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# Making Disclosure: Ideas and Interests in Canadian Securities Regulation

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[Review of Mary G. Condon, *Making Disclosure: Ideas and Interests in Canadian Securities Regulation* (Toronto: University of Toronto Press, 1998)]

Early in her book, Professor Condon bemoans the general lack of Canadian scholarship in the area of securities regulation. Not only is there very little theoretical work in this field, she notes, but also, "even historically descriptive accounts of the Ontario Securities Commission have been notable by their infrequency" (at 15).[1]

For that reason alone, Condon's contribution to scholarship in this area merits attention. But if this book—which focuses upon the development of Ontario securities regulation in the period between 1945 and 1978—offered only historical description, it would not represent quite so significant a step forward. Of course it does offer much more. Professor Condon has attempted to develop a theoretical framework within which to understand the development of Ontario securities regulation. Specifically, as the book's subtitle indicates, she argues that two traditional models often applied to the analysis of securities regulation are both

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1. It might be said that historical treatments of securities law generally are rare. Although much has been written about the South Sea Bubble, and about the legislative developments in North America that began in the early part of this century, the roughly two-hundred year gap between these two periods does not appear to have attracted significant scholarly interest. This was recognized recently by Stuart Banner: "Accounts of securities regulation in the United States tend to begin with the Securities Act of 1933, or at best with the state 'blue sky' laws of the preceding two decades. When the seventeenth, eighteenth, and nineteenth centuries receive any attention, they are usually brushed aside with the poorly informed assumption that securities markets were subject to no law at all." (See Banner, *Anglo-American Securities Regulation: Cultural and Political Roots, 1690-1860* (Cambridge: Cambridge University Press, 1998) at p. 1. Banner's book, in fact, offers interesting parallels to Condon's. He uses a different model. Rather than considering the relative impact of "ideas" and "interests" on the development of securities law, he examines the twin influences of external forces (which would include "changes in economic circumstances, in political thought, and so on") and "an internal process of reasoning." In a sense Banner's external forces roughly parallel Condon's "interests" and his internal process her "ideas" although, to be sure, his model is distinct from hers and appears to attempt to integrate the same dynamic process she observes through a different framework.

inadequate. These two analytical models she identifies as the "interests" school and the "ideas" school. The interests school—which includes the "capture theory" approach of Stigler and others—essentially suggests that securities regulation develops to accommodate articulated interests. According to capture theory, the interests so accommodated are those of the regulated. [2] The "ideas" school may be understood as a view that regulation develops to embody certain powerful ideas or principles which can overwhelm the narrow self-interest of any particular constituency.

Condon argues that neither of these theories of regulation can, individually, explain the evolution of securities laws in Ontario. Among other things, each model is unrealistically static. Interests change over time, she observes. Furthermore, whatever the interplay may be between interest groups and regulators, it is surely not merely a one-sided exchange. More important, perhaps, is Condon's central theme that it is superficial even to suggest that "interests" exist as exogenous things. Rather, interests are themselves constructed in the complex interplay of forces that leads to the formation and implementation of regulation. And ideas, as she attempts to illustrate throughout her book, are also being constantly reformulated. Even when regulatory conclusions persist, often the rationales for those conclusions undergo dramatic change. Thus, the dynamism of changing interests and animating ideas could never realistically be reflected in relatively static (or at least slow-moving) legislative and regulatory processes.

The regulatory process for Condon is, then, "interpretive." Thus, as she puts it, the basic question her survey of Ontario securities law is intended to answer is "how ideas connect to interests to produce regulatory outcomes" (at 3).

Because it seeks to illustrate this theoretical paradigm through specific historical examples, Condon's book operates on two levels, making it useful to at least two different audiences. At one level, it provides a thorough, descriptive survey of the evolution of Ontario securities regulation from 1945 to 1978. This survey is valuable for a number of

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2. In the context of U.S. securities regulation, Joel Seligman has emphatically asserted that capture theory simply cannot explain the actions of the SEC: "Few have suggested seriously that the SEC has been a 'captive' of the industries it regulates. Quite simply, such a suggestion cannot be sustained by a reasonable reading of the Commission's history." J. Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* (Boston: Houghton Mifflin Company, 1982) at xi. "Few" of course is not quite the same as none. Recently, for example, Nobel laureate Merton Miller has suggested that one may usefully view the brokerage industry as the principal beneficiary of securities regulation at least in the United States. See, *e.g.*, M. H. Miller, *Merton Miller on Derivatives* (New York: John Wiley & Sons, Inc., 1997) at 45.

reasons, not the least of which is that it helps to dispel the simplistic and misleading notion that the framing of Canadian securities regulation can be reduced to a mechanical exercise in "Canadianizing" pre-existing U.S. rules. Condon articulates, for example, some of the key distinctions of the Canadian capital markets in the period she is studying, including the overarching significance of the junior mining sector, and the periodically recurring crises in that sector. She also considers the effect these distinctive elements had on policy makers of the day.[3]

At a second level, Condon's thesis about the nature of the interplay of ideas and interests and how this interplay both shapes and is shaped by forms of rhetoric is intriguing in the abstract. However, for me at least, when she attempts to illustrate her thesis with specific examples drawn from the early history of Ontario securities regulation, I am not always convinced that she has, in every case, successfully demonstrated the superiority of her model over some form of capture theory.

For example, when examining the OSC's decisions in the 1950s, she identifies a link made by the Commission between the public interest and the interests of the securities industry. However, she rejects that what she is documenting is really an illustration of capture theory, because she notes that the industry interests were defined by the OSC solely in terms of the interests of the honest dealers (at 48). Furthermore, she argues that "the linking of these two sets of interests [*i.e.*, the public interest and the interests of private mining concerns] was reciprocal . . . *both* sets of interests were interpreted and reinterpreted by the agency through the lens of an agenda of furthering economic development in the province" (at 50). In other words, the interests of the industry did not present themselves in pre-fabricated form, awaiting the OSC's accommodating nod to become embodied in regulatory infrastructure. Instead, the industry interests were themselves shaped by a notion of what the public interest was, even as those in the industry attempted to influence how the public interest was perceived. It is difficult, of course, to separate regulatory intent from regulatory rhetoric. But, at least with respect to the apparent identification of the securities industry with the interests of its most virtuous members, it is not entirely clear that this is not actually consistent with capture theory. To quote Miller, addressing a similar argument in the U.S. context, "[t]hat the SEC sees itself and is seen as policing fraud in the industry actually confirms rather than contradicts Stigler's industry-benefit theory of regulation."[4]

3. Condon's historical survey ends at 1978. But for a reader in 1999, the spectre of the recent Bre-X debacle makes her observations on this issue especially poignant.

4. Miller, *supra* note 2 at 46.

When considering the 1966 *Securities Act*, Condon discusses the controversial practice of permitting certain primary distributions to be undertaken directly on the TSE. The eventual abolition of this practice, together with the enhanced role given the OSC to supervise the exchange, stand as evidence, for Condon, that securities regulators were not captured by private interests such as those of the TSE. She may be right, of course. But it is also plausible that one may still view the reforms of the 1960s through the lens of capture theory, by redefining the nature of the "interests" the regulators may have been endeavouring to serve. If one considers the TSE not *qua* entity, but rather in terms of its brokerage industry members collectively, it might be argued that the 1966 Act actually represented a confluence of the political need to be seen to be doing something (specifically, enhancing disclosure obligations) coupled with the provision of a "safety valve" of widened discretionary powers to be given to an industry-friendly regulator, the OSC, which, according to such a view, might be relied upon to use those powers to ensure that the enhanced disclosure obligations did not cramp the industry's style. Viewed in this way, the very anomaly that Condon identifies in support of her argument that capture theory is of little use in explaining the developments of the 1960s,[5] is equally consistent with the position that capture theory might still have some explanatory power after all.

These are small and isolated examples, to be sure. They should not detract from her central thesis that interests and ideas take shape within a dialectic crucible, a thesis that leads her to valuable insights. For example, as the OSC first undertook to implement the 1945 *Securities Act*, Condon argues that it began to formulate a philosophy of disclosure that served to redefine the traditional debate between the "merit based" or "blue sky" legislation proponents on the one hand, and the disclosure-only proponents on the other. This new philosophy, says Condon, was that a disclosure regime could actually facilitate speculative ventures (especially in the mining sector) precisely because it would obviate the need for regulators to concern themselves with the merits of new issues. The significance of this rationale for a disclosure system is that it seems to differ from the traditional fraud-deterrent rationale for disclosure rules neatly embodied in Louis Brandeis's famous maxim, "Sunlight is said to be the best of disinfectants; electric light is the most efficient policeman."[6]

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5. Condon describes this anomaly in this way at 95-6: "Despite the rhetoric of enhanced disclosure at the public and political levels, the legal discourse of agency discretion embedded in the statute would inevitably shape the practice of applying new disclosure standards."
6. L. D. Brandeis, *Other People's Money* (Washington: National Home Library Foundation, 1933) at 62.

The extent to which the OSC defined the rationale for disclosure regulation is, for Condon, proof that "ideas" do not account for regulatory outcomes, because "ideas" must be given shape in the pursuit of regulatory outcomes. Ideas cannot be seen to define the process, because ideas are only given shape through the process.

The role and nature of ideas then is central to Condon's thesis. Yet, although she has seriously and diligently explored the complex impact of ideas upon the development of securities legislation, the one source of ideas upon which she rarely touches is that of the very field, arguably, most closely connected with securities regulation: financial theory. She does refer generally to the influence of economic ideas of efficiency, but there is very little attempt to probe how more specific ideas in financial economics may have provided an important context within which to understand developing pressures in the securities industry during the period she is studying. Thus, for example, in attempting to situate the 1966 Act, it might have been useful to examine the possible influence of portfolio theory which, by the mid-1960s, had come to dominate the financial intellectual landscape, and has been linked to the wave of mergers that occurred in that era.[7] The capital asset pricing model was emerging as the "next thing" in the field. To what extent did the convergence of those ideas and events help to explain what was happening at the OSC? True, she does refer to the fact that the Kimber Committee Report had evidently arisen out of concerns with a flurry of acquisitions, some of which may have involved unethical behaviour (at 55, quoting J.C. Baillie). And she does allude to the notion that the increasing emphasis on disclosure could be seen as a development consistent with market efficiency, concluding, however, based upon her review of the historical record, that "one virtue of disclosure that was not much vaunted was its contribution to market efficiency" (at 63). This lack of overt reliance on efficiency arguments indicates, to her, that "[t]he link between disclosure and public confidence was mediated by a legal discourse of fairness rather than by a more economic rationale of informed market choice producing efficiency" (at 62).

Subject to these limited exceptions, however, Condon says very little about the possible impact of developments in financial theory. Nor does she consider how financial innovation may have had an impact on the way in which interests were articulated in the regulatory process. In Chapter

7. See, *e.g.*, J.B. Baskin & P.J. Miranti, Jr., *A History of Corporate Finance* (Cambridge: Cambridge University Press, 1997) at 275: "The elaboration of portfolio theory in the 1950s and 1960s provided one of the chief intellectual foundations for conglomerate formation."

5, for example, she examines one of the thorniest issues to confront the OSC during the period which is the subject of her study: the question of the regulation (or de-regulation) of brokers' commissions. Fixed commissions were abolished in the U.S. in 1975. But they were preserved in Ontario until several years later. One might have asked to what extent pressure to lift fixed rates may have been higher in the United States in 1975 because of the increasing use of exchange traded derivatives products in that country. The Chicago Board Options Exchange opened in 1973. Could the growing market for derivatives have put competitive pressure on traditional broker dealers? Fixed commission rates are a problem in a market where participants can, and regularly do, synthesize exposure to traditional securities through financial derivatives. It may very well be that the derivatives market was less developed in Canada in 1975. Could that account, at least in part, for the fact that Canada was slower to abolish fixed rates which—in the absence of such competition—were undoubtedly favoured by the brokers? This is sheer speculation, of course. But a theory perhaps worthy at least of a closer look.

In developing the theory of the mutual interdependence of ideas and interests, perhaps her boldest claim is for the constitutive role played by securities regulation, a role that relies in no small part on some concept of "public confidence." It is recognized, Condon argues, that securities markets cannot exist in the absence of public confidence and "the struggles of interest groups to influence policy and legislation . . . revolve around proposing alternative definitions of this elusive quality of public confidence and various strategies for achieving it" (at 80).

So important is public confidence to the existence of securities markets, in Condon's view, that regulation—the method by which such confidence is assured—is inextricably linked to the existence of the market itself. In other words, regulation is not exogenous to the markets. It is, in her words, "what *constitutes* the market, enabling the whole apparatus to continue to exist" (at 81).

It is not uncommon for lawyers to claim for regulation "constitutive" power. What Condon has tried to do, however, through a very careful micro-analysis of a particularly important period in the development of a very specific and technical regulatory regime, is to put this general notion to the test. In examining how the OSC administered the new 1966 Act, for instance, Condon considers the rhetoric characterizing the disclosure policy debates. Beginning with the OSC's September 1968 Policy Statement, she argues that the OSC was employing a distinctly legal (or fairness) rationale for disclosure—all shareholders should be treated alike—rather than an economic rationale—disclosure is necessary to make markets efficient. Thus, the OSC was not only, she says, defining the scope of the Act's provisions, it was defining the policy objectives of those provisions as well. Specifically, the "public interest" came to be defined by the OSC in terms of investor protection. Nor should this expressed concern for investor protection be seen as a mere "justificatory mask" (at 136) for the protection of private interests, Condon argues, given the willingness of the OSC to discipline individual registrants, criticize the Broker-Dealers' Association, and subject issuers to regulation. One notes, however, that if the nature of the protected interests are defined as those of the traditional broker-dealers, then as Miller and others have argued in the U.S. context, these actions could themselves be viewed as part of a "justificatory mask" for the preservation of the interests of the industry as a whole.

Condon's study ends with an examination of the 1978 *Securities Act*. The emphasis on disclosure that, in her view, served to merge the goals of economic efficiency and equity, now begins to shift to a perceived need for securities issuers to provide continuous disclosure. The struggles surrounding the drafting of that act, particularly with respect to the "material change" definition, certain disclosure exemptions, and the form of the proposed private agreement exemption to the take-over bid rules, took the form, in her words, of "a dynamic and open-ended negotiation. In this process the success of interests depended on their power to persuade decision-makers of the plausibility of their particular visions of how the securities market should operate" (at 223). This was no triumph of private interests then, or of some powerful unifying idea. Rather, it was the culmination of a complex dialectic in which interests and ideas were formed and reformed in the very process of being articulated.

Condon's book is surely a welcome and worthy contribution to Canadian business law scholarship. It offers the results of sound historical research within an illuminating theoretical framework. It is, accordingly, a work that deserves serious attention from students of our securities regime, whether in Canadian law schools or in law practices.