation Paper**") of a committee comprised of staff from the Canadian Securities Administrators (the "**CSA**"). We are not responding to all the Questions raised in the Consultation Paper.

At the outset, it is critical to understand that we are firmly of the view that the benefits and importance of short selling are beyond dispute. Short selling is critical to the vibrancy of our capital markets – short selling improves liquidity and enhances or facilitates price discovery and market efficiency, and it can also prevent or mitigate market bubbles. We wholeheartedly agree with the statements in the Consultation Report to the effect that short selling is a "legitimate trading practice" and can be an important part of an investor's hedging and investment risk management strategy.

In our submissions and responses below, we make reference to a paper authored by lawyers at our firm on short selling regulation in Canada, *An Analysis of the Short Selling Landscape in Canada* (the "**2019 Short Selling Paper**").[1] Our responses are guided by the stated goals of the CSA to seek to improve investor confidence and market efficiency while seeking to reduce systemic risk. In this regard, the four principles outlined in the International Organization of Securities Commissions' ("**IOSCO**") 2009 report, *Regulation of Short Selling* (the "**IOSCO Four Principles**"), which are summarized below, are helpful guideposts:

> ("**IOSCO Principle 1**"): Short selling activities should be subject to appropriate controls to reduce or minimize the potential risks that could affect the orderly and efficient functioning and stability of the capital markets. IOSCO recommended that the "regulation of short selling should *as a minimum requirement impose a strict settlement (such as compulsory buy-in) of failed trades*" [emphasis in original].[2] IOSCO also noted that some jurisdictions have compulsory buy-in or close-out requirements, supported by mandatory pre-borrowing, or locate requirements, as well as T+3 as the standard settlement cycle.[3]
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> ("**IOSCO Principle 2**"): Short selling should be subject to a reporting regime that provides timely information to the market or market regulators.
>
> ("**IOSCO Principle 3**"): Short selling should be subject to an effective compliance and enforcement regime. IOSCO noted that regulators should monitor and inspect settlement failures regularly, implement a "flagging" regime and identify potential market abuses and systemic risk.
>
> ("**IOSCO Principle 4**"): Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development. IOSCO expressed concern that short selling regulation allows desirable market

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[1] P. Davis et al, "An Analysis of the Short Selling Landscape in Canada: a New Path Forward is Needed to Improve Market Efficiency and Reduce Systemic Risk" (October 2019), online (pdf): <http://mcmillan.ca/wp-content/uploads/2020/07/An-Analysis-of-the-Short-Selling-Landscape-of-Canada-Digital.pdf> [2019 Short Selling Paper].

[2] Technical Committee of the International Organization of Securities Commissions, *Regulation of Short Selling, Consultation Report*, (March 2009) at 8, online (pdf): *IOSCO* <www.iosco.org/library/pubdocs/pdf/IOSCOPD289.pdf>.

[3] Since the publication of IOSCO's report, the standard settlement cycle has been changed to T+2.

transactions and that there should be clear definitions of exempted activities and the manner in which these activities should be reported.

For ease of reference, we have used the headings and numbering set out in the Consultation Paper and our submissions are organized under each of the respective Questions. We confirm that in this letter we have not addressed Questions 1-7 and 14.

The views, opinions and recommendations expressed in this letter are solely those of the lawyers whose names are set out at the conclusion of this letter and are not made on behalf of McMillan LLP or any of its clients.

Consultation Questions

8. Are issuers reluctant to approach securities regulators when they believe that they are being unfairly targeted by an activist short seller? If so, why? If not, why not?

From first-hand experience in a number of cases, we believe that issuers are naturally reluctant to approach securities regulators when they believe that they are victims of short selling abuses. You will appreciate that complaining to regulators with respect to short campaigns may be perceived to be a "double-edged sword", as the company itself is in effect inviting investigation by regulators who need to do so in order to evaluate the short sellers conduct. Further, many issuers appear to believe (rightly or wrongly) that so long as some of the allegations of a short campaigner are true, then other allegations that stray widely from the truth or are merely wild conjecture may be excused by securities regulators.

Additionally, and as discussed further below, there has been a lack of enforcement against abusive short selling in Canada. The Investment Industry Regulatory Organization of Canada ("**IIROC**") has demonstrated a reluctance to assist issuers in actions taken to recover damages against short campaigners or ascertaining their identities. As such, any incentive for an issuer to approach securities regulators is further reduced, as there appears to be very little likelihood of enforcement by, or assistance from, securities regulators and self-regulatory organizations ("**SROs**").

9. Is the existing regulatory framework adequate to address the risks associated with problematic activist short selling? Please explain why or why not and provide specific examples of concerns and areas where, in your view, the regulatory framework may not be adequate.

In order to better understand the risks associated with so-called activist short selling, it is first important to understand the risks associated with all short selling, which risks may be exacerbated by those that engage in short campaigns.

We do not believe that the existing regulatory framework is consistent with the IOSCO Four Principles.[4] We believe that the existing regulatory framework does not adequately address systemic risk related to short selling in the Canadian capital markets for the reasons set out in our 2019 Short Selling Paper.[5] We briefly outline below our concerns as they relate to IOSCO Principles 1, 2 and 3.

Naked short selling is *de facto* permitted under IIROC's Universal Market Integrity Rules ("**UMIR**").[6] The fact that the existing regulatory framework in Canada fails to prohibit naked short selling is in direct contravention of IOSCO Principle 1 which calls for short selling to be subject to appropriate controls, such as buy-in provisions or strict settlement provisions. As discussed in more detail below, naked shorting is only prohibited where the seller is unable to settle 10 trading days after the expected settlement date. UMIR provides a regulatory regime for short selling but IIROC appears to be unable to track and assess the extent to which naked shorting actually occurs in Canada. Similarly, IIROC has no way of providing the CSA with data necessary to identify, let alone quantify, the systemic risk naked shorting poses to the Canadian capital markets or the consequences that would materialize if market conditions change and those engaged in naked shorting find it impossible or uneconomical to cover their short positions. That naked short selling is *de facto* legal in Canada poses a significant systemic risk to the Canadian capital markets.

Addressing systemic risk is an exercise in being proactive, and thus steps must be taken to prohibit naked short selling in Canada in order to effectively mitigate systemic risk.

IOSCO Principle 2 calls for increased transparency surrounding short selling. At present, a limited set of short data is made public every two weeks by IIROC. We believe that, given the potential for short selling to inflict harm on markets and the economy, more timely disclosure of short positions and adding new reporting on delivery failures is necessary. Additionally, such changes would provide better congruency between the availability of long position data and short position data. Most importantly, dissemination of information to the market regarding short activity provides important mitigation of systemic risk by ensuring that the market is made aware, in a timely fashion, of any potentially abusive short selling activity and regulators and market participants can respond accordingly.

We are concerned that our existing regulatory system does not keep with the spirit of IOSCO Principle 3, which provides that short selling should be subject to an effective compliance and enforcement regime. There is a clear lack of enforcement activity related to short selling in Canada, especially when compared to other jurisdictions such as the U.S. An effective enforcement regime serves to curtail and deter abusive conduct in the market, and

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[4] Technical Committee of the International Organization of Securities Commissions, *Regulation of Short Selling, Consultation Report*, (March 2009), online (pdf): *IOSCO* <www.iosco.org/library/pubdocs/pdf/IOSCOPD289.pdf>.

[5] 2019 Short Selling Paper, *supra* note 1 at Sections 3.2.5, 7 and 8.

[6] See our response to Consultation Question 10, below.

as such, is an important tool in mitigating against systemic risk in the Canadian capital markets.

10. Have there been market developments or new information since 2012, when UMIR amendments regarding short selling and failed trades were implemented, that would warrant revisiting the existing regulatory framework for short selling? If so, please describe these new developments or information and indicate, providing evidence to support your views:

a. whether, in your view, there is a connection between failed trades and activist short selling;

b. what changes should be considered and why, and specifically with respect to potentially problematic activist short selling activities; and

c. whether there are relevant regulatory requirements in other jurisdictions that should be considered and why.

We do not believe that the amendments made to UMIR in 2012 were sufficient to address the issues and systemic risks associated with short selling notwithstanding any market developments which have occurred since 2012. Specifically, despite the 2012 amendments and as discussed in more detail below, Canada remains out of step with other jurisdictions internationally. We would encourage IIROC to conduct a new, comprehensive study on failed trades, because we believe there were a number of issues with its 2007 *Statistical Study of Failed Trades in the Marketplace* (the "**Failed Trade Study**"),[7] as discussed in our 2019 Short Selling Paper.[8]

Notwithstanding comments from IIROC to the contrary and a similar statement made in the Consultation Paper,[9] naked short selling is *de facto* legal in Canada. In refusing to impose and police positive locate or mandatory pre-borrow requirements for all sales designated as short, IIROC in effect acquiesces and allows naked short selling, except where the short sale was perpetrated in a manipulative or deceptive manner – that is, where the seller had no intent of delivering the shares on settlement. However, even if such a manipulative and deceptive trade were to occur, IIROC appears content with simply ensuring that the perpetrator does not enter into another short sale without having pre-borrowed the security if the naked trade continues to fail to settle 10 trading days after the expected settlement date.[10] Industry participants have been clear that naked short selling is not unusual,

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[7] *General – Results of the Statistical Study of Failed Trades on Canadian Marketplaces.* Market Policy Notice 2007-003 (13 April 2007), online (pdf): *Market Regulation Services Inc.* <www.iiroc.ca/Documents/2007/64AAACCA-3D8D-41B6-A20F-F49AB7F4770D_en.pdf#search=2007%2D003>.

[8] See Section 7.4.1 of the 2019 Short Selling Paper.

[9] *Rules Notice – Notice of Approval – Provisions Respecting Regulation of Short Sales and Failed Trades, IIROC Notice 12-0078 (2 March 2012)* at 9, online (pdf*): Investment Industry Regulatory Organization of Canada* <docs.iiroc.ca/DisplayDocument.aspx?DocumentID=7026F16880C345EAA63555B8802DBBAF&Language=en> *[IIROC Notice 12- 0078].*

[10] 2019 Short Selling Paper, *supra* note 1 at Section 2.5.2.

particularly in the venture market,[11] and even IIROC has recognized that it occurs.[12] Despite this recognition, IIROC apparently does not think it necessary to uniformly enforce compulsory buy-ins.[13]

As a result, Canada is out of step with international jurisdictions with respect to naked short selling. In the U.S., Regulation SHO requires that broker-dealers must have either borrowed or entered into an arrangement to borrow the security, or have reasonable grounds to believe the security can be borrowed in time for delivery on the settlement date.[14] The European Securities and Markets Authority ("**ESMA**"), the financial regulatory agency and European Supervisory Authority of the European Union ("**EU**") goes even further and requires disclosure of evidence of firm arrangements prior to settlement. Similarly, in Australia, the short seller must have a presently exercisable and unconditional right to vest the shares in the buyer, which can be achieved by a securities lending arrangement, or any other legally binding commitment to deliver the securities before the settlement date.[15]

The Ontario Capital Markets Modernization Taskforce (the "**Modernization Taskforce**"), in its January 2021 final report (the "**Final Report**"), noted that the current requirements for short selling under UMIR "are not stringent enough to ensure that short sellers are taking appropriate steps to confirm that adequate securities are available to them to settle any short sale execution prior to entry of the order in the marketplace".[16] The Modernization Taskforce also recognized that the Ontario short selling regime stands in contrast to both the U.S. and the EU, which impose pre-borrow or locate requirements for short sales, and mandatory close-out or buy-in provisions. Recognizing the vulnerability of our regime to abusive short selling, the Modernization Taskforce recommended that IIROC revise UMIR to require an investment dealer to confirm the ability to borrow securities prior to accepting a short sale order.

We submit that the cumulative effect of IIROC's regulation, or lack thereof, fails IOSCO Principle 1, which provides that short selling activities should be subject to appropriate controls to reduce or minimize the potential risks that could affect the orderly and efficient

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[11] Comment Letter from the Investment Industry Association of Canada to the Investment Industry Regulatory Organization of Canada (26 May 2011), online (pdf): *Investment Industry Association of Canada* <iiac.ca/wp-content/themes/IIAC/resources/1566/original/IIAC%20Response%20letter%20re%20Short%20Sale%20Regs%20-FINAL%20(2).pdf>

[12] *Rules Notice – Notice of Approval – Provisions Respecting Short Sales and Failed Trades,* IIROC Notice 08-0143 (15 October 2008), online (pdf): Investment Industry Regulatory Organization of Canada <www.iiroc.ca/Documents/2008/2ABBC107-41D7-4B8D-95D4-C15B07BA25EC_en.pdf> [*IIROC Notice 08-0143*].

[13] *IIROC Notice 12-0078*, *supra* note 9 at 11.

[14] *Short Sales: Proposed Rule,* SEC Release No. 34-48709 (28 October 2003) at § 242.203(b), online: *US Securities and Exchange Commission* <www.sec.gov/rules/proposed/34-48709.htm> [SEC Release No. 34-48709].

[15] See 2019 Short Selling Paper, *supra* note 1 at Section 4.4.

[16] Capital Markets Modernization Taskforce, *Final Report* at 13 (January 2021), online: *Government of Ontario* <https://files.ontario.ca/books/mof-capital-markets-modernization-taskforce-final-report-en-2021-01-22-v2.pdf>. [*Modernization Taskforce Final Report*].

functioning and stability of the capital markets.[17] In this regard, we note that the Ontario Securities Commission (the "**OSC**") and the Autorité des marchés financiers were members of IOSCO's Technical Committee that put forth these key principles and recommendations.[18] IOSCO believes that there should be a minimum requirement of imposing strict settlement rules for failed trades, as exist in the U.S. and the EU. However, it appears that IIROC believes that some attributes of the Canadian market justify a different regulatory regime with respect to this issue. In IIROC's assessment, based on its Failed Trade Study, given that most trade failures result from administrative errors, "hard" close-out provisions are not appropriate.[19] Similarly, in IIROC's view, historic low trade failure rates make it unnecessary to impose positive locate or pre-borrow requirements.[20] Interestingly, IIROC does not expressly extrapolate from these studies to conclude that future systemic risk will remain low. In fact, it gives no substantive reason for this historic low rate. Instead, IIROC appears content to rely on the regulatory tools it has to address specific problems in the future on an as-needed or *ad hoc* basis. The studies, which allegedly support these factual assumptions underlying the IIROC regulations, are discussed in Section 7.4 of our 2019 Short Selling Paper. We have suggested that at the very least, the studies are not as persuasive as put forward by IIROC.

More importantly, however, even if we were to assume that the studies are reliable and justify the conclusions reached by IIROC, it is not clear why such conclusions would lead IIROC to deduce that IOSCO Principle 1 is not applicable to Canada. Historically low numbers of failed trades that are predominantly derived from administrative errors are not a justification for ignoring systemic risk. Systemic risks rarely occur across the entire market at once; they usually start with a sector or a large financial institution and then spread to the entire market.[21] We submit that IIROC should seek to demonstrate that naked short selling and failed trades are not increased in circumstances when significant companies or key sectors in Canada are under direct attack or distress, such as in a short campaign or a sector or general financial crisis or downturn. As we noted in our 2019 Short Selling Paper, IIROC and the CSA in fact have disclosed data that proves the opposite with respect to failed trades.[22] IIROC's ability to use tools such as designations of "Short Ineligible Security" or "Pre-Borrow Security", in an after-the-event manner does not reduce systemic risk. Addressing systemic risk requires proactive effort to identify, police and deter. We suggest that a Canadian securities regulator's mandate requires bolder action.

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[17] *Regulation of Short Selling: Final Report*, IOSCO Technical Committee Final Report (June 2009), at 7, online (pdf): *International Organization of Securities Commissions Technical Committee* <www.iosco.org/library/pubdocs/pdf/IOSCOPD292.pdf> [IOSCO, *Regulation of Short Selling Final Report*].
[18] *Ibid* at 20.
[19] *Rules Notice –Request for Comments – Provisions Respecting Regulation of Short Sales and Failed Trades, IIROC Notice 11-0075* (25 February 2011) at 36, online (pdf): *Investment Industry Regulatory Organization of Canada*.
[20] *Ibid* at 49.
[21] Corporate Finance Institute, "Systemic Risk", online: *Corporate Finance Institute* <corporatefinanceinstitute.com/resources/knowledge/finance/what-is-systemic-risk/>.
[22] 2019 Short Selling Paper, *supra* note 1 at Section 7.4.2.2.

IIROC has chosen to not impose any front-end (locate or pre-borrow requirements) or back-end (compulsory buy-ins) measures to minimize any potential settlement disruptions.[23]

Ultimately, in our view, Canadian securities regulators' mandates cannot be satisfied without the imposition of locate or pre-borrow requirements in respect of short sales, subject to limited exceptions. However, we do acknowledge that compulsory buy-ins may not be required depending on the effectiveness of locate or pre-borrow requirements and the breadth of the application of such regulations.[24]

11. Is the existing disclosure regime for short selling activities adequate? Please explain why or why not, indicating:

a. what disclosure requirements would address risks associated with potentially problematic activist short selling and how would such requirements improve deterrence;

b. what should be the trigger and the timing of any additional disclosure;

c. how can additional disclosure be meaningful without negatively impacting market liquidity; and

d. do you foresee any issues with imposing a duty to update once there has been a voluntary disclosure of a short position?

We have extensively discussed the issue of short selling transparency in the Canadian regime in our 2019 Short Selling Paper, but wish to focus our response on three particular disclosure issues – first, the need for disclosure of failed trades, second, the need for frequent disclosure of information, and finally, why we do not believe that individual (non-anonymous) disclosure of short positions is warranted**.** Additionally, we do not believe a "duty to update" should exist once a voluntary disclosure of a short position has been made.

In considering any disclosure issue, trade-offs between costs, including both financial cost and risk to the markets, and benefits with respect to any regulation, have to be weighed. Another important factor is ensuring that any disclosure regime is consistent as between holders of long and short positions. We have been guided by these considerations in our response.

1. *Disclosure of failed trades.*

As put forward in our 2019 Short Selling Paper, we believe that there should be daily disclosure of failed trade data. We note that when the issue was canvassed by IIROC in 2012, a number of commenters supported the disclosure of failed trade data.[25] Additionally,

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[23] IOSCO, *Regulation of Short Selling Final Report*, *supra* note 17 at para 3.9.
[24] *Ibid* at para 3.7–3.16.
[25] 2019 Short Selling Paper, *supra* note 1 at Section 7.2.2.

we note that the lack of disclosure in the Canadian regime is inconsistent with other regimes, as failed trade data is disclosed in the U.S. and Australia and will be disclosed in the EU beginning in February 2022.[26]

IIROC has predicated much of the divergence of Canadian rules from the IOSCO Four Principles and the regulations of other regimes on the seemingly low number and percentage of failed trades in Canada, and yet it does not make that data available for confirmation and analysis. This approach does not enhance investor protection, confidence in our capital markets, nor market efficiency. We strongly recommend that failed trades, not just extended failed trades, be disclosed at least twice per month; but, as we note below, we see no reason why daily disclosure is neither feasible nor appropriate.

2. *Timely disclosure is required.*

We suggest that proper transparency can only be achieved through timely disclosure. For example, the benefits of price discovery and deterring attempts at market abuse are assisted with timely disclosure. Presently, IIROC makes information on aggregate short positions on a by-issuer basis available every two weeks in Canada, but such a delay is not optimal.

We acknowledge that much of the disclosure on short selling in various jurisdictions does not occur daily.[27] However, several SROs in the U.S. provide daily aggregate short selling volume information for individual equity securities on their websites.[28] Also, most data, particularly with respect to short sale volume and failed trades, are collected daily, including in Canada. We would expect that the cost of providing daily disclosure, particularly where such information is already available, such as failed trades and short trades, would be minimal, particularly when measured against the benefits of a better informed securities market.

Moreover, it is impossible to see how the disclosure of short selling information could negatively affect price discovery, to the point of adversely impacting liquidity, rational capital allocation and the other benefits of proper price discovery. If there is disclosure of aggregated short selling and failed delivery information, there is perhaps some risk that issuers and other market participants will take steps against short sellers. However, it is not

[26] The implementation of the disclosure in Europe has been delayed due to the impact of COVID-19; see European Commission, *Commission Delegated Regulation (EU) 2021/70 of 23 October 2020 amending Delegated Regulation (EU) 2018/1229 concerning the regulatory and technical standards on settlement discipline, as regards its entry into force* (23 October 2020), online (pdf): *Official Journal of the European Union* <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0070&from=EN> [*EC Delegated Regulation 2021/70*].
[27] European Central Bank, *Settlement Fails – Report on Securities Settlement Systems (SSS) Measures to Ensure Timely Settlement* (Frankfurt: European Central Bank, April 2011) at 4, online (pdf): *European Central Bank* <www.ecb.europa.eu/pub/pdf/other/settlementfails042011en.pdf>; Office of Investor Education and Advocacy, "Key Points About Regulation SHO", (8 April 2015) at III, online: *US Securities and Exchange Commission* <www.sec.gov/investor/pubs/regsho.htm> at IV.
[28] See *Short Sales: Proposed Rule,* SEC Release No. 34-48709 (28 October 2003) at IV., online: *US Securities and Exchange Commission* <www.sec.gov/rules/proposed/34-48709.htm>.

clear why short sellers should be treated so differently than other sellers or purchasers of shares. Aggregate long data is readily available on a moment-by-moment basis and, absent clear policy reasons, we do not accept that short selling information should be treated differently. Securities laws are premised on the merits of transparency[29] and we see no reason why that should apply almost exclusively to the long side of the market.

We submit that abusive short selling has some potential to inflict harm on the markets and perhaps even the economy, and timely transparency appears to be a logical and constructive means to limit the negative potential of short selling and enhance its benefits.[30] We therefore recommend daily disclosure of aggregate short positions, short trading and failed trades.

3. *Individual disclosure of short positions not warranted.*

On December 7, 2015, the Executive Vice President, General Counsel and Chief Regulatory Officer of NASDAQ penned a letter (the "**NASDAQ Letter**") addressed to the U.S. Securities and Exchange Commission (the "**SEC**") imploring it to take action to impose public disclosure requirements on investors in respect of their short positions "in parity with the required disclosure of long positions, including the timing for such disclosure and when updates are required."[31] Similar calls for regulatory changes have been made in Canada.

As outlined in our 2019 Short Selling Paper, the EU is the only jurisdiction we reviewed that requires individual public disclosure of positions on a non-market-aggregated, non-anonymous basis. The reasons stated for such disclosure are:

- to provide regulators with early warning signs of a build-up of large short positions;
- to provide regulators with increased capacity to monitor circumstances and recognize potentially abusive behaviour, and that without such disclosure, the identification of significant short positions would require significant resources;
- to assist in identifying unusual short selling activity and the ability to determine whether intervention is required; and

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[29] See *CSA Consultation Paper 91-407 – Derivatives: Registration*, (2013) 36 OSCB 4116, online (pdf): *Ontario Securities Commission* <www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20130418_91-407_derivatives-registration.pdf>. See also US Securities and Exchange Commission, Press Release, "SEC Adopts Rules to Increase Transparency in Security-Based Swap Market" (14 January 2015), online: *US Securities and Exchange Commission* <https://www.sec.gov/news/pressrelease/2015-6.html>.
[30] IOSCO, *Regulation of Short Selling Final Report*, *supra* note 17 at paras 1.3, 1.5, 1.6, and 3.18.2.
[31] Letter from Edward S. Knight (Executive Vice President, General Counsel and Chief Regulatory Officer of NASDAQ) to Brent J. Fields (Secretary of SEC), "Petition for Rulemaking to Require Disclosure of Short Positions in Parity with Required Disclosure of Long Positions" (7 December 2015) at 1, online (pdf): *US Securities and Exchange Commission* <www.sec.gov/rules/petitions/2015/petn4-691.pdf>.

- to assist in the goal of achieving a measure of behavioural change by constraining aggressive large-scale short selling, which may involve unacceptable risks of abuse or disorderly markets.[32]

Each of the regulatory considerations noted above – except the last – are present in all of the jurisdictions reviewed in our 2019 Short Selling Paper, and have been addressed by other means of transparency.[33] With respect to the need to impose public individual non-anonymous disclosure for the purpose of creating behavioural change, we do not accept the premise of the goal. We have seen no evidence, including from EU regulatory authorities, to support the conclusions that large-scale short selling by an individual either increases systemic risk more than short selling by market participants broadly or is directly correlated to illegal activity. In reviewing the EU's rules, it is important to keep in mind that it imposes disclosure obligations for short selling entirely on investors on an individual basis, as opposed to on dealers, and does not disclose short sale volumes. This may explain the need to address systemic risk issues related to short selling by compelling the individual disclosure of significant positions.

Nevertheless, we do see the benefit of individual disclosure, primarily for the reasons outlined in the NASDAQ Letter. However, it is for one of the principal reasons articulated in the NASDAQ Letter – that there should be parity in long and short position reporting – that we have come to the conclusion that the public reporting of individual short positions is unwarranted in Canada.

Unlike in the U.S.,[34] long position individual reporting in Canada, other than in respect of insiders, is only required upon the acquisition of beneficial ownership or the control or direction of 10% or more of the outstanding securities of a class of voting or equity securities of a public company.[35] The primary reason for such disclosure was due to the belief that the accumulation of a holding of 10% or more could impact control:

> The early warning system contained in the securities legislation of most jurisdictions requires disclosure of holdings of securities that exceed certain prescribed thresholds in order to ensure that the market is advised of accumulations of significant blocks of securities that may influence control of a reporting issuer. Dissemination of this information is important because the

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[32] Committee of European Securities Regulators, *Model for a Pan-European Short Selling Disclosure Regime* (Paris: Committee of European Securities Regulators, March 2010) at paras 31, 60–64., online (pdf): *European Securities and Markets Authority* <www.esma.europa.eu/sites/default/files/library/2015/11/10_088.pdf>.
[33] 2019 Short Selling Paper, *supra* note 1 at Sections 4.2, 4.3 and 4.4.
[34] In the U.S., a party that acquires, directly or indirectly, beneficial ownership of more than 5% of a voting class of a company's equity securities must report: see *Securities Exchange Act of 1934*, *supra* note 382 at 15 USC § 78m, § 13 cl (d)(1). In addition, large institutional investors with assets of at least $100 million must file quarterly reports under the U.S. Form 13F regime disclosing those institutional investors' positions; see *Rules and Regulations Under the Securities Exchange Act of 1934*, 17 CFR § 240.13f-1 (2011).
[35] *National Instrument 62-104 Take-Over Bids and Issuer Bids*, (2016) 39 OSCB 4225 at 5.2(1), online (pdf): *Ontario Securities Commission* <www.osc.gov.on.ca/documents/en/Securities-Category6/ni_20160505_62-104_take-over-bids.pdf>.

> securities acquired can be voted or sold, and the accumulation of the securities may signal that a take-over bid for the issuer is imminent. In addition, accumulations may be material information to the market, even when not made to change or influence control of the issuer. Significant accumulations of securities may affect investment decisions, as they may effectively reduce the public float, which limits liquidity and may increase price volatility of the stock. Market participants also may be concerned about who has the ability to vote significant blocks, as these can affect the outcome of control transactions, the constitution of the issuer's board of directors and the approval of significant proposals or transactions. The mere identity and presence of an institutional shareholder may be material to some investors.[36]

In 2013, the CSA proposed that the 10% reporting threshold be reduced to 5% for the reasons noted below:

> We believe this lower threshold is appropriate because information regarding the accumulation of significant blocks of securities is relevant for a number of reasons, in addition to signalling a potential take-over bid for the issuer, such as:
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> - it may be possible for a shareholder at the 5% level to influence control of an issuer;
> - significant shareholding is relevant for proxy-related matters (for example, under corporate legislation, a shareholder can generally requisition a shareholders' meeting if it holds 5% of an issuer's voting securities);
> - market participants may be concerned about who has the ability to vote significant blocks as these can affect the outcome of control transactions, the constitution of the issuer's board of directors and the approval of significant proposals or transactions;
> - significant accumulations of securities may affect investment decisions;
> - the identity and presence of an institutional shareholder may be material to some investors;
> - a lower early warning reporting threshold will provide all market participants with greater information about significant shareholders and thereby enhance market transparency;

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[36] *CSA Notice and Request for Comment – Proposed Amendments to MI 62-104 Take-Over Bids and Issuer Bids, NP 62-203 Take-Over Bids and Issuer Bids, and NI 62-103 Early Warning System and Related Take-Over Bid and Insider Reporting Issues*, (2013) 36 OSCB 2675 at 2676, online (pdf): *Ontario Securities Commission* <https://www.osc.ca/en/securities-law/instruments-rules-policies/6/62-104/proposed-amendments-mi-62-104-take-over-bids-and>.

- a 5% threshold would be consistent with the standard of several major foreign jurisdictions; and

- changes in corporate governance practices have increased the need for issuers to communicate directly with beneficial owners. A lower threshold would provide reporting issuers with greater visibility into their shareholder base and a greater ability to engage with significant shareholders earlier. It would also allow shareholders to communicate among themselves earlier.[37]

Some of the above factors, such as the impact on investment decisions and the enhancement of market transparency, are equally applicable for disclosure regarding significant individual holdings of short positions. Ultimately, the CSA determined not to move forward with the lower threshold for the reasons stated below:

> We originally proposed to reduce the early warning reporting threshold from 10% to 5%. We considered this lower reporting threshold to be appropriate because information regarding the accumulation of significant blocks of securities can be relevant for a number of reasons, in addition to signalling a potential take-over bid for the issuer.
>
> However, a majority of commenters raised various concerns about potential unintended consequences of reducing the early warning reporting threshold from 10% to 5% in light of the unique features of the Canadian public capital markets, including the large number of smaller issuers as well as limited liquidity. These commenters noted the potential risks of reducing access to capital for smaller issuers, hindering investors' ability to rapidly accumulate or reduce large ownership positions in the normal course of their investment activities, decreased market liquidity and increased compliance costs. Taking into account these concerns, we have concluded that it is not appropriate at this time to proceed with this proposal. We are of the view that the intended benefits of the enhanced transparency are outweighed by the potential negative impacts of implementing the lower reporting threshold.
>
> A number of commenters also suggested that the lower reporting threshold should not apply to certain issuers or certain investors. As a result, the CSA explored alternatives for creating a reduced early warning reporting threshold for only a subgroup of issuers or investors. In considering the policy rationale for the early warning system, the complexity of applying a lower threshold to only certain issuers or investors and the associated compliance burden, we

[37] *Ibid* at 2677–2678.

concluded that the reporting threshold should remain at 10% for all issuers and investors.[38]

The CSA concluded that the benefits of individual disclosure for reasons other than issues related to the impact on control of a public company were outweighed by the costs of complying with the new rules and the likely impact on liquidity, which is critical for the Canadian markets, especially for venture stocks.[39] Each of these factors would also be important in any analysis as to whether individual short positions should be disclosed in Canada. More importantly, however, the sole remaining policy rationale for early warning reporting (i.e. the possible impact on control) is simply not applicable to the disclosure of short positions and therefore the strongest argument in favour of such disclosure – establishing parity between long position and short position reporting – is not applicable.

We recognize that the Modernization Taskforce has recommended decreasing the threshold for disclosure of a long position to 5% for non-passive investors. However, in explaining its recommendation, the Modernization Taskforce noted that "share ownership at the 5 percent level is relevant to *control* of an issuer, given that a shareholder can generally requisition a shareholders' meeting if it holds 5 per cent of an issuer's voting securities" [emphasis added].[40] The reasoning underpinning the Modernization Taskforce's recommendation remains that of control over an issuer. Again, this same rationale is not applicable to the disclosure of short positions.

Finally, we also note that the SEC did not require individual funds to disclose short positions.

Accordingly, we do not see a basis for recommending the disclosure of short positions on an individual basis from a policy or public interest perspective.

4. *No "Duty to update" once voluntary disclosure of a short position has been made.*

We do not believe that a duty to update should be imposed on those who voluntarily disclose short positions in a stock, given that this would result in incongruous treatment between holders of short positions and long positions. As we have stated previously, in considering the regulation of short selling, it is important to treat holders of short positions and long positions equally where possible. Presently, there is no requirement to update the market once one has announced their long position in a company, beyond the requirements imposed by the early warning and insider reporting systems in Canadian securities

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[38] *CSA Notice of Amendments to Early Warning System: Amendments to Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids and National Instrument 62-103 The Early Warning System and Related Take-Over Bid and Insider Reporting Issues and Changes to National Policy 62-203 Take-Over Bids and Issuer Bids*, Ontario Securities Commission (25 February 2016), 39 OSCB 1747, online (pdf): *Ontario Securities Commission* <https://www.osc.ca/en/securities-law/instruments-rules-policies/6/62-104/csa-notice-amendments-early-warning-system>.

[39] *Ibid.*

[40] *Modernization Taskforce Final Report*, *supra* note 16 at 68.

regulations. We believe that the imposition of such a rule would just be a thinly veiled disguise for a tool to lessen short selling and thereby negatively impact legal short selling.

We would be wary of any rule which seeks to unfairly attack short sellers. To gauge the impact of such a rule, we would ask whether it would be appropriate to impose such a rule on a portfolio manager who regularly writes articles touting a stock after disclosing his or her long position, and thereby require him or her to update such publications as soon as he or she has unwound the long position.

12. In your view, do the existing enforcement mechanisms adequately deter problematic activist short selling? If so, why? If not, why not?

a. Can deterrence be improved through specific regulation of activist short sellers? If so, how?

For the many reasons discussed above, we do not believe that existing enforcement mechanisms adequately deter problematic activist short selling. In our 2019 Short Selling Paper, we noted that there was a dearth of regulatory enforcement action from IIROC or other Canadian regulatory authorities imposing sanctions in connection with abusive short selling, and we believe this remains the case today. Additionally, where IIROC has taken action, the short selling activity is typically coupled with other breaches of UMIR. This is in contrast to the U.S., which has been more active in enforcement.[41] The lack of enforcement may be falsely reassuring the market of the absence of abusive activity and growing systemic risk.

This lack of regulatory action may also be having a significant impact on investor confidence and may be responsible for the view held by many that there is widespread naked shorting and other significant illegal or abusive activity in Canada.[42] It is critical that these concerns be addressed by securities regulators to ensure there is confidence in our marketplace.

Furthermore, IIROC has shown a reluctance to assist complainants in actions taken to recover damages against short campaigners or ascertaining their identities.[43] Perhaps this is a function of inadequate resources but it only further serves to limit any deterrent effect that the current rules and regime may possess.

Finally, any argument to the effect that there is no activity worthy of enforcement action would appear to be blatantly untrue. It may be suggested that a system built to be more lenient is more likely to have fewer breaches of the law. In fact, since naked short selling is not technically illegal, such activity and other related conduct appears to be less likely to be the subject of regulatory scrutiny in the Canadian regulatory system. As such, we

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[41] 2019 Short Selling Paper, *supra* note 1 at Section 4.2.

[42] See for example, Pete Evans, "Canada needs to toughen short selling rules to weed out abuse, market watchers say" (11 February 2019), online: *CBC* <www.cbc.ca/news/business/short-selling-abuse-1.5009871>.

[43] *Harrington Global Opportunities Fund S.A.R.L. v. Investment Industry Regulatory Organization of Canada* 2018 ONSC 7739.

respectfully submit that existing enforcement mechanisms do not adequately deter problematic short selling.

Deterrence may be improved, in one aspect, by introducing a monetary penalty for failures to close out failed trades. In the U.S., the Financial Industry Regulatory Authority may impose monetary penalties in connection with failures to close out failed trades.[44] In the EU, beginning in February 2022, there will be cash penalties and the potential for suspension on participants of central securities depositories that fail to deliver.[45] While CDS Clearing and Depository Services Inc. charges a fee for failures to deliver securities to settle an outstanding Continuous Net Settlement position, there are currently no penalties imposed under securities laws in connection with failed trades. Canadian securities regulators should consider whether it would be appropriate to impose a fine for failed trades to bring the Canadian regulatory regime in line with comparative jurisdictions. Please also see our response to Questions 13 and 15.

13. Are there additional or different regulatory or remedial provisions that could be considered to improve deterrence of problematic conduct? If so, what are these provisions?

1. *Corrective vs. punitive measures aimed at deterrence.*

a. Corrective intervention

In our 2019 Short Selling Paper, we recommend the addition of regulatory tools that would allow the OSC to intervene during a disinformation campaign or scheme in order to publicly identify misleading or untrue statements. As we discussed then, such a new power could be modeled on section 104 of the *Securities Act* (Ontario),[46] which applies to take-over bids and issuer bids.[47] While the regulator's jurisdiction in section 104 is limited to enforcing compliance with Part XX of the OSA,[48] a comparable jurisdiction to require corrective disclosure could potentially allow an "interested person" – such as an issuer or its security holders – to bring an application to the OSC asking it to intervene in an apparent disinformation campaign, to identify untrue or misleading statements as such, and to provide relief to the interested person. Proactive regulatory intervention could include orders:

- restraining the conduct complained of (for example, restraining the distribution of a document or communication in connection with the disinformation campaign);

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[44] 2019 Short Selling Paper, *supra* note 1 at section 4.2.8.
[45] 2019 Short Selling Paper, *supra* note 1 at Section 4.3.5. The implementation of the cash penalties and suspensions has been delayed due to the impact of COVID-19; see *EC Delegated Regulation 2021/70, supra* note 26 above.
[46] RSO 1990, c S.5 (the "**OSA**").
[47] 2019 Short Selling Paper, *supra* note 1 at Section 7.7.1.
[48] OSA, s 104.

- requiring corrective action, such as an amendment, variation or retraction of any document or statement made in connection with the disinformation campaign; or
- directing persons connected with the disinformation campaign or other persons to comply with the OSA and its regulations.

We recognize that there is a risk that issuers may try to use such remedies to seek the intervention of securities regulators in circumstances where the issuer merely disagrees with an analyst's conclusions or short seller's criticism or even worse, is hiding something. The ability of securities regulators to require the public acknowledgement and correction of unsubstantiated, untrue or misleading information that was directed to the investing public would be a first line of regulatory intervention. In many cases, this might be the only regulatory intervention required to blunt the negative impact of abusive short and distort campaigns.

Setting the appropriate evidentiary threshold for the OSC's intervention in a disinformation campaign will require balancing various competing policy considerations. Too low a threshold would overstretch regulatory resources, undermine the efficiency of the market, hinder price discovery and stifle free speech. Too high a threshold would make such a remedy illusory for public companies and their shareholders, potentially lead to protracted hearings and ultimately provide any relief only after the damage to the public company's reputation and market capitalization is done and is effectively irreversible.

We think that the primary evidentiary onus for such intervention should rest on the interested person seeking relief. At a minimum, this evidentiary burden should require any person seeking regulatory intervention to establish that there are serious, demonstrable grounds to say that the statements complained of are untrue or misleading in a material respect (and potentially a *prima facie* case that the statements are untrue)[49] and that they would reasonably be expected to have a significant effect on the market price or value of the target's securities.[50] As noted by the CSA and discussed above in our response to Question 8, issuers may be hesitant to seek the intervention of securities regulators if an issuer concludes that there is a risk that it cannot satisfy the regulator that the statements that the issuer's management seeks to restrain or correct are in fact inaccurate or misleading. The need for securities regulators to make a preliminary determination of the truth or accuracy of statements published in connection with a short campaign will always be a disincentive for a target's management to bring a complaint about all but the most egregiously misleading statements about the target.

b. <u>Punitive Enforcement Tools</u>

We question whether the creation of new offences in connection with "promotional activities", such as were recently introduced to the British Columbia *Securities Act*, are either necessary or a desirable means to deter abusive short selling.[51] Instead, if the CSA

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[49] The proactive intervention by securities regulators in this regard would be analogous to injunctive relief.

[50] See OSA, subsection 126.2(1).

[51] These new provisions, now in section 50 of the British Columbia *Securities Act*, risk regulatory over-reach, since unlike existing prohibitions on market manipulation, section. 50 only requires that the statements be untrue or

concludes that a new specific prohibition against making misleading or untrue statements in connection with short and distort campaigns or pump and dump schemes is necessary, we think it is important that the specific offence requires proof of a subjective intention[52] to publish untrue or misleading information about the target in order to impact the trading price or value of the target's securities. This "*mens rea*" or "guilty mind" requirement should substantially lessen the risk that market analysts who, in good faith, publish their researched views will be inadvertently captured by a prohibition intended to target abusive short sellers or pump-and-dump promoters.

2. Statutory Private Right of Action

There are a number of reasons why existing private law remedies are ill-suited to address the economic losses that may be suffered by shareholders and issuers as a result of a short campaign. We identified a number of obstacles to both targets and their shareholders in existing private law remedies in detail in the 2019 Short Selling Paper[53] and we remain unaware of any Canadian case where either the target of a short and distort campaign or its security holders have successfully recovered economic losses from those responsible for a short and distort campaign.

In its 1997 final report, the Toronto Stock Exchange Committee on Corporate Disclosure[54] (the "**Allen Committee**") recommended the creation of a statutory right of action to complement regulatory enforcement of continuous disclosure obligations imposed on issuers under securities law, now forming Part XXIII.1 of the OSA. Part of the impetus for this recommendation was an acknowledgement of the difficulties investors had in successfully recovering financial losses under existing private law remedies, such as actions for negligent misrepresentation. By eliminating the need for security holders to prove detrimental reliance on the alleged misstatements, the statutory cause of action now provides recourse to the investing public to seek redress from those responsible for ensuring accurate secondary market disclosure.

We believe that a similar argument can be made in favour of providing target corporations and their security holders with a statutory private right of action against short sellers who can be proven to have engaged in a short and distort campaign. To date, existing private law remedies have proven inadequate to either compensate investors or deter problematic activist short sellers.[55]

Any new private right of action for "short and distort" campaigns and other forms of market manipulation would have to have significantly different underlying policy considerations than

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misleading – there is no mental element in the offence. We see this provision as potentially penalizing analyst or others who comment in good faith on the performance of various issuers for being incorrect. How the British Columbia Securities Commission will interpret this provision in light of long-standing case law regarding strict liability will be interesting to see over time. At the very least, someone charged under section 50 should be entitled to a due diligence defence establishing that reasonable care was taken to ascertain the statements made were true or not misleading.

[52] Subjective intent could include actual knowledge or reckless disregard or indifference to the truth of the statements made.

[53] 2019 Short Selling Paper, *supra* note 1 at Section 7.7.1.

[54] Toronto Stock Exchange Committee on Corporate Disclosure, *Toward Improved Corporate Disclosure* (Toronto: Toronto Stock Exchange, 1997).

[55] Section 5.4 of our 2019 Short Selling Paper discusses potential existing civil remedies for both targets and security holders as well as the conceptual and practical shortcomings of these existing remedies.

the private action for secondary market disclosure recommended by the Allen Committee. The private right of action created under Part XXIII.1 of the OSA placed primary policy emphasis on deterrence over compensation, in part because the financial burden of an award of damages payable by an issuer in connection with its secondary market disclosures would ultimately be borne principally by long-term investors. These concerns do not exist in connection with a private right of action against those responsible for a short and distort campaign. Instead, compensatory interests of targets and security holders must be balanced against the risk of chilling free speech and the willingness of activist shareholders, legitimate market analysts and others to criticize or comment on the performance of a target's management, to point out weaknesses and even deceit in the target's disclosure, business plans and assumptions, or to simply raise concerns that the target's market valuation is inflated.

For these reasons, as discussed in the next section below, we caution that a private right of action must be based on a short seller's deliberate and calculated conduct and not mere negligence or simply having made a good faith mistake and thereafter being proven wrong.

A. Conduct giving rise to a private right of action

A statutory right of action cannot and should not be a form of insurance or promise of recompense against investor losses due to the market's subsequent loss of faith in the target. Activist short sellers should not be made insurers against losses that are actually caused by ordinary investment risk, poor performance, mismanagement, *etc.* or where the market later judges the issuer's securities to be over-priced. In our view, any private right of action should be based on existing prohibitions in securities legislation against market manipulation, such as in subsections 126.1 and 126.2 of the OSA. A private action for damages could be available to an issuer and its security holders against any person or company (and not simply those who are otherwise subject to securities legislation) who makes a statement, whether orally or in writing, about the business, affairs or management of an issuer:[56]

(1) where that person or company knew or reasonably ought to have known,

a) that the statement would be generally disclosed to the public,

b) that the statement in a material respect at the time and in light of the circumstances in which it was made is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading;

c) with the intention or with reckless disregard to whether the statement would contribute to an artificial price for the issuer's securities or would be reasonably expected to have a significant impact on the market price or value of the issuer's securities; and

[56] While we propose this language in connection with abusive conduct in connection with short and distort campaigns, there is no reasons why the same prohibition on market manipulation could be used to create a private right of action against those engaged in a pump and dump scheme.

(2) where the market price or value of the securities of the issuer is impacted following the public release of the statement.

A private right of action for market manipulation should include statutory defences available to the short campaigner or others responsible for public statements regarding the issuer made in connection with a short campaign, similar to those available to a responsible issuer or influential person in the existing statutory causes of action for secondary market disclosure in Part XXIII.1 of the OSA. In particular:

- a due diligence defence, where it arises on the facts, could be forwarded as evidence that the short campaigner did not knowingly publish false or misleading information about the target;
- evidence of due diligence may include evidence that the short campaigner relied on the opinion or analysis of an expert if that expert consented (in writing) to having his or her opinion included in the short campaigner's public statements;
- even where there has been a significant change in the trading price or market value of the target's securities, a security holder's knowledge that the information in a short campaigner's analysis, report or other public statements is inaccurate or wrong may be relevant if the decision to sell or not to sell or buy or not buy the target's securities,[57] is not causally linked to the misinformation.

Finally, short of actual knowledge that the information disseminated by an abusive short seller is untrue, there should be no need for potential plaintiffs to demonstrate that they relied on the misinformation released by those responsible for the short and distort campaign. While some security holders may well choose to sell based on the misinformation used in a short and distort campaign (or buy in a pump and dump scheme), others, such as long-term investors, may also be harmed by deliberate misinformation campaigns who chose not to sell despite the information campaign and change in market valuation.

B. Courts as gatekeepers

A new private right of action must include provisions that address and minimize the risk that it will be used by enterprising class action lawyers to bring strike suits following any well publicized short campaign. As a result, we suggest that a statutory private right of action have procedural safeguards similar to those under Part XXIII.1 of the OSA, which places the court as the gatekeeper to such proceedings. At a minimum, the proposed plaintiffs in any private right of action to recover damages for market manipulation should be required to meet a good faith standard similar to that in Part XXIII.1 of the OSA.

C. Measure of damages and damages caps

We think that the most difficult policy questions in creating a statutory cause of action against abusive short sellers will be related to: (a) the appropriate measure of damages, (b)

[57] We recognize that the question of causation could cause a bifurcation of issues in class proceedings. The evaluation of individual claims however is not new to class action law. For example, in *Andersen v St. Jude Medical, Inc,* 2012 ONSC 3660, the Ontario Court accepted rebuttable presumptive thresholds for individual causation in a personal injury class action involving medical devices (discussion at paras 539 through 562).

the theory of recovery for such damages; and (c) whether there should be any limitation on the liability of those responsible for economic losses resulting from their deceptive conduct and manipulation of the market.

For example, the policy objective underlying Part XXIII.1 of the OSA is to encourage responsible issuers to make timely and accurate disclosure to the market. For that reason, issuers can limit their exposure to losses by making corrective disclosure. Allowing responsible issuers to limit their exposure to damages by making corrective disclosure provides an incentive to encourage compliance. While a new right of action for market manipulation would clearly have deterrence as a key policy objective, we do not think that an appropriate "carrot" exists for those who deliberately engage in market manipulation. Allowing abusive short sellers to limit the period in which they may be liable for damages by issuing "corrective disclosure" on its own may have no deterrent effect. Instead, it may simply allow abusive short sellers to make their profits and then end their exposure to damages by issuing some form of corrective disclosure after their short positions are closed. It is also unclear who will determine whether any subsequent statements are sufficiently "corrective" to provide the markets with sufficient information to allow for proper price discovery. Further, the damages to the target and its security holders may extend beyond the time at which corrective disclosure is made.

Similarly, a remedy based on the disgorgement of the abusive short seller's profits may not be a sufficient deterrent to discourage abusive market manipulation and more importantly does not address the need for compensatory damages. Disgorgement is typically an alternative remedy based in equity. Gains-based restitution, for example, may be ordered even in the absence of more than a nominal financial loss where the gains were achieved through a breach of a duty recognized in equity (such as a fiduciary duty). No such equitably duties are imposed on investors in their capacity as security holders.[58] Moreover, if all an abusive short seller has to do is pay its profits at the end of litigation, it is questionable whether a private right of action will have any deterrent effect and would not address the need for compensation to those who have suffered losses. While it may be difficult to find the appropriate measure of damages, the adversarial process, with the creativity of an experienced securities class action bar, is well-suited to grapple with issues such as causation and mitigation in the factual matrix of specific cases and to advance various theories of recovery supported by evidence.

[58] The conceptual basis for compensation in a statutory private right of action should not be based on equitable theories, such as waiver of tort.

15. Is it important that a statement have actual market impact to trigger enforcement action by securities regulators?

a. Should another standard be used? For example, in your view is the "reasonable investor" standard a preferable approach (e.g., would a reasonable investor consider that statement important when making an investment decision)? If so, why? What are the potential implications of such a change?

In answering this question, we distinguish between regulatory intervention and regulatory enforcement on one hand and a statutory civil right of action on the other. In the case of the latter, as discussed above in Question 13, we believe that the compensatory nature of a private right of action should require the target and its security holders to establish that they suffered actual losses which, on a balance of probabilities on the facts of the particular case, are causally connected to public statements made in a short and distort campaign. The creation of a private right of action, which would be primarily compensatory in nature, would allow securities regulators to focus primarily on deterrence through proactive regulatory intervention.

Proactive and deterrence-focused regulatory intervention, however, would justify a lower threshold to trigger intervention, such as the "reasonable investor" standard.

We see proactive regulatory intervention, similar to the regulator's jurisdiction in section 104 of the OSA to restrain abusive conduct and require corrective action in the context of Part XX of the OSA, as a potential first line of protection for public markets from misinformation campaigns led by problematic activist short sellers. The intervention of securities regulators to require corrective disclosure or to otherwise intervene in a short and distort campaign justifiably could be triggered on a "reasonable investor" standard where it appears that a company or individual are engaged in conduct contrary to either subsections 126.1 or 126.2 of the OSA (or equivalent provisions in other jurisdictions). We see this type of proactive and corrective intervention serving a similar purpose as ensuring that issuers appropriately disclose material changes.

The "reasonable investor" standard is well understood in the context of continuing disclosure and existing jurisprudence would provide guidance to the application of this standard in the context of abusive market conduct such as short and distort campaigns and pump and dump schemes. We do not think that regulatory intervention based on a "reasonable investor" standard creates a significant change or unduly lowers the threshold for regulatory enforcement. In fact, we note that the Alberta Securities Commission applied a "reasonable investor" standard in *Re Cohodes*.[59]

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[59] *Re Cohodes,* (10 October 2018), ABASC 161 at para 82, where the ASC concluded that Cohodes publicly expressed opinions did not command sufficient respect in the market to conclude that a "reasonable investor" would find his statements credible or useful in making an investment decision.

If you wish to discuss any aspect of this letter, we would encourage you to contact any one of the following lawyers who would be pleased to speak to you at your convenience:

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Yours truly,

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