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Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission
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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

To the attention of:

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Dear Sirs/Mesdames:

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

This letter is submitted in response to the public consultation being undertaken by the Canadian Securities Administrators (**CSA**) described in CSA Consultation Paper 25-403 *Activist Short Selling* (the **Consultation**). We recognize the difficulty regulators will have in striking the right balance between a small number of activist short sellers whose actions are motivated solely by artificially depressing market price and those engaged in short selling activities which provide needed market liquidity and appropriate market price adjustment. We have the following responses to the questions raised in the Consultation:

II. Research and Empirical Findings

1. What is your perception about activist short sellers? Please describe the basis of that perception.

The Consultation appropriately distinguishes between activist short sellers and directional short sellers. While we recognize the important function of short sellers in the market place in increasing liquidity and adjusting market price. We do however have concerns regarding the unquantifiable number of activist

short sellers (especially anonymous activist short sellers) who operate with the primary intention of depressing market price for personal gain and incite others to trade in securities based upon false, misleading or incomplete information. Such information may contain broad allegations of fraud and director and management dishonesty which may have a negative effect not only on an issuer's share price but also on its business, reputation and use of resources, as well as the personal reputations of its directors and management. As such activists do not engage with issuers prior to issuing such misinformation, issuers and their auditors may be unable to respond to such information in a timely and cost sensitive manner. We are of the view that a stronger regulatory regime is needed to address these concerns.

2. Can you give examples of conduct in activist short selling Campaigns that you view as problematic?

Conduct that is indicative of a "short and distort" campaign is problematic. Such conduct includes the publication of information about an issuer by a source who knows, ought reasonably to know or fails in exercising any diligence in determining that the information is false, misleading or exaggerated. Frequently the source is anonymous and the information contains inflammatory language and is disseminated on a broad platform such as social media, with the intent that it will depress the price at which the issuer's securities are trading. The activist may make misleading allegations that the issuer, through its directors and management, has engaged in fraudulent or dishonest activities. Unlike other shareholders, an activist short seller does not engage with the issuer in an attempt to allow the issuer to rectify the perceived informational shortcoming before publication to insure the market is not misled. This conduct suggests that the activist's interest is not aligned with the interests of the issuer, its directors and management, its shareholders and other stakeholders.

3. Given the focus of the available data is on prominent activist short sellers, what is your view regarding less prominent activist short sellers or pseudonymous activist short sellers targeting Canadian issuers? How can they be identified? Is there any evidence that they are engaging in short and distort Campaigns?

The regime requires more transparent and timely disclosure of activist short selling . IIROC's Universal Market Integrity Rules (**UMIR**) were last amended in 2012. Those rules provide non-aggregated data on short selling activities which are reported on a semi-monthly basis. Such reporting should be provided by IIROC on a daily basis to reflect faster trading times, on a non-aggregated basis and where possible should identify the short seller. In addition, naked short selling should be prohibited as it is in comparative jurisdictions. Enhanced surveillance of information posted on social media correlated to trading patterns in the securities of affected issuers should also be undertaken. Social media platforms have been reluctant to identify anonymous or pseudonymous posters so are unlikely to assist in the identification of them.

4. What empirical data sources related to Campaigns should we consider?

There is already considerable data in the market place as set out in the Consultation. The CSA may wish to conduct a continuous disclosure review of issuers who have been subject to anonymous short selling activists to review that disclosure compared to statements on such issuers made by activists. The CSA should continue to monitor international developments especially in those jurisdictions which have similar markets to Canada e.g. Australia. Australia has more stringent requirements than Canada but similarly has a large base of resource issuers and less liquidity in its market as opposed to the US.

5. In 2019, there was a large drop in the number of Canadian issuers targeted by prominent activist short sellers compared to the year before. Are there market conditions or other circumstances that in your view could lead to an increase? Please explain.

In general, markets that are considered to be overvalued give rise to increased opportunities for activist short sellers. In addition, individual issuers that are in the opinion of the activist overvalued also present opportunities to buy high and sell low. Given the recent volatility of the markets and record rises in the market, opportunities may increase for such activists. An increase in focus on pandemic and ESG disclosure, which is developing at a rapid pace, may result In increased scrutiny by activist short sellers and, in fact, all shareholders. Such disclosure may result in more attacks by activist short sellers which focus investors on these areas of disclosure about which investors may have strong views on. Finally, the rise in the use of social media and an increase in trading, especially by retail investors and other investors who rely on social media when making decisions to trade in securities, may provide fertile grounds for increased activity.

6. Is there any specific evidence that would suggest that Canadian markets are more vulnerable to activist short selling, including potentially problematic activist short selling (e.g., size and type of issuers, industries/sectors represented or other market conditions)? (Please provide specific examples of these vulnerabilities, and how they differ from other jurisdictions.)

We are not aware of any statistical or specific information that would suggest this. However we do note in our earlier comments the large number of commodity issuers in the Canadian market which are potentially more volatile to attack by activist short sellers.

7. Do issuers have practical limitations in terms of their ability to respond to allegations made in a Campaign? If so, what are these limitations, and do you have any recommendations on how to alleviate them?

Yes. It can be extremely difficult (particularly for smaller issuers) to respond quickly when a short seller makes broad allegations about the issuer and its management which may include allegations of fraud. Typically an independent internal investigation will be required in order to resolve the allegations, which is both time consuming and expensive. A partial response to the allegations by the issuer only invites further adverse comment by the short seller.

Suing short sellers – many of which are based outside Canada – in a Canadian court also presents jurisdictional challenges. Defendants may not be responsive to Canadian court actions, or may refuse to attorn to the jurisdiction of Canadian courts, presenting an initial and costly hurdle to having the merits of the suit addressed.

In addition, suing the short seller for defamation is not a viable option in Canada. Anti-SLAPP (Strategic Lawsuits Against Public Participation) legislation makes it a near certainty that the issuer plaintiff will face a motion by the defendant short seller to dismiss the action on the basis that the proceeding arises from an expression relating to a matter of public interest. Under the Ontario legislation, for example, so long as a defendant short seller can meet the relatively low threshold of demonstrating that its statements “relate to a matter of public interest”, the plaintiff issuer will have its suit dismissed unless it can prove that (1) that the proceeding has substantial merit; (2) that the short seller defendant has no valid defence; and (3) that the harm that either has been suffered or that is likely to be suffered by the plaintiff as a result of the short seller’s statements is sufficiently serious that the public interest in permitting the action to continue outweighs the public interest in protecting the defendant’s expression. This is a very difficult test to meet at an early stage of the litigation.

Further, even if the anti-SLAPP motion is dismissed and the plaintiff issuer ultimately manages to obtain a defamation judgment in its favour, it will then have to take further steps to seek to enforce the

judgment in the jurisdiction in which the short seller maintains assets, which is a cumbersome and expensive process and presents real uncertainty in being able to collect on a defamation judgment.

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?

In our experience, issuers are reluctant to seek regulatory intervention. There is a concern that to do so may result in the spotlight being focused on the issuer's public disclosure record, rather than on the activities of the short seller.

In addition, in those cases where issuers have made an attempt to engage with the regulator, the regulator has typically expressed reservations about intervention by enforcement without evidence that the activist's comments in fact caused a material impact on the price at which the issuer's shares were selling. This can be difficult to establish.

III. Regulatory Framework

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.

No, the existing regulatory framework is not adequate to address problematic activist short selling. Compared to certain other jurisdictions, Canadian short selling rules are lenient.

There is no current prohibition on "naked" short selling. Naked short selling occurs when there is no assurance there are securities to be purchased or borrowed to settle positions. This is exacerbated in Canada by a lack of liquidity in many securities in the market. Canada only requires that a short seller have as "reasonable expectation" of settling a short sale. We support the recommendation of the Capital Markets Modernization Taskforce (**Taskforce**) regarding a prohibition against naked short selling. The implementation of this recommendation would mean that (other than in the case of "easy to borrow" securities i.e. liquid securities), UMIR would be amended to require confirmation of the ability of a person to borrow securities to settle the short sale. In the event of a failure to settle, UMIR would require a mandated buy-in, subject to limited exceptions. The CSA should consider amending the UMIR rules to adopt the Taskforce recommendations regarding confirmation and mandatory buy-in.

Secondly, the CSA may wish to mandate disclosure to the regulators and the public when an individual short seller reaches a certain threshold based on a percentage of an issuer's issued and outstanding share capital.

Finally, existing prohibitions on misleading statements in securities legislation are currently inadequate for reasons explained below.

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:

The incidence of activist short sellers has increased significantly since 2012 as outlined in the Consultation. Canadian rules are not as robust as those of other jurisdictions. In addition the role of social media has increased significantly and allows malicious information and misleading information to be widely and instantaneously disseminated. We support further consideration of a ten day hold period as outlined in the Consultation.

In addition, there appears to have been a spate of short seller reports targeting Canadian issuers in recent years, many of which emanated from short sellers in the US. . As a result, a review of activist short selling is overdue.

11. Is the existing disclosure regime for short selling activities adequate? Please explain why or why not, indicating what disclosure requirements would address risks associated with potentially problematic activist short selling and how would such requirements improve deterrence?

Please see our responses above.

IV. Enforcement and Remedies

12. In your view, do the existing enforcement mechanisms adequately deter problematic activist short selling? If so, why? If not, why not? Can deterrence be improved through specific regulation of activist short sellers? If so, how?

They do not, and to date any enforcement actions against short sellers arising out of their reports about Canadian issuers have met with failure.

The difficulty lies in the wording of the offences contained in securities legislation. For example, section 126.1 of the *Securities Act* (Ontario) requires that a person make a statement that he knows or ought reasonably to know in a material respect is misleading or untrue and would reasonably be expected to have a significant effect on the market price or value of a security. Knowingly or recklessly making a statement about an issuer that is misleading or untrue is not sufficient.

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?

There are. Consideration should be given to the enactment of any or all of the following provisions. (Persons who are registered with the Commission would be exempt from them):

a) requiring that any person that is publishing a statement concerning the veracity of an issuer's public disclosures disclose that person's position in the securities of the issuer (either long or short), and any other arrangement that may result in financial gain to the person as a result of, or in connection with the publication of the statement.

b) requiring that any person that that is publishing a statement concerning the veracity of an issuer's public disclosures, and (i) which has either a long or short position in the securities of the issuer to which the statement relates, or (ii) is in any arrangement that may result in financial gain to the person as a result of, or in connection with the publication of the statement, adhere to the same standards of professionalism and objectivity as are required by the CFA Institute of its members.

c) prohibiting the publication by a person (i) that has either a long or short position in an issuer's securities, or (ii) that is in an arrangement that may result in financial gain as a result of the publication of a statement by it about an issuer, of any statement about the issuer that the person knows or ought reasonably to know is false or misleading.

The securities regulators may also wish to consider introducing a civil right of action for those investors purchasing or selling in the secondary market by extending secondary market liability to persons who issue disclosure that contain a misrepresentation. This is identified as a potential remedy in the Consultation.

14. Can you provide examples of specific activist short selling conduct that in your view is problematic but may not fall within the scope of existing securities offences such as market manipulation and misrepresentation/misleading statements? In your view, how should this problematic conduct be addressed by regulators?

We have observed the publication by short sellers of false and misleading information about issuer clients using inflammatory rhetoric that we believe had a negative impact on the market price of the issuer's securities. However, it was difficult to prove to the satisfaction of the securities regulator that the adverse market impact was caused solely by the short seller's misleading statements, or that the impact was material. See our comments above about how to address this.

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

No. Market impact should not be the test. Importing a "reasonable investor" standard would not be a material improvement. We consider that the legislative amendments proposed above would best address the situation.

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This letter has been prepared by certain members of the Toronto Securities and Litigation Law Groups of Norton Rose Fulbright Canada LLP but may not reflect the views of each of its members. It should not be considered to be the view of Norton Rose Fulbright LLP or any of its clients. If you have any questions concerning these comments, please contact Linda Fuerst (416) 216-2951 (direct line) or by email at linda.fuerst@nortonrosefulbright.com or Tracey Kernahan (416) 216-2045 (direct line) or by e-mail at tracey.kernahan@nortonrosefulbright.com.

Yours very truly,

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