

Ontario Securities Commission Reviews: An Exercise in Futility or a Road out of the Quagmire?

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In recent years many market participants have experienced protracted reviews by Staff of the Ontario Securities Commission in relation to registration applications, prospectus reviews and proposed transactions involving the change of ownership of a registrant. In cases where it appears to be impossible to obtain the blessing of Staff, either at all or on a timely basis, the only recourse available is to request an “opportunity to be heard” by the Director of the branch in question, followed by a hearing and review before a hearing panel of the Commission. Is the pursuit of this process merely an expensive exercise in futility or is there the potential to obtain a favourable outcome?

In the appropriate case, parties at the ‘end of the road’ in their dealings with Staff can have a realistic chance of success at a hearing and review before the Commission. Achieving success through this process is not without its challenges. However, in hearing these cases, the Commission has demonstrated a willingness to facilitate business, over the objections of Staff, provided the investing public is appropriately protected.

The Commission’s willingness is illustrated in two recent cases: *Kingship Capital Corporation et. al. (Re)*¹ (**KCC**) and *Citadel Income Fund and Energy Income Fund (Re)*² (**Citadel**). In these cases, the Commission allowed a change of ownership transaction (KCC) and a warrants offering (Citadel) to proceed over the objection of Staff and the Directors of Compliance and Registrant Regulation (**CRR**) and Investment Funds. This is good news for market participants as it signals a possible route out of the quagmire of the

Staff approval process

Notably, in both cases Staff relied on the fact that there was an ongoing enforcement investigation. Despite this, the Commission resisted the urging of Staff to defer a decision until the conclusion of the investigation or to transform the application for a hearing and review into a *de facto* enforcement proceeding.

The Process

There are several categories of approvals required from Staff of the Commission before certain proposed business activities can occur in Ontario’s capital markets. Common examples are applications for registration, the receipting of prospectuses for public offerings and the approval of changes in the ownership of registrants or a change of investment fund managers. In cases where OSC Staff has concerns, an “applicant” will receive correspondence from Staff seeking responses to their concerns and, frequently, requests for further information. In some cases the information requests can be extensive. Staff’s lists of concerns can morph and expand. Once Staff has expressed a need for further information or has expressed concerns that require a response, the “process” can stretch over many (many) months.

If Staff cannot be satisfied, they can recommend against the proposed action, in which case the applicant can request an opportunity to be heard by the Director. However, if Staff does not make a recommendation either way, applications can languish. In these circumstances, Staff should be asked to make a decision one way or the other.

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If this does not occur, it is reasonable to treat the non-response as a refusal and request an opportunity to be heard. Alternatively, the opportunity to be heard by the Director can be waived entirely. Due to the increased expense and improbability of success before the Director, this is a strategy worthy of consideration.

In the past, an opportunity to be heard by the Director was relatively informal and could be conducted with minimal cost. It provided a forum to negotiate terms to address the concerns of Staff. Unfortunately the trend has been towards increasingly adversarial proceedings involving documentary evidence and the testimony of witnesses. This process inevitably results in the Director siding with Staff who, after all, are supervised by and report to the Director. After losing before the Director, any person "directly affected by" the decision may seek a hearing and review before the Commission. Although the members of the Commission sit as the board of directors of the Commission and are ultimately responsible for the organization, the Commissioners that preside over contested hearings do not work directly with OSC Staff. Accordingly, they are able to bring a more independent perspective than a Director.

Strategies for Success on a Hearing and Review

A hearing and review before the Commission, typically before one or two Commissioners, is a hearing *de novo*. This means that the issue will receive fresh consideration and the party applying does not have the burden of convincing the Commission that the Director's decision was wrong. KCC and *Citadel* are two examples of cases where parties have prevailed before the Commission after failing with Staff.

KCC

Sections 11.9 and 11.10 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* effectively provide Staff with a veto over certain transactions involving the change of ownership of registered securities dealers. In KCC, Pro-Financial Asset Management (PFAM), in light of ongoing financial and compliance issues, had agreed to an order that imposed significant terms and conditions on its registration and eventually reached an agreement to sell its assets to KCC. One of the terms of the transaction was that the management team of PFAM would be employed by KCC after the sale. In addition, concurrently with the acquisition of the PFAM assets, KCC would be recapitalized by a new owner.

After several months of back and forth and the exchange of a considerable amount of information, Staff objected to the transaction. Although the applicants waived an opportunity to be heard, the Director of CRR issued a decision refusing to grant the requisite approval under NI 31-103, citing concerns with proposed management and the new firm's ability to comply with its regulatory requirements. Thereafter, KCC and PFAM successfully obtained the Commission's approval for the transaction on a hearing and review.

A key strategy which contributed to the success of this case was the decision to make unilateral changes to the proposed transaction to address the concerns of Staff. These changes were unilateral in that they were not accepted or agreed to by Staff. Rather, they were presented to the Commission at the hearing and review. In rejecting the transaction, Staff had heavily relied on the compliance record of PFAM and an ongoing investigation into PFAM. By changing the contemplated role of the PFAM principal

from Chair of the Board to a consultant pending the conclusion of the investigation, the applicants addressed a major objection of Staff. This allowed the Commission to focus the hearing on the terms of the proposed transaction without the need to hear potentially extensive evidence called by Staff concerning alleged PFAM compliance deficiencies.

In addition, KCC called evidence that it had retained North Star Compliance and Regulatory Solutions, an experienced compliance consultant, to implement the appropriate compliance policies and procedures. KCC also called the evidence of the proposed new owner to give the Commission comfort that he was committed to the success of the business and that KCC would be properly capitalized after the transaction. The principal of PFAM also testified about his planned role with KCC.

In the result, the hearing and review offered an opportunity for KCC and PFAM to have the key issues in the proceeding heard and considered in a relatively streamlined and efficient manner. They were able to satisfy the Commission that Staff's concerns would be addressed, notwithstanding Staff's continued objection.

Citadel and Energy Income Funds

In this case, the Director of Investment Funds refused to issue a receipt for a prospectus for a warrants offering due to Staff's purported concerns about the integrity of the President of the Investment Fund Manager (IFM) based on prior merger transactions that had been undertaken with other investment funds, with which Staff disagreed. Reflective of the polarized positions that had developed between the IFM and Staff, Staff of the enforcement branch launched an enforcement proceeding days before the scheduled hearing and review. Staff then sought to stay the hearing and review pending the conclusion of the enforcement proceeding. The Commission refused to grant the stay.

Detailed affidavit evidence was filed by the President of the IFM concerning the motivation for and business rationale for the prior merger transactions as well as for the proposed offering objected to by Staff. Evidence of a member of the independent review committee was summonsed. In a pivotal moment in the hearing, he was asked directly by a Commissioner whether he had any concerns about the integrity of the President. He testified that he did not. In overturning the Director's decision and granting the receipt, the Commission found that Staff's unproven allegations did not provide a sufficient basis to conclude that the business of the fund manager could not be conducted with integrity. This decision

was made without prejudice to the findings that the future hearing panel could make on the enforcement proceeding. In the result, the Commission did not accept that a pending enforcement proceeding had to hold up a legitimate business activity or transaction.

Concluding Observations

Achieving a positive outcome before the Commission on a hearing and review is possible. A hearing and review presents an opportunity to call and receive fresh consideration of evidence regarding the probity of the transaction or application at issue and to address investor protection concerns. In both cases the Commission had a chance to hear the testimony and ask direct questions of the key individuals involved.

A hearing and review can, therefore, be a practical forum for facilitating the approval of an application or proposed transaction if an impasse is reached with Staff. Having said that, the process is not for the weak of spirit or the light of wallet. Staff have shown a propensity to throw considerable resources at these cases to oppose applications. There is a risk that the hearing and review will be converted into a *de facto* enforcement proceeding with an unwieldy evidentiary record. Nonetheless, there is a road out of the quagmire, albeit one that is heavily guarded by Staff.

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Notes

1. *Citadel Income Fund and Energy Income Fund (Re)* (2011), 34 OSCB 8554
2. *Kingship Capital Corporation et. al. (Re)* (2014), 37 OSCB 6923