Québec Court of Appeal Rejects Several Aspects of Pan-Canadian Securities Regime

May 19, 2017

On May 10, 2017, the Québec Court of Appeal (the "Court of Appeal") ruled that the plan to implement a new regulatory regime for a pan-Canadian securities regime is unconstitutional in several respects.[1] The decision was in response to a reference from the government of Québec who took issue with the constitutionality of the proposed regime.

Background

In a landmark ruling in 2011, the Supreme Court of Canada acknowledged that certain aspects of securities regulation raised valid national concerns but rejected the federal government's claim to constitutional authority to displace day-to-day provincial regulation of the securities industry.[2]

In September 2014, the federal government and the governments of Ontario, British Columbia, Saskatchewan and New Brunswick announced that they signed a memorandum of agreement (the "MOA") formalizing the terms of a Cooperative Capital Markets Regulatory System. See our prior bulletin on the proposed regime. Since then, the governments of Prince Edward Island and the Yukon have entered into the MOA. The government of Québec did not enter into the MOA.

Pursuant to the MOA, a Capital Markets Regulatory Authority (the "CMRA") would administer both the federal and provincial securities acts and would act in accordance with a single set of regulations.

The uniform *Provincial Capital Markets Act* (the "Uniform Act"), which would be enacted by each participating province and would replace existing provincial securities legislation, purports to harmonize the approaches taken by the various signatory provinces. The complementary federal *Capital Markets Stability Act* (the "CMSA") addresses those areas under federal jurisdiction, equipping the CMRA with national data collection powers to monitor activity in capital markets and providing the CMRA with the requisite tools to manage systemic risk related to capital markets on a national basis.

Both the Uniform Act and the CMSA empower the CMRA to make regulations. At the head of this proposed regime sits a Council of Ministers that would supervise the CMRA and approve any regulations adopted under the Uniform Act and the CMSA. The Council of Ministers consists of the federal minister of finance and the minister responsible for capital markets regulation from each participating province or territory.

The legislation establishing the CMRA has not yet been published.

Issues & Analysis

On July 15, 2015, the government of Québec referred two questions to the Court of Appeal regarding the constitutional validity of certain aspects of the proposed regime:

1. Does the Constitution of Canada authorize the implementation of pan-Canadian securities regulation under the authority of a single regulator, according to the model established by the most recent publication of the MOA?
2. Does the most recent version of the draft of the CMSA exceed the authority of the Parliament of Canada over the general branch of the trade and commerce power under subsection 91(2) of the *Constitution Act, 1867*?

Constitutionality of Proposed Regime

On the first question, the majority of the Court of Appeal concluded that the proposed regulatory regime for Canadian capital markets was unconstitutional for several reasons.

First, the mechanism for amending the Uniform Act would subject the provincial legislative jurisdiction to the approval of an external entity, which is unconstitutional. By delegating legislative powers to the Council of Ministers, it imposes a limit on the parliamentary sovereignty of the participating provinces. The majority summarized its reasons as follows:

"The mechanism for amending the Uniform Act set out under the Regime fetters the parliamentary sovereignty of the participating provinces and is consequently unconstitutional. It subjects the province's legislative jurisdiction to the approval of an external entity (the Council of Ministers), which is impermissible."[3]

In the majority's view, the proposed regime aims to set aside this fundamental principle by empowering the Council of Ministers to dictate amendments to the Uniform Act to reluctant participating provinces.[4]

Second, the majority stressed that the voting mechanism of the Council of Ministers also undermines the constitutionality of the proposed regime because it would allow certain provinces to exercise a veto over federal initiatives that seek to guard against systemic risks related to capital markets. According to the majority, this veto right of the participating provinces is irreconcilable with the principle of federalism and would render the CMSA unconstitutional.

Constitutionality of CMSA

On the second question, the majority concluded that the most recent version of the CMSA does not fall beyond the jurisdiction of the Parliament of Canada under Subsection 91 (2) of the *Constitution Act, 1867*. This question was specifically focused on the constitutional validity of the CMSA, independently of the proposed regime as a whole.[5]

To assess whether the CMSA falls under the federal head of power over the general trade and commerce branch, the majority applied the two-part test stated by the Supreme Court of Canada in *General Motors*.[6] After taking into account the stated purposes of the CMSA, the majority held that the pith and substance of the CMSA was to promote the stability of the Canadian economy by managing systemic risks related to capital markets having the potential to have material adverse effects on the Canadian economy.[7] As such, the majority concluded that the pith and substance of the CMSA falls within the authority of the Parliament.

However, notwithstanding the validity of the CMSA, the legislation was tainted by the provisions relating to the Council of Ministers which the Court of Appeal found to be unconstitutional. Accordingly, the majority concluded that, unless these provisions are removed, the CMSA should be considered unconstitutional as a whole.[8]

Justice Schrager

Justice Schrager wrote a separate opinion and concluded that the CMSA was constitutionally valid.[9] However, he could not rule one way or the other regarding the Uniform Act absent legislation establishing the CMRA.[10] Justice Schrager also declined to answer the question of whether the proposed regime would be constitutional as a whole and held that the constitutional validity of the MOA could not be subject to judicial scrutiny on the reference.[11]

Conclusion

On July 22, 2016, it was announced that the single securities regulation system would be operational in 2018.[12] The decision of the Court of Appeal may push back this timeline as the federal government examines its options.

One likely option is for the federal government to seek the opinion of the Supreme Court of Canada on the proposed new regulatory regime either through an appeal of the decision of the Court of Appeal or by a separate reference to the Supreme Court of Canada. The decision of the Supreme Court of Canada would take precedence over that of the Court of Appeal should this happen.

Another option is to move forward with the implementation of the proposed new regulatory regime and address the governance role of the Council of Ministers to accommodate the Court's concerns.

Either way, the path forward promises to be extraordinarily challenging as the legislation implementing the new regulatory regime has yet to be introduced.

[1] Renvoi relatif à la réglementation pancanadienne des valeurs mobilières, 2017 QCCA 756.

[2] *Reference re Securities Act* [2011] 3 S.C.R. 837. See our prior bulletin discussing the implications of this decision.
[3] *Supra* note 1, par. 55.
[4] *Supra* note 1, par. 65.
[5] *Supra* note 1, par. 105.
[6] *General Motors of Canada Ltd. v. City National Leasing*, [1989] 1 S.C.R. 641.
[7] *Supra* note 1, par. 128.
[8] *Supra* note 1, par. 138.
[9] *Supra* note 1, par. 146.
[10] *Supra* note 1, par. 210.
[11] *Supra* note 1, par. 174.
[12] See our prior bulletin.

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