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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
New Brunswick Securities Commission
Prince Edward Island Securities Office
Office of the Superintendent of Securities, Government of Newfoundland and Labrador
Department of Community Services, Government of Yukon
Office of the Superintendent of Securities, Government of the Northwest Territories
Legal Registries Division, Department of Justice, Government of Nunavut

Ashlyn D'Aoust
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Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Montreal, QC H4Z 1G3

Dear Ms. D'Aoust and Ms. Beaudoin:

Re: Proposed Amendments to Regulatory Regime for Venture Issuers

Thank you for the opportunity to comment on Proposed National Instrument 51-103 – *Ongoing Governance and Disclosure Requirements for Venture Issuers* ("NI 51-103") and the related amendments.

By way of introduction, Siskinds LLP is one of the leading plaintiff securities class action firms in Canada. While we act in a broad range of shareholder rights litigation, the focus of our practice is representing institutional and retail shareholders in securities class actions arising out of disclosure violations by issuers, their directors and officers, and other market participants. We have been and are counsel to the plaintiffs in numerous class actions in which claims for prospectus and secondary market misrepresentation have been asserted under

section 130 and Part XXIII.1 of the Ontario *Securities Act* (the "*OSA*"), and the equivalent provisions of the Securities Acts of the other Canadian provinces and territories. A number of those cases have involved issuers that would qualify as "venture issuers" under NI 51-103.[1]

We have a number of specific comments on the proposed amendments, which are addressed in the last section of this submission. We also have serious concerns with the proposed amendments from a policy perspective, which we discuss first below. In our view, there is no justification for any further relaxation of the disclosure and governance obligations of venture issuers beyond the numerous concessions that are already afforded to venture issuers under the existing securities regulatory regime.

Stronger Public Regulation is Required for Venture Issuers

It is widely recognized that the private enforcement of securities laws through mechanisms such as private litigation is an important tool in ensuring general compliance with securities legislation. Indeed, some empirical studies have suggested that private enforcement mechanisms are more effective than public enforcement mechanisms in this regard.[2] In any event, it is clear that public and private enforcement of securities legislation both have complementary roles to play. They operate in conjunction to secure a common objective, which is ensuring general compliance with securities regulations. It is widely understood that a robust and effective system of both public and private enforcement mechanisms is essential to an effective regime for the enforcement of securities legislation.[3]

In Canada, Professor Poonam Puri has documented how the successful interplay between public and private enforcement mechanisms has been essential in promoting stability and capacity in Canadian capital markets.[4] This dualistic conception of securities law enforcement has also been affirmed by Ontario courts. In *Fischer v IG Investment Management Ltd*, Chief Justice Winkler acknowledged "the role of private enforcement, including class action litigation, in regulating the behaviour of capital market participants."[5]

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1 E.g. Bear Lake Gold Ltd., Cathay Forest Products Corp. and Zungui Haixi Corporation.

2 La Porta, R., Lopez–de–Silanes, F., Shleifer, A., "What works in securities laws?" (2006), 61 J. Finance 1; S. J. Choi and A. C. Pritchard, "SEC Investigations and Securities Class Actions: An Empirical Comparison" (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2109739 (last accessed December 5, 2012).

3 H. E. Jackson and M. E. Rowe, "Public and Private Enforcement of Securities Laws: Resource-Based Evidence" (2009), 93 J. Financial Econ. 207.

4 Poonam Puri, "Securities Litigation and Enforcement: The Canadian Perspective" (2012), 37 Brooklyn J. Int'l L. 967.

5 *Fischer v IG Investment Management Ltd*, [2012] OJ no 343 at para 49.

The regulation of securities markets takes on added importance with respect to venture issuers. The unfortunate reality is that the risk of investor fraud is higher among companies that are less established, are starved for capital, and possess fewer resources to ensure compliance with applicable disclosure requirements.[6] Thus, the need for effective regulation is greater when it comes to venture issuers.

However, private enforcement of securities laws through class action litigation is actually weaker with respect to venture issuers. That is because it is less likely to be economical to pursue a class action against a small cap issuer. That is particularly the case for secondary market securities class actions under Part XXIII.1 of the *OSA*. The liability of an issuer under Part XXIII.1 is capped by a "liability limit" equal to the greater of 5% of the issuer's market capitalization and $1 million. Overall, the liability limits of venture issuers are likely to be lower than those of non-venture issuers. Moreover, the issuer's liability limit under Part XXIII.1 will apply even in cases of fraud. As a result, in many secondary market cases against venture issuers, it will be uneconomical to seek a remedy under Part XXIII.1 and investors will be forced to pursue riskier remedies under the common law. Empirical data confirms that smaller issuers are sued for securities fraud at a disproportionately lower rate than larger issuers.[7]

Thus, public regulation needs to be more robust in order to compensate for weaker private enforcement with respect to venture issuers, and to restore the balance between public and private enforcement mechanisms that is so crucial to an effective securities regulation regime. Similarly, lower standards for continuous disclosure threaten to contract even further what is already a precariously low level of private enforcement when it comes to venture issuers. In its efforts to streamline continuous disclosure obligations for venture issuers, the CSA must be mindful not to do so in a manner that interferes with the efficient functioning of the securities law enforcement regime. If the relaxation of the disclosure obligations of small cap issuers

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6 See e.g. Final Report of the Advisory Committee on Smaller Public Companies to the Securities and Exchange Commission (2006), http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf (last accessed 21 November, 2012) (noting that "small firms consistently have more misstatements and restatements of financial information, nearly twice the rate of large firms.... Alarmingly, these small firms also make up the bulk of accounting fraud cases under review by regulators and the courts (one study puts it at 75 percent of the cases from 1998-2003)."); Donald C. Langevoort, "Angels on the Internet: The Elusive Promise of Technological Disintermediation for Unregistered Offerings of Securities," 2 J. Small & Emerging Bus. L. 1 at 2 (1998) ("investment frauds have always been, and will always be, heavily concentrated among new and unfamiliar ventures..."), Jill E. Fisch, "Can Internet Offerings Bridge the Small Business Capital Barrier?", 2 J. Small & Emerging Bus. L. 57 at 82 (1998).

7 Douglas Cumming and Sofia John, "Exchanges and Their Investors: A New Look at Reporting Issues, Fraud, and Other Problems by Exchange" (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1985319 (last accessed 21 November 2012).

undermines this regime and in turn causes the market to conclude that investing in small cap issuers is riskier than before, then the cost of capital for these issuers will increase, which will defeat one of the purposes of the proposed changes to NI 51-103.

Greater Protections are Required for Retail Investors

As the CSA has acknowledged, investors in venture issuers are "proportionately more likely to be retail investors with small positions."[8] The CSA suggests that this justifies reduced continuous disclosure obligations for venture issuers because such investors have less time and resources to devote to reading complex disclosure documents.[9]

We respectfully disagree with the argument that details should be removed from disclosure documents because retail investors are less likely to read them otherwise. We certainly agree that the behaviour, interests, and expectations of retail investors will tend to diverge in key respects from those of institutional investors. However, another key difference is that retail investors will tend to be in a more vulnerable position financially, and more dependent on publicly available information. Crucially, they also have less ability to hold issuers accountable for their misrepresentations. Detailed disclosure obligations enhance their ability to hold issuers accountable. Thus, if anything, retail investors have greater need of the powers and protections afforded by rigorous disclosure obligations. Furthermore, even if retail investors have less time to review complex disclosure documents than institutional investors, market professionals upon whom retail investors rely, such as investment advisers, analysts, the financial press and underwriters, do have the time and resources to study and absorb complex disclosures. Therefore, greater detail in the disclosures of venture issuers will enable those market professionals to provide better quality advice to their clients in regard to those issuers.

Specific Comments

In light of the above, we strongly urge the abandonment of the proposal to replace interim MD&As with significantly watered-down "quarterly highlights" relating to the issuer's operations and liquidity. Interim MD&As provide highly valuable financial disclosure and, in our respectful view, their elimination in favour of "quarterly highlights" will have a detrimental impact on the quality of disclosure being provided to venture investors. Moreover,

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8 Ontario Securities Commission, "Proposed National Instrument 51-103 Ongoing Governance and Disclosure Requirements for Venture Issuers and Related Amendments: Supplement to the OSC Bulletin," July 29, 2011, Volume 34, Issue 30 (Supp-5).

9 *Ibid.* at 5.

as was the case with the previous proposal to eliminate altogether three and six month financial reporting for venture issuers, the elimination of detailed interim MD&As will create an informational gap in that investors will only receive detailed financial disclosure from issuers once a year.

We also query whether the CSA properly considered the cost-benefit calculus before proposing to replace interim MD&As with "quarterly highlights". Of the two surveys conducted with respect to this issue, the first received only nine responses from venture investors and the second was not opened up to investors. The surveys were dominated by issuers and, in particular, venture issuers with very small market capitalizations, for which compliance costs are obviously a significant concern.[10] Proper consideration needs to be given to the impact of this proposal on investors.

We also disagree with the proposal to require venture issuers to provide only two years of executive and director compensation disclosure, rather than three years. The provision of compensation disclosure for three years in one place in the information circular imposes a negligible additional burden on issuers, whereas it provides useful comparative information for investors in assessing the remuneration of directors and executive officers.

Thank you again for the opportunity to comment on the proposed amendments.

Yours truly,

Siskinds LLP

Per:
A. Dimitri Lascaris, Anthony O'Brien and James Yap

10 Annex H at pgs 234-235.