Ontario Securities Commission | Commission des valeurs mobilières de l'Ontario | P.O. Box 55, 19th Floor 20 Queen Street West Toronto ON M5H 3S8 | CP 55, 19e étage 20, rue queen ouest Toronto ON M5H 3S8

IN THE MATTER OF THE *SECURITIES ACT*,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
PHOENIX CAPITAL INCOME TRUST AND PHOENIX CAPITAL INC.

DECISION

Hearing:	November 3, 2009	
Decision:	November 13, 2009	
Panel:	James D. Carnwath James E. A. Turner	Commissioner (Chair of the Panel) Vice-Chair
Counsel:	Mary L. Biggar	for the Applicants, Phoenix Capital Income Trust and Phoenix Capital Inc.
	John A. Campion Andrew D. Burns Donald Park	for Staff of the Commission

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PART I: OVERVIEW

[1] On September 22, 2009, the Applicants sought to file a draft Notice of Hearing and Statement of Allegations (the "Draft Notice of Hearing") with the Secretary of the Commission (the "Secretary").

[2] The Draft Notice of Hearing stated it was a notice for a hearing to be held before the Commission to consider, among other things:

> (a) whether, in the opinion of the Commission, it is in the public interest, pursuant to ss. 127 and 127.1 of the Act, to order that Staff of the Commission be reprimanded;
>
> (b) whether, in the opinion of the Commission, it is in the public interest, to order Staff to rectify its past non-compliance with Ontario securities law to the extent rectification is practicable…

[3] On September 22, 2009, the Secretary returned the Draft Notice of Hearing to the Applicants. The Applicants were told that Rule 2.1 of the *Rules of Procedure of the Ontario Securities Commission* (2009), 32 O.S.C.B. 1991 (the "Commission Rules") did not give the Secretary authority to issue a s. 127 hearing under the *Ontario Securities Act*, R.S.O. 1990 c. S.5, as amended (the "Act") brought by any person other than Staff of the Commission ("Staff").

[4] The Applicants now move for directions of the Commission with respect to issuing a Notice of Hearing in the form of the Draft Notice of Hearing pursuant to s. 127 of the Act.

PART II: ISSUES

[5] There are two issues:

> (a) Does a person other than Staff of the Commission have the right to seek a s. 127 hearing in order to obtain the relief requested by the Applicants, on the basis that the hearing would be in the public interest?

(b) Assuming without deciding that the answer to question (a) is "yes", do the facts of this case justify ordering the hearing?

PART III: FACTS AND BACKGROUND

[6] On July 27, 2005, the Applicants filed a preliminary prospectus (the "Preliminary Prospectus") with the Commission and other Canadian jurisdictions. A receipt for the Preliminary Prospectus was issued by the Commission on July 28, 2005.

[7] By letter dated October 19, 2005, Staff advised the Applicants that l'Autorité des marchés financiers ("AMF") would be acting as principal regulator in respect of the Preliminary Prospectus. The Applicants were told:

> This decision is a result of discussion with the AMF regarding a publicly announced investigation on Mount Real Corporation (a Quebec based corporation) and possible links between Phoenix Capital Income Trust and Mount Real Corporation and/or related parties.

[8] On November 1, 2005, the Applicants withdrew the Preliminary Prospectus from a number of jurisdictions, including, among others, the Province of Quebec.

[9] By letter dated November 8, 2005, Staff acknowledged the Applicants' withdrawal of the Preliminary Prospectus and advised the Commission would now be acting as principal regulator in respect of the Preliminary Prospectus filing. Staff advised the Applicants:

> As a result of discussion with [AMF] regarding a publicly announced investigation with respect to Mount Real Corporation and possible links between Phoenix Capital Income Trust and Mount Real Corporation and/or related parties, we are not prepared to recommend to the Director that a receipt be issued until the AMF's investigation has been concluded.

[10] The Applicants wrote to Staff on January 9, 2006 saying:

> Poor drafting resulted in the total rejection of [the Preliminary Prospectus]. This increased our own legal costs to several times the amount of [the] initial estimate, and increased other related costs. As a result of the delay from the AMF investigation, the substantial expenditure on legal fees and other costs associated with the offering may be wasted, resulting in a material erosion of working capital available to complete the offering.

[11] Applicants' counsel wrote to Staff on March 20, 2006 requesting:

> If a receipt is not issued soon, I respectfully request the referral of two questions to the Commission under section 61(4) of the Act, being:
>
> 1. Would a further delay of issuing a receipt to Phoenix Capital Income Trust be tantamount to a refusal to issue a receipt?
>
> 2. If yes, is Phoenix Capital Income Trust entitled to sufficient disclosure of the nature and evidence of the investigation, so that it can make full answer?

[12] On April 5, 2006, Applicants' counsel wrote to Staff saying that they intended to re-file the Preliminary Prospectus and asked Staff as follows:

> We request a meeting with a Commissioner pursuant to OSC Notice 15-701. Alternatively, I see no alternative but an application to the Divisional Court for judicial review, on the basis that a further delay by the OSC would be tantamount to a refusal without a hearing. …

[13] Staff replied on April 21, 2006:

> We refer to your letter dated March 20, 2006 with respect to the issuance of a receipt for the final prospectus of Phoenix Capital Income Trust (Phoenix) and your request for the referral of two questions to the Commission under section 61(4) of the [Act] or for a meeting with a Commissioner pursuant to OSC Notice 15-701…In our view, it would be more appropriate for the Director to make a determination with respect to the issuance of a receipt for the final prospectus of Phoenix, pursuant to section 61 of the Act. Pursuant to section 61(3) of the Act, Phoenix would be given an opportunity to be heard before the Director prior to any decision of the Director to refuse to issue a receipt. If the Director were to refuse to issue a receipt, Phoenix would be entitled to a hearing and review of the Director's decision by the Commission, pursuant to section 8(2) of the Act. Pursuant to section 9(1) of the Act, a decision of the Commission may be appealed to the Divisional Court.

> Staff are considering whether to recommend to the Director that she refuse to issue a receipt for the final prospectus of Phoenix, on the basis of links between Phoenix and Mount Real Corporation and/or related parties. In order to assist us in considering this matter, please provide us with responses to the following questions…

[14] Applicants' counsel wrote Staff on May 26, 2006 saying they were:

> …instructed to bring an application to the Ontario Superior Court seeking a determination of whether there are any links between Phoenix and Mount Real Corporation and/or related parties which are material to potential investors, or alternatively, an order requiring the OSC to make such a determination within 30 days.

A draft Notice of Application was attached to the letter that Applicants' counsel said he expected to "file with the Divisional Court early next week."

[15] Staff wrote Applicants' counsel on June 5, 2006 and said:

> …in the event that Phoenix files a final prospectus [Staff] will recommend to the Director that she refuse to issue a receipt of the final prospectus.

[16] By letter dated June 13, 2006, Applicants' counsel wrote to Staff and the Executive Director of the Commission and requested:

> (a) The Executive Director…arrange a meeting with a Commissioner pursuant to OSC Notice 15-701. At the meeting, we would attempt to resolve the differences of opinion or interpretation without a hearing, or narrow the issues of concern.
>
> (b) Alternatively, that the Director [Corporate Finance] refer the following question to the Commission for determination, pursuant to section 61(4) of the [Act]… 'Are there sufficient links between Phoenix and Mount Real Corporation and/or related parties to deny the receipt of the Phoenix's [sic] prospectus, according to the factors enumerated in section 61 of the [Act]?'

[17] On June 23, 2006 a conference call was held between Staff and Applicants' counsel. Applicants' counsel was invited by Staff to prepare and file a final prospectus.

[18] During October and November 2007, the Applicants issued six statements of claim in the Ontario Superior Court of Justice (the "Statements of Claim"). Each of the Statements of Claim

alleges substantially similar facts. Two of the Statements of Claim name four members of Staff as defendants. Four of the Statements of Claim name the Commission as a defendant (the "OSC Claims").

[19] The OSC Claims seek:

> A declaration that [Staff] had no basis for recommending against the issuance of a receipt for the prospectus for Phoenix Capital Income Trust (the "Trust") and that the constructive denial of the recommendation of the issuance of a receipt and the interference in the reorganization of the affairs of Phoenix Capital Inc. ("Phoenix") was a result of negligence and a lack of acting in good faith that resulted in substantial damages to all stakeholders in the Trust and Phoenix…

PART IV: APPLICABLE LEGISLATION

[20] Section 127 of the Act has received extensive consideration by the Supreme Court of Canada in the *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission),* [2001] 2 S.C.R. 132 *("Asbestos").*

[21] Iacobucci J., writing for the Court, began his analysis of s. 127 by noting that:

> The legislature clearly intended that the OSC have a very wide discretion in such matters. The permissive language of s. 127(1) expresses an intent to leave it for the OSC to determine whether and how to intervene in a particular case…[para. 39].

[22] Iacobucci J. then turned to observe that s. 127 is a regulatory provision. At para. 42:

> Second, it is important to recognize that s. 127 is a regulatory provision. In this regard, I agree with Laskin J.A. that "[t]he purpose of the Commission's public interest jurisdiction is neither remedial nor punitive; it is protective and preventive, intended to be exercised to prevent likely future harm to Ontario's capital markets" (p. 272). This interpretation of s. 127 powers is consistent with the previous jurisprudence of the OSC in cases such as Canadian Tire, supra, aff'd (1987), 59 O.R. (2d) 79 (Div. Ct.); leave to appeal to C.A. denied (1987), 35 B.L.R. xx, in which it was held that no breach of the Act is required to trigger s. 127. It is also consistent with the objective of regulatory legislation in general. The focus of regulatory law is on the protection of societal

> interests, not punishment of an individual's moral faults: see R. v. Wholesale Travel Group Inc., [1991] 3 S.C.R. 154, at p. 219. [para. 42]

[23] Iacobucci J. went on to state that s. 127 "Orders in the public interest" were not punitive but rather their purpose was to restrain future conduct that is likely to be prejudicial to the public interest in fair and efficient capital markets. In contradistinction, he found it was for the courts to punish or remedy past conduct under ss. 122 and 128 of the Act respectively.

[24] Iacobucci J. summarized his analysis of s. 127(1) as follows:

> In summary, pursuant, to s. 127(1), the OSC has the jurisdiction and a broad discretion to intervene in Ontario capital markets if it is in the public interest to do so. However, the discretion to act in the public interest is not unlimited. In exercising its discretion, the OSC should consider the protection of investors and the efficiency of, and public confidence in, capital markets generally. In addition, s. 127(1) is a regulatory provision. The sanctions under the section are preventive in nature and prospective in orientation. Therefore, s. 127 cannot be used merely to remedy Securities Act misconduct alleged to have caused harm or damages to private parties or individuals. [para. 45]

[25] We note that the Applicants had requested on two occasions that the Executive Director arrange a meeting with a Commissioner pursuant to OSC Notice 15-701. The first request was made April 5, 2006 in a letter addressed to a member of Staff. The second request was made in a letter addressed to the Executive Director and others dated June 13, 2006. OSC Staff Notice 15-701 provides that the Commission has implemented a procedure which would enable Staff and an applicant, or an issuer or selling security holder which has filed a preliminary prospectus, to meet with a Commissioner to attempt to resolve serious differences of opinion or interpretation which have arisen between Staff and the applicant, or to narrow the issues in dispute.

PART V: ANALYSIS

(a) Does a person other than Staff of the Commission have the right to seek a s. 127 hearing on the basis that the hearing would be in the public interest?

[26] We find it unnecessary to decide this question on the facts of this case. We are not prepared to find that no person other than Staff can seek the exercise of discretion given to the Commission by s. 127. It is possible to hypothesize a situation where the public interest would require the Commission to grant a third party the right to pursue a s. 127 remedy if it met the requirements identified by Iacobucci J. in *Asbestos.* The Commission has done so in a limited number of circumstances. This is not such a case.

(b) **Assuming without deciding that the answer to question (a) is "yes", do the facts of this case justify ordering the hearing?**

[27] The answer to question (b) above is "no". The remedy sought by the Applicants is punitive and retrospective. It does not satisfy the requirement that the proper use of s. 127 is to restrain future conduct that is likely to be prejudicial to the public interest. The sanctions sought by the Applicants are not preventive in nature nor are they prospective in orientation. A review of the Statements of Claim filed by the Applicants in the Superior Court of Justice confirms our view that the Applicants seek to use s. 127 for a purpose found to be improper in "*Asbestos"*:

> Therefore, s. 127 cannot be used merely to remedy Securities Act misconduct alleged to have caused harm or damages to private parties or individuals. [para. 45]

[28] We reject the submission that the Staff "constructively refused" to issue a final receipt under subsection 61(1) of the Act. On the facts before us, the Applicants did not file a final prospectus. Accordingly, no decision was required whether to issue a receipt for a final prospectus. Further, the only person authorized to grant or refuse a receipt for a final prospectus is the "Director", defined in the Act as the Executive Director of the Commission, a Director or Deputy Director of the Commission, or a person employed by the Commission in a position designated by the Executive Director for the purpose of this definition. There is no evidence of such a refusal by a "Director" in the material. Had there been such a refusal, that decision could have been appealed to the Commission under subsection 8(2) of the Act.

[29] We note that the Applicants attempted to take the benefit of the Commission's policy as expressed in OSC Notice 15-701, referred to above. The notice directs an applicant to "advise the Executive Director of a desire to meet with a Commissioner" to attempt to resolve or narrow the issues in dispute. It then provides that if both the Executive Director and the applicant issuer agree that "a meeting may be helpful", the Executive Director will arrange such a meeting. The Applicants do not appear to have received a response from the Executive Director to its letter of June 13, 2006, saying that such a meeting would not be helpful. The Applicants deserved to receive a response.

Dated at Toronto this 13th day of November, 2009.

"James D. Carnwath"	*"James E. A. Turner"*
James D. Carnwath	James E. A. Turner