PUBLIC OFFERING COMPANIES AND NON–PUBLIC OFFERING COMPANIES UNDER THE ONTARIO BUSINESS COPORATIONS ACT, 1970*

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The Ontario Business Corporations Act, 1970 became effective on January 1, 1971.[1] It replaced the distinction between public and private companies with one turning on the concept of offering securities to the public. The B.C.A. thus distinguishes between public offering companies (companies offering their securities to the public) and non-public offering companies (companies not offering their securities to the public). How does this new distinction differ from the former act's classifications of the public and the private company? What are the requirements in the B.C.A. which apply to public offering companies and do not apply, or apply differently, to non-public offering companies? What is the impact of the new distinction on companies incorporated under previous Ontario corporations legislation and on companies to be incorporated under the B.C.A. in the future? When can public offering companies be reclassified as non-public offering companies? This paper will discuss each of these questions in order.

I. Previous Distinction Between Public and Private Companies

The B.C.A. replaces the former public versus private company distinction with a new basic definition. It reads:

> S. 1(9) A body corporate shall be deemed to be offering its securities to the public where,

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[1] Ont. Stat. 1970 c. 25 [hereinafter cited as B.C.A.]. The B.C.A. replaces the Corporations Act, ONT. REV. STAT. c. 71 (1960) *as amended* for business corporations. The Corporations Act continues to apply to corporations with objects of a social nature, co-operative corporations, insurance corporations and corporations to which The Credit Unions Act, ONT. REV. STAT. c. 79 (1960) applies.

> (*a*) in respect of any of the securities of which a prospectus or statement of material facts has been filed with and accepted by the Commission under *The Securities Act, 1966,* or any predecessor thereof, so long as any of such securities are outstanding; or (*b*) any of the shares of which are listed and posted for trading on any stock exchange in Ontario recognized by the Commission,
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> except that where, upon the application of a corporation that has fewer than fifteen shareholders, the Commission is satisfied, in its discretion, that to do so would not be prejudicial to the public interest, the Commission may order, subject to such terms and conditions as the Commission may impose, that the Corporation shall be deemed to have ceased to be offering its securities to the public.

The former act defined "public company" as a "company that is not a private company" [2] and "private company" as:

> a company as to which by its special Act, letters patent or supplementary letters patent,
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> (i) the right to transfer its shares is restricted,
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> (ii) the number of its shareholders, exclusive of persons who are in the employment of the company, is limited to fifty, two or more persons holding one or more shares jointly being counted as a single shareholder, and
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> (iii) any invitation to the public to subscribe for its shares or securities is prohibited. [3]

The United Kingdom Companies Act, 1907 [4] first introduced the definition of private company, although the Companies Act, 1900 [5] earlier had prohibited allotment of shares offered to the public for subscription unless certain conditions were satisfied. This prohibition did not apply in the absence of an invitation to the public. The Ontario Companies Act, 1912 [6] and all of the Canadian incorporating jurisdictions except Quebec and Nova Scotia subsequently copied the distinction. It was not introduced in the United States. There state governments introduced securities legislation for the protection of the public investor as early as 1911 (Kansas) and the federal government followed this initiative in response to the market crash in 1929 with the Securities Act, 1933 [7] and the Securities Exchange Act, 1934. [8] Over the years in Canada and the United Kingdom the main thrust of the distinction was directed to whether a company would have to disclose its affairs, particularly financial, to the public. The private company, being the business vehicle of the small family or closely associated group, was not required to make this disclosure. In 1962 the United Kingdom Committee on Company Law [9] concluded that *all* limited liability companies should be compelled to file annual accounts open to the public with the Registrar of

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[2] The Corporations Act § 1(*g*).

[3] *Id.* § 1(*f*).

[4] 7 Edw. 7, c. 50, § 37, subsequently incorporated into the Companies (Consolidation) Act, 1908, 8 Edw. 7, c. 69.

[5] 63 & 64 Vict., c. 48, § 4.

[6] Ont. Stat. 1912 c. 31.

[7] Ch. 38, § 1, tit. III, 48 Stat. 74 (1933).

[8] Ch. 404, § 1, 48 Stat. 881 (1934).

[9] REPORT OF THE COMPANY LAW COMMITTEE (ENGLAND) para. 56 (1962).

Companies. It therefore proposed the abolition of the public versus private company distinction.

The 1967 Report of the Select Committee on Company Law of the Ontario Legislature (*Lawrence Report*) [10] provided the reform basis for the B.C.A. It recommended the abolition of the public versus private company distinction on two grounds. First it noted that the Ontario Corporations Act, unlike the U.K. Companies Act, had never required companies incorporated under it, whether public or private, to file annual financial statements with a government agency. Rather it was the Ontario Securities Act which carried this disclosure burden and obliged public companies to place annual and semi-annual reports on public file with the Ontario Securities Commission. [11] Consequently the Lawrence Committee concluded that since Ontario Corporations legislation had not adopted the disclosure reason for the distinction and it was about to disappear in the U.K., whether it should continue in Ontario must be considered apart from the issue of companies being required to place on public file detailed financial statements.

The second ground for the Lawrence Committee's recommendation turned on the prohibition against private companies offering their shares and other securities to the public. It noted that the substantial impact of this prohibition and its enforcement fall within Ontario securities legislation rather than the corporations statute. A provision in the corporation's charter prohibiting the offering of shares to the public was not "an efficacious method of regulating against improper distribution of corporate securities." [12] Furthermore the securities legislation had recently been modernized. Accordingly the distinction should disappear from corporations legislation.

The result, it is submitted, is not entirely satisfactory. Previously, with the distinction between public versus private company defined clearly in the Corporations Act there was no difficulty in ascertaining into which category a company fell for purposes of the requirements of the Corporations Act. In short, the distinction and the consequences which flowed from it were self-contained in the Corporations Act. The definition which replaces the public versus private company distinction takes its determining criteria from requirements of the Securities Act, 1966, [13] in spite of the fact that the two grounds for abolishing the distinction purported to divorce the Corporations Act categorization from the functioning of securities legislation. In addition it is not clear whether the specified criteria for the distinguishing test in the B.C.A. are exhaustive. Even if they are the issue of whether or when the Securities Act, applies is not free from doubt in all cases. In sum, to determine what requirements of the B.C.A. apply to one or other category of

[10] INTERIM REPORT OF THE SELECT COMMITTEE ON COMPANY LAW (Ont. 1967) [hereinafter cited as the LAWRENCE REPORT].

[11] As of October, 1968 under the Commission's and Toronto Stock Exchange's Timely Disclosure Policy they were also required to make immediate disclosure of and place on public file reports of all material events which would be expected to have an impact on trading in their securities.

[12] LAWRENCE REPORT 16.

[13] The Securities Act, Ont. Stat. 1966 c. 142 [hereinafter cited as the Securities Act].

company, regard must be had to a different statute, the Securities Act, and to determine whether that act applies can be a very complex question.

Considered less critically, the new definition in the B.C.A. signifies the important link between corporations and securities legislation in Ontario by causing the distinguishing factor in the definition of public versus non-public offering companies to turn on the regulatory mechanism of the Securities Act. [14] The interrelationship between corporations and securities legislation in Ontario had already achieved substantial importance with the amendments to both sets of legislation in 1966 following the Kimber Report recommendations of the previous year. [15] It is particularly pronounced in the changes affecting public offering companies in the new B.C.A.

In comparing the Securities Act with the B.C.A., however, it is necessary to analyze carefully the application of each set of provisions to types of corporations (Ontario incorporated, non-Ontario incorporated, public offering, non-public offering). It is impossible simply to distinguish the two acts by suggesting the new B.C.A. governs the relationship between an Ontario incorporated business corporation and its securities holders and the Securities Act, provides protection to the public in Ontario investing in securities of corporations whether incorporated in Ontario or not. In some instances the B.C.A. stipulates requirements applying to non-Ontario incorporated companies. [16] In some parts, the Securities Act applies its requirements equally to Ontario incorporated and non-Ontario incorporated companies [17] and in other parts applies its requirements only to non-Ontario incorporated companies. [18] This mixture symbolizes as well as anything that the precise jurisdictional spheres of corporations and securities legislation in Canada are still evolving and have not been finally determined.

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[14] *Id.*

[15] REPORT OF THE ATTORNEY GENERAL'S COMMITTEE ON SECURITIES LEGISLATION IN ONTARIO (Ont. 1965) [hereinafter cited as the KIMBER REPORT].

[16] See for example the mandatory trust indenture provisions of the B.C.A. § 57-62, discussed *infra*. The basis for the application of the B.C.A. to companies incorporated outside Ontario (and a source of some confusion) begins in § 1(9), the provision distinguishing public and non-public offering companies. The opening phrase of that subsection reads "a body corporate shall be deemed...." It does not read a corporation shall be deemed. Section 1(1)5 defines "body corporate" to mean "*any* body corporate with or without share capital and *whether or not* it is a corporation to which this Act applies" (emphasis added). "Corporation" as used in that item and distinguished from "body corporate" is itself defined in item 9 of the same subsection to mean "a body corporate with share capital to which this Act applies." Finally § 2(1) states the "corporations" to which the B.C.A. applies are corporations incorporated under the general corporations act or a special incorporating act of the Ontario Legislature. Note in the concluding words of § 1(9) the exempting provision is only available to a "corporation" and not to "a body corporate." Does this mean for example that a federally incorporated public company now having less than fifteen shareholders could not apply for exemption from the mandatory trust indenture provisions?

[17] *E.g.*, the basic registration for trading requirement (§ 6) or qualification of a prospectus provision (§ 35).

[18] *E.g.*, the proxies and proxy solicitation (§ 100), insider trading (§ 108) and financial disclosure (§ 118) provisions.

II. Requirements in the B.C.A. Which Apply to Public Offering Companies only or Which Apply to Non-Public Offering Companies Differently

There are important consequences which flow from the fact of a corporation being a public offering company rather than a non-public offering company. These can be seen by considering what requirements of the B.C.A. apply to public offering companies only or apply to non-public offering companies differently.

A. *Redemption of Special Shares*

The B.C.A. continues the provisions in the former act (sections 27 (7) and (8)) permitting a corporation to redeem all or part of its preference shares. A minor difference is that the B.C.A. substitutes the broader description "special shares" for "preference shares" in the former act. Section 34(3) repeats the provision of the former act applicable to private companies in permitting a non-public offering company to redeem all or any of the redeemable special shares within one year of their holder leaving the company's employ or dying.

B. *Purchase of Special Shares for Cancellation and Purchase of Common Shares from Surplus*

Section 35(1) provides that where special shares are made purchaseable for cancellation by the articles (the name for the constituting documents replacing the letters patent of the former act) the purchase may only be effected pursuant to tenders where the corporation has sent a request for tenders to all shareholders. The corporation must accept only the lowest tenders. An exception exists where all the holders of a class consent to the purchase or "where the purchase is made on the open market." Although "open market" is not defined it seems that this exception would only apply to public offering companies. "Open market" would appear to be premised on a public holding of these securities and an anonymous "auction" rather than a face to face negotiated purchase.

A similar exception seems to exist in the purchase of common shares out of surplus. The B.C.A. is significantly different than the former act in this respect. It reverses the old rule in *Trevor v. Whitworth* [19] and now permits a corporation to purchase any of its common shares out of surplus. [20] Section 39, which gives a corporation this power if authorized in the articles, requires that such purchase be made (a) by invitation addressed to all shareholders for tenders and *pro rata* from the shares so tendered, (b) from *bona fide* full-time employees and former employees of the corporation, or (c) by purchase on the open market where the corporation is a public offering

[19] 12 App. Cas. 409, 57 L.T.R. (n.s.) 457 (1887)

[20] Note that what kind of "surplus" is not specified. However, § 174 of the B.C.A. distinguishes between contributed surplus and earned surplus and indicates how each should be shown in the financial statement of surplus. Consequently when common shares are purchased out of surplus problems may arise as to which type of surplus should be used first and how the purchase should be accounted for.

company. This last method again is limited to public offering companies but this time the act explicitly so states.

C. *Application of Insider Reporting and Liability Provisions to a Corporation Purchasing its own Common Shares*

Section 41 of the B.C.A. provides that a corporation purchasing common shares out of surplus or reselling them, as now permitted under section 40(1)(*b*)(ii), is deemed to be an insider with respect to purchase or resale of its own shares. [21] Therefore it is subjected both to the insider trading reporting and liability requirements of the act as set out in sections 148-152.

This deeming provision is somewhat unusual because it has the effect of making the corporation an insider of itself. Also in applying to non-public offering companies as well as public offering companies it is broader than the conventional insider definition in the B.C.A. which comprehends directors, senior officers and ten percent shareholders of public offering companies only. [22]

It is interesting that the Legislature has attached insider reporting and liability obligations where a corporation purchases (or resells) its own common shares but not where it does the same with its special (preference) shares. The answer may simply be that authority to purchase common shares is novel with the B.C.A. and authority to purchase preference shares had been present long before the introduction of insider legislation. It sets the stage for the ironic situation where a corporation uses inside information for purchases from its common shareholders and is liable to them yet uses the same inside information for purchases from its preference shareholders and is not liable to them. However, before simply amending the provision to extend it to a corporation's purchase of its own preferred shares, some thought should be given to the reasonableness of requiring an insider trading report from a non-public offering corporation each time it redeems preferred shares.

One might anticipate some interesting problems arising from the allegation that a corporation has used specific confidential information in purchasing or reselling its own common shares. A corporation will always have information in its possession that is not generally known. The plaintiff share-

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[21] An interesting problem arises under the Securities Act, when the corporation resells these "treasury" shares. Would such resales be "trades that are made for the purpose of distributing to the public securities issued by a company and not previously distributed" within the meaning of § 1(1)16i? If so, a prospectus should be qualified or an exemption found. The root question is whether such securities have been "previously distributed." If that phrase is interpreted as "having already gone through primary distribution to the public" (and it is submitted it should not be so interpreted) then the question turns on whether the company purchased the securities through a public or non-public source prior to the resale. *Quaere* whether a corporation could ever hold a sufficient number of its securities to materially affect its control and be required to qualify a prospectus or find an exemption under § 1(1)16ii? It would seem that the corporation owns these treasury shares (but not, it is submitted, its authorized but unissued shares) so that isolated trades would be exempt from the § 6 licensing or registration requirement under § 19(1)2.

[22] B.C.A. § 1(1)15.

holder will, of course, have the burden of showing that the corporation made use of that specific confidential information in effecting the transaction and that, if known, the information might reasonably be expected to affect materially the value of the shares. Recent English case law [23] suggests that it is a breach by directors of their fiduciary duty to act *bona fide*, in the best interests of the company and for a proper purpose when they issue shares (into friendly hands) to thwart an impending take-over bid but the breach can be ratified and the issue approved by a majority of shareholders in general meeting. What is the impact of the directors' fiduciary duty [24] or the corporation's insider liability when the corporation buys up its common shares to thwart a take-over bid and the bid has not yet been announced?

D. *Restrictions on Transfer of Shares*

The former act required that a private company restrict the transfer of shares as a condition of qualifying as a private company. [25] Section 47 of the B.C.A. prohibits a corporation from having such restrictions unless authorized by the articles. It then prohibits a corporation with such restrictions from offering its shares to the public. Two exceptions are made to this prohibition. The first is where the restriction is necessary under any act of Canada or Ontario as a condition to the obtaining, holding or renewal of authority to engage in any activity necessary to the undertaking. The second exception anticipates mandatory Canadian ownership legislation—where the restriction is necessary for the purpose of achieving or preserving the status of a Canadian corporation under any act of Canada or Ontario.

Section 47(3) continues the provision of the former act permitting the corporation to have a lien on shares registered in the name of a shareholder indebted to the corporation, except where the shares are listed on a stock exchange recognized by the Commission. [26] Section 51(5) requires that the share certificate have the restriction noted conspicuously on the share certificate where there are provisions in the articles of the corporation restricting transfer of the shares. In the case of a lengthy complicated restriction this raises the problem of whether the complete details of the restriction must be fully set out on the share certificate or whether the fact that there is a restriction with a reference to where the full text can be found set out on the certificate is a sufficiently conspicuous notation. The literal text of section 51(5) might suggest the former. The impracticability of this literal interpretation for a lengthy restriction and the provision in section 70(1) that a purchaser is deemed to have notice of the terms of a security including "those made part of the security by reference to another . . . document" suggest the latter.

[23] Hogg v. Cramphorn Ltd., [1967] 1 Ch. 254, [1966] 3 All E.R. 420 (1963) and Bamford v. Bamford, [1969] All E.R. 969 (C.A.).

[24] See in this connection the U.S. case of Bennett v. Propp, 187 A. 2d 405 (Del. 1962) where a corporation's president was held liable to account to it for damages "for the tort of using corporate funds to maintain control."

[25] Corporations Act, ONT. REV. STAT. c. 71, § 1(*f*) (1960).

[26] The Commission is defined in the B.C.A. § 1(1)8 as the Ontario Securities Commission [hereinafter cited as O.S.C.]. The only stock exchange recognized by the O.S.C. under the Securities Act, § 139(1) is the Toronto Stock Exchange.

E. *Mandatory Trust Indenture Provisions*

The B.C.A. (sections 57-62) requires that a trust indenture [27] under which a body corporate issues or guarantees debt obligations be circumscribed by a number of mandatory provisions. These establish a standard of statutory care, diligence and skill for the trustee measured against "the reasonably prudent trustee" in comparable circumstances, oblige the trustee to examine certain evidence furnished to him, require the trustee to give notice to holders of securities issued under the debenture of all events of default, prohibit broad exculpatory clauses relieving the trustee from liability and eliminate potential conflict of interest situations involving the trustee such as acting in addition as a receiver and manager or liquidator of the assets or undertaking of the issuer or guarantor of the debt obligations. The provisions are modelled on the U.S. Trust Indenture Act of 1939 administered by the Securities and Exchange Commission. Two of three objectives of that act when introduced in the United States were to provide full and fair disclosure on the original issue of debt obligations and throughout their lifetime and to provide machinery for continuing disclosure to security holders and under which they might get together to protect their own interests. The Lawrence Committee observed that these first two objectives were satisfactorily met in the revised Ontario securities legislation. However they concluded that the third, that security holders have the services of a disinterested trustee conforming to high standards of conduct as itemized above, should be prescribed in the B.C.A.

Section 62 indicates that these mandatory provisions apply both prospectively and retrospectively, that is to any future trust indenture and any past one under which debt obligations are outstanding or may in future be issued. Furthermore the language of section 57(2) suggests an interesting geographical distinction. These mandatory provisions apply: (a) to Ontario incorporated companies offering their debt obligations to the public anywhere and, (b) to non-Ontario incorporated companies offering their debt obligations under a trust indenture to the public in Ontario. In (a) the jurisdictional nexus of Ontario incorporation is used to provide protection for security holders resident outside Ontario. This is particularly seen where the trustee to whom the mandatory provisions apply is defined [28] to mean any person named as trustee, whether or not the person is a trust company authorized to carry on business in Ontario In (b) the jurisdictional nexus of protection of security holders resident in Ontario is used to apply the mandatory provisions to debt obligations of non-Ontario incorporated companies. The B.C.A. also uses the geographical test of offering debt obligations under a trust indenture in Ontario to require the corporation to have a trustee resident or authorized to do business in Ontario. [29] In the event of

[27] Defined in § 57(1)(*a*) to mean "any deed, indenture or document howsoever designated, including any supplement or amendment thereto, by the terms of which a body corporate issues or guarantees debt obligations and in which a trustee is named as trustee for the holders of the debt obligations issued or guaranteed thereunder."

[28] B.C.A. § 57(1)(*b*).

[29] *Id.* § 57(3). This subsection reads: "Every body corporate whose debt obligations are offered to the public in Ontario or issued under a trust indenture in Ontario shall have a trustee resident or authorized to do business in Ontario." It would seem

interjurisdictional or constitutional conflict in the future there may be some argument that (a) is more appropriately governed by the securities legislation in the jurisdiction where the security holders are resident and (b) is more appropriately governed by the securities legislation of Ontario, or alternatively, to use the normal jurisdictional logic of the B.C.A., by the corporations legislation of the incorporating jurisdiction.

F. *Restriction on Transfer Appearing on the Share Certificate*

Sections 63-97 of the B.C.A. replace most of the former act's provisions relating to share transfers and share certificates with a "negotiable instruments law for securities" modelled on Article 8 of the United States Uniform Commercial Code. [30] Section 72(1) stipulates that unless a restriction on transfer imposed by the issuer (which must ordinarily be a non-public offering corporation) is noted conspicuously on the security itself it is ineffective except against a person who has actual knowledge of it. The same section contains a saving provision for private companies under the former act. That saving provision provides that where a corporation was incorporated as a private company under predecessor acts the words "private company" appearing conspicuously on the face of its securities issued prior to section 72 coming into force shall be deemed to be notice of the restriction on the transfer of the securities.

One of the "futuristic" innovations in the B.C.A. which suggests an exception to the negotiable instruments law for securities will apply only to securities of public offering companies and perhaps only to some of these initially, such as shares listed on the Toronto Stock Exchange. Section 91 anticipates the creation of a central clearing corporation to act as custodian of frequently traded share certificates. At present various institutions in the investment community have begun plans to introduce such a custodian corporation in 1972. It would immobilize share certificates in bearer form, or endorsed in blank, or registered in the name of the clearing corporation. It would thus reduce the paper work in transfers by eliminating the need for

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that there is a drafting flaw in this subsection. As it is, with the broad definition of debt obligation in § 1(1)11 to include note or other similar obligation whether secured or unsecured, a corporation raising money in the short term money market or giving a promissory note to its banker in Ontario would require a resident trustee. It is submitted that the draftsmen intended the resident trustee to be required of every corporation whose debt obligations are offered to the public in Ontario *and* issued under a trust indenture.

[30] The intent of the B.C.A. is to apply this "negotiable instruments law" only to securities of Ontario incorporated companies. § 67 stipulates:

> (1) The validity of a security and the rights and duties with respect to registration of transfer of an issuer that is a corporation or body corporate incorporated under the laws of Ontario are governed by this Act and the laws of Ontario.
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> (2) The validity of a security and the rights and duties with respect to registration of transfer of an issuer that is a body corporate other than a corporation or a body corporate under the laws of Ontario, are governed by the law, including the conflict of law rules, of the jurisdiction in which the body corporate was incorporated.

old share certificates to be cancelled and new ones issued by the transfer agent and the documentation relating thereto. Section 91 accordingly stipulates that in the case of such publicly traded securities eligible for inclusion in the clearing corporation a transfer or pledge can be effected by appropriate entry in the clearing corporation's computer.

G. *Rights of Dissenting Shareholders*

The new act significantly expands the rights of dissenting minority shareholders of both public offering and non-public offering companies. Section 100 of the B.C.A. continues the right of a shareholder in a non-public offering corporation, formerly available to shareholders of private companies, to require the corporation to purchase his shares if a meeting of shareholders or of any appropriate class of shareholders confirms a directors' resolution: (a) authorizing some disposition of the corporation's undertaking, or (b) authorizing the deletion of the restriction on transfer of shares, or (c) approving an agreement for the amalgamation of the corporation. The dissenting shareholder exercising this privilege must have voted against the confirmation of the resolution, must give notice in writing to the corporation within ten days following the meeting and if there is failure to agree on the price of such shares the price and terms will be determined by the court on the application of the dissenting shareholder.

The B.C.A. in section 102 continues the provision of the former act, which permitted holders of equity shares carrying at least five per cent of the voting rights to require the directors to give notice to shareholders of a resolution to be moved at the next shareholders' meeting or to circulate a statement of not more than 1,000 words with respect to any proposed resolution or business to be dealt with at the next meeting. In the former act the directors were not bound to give notice of any such resolution or to circulate any such statement unless they were so requested ten days before the meeting in the case of a requisition requiring notice of a resolution and seven days before the meeting in the case of a requisition requiring a statement to be circulated. Under the new act the time limits of ten days and seven days respectively are repeated for non-public offering corporations. However for public offering corporations the minimum time periods are increased to twenty-one days for the notice of a resolution and fourteen days for the statement.

H. *Shareholders' Meetings and Solicitation of Proxies*

Section 106(1) stipulates that in the absence of other provisions in the articles or by-laws notice of the time and place of meetings must be sent to shareholders of public offering companies twenty-one days or more before the meeting and to shareholders of non-public offering companies ten days or more before. In either case it must not be sent more than fifty days before. Section 106(2) provides that these time limits are the minimum and maximum for specific notice provisions in the articles or by-laws.

The B.C.A. (sections 115-121) continues the proxy solicitation reforms for increased shareholder democracy first introduced as amendments to the

former act [31] and the Securities Act in 1966. These required that a standard form of proxy be sent to voting shareholders prior to shareholders' meetings accompanied by an information circular with details of each item on the proxy. The Securities Act will continue to apply these requirements to non-Ontario incorporated companies issuing equity shares [32] for which a prospectus has been qualified with the O.S.C. since May, 1967 and to non-Ontario incorporated companies whose shares are listed and posted for trading on the Toronto Stock Exchange. Section 119(1) of the B.C.A. applies these requirements to all Ontario incorporated public offering companies. In the former act the private company, and public companies with less than fifteen shareholders, were automatically exempt. Section 119(2) continues the former provision permitting any interested person to apply to the O.S.C. for an order exempting that person or company from all or part of the requirements where the O.S.C. is satisfied there is adequate justification for doing so. The exempting order may be made on such terms and conditions as seem just and expedient. The B.C.A. continues the former automatic exemption from the requirement that an information circular accompany the proxy where the solicitation is not made on behalf of management and the total number of shareholders whose proxies are solicited is not more than fifteen.

The particulars of the proxy solicitation rules are these. Management sending to shareholders the notice of shareholders' meetings and all persons other than management soliciting shareholders prior to a shareholders' meeting must send a prescribed form of proxy. It must indicate whether or not the proxy is solicited by or on behalf of the management of the company and contain a blank for dating the proxy. It must provide item by item opportunity on the proxy for the shareholder to specify that the shares are to be voted in favour of or against each item identified as a matter intended to be acted upon, other than the election of directors and the appointment of auditors. The proxy must be accompanied by an information circular. This must contain information pertaining to future revocability of the proxy, the persons or companies making the solicitation, the interest of various persons in matters to be acted upon, the voting shares and principal holders thereof, the election of directors, the remuneration of management and others, the interest of management and others in material transactions, the appointment of auditors, management contracts, and sufficient detail on any other matters to be acted upon at the meeting to permit shareholders to form a reasoned judgment concerning such matters.

I. *Number of Directors*

The B.C.A. effects a substantial change from the former act in permitting companies with only one shareholder to be incorporated. This initiative is also followed in the B.C.A. in the case of directors [33] for non-

[31] Ont. Stat. 1966 c. 28.

[32] Section 1(1)7 of the Securities Act and § 1(1)13 of the B.C.A. define equity share to mean any share carrying voting rights under all circumstances and any share carrying voting rights by reason of the occurrence of any contingency that has occurred and is continuing.

[33] At § 122.

public offering corporations where it is simply required that the board consist of at least one director. In the case of public offering companies the board must consist of not fewer than three directors of whom at least two must be outsiders, that is, not officers or employees of the corporation or of any affiliate of the corporation. The Lawrence Committee justified its recommendation that three natural persons were no longer the necessary minimum number of incorporators or shareholders on very pragmatic grounds. It observed that the one man company often existed in fact: two of the necessary three persons holding legal title to one share with beneficial ownership in the third person who beneficially owned all the shares in the company. The Committee concluded since the limited corporation was a separate legal entity distinct from its incorporators and shareholders, it should not matter in law whether the company had one beneficial owner or many or whether the one owner was a natural person or a corporation. The Committee followed this logic in recommending that the minimum number of three directors could be reduced to one in the non-public offering corporations. However, in the case of public offering corporations, the Committee concluded that the public shareholders required the protection of more than one director on the board and recommended a minimum of three. The Legislature in enacting the proposal also added the proviso that at least two of them should be outsiders, presumably to extend this protection and build in a perspective from outside the corporation. An interesting question is whether or not the new statutory standard of care, diligence and skill measured by that of a reasonably prudent person in comparable circumstances [34] is different for outside directors contrasted with directors who are also officers and employees of the corporation. [35] An analogous question is how the standard differs for directors of public offering companies as contrasted with non-public offering companies.

J. *Insider Trading Reporting and Liability*

The new act (sections 148-152) continues the 1966 amending provisions to the former act imposing insider trading reporting and liability. These provisions require: (a) directors, (b) senior officers, and (c) persons beneficially owning directly or indirectly or controlling equity shares carrying more than ten per cent of the voting rights attached to all equity shares of a public offering company to report their initial holdings of securities of the company, and any subsequent change within ten days after the end of the month in which such change took place. These reports are filed with the O.S.C., are open to the public and are summarized in the O.S.C. monthly bulletin.

Section 150 imposes liability on every insider of a company or associate [36] or affiliate [37] of such insider who in connection with a transaction

[34] B.C.A. § 144.

[35] For a significant recent United States case applying a due diligence test on a securities issue to outside and inside directors see Escott v. BarChris Construction Corp., 283 F. Supp. 643 (S.D.N.Y. 1968) and the BarChris Symposium, BUS. LAWYER, January, 1969, at 523.

[36] Defined in § 1(1)3.

[37] Defined in § 1(1), (4), (5).

related to the securities of the company makes use of any specific confidential information for his own advantage that if generally known might reasonably be expected to affect materially the value of the securities. The transaction giving rise to reporting and to liability may involve either a debt security or a share. The reporting requirement is absolute—applying in every transaction. Liability only impinges in the case of impropriety—abuse of confidential information. The liability is two-fold: to compensate any person for any direct loss suffered and also to be accountable to the company for any direct benefit or advantage received by the insider, associate or affiliate. It is still a moot question whether the two-fold liability gives rise to double recovery from the insider. The use in section 150 of the conjunctive phrase "and is also" joining the twin liabilities would suggest the possibility of double damages in spite of the Kimber Report's specific recommendation to the contrary. [38]

These insider provisions apply in the B.C.A. only with respect to public offering companies incorporated in Ontario and not to non-public offering companies incorporated in Ontario (with the exception of a corporation being deemed an insider of itself referred to above). In the former act they applied only to public companies with fifteen or more shareholders. [39] The Securities Act provisions apply to non-Ontario incorporated companies who have issued equity shares for which a prospectus has been qualified since May, 1967 or whose shares are listed and posted for trading on the Toronto Stock Exchange. [40]

Recently the O.S.C. has published a policy statement reversing its former policy and now requiring insiders to file "nil reports." [41] Accordingly a person on becoming an insider who does not beneficially own any shares (such as a senior officer) will still have to file an insider report stating that fact. Special note should also be made of the "deemed ownership" provisions in section 1(6) of the B.C.A. which extend the insider chain through parent-subsidiary corporation, controlled corporation, and affiliated corporation relationships and where again the corporation one or more removed in the chain (as opposed to the corporation whose securities are being traded) need not be Ontario incorporated.

K. *Furnishing of List of Shareholders*

The former act [42] provided that any person upon payment of a reasonable charge and filing an affidavit could require a corporation or transfer agent to furnish an alphabetical list of shareholders of a public company with the number of shares owned by each person and the address of each person. The same provision is found in the B.C.A. [43] and it applies only to public

[38] KIMBER REPORT para. 2.30: "In view of the novelty in Ontario law of the legal principles underlying the recommended causes of action, the Committee recommends that the legislation be drafted so as to avoid double liability on insiders in respect of particular transactions involving improper insider trading."

[39] ONT. REV. STAT. c. 71, § 71(1)(*e*) (1960).

[40] At § 108(1)(*b*).

[41] O.S.C. Bulletin, August 1970, at 114.

[42] ONT. REV. STAT. c. 71, § 319(1) (1960).

[43] At § 164(1).

offering corporations. This provision will facilitate take-over bids for public offering companies and circulation of all shareholders by a dissident shareholder group.

L. *Auditors and Financial Statements*

Sections 167 through 171 of the B.C.A. carry forward and extend somewhat the audited financial statement requirements which were significantly expanded in the 1966 amendments to Ontario corporations and securities legislation. These provisions do not apply in the B.C.A. where in a financial year all the shareholders of a corporation consent in writing and the corporation satisfies the following three conditions: (a) it is not offering its securities to the public, (b) it has five or fewer shareholders, and (c) it has assets not exceeding 500,000 dollars and sales and gross operating revenues not exceeding 1,000,000 dollars, as shown on the financial statement of the corporation for the preceding year. This exemption [44] only applies in respect of the year in which the shareholders' consent is given. Public offering companies therefore, and those non-public offering corporations that do not satisfy all three conditions set out above and do not have the requisite consent in writing of all shareholders, must comply with sections 168 through 171. This exemption from the requirement that an outside auditor be appointed represents an important change from the first introduction of the new Business Corporations Bill in May, 1968. Then, following the pattern in most Canadian incorporating jurisdictions, the appointment of an auditor was made mandatory for all companies. The Special Committee on Corporation Law of the Institute of Chartered Accountants of Ontario recommended that a waiver be permitted for small closely held corporations where, because of small numbers and close association with the operations of the business, it was an unnecessary extra expense. A major competing argument was that the protection of creditors and a minimum accounting standard applicable to all limited liability companies required the mandatory audit. The balancing judgment that was made by the drafting committee is reflected in the present exemption introduced as an amendment to the first bill and which, it is expected, will permit numerous small closely held companies in Ontario to avoid retaining an auditor.

Assuming the exemption is not available, section 168 requires that the shareholders at each annual meeting appoint an auditor. They may by majority vote at a general meeting remove an auditor before his term expires and may by majority appoint another in his stead but before removing him the corporation must give notice to the auditor. He then has the right to make representations in writing concerning his proposed removal and these representations must be sent to all shareholders. The provisions of section 170 are intended to assure the independence of the auditor by prohibiting securities holdings in the corporation or employment, partnership, or kinship relationships with any director of the corporation and forbidding an auditor from being appointed receiver or liquidator of the corporation. The auditor's report to shareholders on the financial statement laid before the corporation at the annual meeting must contain the standard statement whether "in his

[44] At § 167(1).

opinion the financial statement . . . presents fairly the financial position of the corporation and the results of its operations for the period under review in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding period, if any." [45] Two new provisions [46] permit a shareholder whether or not entitled to vote to require the auditor's attendance at shareholders' meetings on notice of five days or more and require the auditor if present at a shareholders' meeting to answer inquiries concerning the basis upon which he formed the opinion stated in the report he has made.

M. *Regular Financial Statements*

A distinction is made between public offering and non-public offering corporations regarding the information to be laid before the annual meeting of shareholders by the directors. For non-public offering companies section 172(1) stipulates that the directors must put before the annual meeting of shareholders a financial statement for the period commencing immediately after the end of the last completed financial year and ending not more than six months before the annual meeting, or if the corporation is newly incorporated for the period commencing on incorporation and ending not more than six months before the annual meeting. It is to be made up of: (a) a statement of profit and loss for the period, (b) a statement of surplus for the period, and (c) a balance sheet as at the end of the period.

For public offering companies the directors must lay before each annual meeting a financial statement for a newly incorporated company for the period commencing on incorporation and ending not more than six months prior to the meeting and for other public offering companies a *comparative* financial statement relating separately to the period representing the last completed financial year ending not more than six months before the meeting *and* to the period representing the financial year immediately preceding the last completed financial year. The public offering corporation's financial statement must be made up of: (a) a statement of profit and loss for each period, (b) a statement of surplus for each period, (c) a statement of source and application of funds for each period, [47] and (d) a balance sheet as at the end of each period.

In the case of both public offering companies and non-public offering companies the report of the auditor to the shareholders and any further information respecting the financial position of the corporation as the articles or by-laws of the corporation require must be laid before the shareholders at the annual meeting of shareholders. The statement of profit and loss must, additionally in the case of a public offering company set out sales or gross operating revenue. Such a corporation may apply to the O.S.C. for permission to omit disclosure of sales or gross operating revenue. The Commission may grant such permission on such terms and conditions as it may wish to

[45] *Id.* § 171(2).

[46] *Id.* § 171(13), (14).

[47] In the case of a mutual fund company or investment company this must be a statement of changes of net assets for each period.

impose when it is satisfied that in the circumstances the disclosure of such information would be unduly detrimental to the interests of the corporation. [48]

The balance sheet for both public offering and non-public offering companies must disclose the number of common shares purchased and the number of common shares resold since the date of each such purchase and resale and the price at which each such purchase or resale was made. [49] In the case of public offering companies, the financial statement or note thereto must disclose "the amount of any obligation for pension benefits arising from service before the date of the balance sheet, whether or not such obligation has been provided for in the accounts of the corporation, the manner in which the corporation proposes to satisfy such obligation and the basis on which it has charged or proposes to charge the related costs against operations. [50] Section 179 permits a "holding corporation" to consolidate in its financial statement the financial statements relating to the assets and liabilities and income and expense of any one or more subsidiaries. But whether or not the assets and liabilities and income and expense of any one or more of the subsidiaries of the holding corporation are included in the financial statement of the holding corporation, true copies of the latest financial statement of each subsidiary are to be kept open for examination by shareholders of the holding corporation at the head office. The directors may by resolution refuse the right of such examination if they deem it unduly detrimental to the interest of the corporation or the subsidiaries. In the case of public offering corporations such resolution of refusal may be referred by the shareholder to the O.S.C. to be set aside or in the case of non-public offering corporations to the court to be set aside.

N. *Audit Committee*

Section 182 contains a new provision requiring that directors of public offering companies elect annually from among their number an audit committee of no less than three directors of whom the majority shall not be officers or employees of the corporation or its affiliates. They hold office until the next annual shareholders' meeting. The financial statements of the corporation are to be submitted to the audit committee for review and thereafter to the board of directors. The auditor has the right to appear before and be heard at any meeting of the audit committee. He is required to appear before the audit committee when so requested by the committee. The auditor may request the audit committee to meet to consider any matters the

[48] The power to grant this exemption was initially vested in the court for Ontario incorporated companies and in the O.S.C. for companies incorporated outside Ontario. Subsequently the power to exempt was vested in the O.S.C. for both types of companies. To see the greater stringency with which the O.S.C. exercises the power and the criteria for its use compare *Greb Industries Ltd.*, O.S.C. Bulletin, July, 1970, at 109 where the O.S.C. denied the exemption, with *Re* Maher Shoes Ltd., [1967] 2 Ont. 684 at 688, 65 D.L.R.2d 105, at 109 (High Ct.) where the court describes the granting of the exemption three years earlier to the same company. In October 1970 (not yet reported) the O.S.C. denied the exemption to Maher Shoes Ltd. which company had received it on two earlier occasions before the court.

[49] B.C.A. § 177(1)27.

[50] *Id.* § 178(3)16.

auditor believes should be brought to the attention of the directors or shareholders.

O. *Sending Financial Statements to Shareholders*

Section 184 requires that a public offering company shall send to each shareholder a copy of the company's financial statement and the auditor's report twenty-one days or more before the date of the annual meeting. Any amendment to the statement or report must also be sent. In the case of non-public offering corporations a shareholder is entitled on demand to be furnished with a copy of the financial statement or auditor's report. In addition section 185(1) requires that public offering corporations send to each shareholder a copy of a comparative interim financial statement for the six-month period commencing immediately after the last completed financial year (or date of incorporation in the case of a newly incorporated company) and for the comparable six-month period of one year earlier. It must contain a statement of source and application of funds for each period, sufficient relevant financial information in summary form to present fairly the results of the operations of the corporation for each period including the statement of sales or gross operating revenue, extraordinary items of income or expense, net income before taxes, taxes on income and net profit or loss. The B.C.A. provides that on the application of any interested person the O.S.C. may vary the six-month period on such terms and conditions as seem just and expedient and entitles the corporation to apply to the O.S.C. for permission to omit interim sales or gross operating revenue under the same circumstances as outlined above for the annual statement.

P. *Amendment of Articles*

A corporation may amend its articles of incorporation [51] to provide for restrictions on the transfer of the shares or any class of shares and such amendment shall be authorized by a resolution of the board of directors and confirmed in writing by one hundred per cent of the shareholders or by at least ninety-five per cent of the shareholders having at least ninety-five per cent of the issued capital. In the case of the latter confirmation, the resolution is not effective until twenty-one days notice of the resolution has been given by sending the notice to each shareholder and only if none of the shareholders at the expiration of the twenty-one days has dissented in writing.

III. Bodies Corporate Deemed to be Offering Securities to the Public

How does one determine when a company is or will become a public offering corporation? The definition or deeming provision in section 1(9) of the B.C.A. states two disjunctive triggering conditions either of which is used to determine whether a body corporate is deemed to be offering its securities to the public.

[51] *Id* § 189(1)(*m*).

The use of the phrase "shall be deemed" rather than a straightforward definition such as "a body corporate offers its securities to the public where, but only where" suggests that the two triggering conditions are not exhaustive but merely inclusive. This confusion is bound to create problems in determining whether the requirements outlined in Part II above apply to a particular corporation. [52] Consider the following situations. First assume that a non-public offering corporation makes a successful share exchange takeover bid for a public offering corporation under Part IX of the Securities Act; such a bid is exempted from the prospectus and registration requirements by section 19(1)9 of the Securities Act. Yet the shares of the acquiror company are now widespread in the hands of many persons formerly shareholders of a public offering corporation. Secondly, consider a non-public offering corporation which makes a broad private placement of its securities to a great number of investment institutions and is exempted from the prospectus and registration requirements by sections 19(1)3 and 19(3) of the Securities Act. Thirdly, assume that some years elapse from the time of the private placement described above and, a change of circumstances having occurred and the investment intention of the institutions having expired, the privately placed securities are resold to a greater number of individuals. Finally, consider a corporation which had, in fact, offered its securities to the public in Ontario but had contravened the Securities Act by not qualifying a prospectus. Common sense suggests all four of these corporations should be considered public offering corporations even though they do not satisfy either of the triggering conditions in the definition. A merely inclusive rather than an exhaustive interpretation of these conditions would permit the common sense position to prevail. Some assistance for the merely inclusive interpretation may be gleamed from other language in the B.C.A. Subsections (2), (3), (4) and (5) of the same section one are deeming provisions. The use of the words "if, but only if" in these subsections makes it clear that those deeming provisions are exhaustive. It may therefore be argued by implication that the omission of equivalent words in section 1(9) means that the latter is not exhaustive. Furthermore where the B.C.A. does apply specific requirements to public offering companies (as outlined in Part II above) it does not always use precisely the same language formulation as section 1(9) and makes no cross reference to it. [53]

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[52] In Hickey v. Stalker, 53 Ont. L.R. 414, [1924] 1 D.L.R. 440 (1923), Middleton, J. refers to an earlier decision in interpreting "deemed." *Id.* at 418, [1924] 1 D.L.R. at 444: "The word 'deemed' has acquired no technical or peculiar signification when used in legislation, but, like other words, must be interpreted with reference to the whole Act of which it forms a part." He elaborates on this rule at 419, [1924] 1 D.L.R. at 445:

> I think this modified meaning should be given to the word as found in our statute, for it will not only save the legislation from being unjust but also from being absurd. That it is the duty of the Court, in seeking the true legislative intention of an Act, which undoubtedly is the sole duty of the Court, to regard the possible consequences of alternative constructions of ambiguous expressions, has been determined in many cases.

[53] If the "merely inclusive" interpretation is correct does a corporation which does not satisfy either condition (*a*) or (*b*) of § 1(9) but has made a public offering in the past always remain a public offering corporation?

It may be of some significance that the basic definition turns on a present *offering* of securities without there necessarily being a concluded contract of sale, rather than focusing on the past act of securities having been sold to the public. The words "offer" or "offering" are not defined in the Securities Act. However, the Securities Act prohibits "trading" in a security without registration (obtaining a licence) (section 6) and requires a prospectus (or statement of material facts) for a "trade" in security "where such trade would be in the course of primary distribution to the public" (section 35). It defines "trade" or "trading" in a very expansive manner to include:

> i. any sale or disposition of or other dealing in or any solicitation in respect of a security for valuable consideration, whether the terms of payment be on margin, instalment or otherwise, or any attempt to do one of the foregoing,
>
> . . . .
>
> v. any act, advertisement, conduct or negotiation directly or indirectly in furtherance of any of the foregoing. [54]

Finally in the opening clause of the deeming provision it should be noted that the "offering" is one of "securities" and not simply shares of the body corporate. Security is expansively defined [55] to mean "any share or any class of shares or any debt obligation of a body corporate." "Debt obligation" is defined [56] to mean "a bond, debenture, note or other similar obligation of a body corporate, whether secured or unsecured." Thus a public offering of debt securities by a corporation with only one shareholder will cause it to be a public offering company.

Both of the triggering conditions of section 1(9)—clause (*a*) and clause (*b*)—turn on regulatory provisions of the Securities Act. The second of these conditions, clause (*b*), is the less complex of the two. It deems a body corporate to be offering its securities to the public where "any of the shares . . . are listed and posted for trading on any stock exchange in Ontario recognized by the Commission." Listing and posting of shares for trading on the Toronto Stock Exchange are governed by the Toronto Stock Exchange Act [57] and its by-laws and rules. Very simply the conditions which must be satisfied by a company before its shares may be listed and posted for trading on the Exchange are minimum capital requirements, minimum earnings history, minimum breadth of public share ownership and the execution of the listing agreement by which the company and its officers agree to pay the appropriate fees and abide by the regulations and policies of the Exchange. These minimum listing requirements differ significantly as between industrial companies and mining companies. Similarly the removal from listing of a company's shares on the Exchange is governed by the regulations and policies of the Exchange. Clause (*b*) refers to a present state of fact to determine whether a body corporate is offering its shares to the public, that is, present listing. That question of fact may be determined by simply refer-

[54] Ont. Stat. 1966 c. 142, § 1(1)31.
[55] B.C.A. § 1(1)24
[56] *Id.* § 1(1)11.
[57] Ont Stat. 1968-69 . 132

ring to the presently listed shares of companies on the Exchange which is a specifically ascertainable matter.

Clause (*a*) deems a body corporate to be offering its securities to the public where "in respect to any of the securities... a prospectus or statement of material facts has been filed with and accepted by the Commission under *The Securities Act, 1966*, or any predecessor thereof, so long as any of such securities are outstanding...." Compared to clause (*b*) it is more complex. It refers both to a past and a present state of fact—past, that a prospectus or statement of material facts has at least once in the past been filed and accepted, and present, that any of the securities at one time qualified by that prospectus or statement of material facts are still at present outstanding. Secondly, clause (*a*) turns on the broad term securities [58] which includes debt obligations in addition to shares. Shares are the only tradeable instruments referred to in clause (*b*).

The prospectus must be filed with and accepted by the O.S.C. to avoid the prohibition in the Securities Act. [59] There are various exemptions from this prohibition found in section 58 of the Securities Act. Furthermore, section 59 gives the Commission a discretionary power on the application of an interested person to rule whether a proposed or intended trade would be in the course of primary distribution to the public where doubt exists. Primary distribution to the public is defined in section 1(1) item 16 of the Securities Act. It is a very difficult definition. For present purposes it is sufficient to note that it contains two branches. The first branch declares that the first issuance of a company's securities to the public is primary distribution to the public. The second branch declares that a distribution of already outstanding securities to the public derived from the holdings of any person or group holding a sufficient number of any securities to materially affect control of a company is primary distribution to the public.

One of the section 58 exemptions to the section 35 prohibition recognizes the "statement of material facts" as a valid substitute for the prospectus. Section 58(2)(*b*) permits securities listed and posted for trading on the Toronto Stock Exchange to be distributed to the public through the facilities of the Exchange if a statement of material facts complying with the rules of the Exchange and the Commission is filed and accepted by both bodies. In practice the statement of material facts may be almost as substantial a document as the prospectus itself. By virtue of section 58(3) the two-day absolute right to withdraw from purchase, the ninety-day right to rescind contingent on a misrepresentation and the civil liability of directors,

[58] Note that the definition of securities in the Securities Act, § 1(1)24 is considerably broader than the definition in the B.C.A. § 1(1)24.

[59] Ont. Stat. 1966 c. 142, § 35(1) reads:

> No person or company shall trade in a security either on his own account or on behalf of any other person or company where such trade would be in the course of primary distribution to the public of such security until there have been filed with the Commission both a preliminary prospectus and a prospectus in respect of the offering of such security and receipts therefor obtained from the Registrar.

the chief financial and chief executive officer and promoters for misrepresentation apply to the statement of material facts as well as the prospectus.

It is now necessary to consider the application of the basic definition to various previously and future incorporated companies.

A. *Pre-prospectus Companies*

If the two triggering conditions in the basic definition are exhaustive in categorizing public offering companies then companies whose securities were sold to the public prior to the introduction of prospectus requirements into Ontario securities (1945) or corporations legislation (1907), but whose shares are not listed on the Exchange would not be public offering corporations under the definition. It has been suggested above that the two conditions are not exhaustive for purposes of the definition. If so it would seem these companies would be public offering corporations today so long as their securities are still held by the public.

B. *Companies Whose Securities Have Been Sold to the Public Since the Introduction of Prospectus Requirements*

In the case of companies whose securities have been sold to the public (but whose shares are not presently listed on the Exchange) since the prospectus requirements were introduced first in Ontario corporations legislation and later in Ontario securities legislation, an interpretive problem arises in clause (*a*) of the basic definition. The factor that causes the clause to apply to a corporation is that a prospectus or statement of material facts has been "filed with and accepted by the Commission under *The Securities Act, 1966*, or any predecessor thereof." The immediate predecessor of the Securities Act, 1966 is the Securities Act, 1945. [60] That 1945 act, for the first time in Ontario securities legislation, prohibited a trade "in the course of primary distribution to the public" until a "statement" had been filed with the Commission. [61] It would seem that "statement" might be interpreted as equivalent to "prospectus" or "statement of material facts" so that these companies would be caught by the basic definition. However the predecessor to the Securities Act, 1945 did not require a prospectus to be filed for acceptance by the Commission. Rather the Security Frauds Prevention Act, 1928 [62] defined fraudulent activities and licensed brokers and salesmen but left it to The Companies Information Act, 1928 [63] and *its* predecessors, the Ontario Companies Act (1912) [64] and the Ontario Companies Act (1907) [65] to require a prospectus to be filed with the Provincial Secretary for the public issue of securities. A reasonably strict construction of clause (*a*) suggests that only companies issuing securities to the public after 1945 are caught by clause (*a*). Companies issuing securities to the public before 1945 (and not

[60] Ont. Stat. 1945 c. 22.
[61] *Id.* § 49.
[62] Ont. Stat. 1928 c. 34.
[63] Ont. Stat. 1928 c. 33.
[64] Ont. Stat. 1912 c. 31.
[65] Ont. Stat. 1907 c. 34. For a brief history of securities and companies legislation in Ontario see J. WILLIAMSON, SECURITIES REGULATION IN CANADA 3-46 (1960).

since) would not strictly have filed a "prospectus" or equivalent with the Commission under the predecessor of the Securities Act, 1966. However, an interpretation within the spirit though not the literal terms of the basic definition would suggest that clauses (*a*) and (*b*) are not exhaustive of its impact and that companies issuing securities to the public between 1907 and 1945 and being required to file a prospectus with the Provincial Secretary are still public offering companies provided their securities are still publicly held. Accordingly, if this more liberal and non-exhaustive interpretation of the basic deeming provision were correct there would be three types of public offering corporations: (1) those which have qualified a prospectus or statement of material facts, whose securities are still outstanding, (2) those whose shares are listed on the Exchange, and (3) those which have offered securities to the public not in (1) or (2) above, but whose securities are still publicly held. [66]

C. *Private Companies Making a Public Offering*

Companies previously classified as private making an offering to the public after Jaunary 1, 1971 will be required to amend their articles of incorporation under section 189 of the B.C.A. and file the amendment with the Department of Financial and Commercial Affairs under section 190 and section 191. The securities to be issued to the public will require a prospectus to be qualified with the O.S.C. and accordingly the company will be deemed to be a public offering corporation. Whether or not such a company is making an offering to the public is a question which will be answered on the same criteria discussed immediately below for newly incorporated companies.

D. *Companies Incorporating and Making a Public Offering after January 1, 1971*

Perhaps the most difficult question concerning the basic definition is to determine which of those companies incorporated after January 1, 1971 are public offering companies. Assuming that their shares are not immediately listed and posted for trading on the Toronto Stock Exchange, the first issue is whether a prospectus must be qualified. This question turns on whether the securities are being offered to the public and in turn on who is the public. Take the simple example of five employees leaving their employer and incorporating their own company under the B.C.A. Each of the five contributes cash or other valuable consideration on incorporation and in turn takes back shares of the newly incorporated corporation.

The first general point is that public is such a broad and amorphous concept that it must be interpreted in the context in which it is used—here corporations and securities legislation. Accordingly, meanings attributed to the concept under public hospitals or public schools acts or case law defining offences against public morals or public nuisance are of little help.

[66] This third category raises the interesting interpretive question (and a fourth category) whether the securities must still be publicly held.

There are at least three views of who the public is in Canadian jurisprudence interpreting the concept in securities legislation. The first is that the public is any and every person; this is the exhaustive anyone view. The second view is that the public comprises only those members of the community who need the protection of the Securities Act and in particular the information in the prospectus to make an informed investment decision. This is the United States view deriving from the need for protection test enunciated by the Supreme Court in *S.E.C. v. Ralston Purina* [67] interpreting the concept "public" under the Securities Act, 1933. The third view is that the public is the whole community which suggests that every member in a given viable community unit must be approached before there is a dealing with the public in securities. The third view—the whole community is the public—is largely academic at present although it is mentioned in the cases as a possibility.

For many years in Ontario many practitioners agreed that the proper approach to who is the public was based on view number two provided it was clearly understood that view number two comprehended the singular as well as the plural. To state the proviso another way, there could be an offering to the public even when one person only had been approached if *he* needed the protection of the prospectus. Equally there could be approaches to a number of people which would not be an offering to the public if *they* did not need the protection of the act. Given this approach, the difficult question remained of whether a specific person needed the protection of the act. If he did, then any dealing with him would require that a prospectus be qualified first. This factual determination, however, was one which the practitioner could and did make on his own determination. It would be a very cautious practitioner who would determine that the five incorporators in our example needed the protection of the act— the information contained in a prospectus—before they could take securities of the company they were incorporating when in fact any information that would go into that prospectus would be information that they themselves would produce.

Recently, however, there has been some suggestion that the O.S.C. favours view number one, that is, that a dealing with any single person must be a dealing with the public. This suggestion is partly substantiated by the large numbers of section 59 applications being made to the O.S.C. for a ruling as to whether or not, in the case of doubt, a given trade would be a primary distribution to the public. Many of these rulings are made in favour of the applicant but on facts which according to view number two would clearly not be situations in which the purchasers required the protection of the act. [68]

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[67] 346 U.S. 119, 97 L. Ed. 1494 (1953).

[68] The O.S.C.'s MERGER REPORT indicated that in the period from May 1, 1967 to December 31, 1969 the Weekly Summary published by the O.S.C. disclosed a total of 449 applications made under § 59 and in 399 of these the O.S.C. ruled that the initial trade contemplated would not be in the course of primary distribution to the public. REPORT OF THE COMMITTEE OF THE ONTARIO SECURITIES COMMISSION ON THE PROBLEMS OF DISCLOSURE RAISED FOR INVESTORS BY BUSINESS COMBINATIONS AND PRIVATE PLACEMENTS 181, App. VI (1970) [hereinafter cited as MERGER REPORT].

A second indication of the O.S.C.'s inclination towards the view that anyone is the public is found in the *Merger Report* itself, a report of three of the O.S.C. Commissioners. Chapter three of that report entitled "Who are the Public" states:

> The word "public" must be viewed in the light of the regulatory scheme in which it is found. In the context of a distribution to the public three alternative meanings for "public" have been suggested: first that the distribution must be to *every* member of the community, next to *any* member of the community, and lastly, the distribution may be to all but *certain* members of the community. It may be concluded that our present legislation represents a combination of the second and third alternatives. Section 35, as we noted previously, appears to direct its attention to each and every one of us. The exemptions then go on to provide a specific list of exceptions to the general requirement.
>
> ....
>
> ... We have concluded that the Legislature intended that the protection of the Act should in fact be afforded to virtually everyone excepting those that it specifically exempted from its protective umbrella. [69]

The suggestion that emerges from this report is that "virtually everyone" is the public and *only* those specifically exempted by statute either are not, or do not require the protection of the prospectus. Therefore, if a specific statutory exemption cannot be found or if a section 59 ruling is not obtained, any other dealing with any other person is a dealing with the public requiring a prospectus. To return to our example of five incorporators, if a specific statutory exemption cannot be found or a section 59 ruling is not available then they would be required to qualify a prospectus for a sale of "their" company's securities to themselves.

This example took on new importance as of January 1, 1971 when the B.C.A. came into force. Prior to then the principal exemption from the registration and prospectus provisions of the Securities Act relied on by newly forming private companies was section 19(2)9. This exempts "securities issued by a private company if the securities are not offered for sale to the public." Private company is defined in the Securities Act [70] in the same way as in the former act. But the private company disappears from the B.C.A., being replaced by the public versus non-public offering definition. Therefore, unless a specific statutory exemption for incorporators is introduced into the Securities Act, under view number one any company issuing shares to its incorporators will be offering its securities to the public and require a prospectus. It will also be in breach of section 6 of the Securities Act which prohibits a trade to anyone unless the offeror is licensed or trades through a licensed person. The solution to this dilemma will not appeal to those who insist on consistency between statutes. It turns on the fact that the private company definition still remains as an intrinsic provision of the Securities Act. The incorporators of the non-public offering company will simply include the three traditional restrictions of the private company in the articles of incorporation, be careful to avoid any offering to the public and take

[69] *Id.* para. 3.11 and 3.14. *See also* para. 8.01 which sums the consideration of public thus: "This conclusion is based on the premise that the legislation intends to protect everyone."

[70] Ont. Stat. 1966 c. 142, § 1(1)17.

advantage of the Securities Act section 19(2)9 private company exemption. Of course even before the disappearance of the private company, view number one suggests that the private company section 19(2)9 exemption is not available in any case because that exemption is expressly conditioned on there being no offering to the public and that view indicates that an offering to any one—even an incorporator it seems—is an offering to the public.

Proponents of view number one distinguish view number two as being based on the U.S. Securities Act, 1933 and inappropriate for the Ontario Securities Act, 1966. They suggest the structure of the U.S. act is significantly different than the structure of the Ontario act. The U.S. act states broadly in section 5 that it is unlawful for anyone, by any interstate commerce or use of the mails, to sell or deliver any security unless a registration statement (prospectus) is in effect. Then section 4(1) exempts from this prohibition transactions not involving a public offering. By contrast the Ontario Securities Act prohibits a trade which would be a primary distribution to the public and then sets out a great many categories of specific exemptions compared to the one broad non-public exemption in section 4(1) of the U.S. act. Furthermore, in case these specific exemptions are not sufficiently exhaustive, the Ontario act in section 59 gives a discretion to the Commission where any doubt remains. In particular, one of these specific statutory exemptions in the Ontario act is an exemption for trades by a company to its employees.[71] This was precisely the trade which the U.S. Supreme Court in *Ralston Purina* (the case which spawned the need for protection or "need to know" test) specifically determined to be a trade with the public and required a registration statement (prospectus). The exemptions in the Ontario act are based on the "need to know" test, the difference being that the Legislature has applied this test and established those categories where it deemed the need to know did not exist.

Proponents of view number two reply to this argument this way. If view number one were intended, the Ontario act would never have used the concept "public" at all. In requiring a prospectus section 35 of the Ontario act simply would have banned trading with anyone (as section 6, the licensing requirement of the act, does) without introducing the concept of public. It then would have provided specific exemptions. Proponents of view number two argue further that the categorical distinction between public and non-public is implicit in some of the exemptions from both registration and prospectus in the act itself. For example, they point to section 19(2) which exempts:

> 4. Mortgages or other encumbrances upon real or personal property, other than mortgages or other encumbrances contained in or secured by a bond, debenture or similar obligation or in a trust deed or other instrument to secure bonds or debentures or similar obligations, if such mortgages or other encumbrances *are not offered for sale to the public* except by a person or company registered under *The Real Estate and Business Brokers Act.*
>
> 5. Securities evidencing indebtedness due under any conditional sales contract or other title retention contract providing for the acquisition of

[71] *Id.* § 19(1)10.

> personal property if such securities *are not offered for sale to the public.*
>
> ....
>
> 9. Securities of a private company issued by the private company if the securities *are not offered for sale to the public.* [Emphasis added].

They conclude that if the "public" meant every single person then the proviso which turns on the concept "public" would be meaningless in these exemptions.

Those favouring view number two suggest that the basic premise for a section 59 ruling—the existence of doubt as to whether a proposed trade would be primary distribution to the public—connotes doubt as to who is the public and not simply as to whether one of the statutory exemptions is applicable. They suggest that if view number one prevailed then section 59 would not turn on the question of doubt but would give the Commission a discretion which went beyond resolution of doubt. It would permit the Commission to exempt by administrative ruling a trade with any single person for which a specific statutory exemption had not been created and yet where the "need to know" test did not dictate a prospectus should be qualified. Perhaps the most telling argument of all is that the basic definition in the B.C.A. is premised on there being public and non-public offering companies, the very distinction in the U.S. Securities Act, 1933.

The case law on who is the public in Canadian securities legislation is unfortunately sparse and imprecise. There do not appear to be any cases which clearly enunciate that *S.E.C. v. Ralston Purina Co.* provides equal interpretive authority for the Ontario Securities Act as it did for the U.S. Securities Act of 1933. In that case the U.S. Supreme Court decided that sales by the defendant company of its own securities to its own employees totalling 2,000,000 dollars over four years under a stock investment plan was a distribution to the public because only some of the employees had a position in the company which would render the giving to them of prospectus type information superfluous. Mr. Justice Clark speaking for the Court said:

> The design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions. The natural way to interpret the private offering exemption is in light of the statutory purpose. Since exempt transactions are those as to which "there is no practical need for [the bill's] application", the applicability of section 4(1) should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction "not involving any public offering".
>
> The Commission would have us go one step further and hold that "an offering to a substantial number of the public" is not exempt under § 4(1). We are advised that "whatever the special circumstances, the Commission has consistently interpreted the exemption as being inapplicable when a large number of offerees is involved". But the statute would seem to apply to a "public offering" whether to few or many. It may well be that offerings to a substantial number of persons would rarely be exempt. Indeed nothing prevents the Commission, in enforcing the statute, from using some kind of numerical test in deciding when to investigate particular exemption

> claims. But there is no warrant for superimposing a quantity limit on private offerings as a matter of statutory interpretation.[72]

In making the statement: "But the statute would seem to apply to a public offering whether to few or many," Clark added in his judgment a footnote to Viscount Sumner's frequently quoted dictum (quoted below) in *Nash v. Lynde*[73] the English House of Lords case usually referred to in the Canadian cases.

In *Nash v. Lynde* a jury had made the finding of fact that there had been an offer to the public. The House of Lords considered the question whether the documents concerned were a prospectus which had been issued and decided they were not. However there are dicta relating to the question who is the public:

> [Lord Hailsham at 164] [I]t is sufficient . . . that the prospectus . . . should be proved to have been shown to any person as a member of the public and as an invitation to that person to take some of the shares referred to in the prospectus . . . .
>
> [Viscount Sumner at 168-69] I am anxious not to say anything that would make the way of the share canvasser less hard than s. 81 makes it already, but to me it is difficult to think of a prospectus being issued without some measure of publicity, however modest, and I think it is also impossible to do so, unless the steps taken are taken with the intention of inducing a subscription by the person invited to subscribe for the securities. I do not think that the term is satisfied by a single private communication between friends, even if they are business friends, or even though preparations have been made for other documents to be used in other communications if none such take place. In the present case all that constituted the "issue" was that one of the directors, in the course of a general endeavour to find money, was furnished with some copies of these typewritten documents and gave one of them to a friend, who as requested, passed it on to a friend of his own. I cannot believe that any one in business would call this the issue of a prospectus.
>
> Though literally it is true that the issue is not expressly said in the section to be an issue to the public, I think that it must be so in substance, otherwise any private letter, written by a person engaged in forming a company and advising his correspondent to take shares, would become an issued prospectus if other letters were written by him asking others to do the same. "The public" . . . is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve: perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be open to anyone who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not. A private communication is not thus open . . . .
>
> [Lord Buckmaster at 170] The question of what does or does not amount to an issue is a question of fact in each case and is not capable of a rigid and exact definition, but in my opinion it certainly does not necessarily involve a general application impartially made to all members of the public. A distribution of a prospectus among a well defined class of the public would be an issue within the meaning of s. 81 . . . .

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[72] 346 U.S. 119, at 124-25, 97 L. Ed. 1494 at 1498-99 (1953).
[73] [1929] A.C. 158 (1928).

Rex v. Empire Dock Ltd.,[74] one of the earliest Canadian reported decisions, is not particularly helpful because the answer on the facts was so obvious. There an appeal by a private company from its conviction for inviting the public to subscribe for its securities was dismissed where the invitation was made to 1,400 persons, of whom 600 were complete strangers. Those so canvassed included two-thirds of the lawyers in Vancouver. Mr. Justice Lennox stated:

> ... [N]ot only reason but all the authorities stress the point that the meaning of the words "the public" cannot be tied down to a specific quantity and that, when the term is used, it must be considered as relative to the question at issue and the circumstances of each particular case. Even the words "friend", "customer" and "connection" must also not be narrowed to the particular from the general. A man may call another his friend and yet he may be a mere nodding acquaintance....
>
> ... [T]here must be some point (to be decided in each case) where "private" ends and "public" begins.[75]

Regina v. Piepgrass[76] a more recent Canadian case, is more helpful because it contains a good review of other case authorities. There the accused, a director and officer of a private company, sold shares in the company to five people, four of whom he had previous business dealings with. However, they were not "in any sense friends or associates of the accused, or persons having common bonds of interest or association." In addition to the five subscriptions accepted by the company "the accused turned in a 'lot of them that were refused' because the persons applying were not financially capable of putting in the required money." The Alberta Supreme Court, Appellate Division, upheld his conviction for trading without registration as a broker and held that the exemption for "securities of a private company... where the securities are not offered for sale to the public" was not available to him. Mr. Justice Macdonald stated:

> If the word "public" in... *The Securities Act, 1955*, is to be construed in its widest sense it would include all members of the community. In the *Shorter Oxford Dictionary* "public" is defined in part as follows:
>
> "That is open to, may be used by, or may or must be shared by, all members of the community."
>
> If the word "public" then is to be construed in its widest sense it is clear that unless there would be a general invitation to all members of a community by a person offering shares in a private company, such person would not be in breach of the statute.
>
> That view, in my opinion, is far too wide considering the objects of the statute and the rigorous manner by which the public generally are protected by its other provisions from offering of securities.
>
> It seems to me that the very essence of a private company envisages the idea that it is of private, domestic concern to the people interested in its formation or in later acquiring shares in it. It is one thing for an individual or group of individuals to disclose information to friends or associates, seeking support for a private company being formed or in existence, pointing out its attractions for investment or speculation as the case may be,

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[74] 55 B.C. 34 (County Ct. 1940).
[75] *Id.* at 37-38.
[76] 29 W.W.R. (n.s.) 218, 23 D.L.R.2d 220 (Alta. 1959).

> but it is quite another thing for a private company to go out on the highways and byways seeking to sell securities of the company and particularly by high pressure methods, that is, by breaking down the sales resistance of potential purchasers and inducing them to purchase.
>
> It is clear from the cases cited and from the authorities cited that it is impossible to define with any degree of precision what is meant by the term "offer for sale to the public". It follows that in each instance the court will be called upon to determine whether or not the sale of the securities of the private company transcended the ordinary sales of a private domestic concern to a person or persons having common bonds of interest or association. It is clear from the authorities that whether or not there was an offering to the public is a finding of fact. [77]

It is submitted that the case law [78] suggests a non-public or private category distinct from public and provides considerable support for view number two analogous to the U.S. "need to know" test. If this is correct, a release of the U.S. Securities and Exchange Commission in 1962 [79] commenting on the non-public offering exemption in the 1933 U.S. act may be helpful in Ontario. It explains that "whether a transaction is one not involving any public offering is essentially a question of fact and necessitates a consideration of all surrounding circumstances, including such factors as the relationship between the offerees and the issuer, the nature, scope, size, type and manner of the offering." On the issue of number of offerees the release states "the number of persons to whom the offering is extended is relevant only to the question whether they have the requisite association with the knowledge of the issuer which makes the exemption available." On identity of offerees it says "consideration must be given not only to the identity of the actual purchasers but also the offerees." On sale of promoters it states "the sale of stock to promoters who take the initiative in founding or organizing the business would come within the exemption. On the other hand, the transaction tends to become public when the promoters begin to bring in a diverse group of uninformed friends, neighbours and associates." The release then considers in some detail other factors such as size of offering, facilities used, acquisition for investment, period of retention, change of circumstance in investment intent, and integration and related series of offerings. Even if this release is of assistance in Ontario, however, it must be viewed cautiously in that it was produced by the Securities and Exchange Commission as a guide only and for a substantially different business and legislative-administrative environment than exists in Ontario.

IV. Public Offering Companies Applying for Reclassification as Non-Public Offering Companies

The final point of focus is the undeeming provision in the concluding words of the basic definition:

> ... where, upon the application of a corporation that has fewer than 15

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[77] *Id.* at 227, 23 D.L.R.2d 220, at 227.

[78] *See also* R. v. Golden Shamrock Mines Ltd., [1965] 1 Ont. 692 (1964) where the court found that an offer for sale to the public was made through a general advertisement. Unfortunately the case is rather terse in its reasoning.

[79] Securities Act, 1933, S.E.C. Release No. 4552, November 6, 1962.

> shareholders, the Commission is satisfied, in its discretion, that to do so would not be prejudicial to the public interest, the Commission may order, subject to such terms and conditions as the Commission may impose, that the Corporation shall be deemed to have ceased to be offering its securities to the public. [80]

This is a new provision and introduces a type of numbers test—fifteen shareholders—to give the Commission discretion to change the company's status from a public offering company and therefore to determine that all or some of the requirements applicable to public offering companies shall cease. Presumably the underlying rationale of this provision which the Commission will examine in making such determinations is this. Where there are fewer than fifteen shareholders of a corporation it has become so closely held that all of the shareholders have formed a substantial awareness of the corporation's affairs and do not need the disclosure protections of the B.C.A. to ensure that their investment in the corporation is properly managed. The obvious example for the application of the undeeming provision would be the company which at one time filed a prospectus but was later the subject of a take-over bid and its shares are now solely held by the take-over bidder or at least are closely held. [81]

The numbers test of fifteen has the attractive advantage of certainty. It is occasionally employed elsewhere in the B.C.A., for example as one of the conditions precedent to the exemption from audit provisions (section 167—five or fewer shareholders). It was also one of the three limiting conditions for the private company in the former act and as presently defined in the Securities Act (no more than fifty shareholders excluding employees). Different variations of numbers tests are employed for reasons of certainty elsewhere in the Securities Act. [82] At one time it was thought (although it is now somewhat discounted) that a "rule of thumb" interpretation of the U.S. Securities Act, 1933 permitted an offer to fewer than twenty-five offerees to be considered a non-public offering. However if subsequent legislative draftsmen view the desire for precision as paramount a numbers test for the basic distinction between public and non-public offering companies has some attraction.

V. Conclusion

It is apparent that the distinction between public and non-public offering companies is a fundamental one with important consequences flowing from it in the B.C.A. In linking this distinction to substantive requirements of the Securities Act the Legislature has made more complex the determination of on which side of this distinction a given company falls than was the

[80] B.C.A. § 1(2)9.

[81] It is suggested that an early amendment to the undeeming provision should substitute "body corporate" for "corporation" in its seventh last and second last lines to ensure the provision is available to companies incorporated outside of Ontario.

[82] For example, § 80(*g*) defines a take over bid in terms of an aggregate accumulation of twenty per cent or more of outstanding equity shares and § 80(*b*)(iii) exempts such a take over bid when the offer is made for shares of a public company with fewer than fifteen shareholders in Ontario.

case with the public versus private company distinction. Some of these complexities will have to be worked clean by early court interpretation or preferably by earlier statutory amendment. Such a statutory amendment should attempt to provide as much certainty as possible. It therefore should recast section 1(9) to make its two triggering conditions clearly exhaustive for all public offering corporations. Gradual experience with the provision may establish evidence for its enlargement but it is submitted that clarity is most desirable now. It is also suggested that in so recasting, the first clause include a securities exchange take-over bid as one of its triggering conditions. The following amending provision for section 1(9)(*a*) is cast in language which accomplishes these objectives:

> For the purposes of this Act, a body corporate is offering its securities to the public if, but only if,
>
> (a) any of its securities are outstanding in respect of which a prospectus, statement of material facts, or securities exchange take over bid circular has been filed under the Securities Act, 1966; the Securities Act, 1947; or the Securities Act, 1945.