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Securities Law in the Internet Age: Is “Regulating By Analogy” the Right Approach?

Anita Indira Anand*

Securities regulation relating to the Internet calls on issuers to ensure that an electronic document being delivered to shareholders or investors conforms to existing rules. As the Internet becomes increasingly accessible, should the dominant approach to securities regulation give way to a new approach that recognizes the technological advantages of the Internet? The author argues that the current “paper-based” approach to the disclosure of information is incompatible with the reality of communication in cyberspace. The present regime excessively limits the effectiveness of “webrersions” of a document, which may include hyperlinks and multimedia applications. The author re-evaluates current law and suggests the adoption of an “Internet Initiative” to account for recent developments in information technology.

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Introduction

Securities regulation in Canada seeks to ensure that investors in capital markets are adequately protected when they make decisions about whether to buy or sell securities in public corporations. In order to achieve this objective, securities regulators have established a complex regime that is built upon disclosure of information requirements. These requirements pertain to documents that inform investors about the financial successes and failures of a corporation, invite investors to participate in a transaction to raise capital for the corporation and provide information about transactions that involve a change of control of a corporation. The regime is “paper based” in the sense that documents sent to shareholders for any of these purposes must comply with prescribed rules relating to their contents.

The advent of the Internet as a means of communication raises questions about the applicability and efficiency of a paper-based system. The Internet enables corporations to communicate with shareholders and potential investors in a more timely and cost-effective manner. For instance, corporations are able to conduct offerings to shareholders on the Internet by posting prospectuses to a designated website. Corporations can also disseminate financial reports and other continuous disclosure documents over the Internet to existing shareholders by e-mail and website

1. See for example, Securities Act (Ontario), R.S.O. 1990, c. S.5, s. 2.1 (new S.O. 1994, c. 33, s.2) [Hereinafter, the “Securities Act”].
2. As the Chair of the Ontario Securities Commission asked, How do we ensure that a regulatory structure that had its last major overhaul more than 30 years ago does not stifle market creativity? How do we enhance rather than impede the ability of the Canadian markets to attract capital and create wealth? How do we ensure that advances in technology do not outpace our ability to adequately protect investors? How do we ensure that growing participation in capital markets is matched by growing understanding of them?
postings.3 Distributing information by these methods permits a corporation to make the information available to a global audience instantaneously. In Canada, regulation of the Internet in the securities context has been done not through legislation but primarily through two National Policies promulgated by the Canadian Securities Administrators (CSA).4 These policies do not alter the substantive law. Rather, they clarify how market participants can comply with existing law by using the Internet and other forms of electronic communication. In my view, the approach of the CSA in the National Policies is to “regulate by analogy” to current regulation.5 In other words, there is no new law that replaces existing securities law with respect to electronic delivery, disclosure of documents and trading of securities. Current securities laws continue to apply to communication over the Internet.

In this article, I will examine whether “regulating by analogy” is appropriate: should existing laws be applied “as is” to

communications in cyberspace? I will argue that the present approach of the CSA is, in the long-term, incompatible with a world in which corporations communicate electronically with investors and other interested parties. I will contend that the CSA's concern that investors have access to a paper version of a document which is identical to the electronic version is an unnecessary and potentially misguided requirement. I will also present an alternative approach to regulating by analogy and will recommend that regulators consider how securities laws can be reformed to account for communication over a medium which is universally accessible and increasingly used.

I. Current Regulation

In December 1999, the CSA officially adopted National Policy 11-201 "Delivery of Documents by Electronic Means" and National Policy 47-201 "Trading in Securities using the Internet and other Electronic Means". These Policies were published for comment in December 1998 and were adopted without substantial amendment. The substantive aspects of these Policies are set forth below.

A. National Policy 11-201

NP 11-201 provides guidance on when prospectuses, financial statements, trade confirmations, account statements and proxy-related materials can be sent electronically to prospective investors and shareholders, or filed electronically with the Commission.

The term "electronic delivery" is defined as "the delivery of documents by facsimile, electronic mail, CD-ROM, diskette, the Internet or other electronic means."

Despite this broad definition, the Policy does not apply to any method of

6. NP 11-201, supra note 4.
7. NP 47-201, supra note 4; National Policies, supra note 4.
8. NP 11-201, s. 1.3 (1).
9. Ibid., s. 1.1.
delivery which is mandated by securities legislation such as the use of pre-paid mail for the delivery of proxy-related materials.\textsuperscript{10}

Under NP 11-201, an issuer should satisfy four requirements when delivering a document by electronic means. First, the recipient of the document should receive notice that the document has been, or will be, sent electronically. Second, the recipient should have easy access to the document. Third, the issuer should have evidence that the document has been delivered or otherwise made available to the recipient. Finally, the document that is received should not be different from the document delivered or made available by the deliverer.\textsuperscript{11}

The first three of these items may be satisfied by obtaining the prior consent of the intended recipient to electronic delivery of the document and then delivering it in accordance with that consent.\textsuperscript{12} In the absence of such consent, the issuer may deliver the document electronically, but at the risk of having greater difficulty in subsequently proving that the requirements were satisfied in the circumstances.\textsuperscript{13}

Notice of electronic delivery of the document can be effected electronically or by another means as long as the recipient is advised of the proposed form of delivery.\textsuperscript{14} While delivery by e-mail may not require prior notice, merely placing a document on a website to be downloaded would require separate notice to be given to each intended recipient.\textsuperscript{15} The Policy recommends that the issuer obtain consent from the recipient of the document and that, for example, the recipient monitor the issuer’s website on a regular basis. In such a case however, the issuer would not have to provide separate notice to the recipient on each occasion that a document is posted to the site.

\textsuperscript{10} Ibid., s. 1.3(3).
\textsuperscript{11} Ibid., s. 2.1(2).
\textsuperscript{12} Ibid., s. 2.1(4).
\textsuperscript{13} Ibid., s. 2.1(5). The Policy also sets out a form of consent in App. A of the document.
\textsuperscript{14} Ibid., s. 2.2(1). The Policy specifically states that notice can be provided by “electronic mail, telephone or communication in paper form.”
\textsuperscript{15} Ibid., s. 2.2(2).
The Policy states that effective electronic delivery of a document requires that the document be received by the recipient without alteration or corruption. The burden is on the provider of the document to ensure that the integrity of the document is maintained through the electronic delivery process. This burden cannot be shifted to the intended recipient by agreement or waiver.16

B. National Policy 47-201

NP 47-201 addresses the issues of jurisdiction, registration and other statutory requirements in connection with trading and offering securities through the Internet. The Policy recognizes that documents posted on the Internet are accessible not only to intended recipients but also to anyone else who has access to the Internet.17 Thus, a person will be considered to be trading securities in a particular jurisdiction within or outside Canada if the person posts on the Internet a document that offers or solicits trades of securities, and if that document is accessible to persons in that local jurisdiction.18

However, such a posting will not be considered to be a “trade” or “distribution” under the relevant provincial securities statute if two requirements are met. First, the posted document must contain a prominent disclaimer that identifies the only jurisdictions in Canada or outside Canada in which the offering or solicitation is qualified to be made (excluding the local jurisdiction). Secondly, reasonable precautions must be taken by all persons or companies offering or soliciting trades of securities through the document posted on the Internet not to sell to anyone resident in the local jurisdiction.19

NP 47-201 reminds market participants that registration requirements will apply in connection with the posting of a

16. Ibid., s. 2.6.
17. NP 47-201, s. 2.1.
18. Ibid., s. 2.2(1).
19. Ibid., s. 2.2(2).
prospectus or other offering document on the Internet for use in connection with a distribution in a local jurisdiction. In particular, a person posting an offering document must be registered to trade in the local jurisdiction, have the benefit of an exemption from the registration requirements in connection with the distribution in the local jurisdiction or refer all inquiries to a registered dealer in the local jurisdiction. Thus, by implication, it is clear that NP 47-201 permits Internet offerings either by way of a prospectus or under an exemption as long as the issuer complies with statutory requirements.

Despite this relevant allowance, the Policy provides no relief from provisions of the Securities Act where a prospectus has been delivered electronically. For instance, the statutory requirement that a person distributing securities under a prospectus record the names and addresses of all persons receiving a copy of the preliminary prospectus continues to apply. In other words, even if a recipient has merely viewed (but not downloaded) the preliminary prospectus online, the issuer must still record the recipient's name and addresses.

NP 47-201 also permits roadshows to be conducted over the Internet provided that they comply with relevant securities legislation and in particular requirements relating to waiting periods. The Policy recommends four guidelines to ensure such compliance. First, the electronic roadshow should contain a statement that the information provided does not represent all the information in the preliminary prospectus. Second, a copy of the preliminary prospectus should be made available to all viewers of the transmission. Third, electronic access to Internet transmissions of the roadshow should be controlled by the issuer or underwriter to ensure that viewers are identified and have been offered a preliminary prospectus. Finally, the roadshow should not be transmitted unless all viewers have agreed not to copy or

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20. Ibid., s. 2.2(3).
21. Ibid., s. 2.2(3).
22. Ibid., s.2.5(3).
23. Ibid., section 2.7(2).
further distribute the roadshow transmission.\textsuperscript{24} Issuers and underwriters are requested to take reasonable steps to prevent copying or further distribution of transmissions.

II. What is “Regulating by Analogy”?

Ontario securities law contains requirements to “send”, “deliver”, “notify”, “furnish” and “provide” documents to shareholders, investors and intermediaries. For instance, the \textit{Securities Act} states that management of a reporting issuer must send a proxy form by prepaid mail prior to a shareholders’ meeting.\textsuperscript{25} The \textit{Securities Act} also provides that “[a]ny dealer distributing a security . . . shall . . . send a copy of the preliminary prospectus to each prospective purchaser . . . ”.\textsuperscript{26} The \textit{Securities Act} further stipulates that a dealer not acting as agent of the purchaser who receives a subscription for a security offered in certain distributions must “send by prepaid mail or deliver to the purchaser the latest prospectus . . . ”.\textsuperscript{27}

However, these provisions are not specifically defined to encompass electronic communications. Although they may be broad enough to accommodate electronic delivery, the legislation was not drafted with this as one of its underlying purposes. In fact, it is generally accepted that securities legislation is “paper-based” in that it contemplates delivery of the documents in paper form alone.

In light of this inherent paper bias, regulators have struggled with how to integrate the Internet into concepts currently embedded in securities law. In its 1995 “Electronic Delivery Release”, the U.S. Securities and Exchange Commission (SEC) stated that it wished to facilitate and to encourage the electronic distribution of information. The 1995 Release provided that delivery of information through an electronic medium could

\textsuperscript{24} \textit{Ibid.}, section 2.7(2).
\textsuperscript{25} \textit{Supra} note 1, s. 85.
\textsuperscript{26} \textit{Ibid.}, s. 66.
\textsuperscript{27} \textit{Ibid.}, s. 71 [Emphasis in original].
satisfy delivery or transmission obligations under U.S. securities laws. However, the SEC was reluctant to permit divergence from particular requirements contained in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Company Act of 1940. According to the SEC, requirements under these statutes and state law would continue to govern the conduct of market participants in delivering documents.

In order to permit electronic communication, the SEC adopted what is now known as the “analogy to paper” approach:

... the question of whether delivery through electronic media has been achieved is most easily examined by analogy to paper delivery procedures ... Information distributed through electronic means [will satisfy] the delivery or transmission requirements of the federal securities laws if such distribution results in the delivery to the intended recipients of substantially equivalent information as these recipients would have had if the information were delivered to them in paper form. As is the case with paper delivery, there should be an opportunity to retain a permanent record of the information.

Regardless of whether information is delivered electronically or otherwise, the document must be prepared and delivered in keeping with federal securities laws in the same manner as paper documents.

To varying degrees, the Financial Services Authority (FSA) in the United Kingdom and the Australian Securities and Investment Commission (ASIC) have also adopted the analogy to paper. The FSA has stipulated that the Financial Services Act 1986 “applies to the internet as it would to other media such as a letter, a fax or

29. 15 U.S.C. 77(a) et seq.
30. 15 U.S.C. 78(a) et seq.
32. The 1995 Release, supra note 28 at 7 [emphasis added].
33. Ibid., n. 20.
34. Financial Services Act 1986, c. 60.
a phone call. The Internet is in many ways just another medium.35 Similarly, the ASIC issued a policy which specifies that “[a]ll provisions in the Law applying to prospectuses generally apply to electronic prospectuses.”36 The ASIC’s reliance on the substantive law results from its view that disclosure in paper form remains the primary frame of reference for most investors.37

Unlike the SEC and the FSA, the CSA has not explicitly adopted the analogy to paper approach. However, consistent with the 1995 Release, the CSA seeks to facilitate use of the Internet by market participants without altering the substantive law. In response to comments regarding NP 11-201, the CSA stated:

... NP 11-201 does not mandate any particular procedures or rules regarding the use of the electronic medium by market participants. Instead, NP 11-201 sets out guidelines while allowing participants to determine how they wish to comply with corporate and securities law requirements for the delivery of materials to securityholders. NP 11-201 does not change any substantive law requirement.38

35. Financial Services Authority, “The Perimeter and the Internet”, online: Financial Authority Services Homepage <http://www.fsa.gov.uk/enforcement/lc/ib_internet.html> (last modified: 26 September 2001). An example of the way in which the FSA has implemented its regulation-by-analogy approach is in the area of enforcement. Issuing an advertisement in the U.K. which has not been approved by a person under the UK Act may be a criminal offence carrying punishment by imprisonment or fine. The FSA has stated that its enforcement stance in relation to advertising on the Internet “reflects its enforcement policy generally.” Thus, it recommends that advertisers control their websites and possibly restrict access to them. See Financial Services Act 1986, c. 60, s. 57.


37. Ibid., s. 5.

In fact, NP 11-201 indicates that a document sent by electronic delivery "should be sent in a way that enables the recipient to retain a permanent record of the document, as is the case with paper delivery of a document." In addition, issuers must "make a paper version of every document delivered by electronic means available at no cost to a recipient upon request . . . regardless of the form in which the document was originally delivered." Similarly, under NP 47-201, the requirement that a company distributing securities under a prospectus record the name and addresses of all persons that have received a copy of the preliminary prospectus continues to apply even if the prospectus is distributed by electronic means.

Thus, these provisions support the contention that the CSA is in fact regulating by analogy through the continued application of current securities laws to communication in cyberspace. The question now becomes whether this is the best approach — in both the short and long term — to regulating the Internet in the securities law context.

III. Is Regulating by Analogy the Best Approach?

The issue of how to regulate the Internet pervades analyses in almost every area of law and has prompted one academic to ask, "[s]hould this new space, cyberspace, be regulated by analogy to the regulation of other space, not quite cyber, or should we give


39. NP 11-201, s. 2.3(5).
40. Ibid., s. 2.3(6).
41. NP 47-201, s. 2.5(1).
up analogy and start anew?” In the securities law context, this question involves a consideration of whether current laws that apply to communication by telephone or by mail should also govern Internet communication.

The primary difficulty with the regulate-by-analogy approach is that there are certain aspects of Internet communication that are difficult to analogize to paper. For instance, issuers often place a "hyperlink" in a disclosure document or on a website. These hyperlinks enable readers of the document to click on a predefined linkage and be transferred to another Internet address, which may be an entirely different document.

In response to the use of hyperlinks in disclosure documents, the SEC developed what is now known as the "envelope theory". This theory holds that documents hyperlinked or in close proximity to each other on the same website are considered to be delivered together as if they were in the same paper envelope. However, the envelope theory was silent on the following issues: If a prospectus is posted on a website, is everything on the website part of the prospectus? How large can this virtual envelope be? What if information on a third party’s website is “framed” or “inline”?

42. L. Lessig, supra note 5 at 1743. See also T. Hardy, “The Proper Legal Regime for Cyberspace” (1994) 55 U. Pitt. L. Rev. 993 at 995, who states, “Should [cyberspace] issues provoke a legislative response, a case-by-case judicial response, or are there yet other mechanisms by which disputes may be avoided and resolved?”

43. In the 1995 Release, supra note 28, the SEC provided a number of examples to assist issuers and market intermediaries in meeting their delivery obligations when using electronic media. Market participants came to refer to these examples as the "envelope theory".

44. Ibid.

45. “Framing” is a type of hyperlinking in which information from a separate website is imported to the website being used and displayed within a constant on-screen border. Because information from an issuer’s website and the hyperlinked website could be visible at the same time, the user may not be aware that the displayed material is from a different website. See SEC Release Nos. 33-7856, 34-42728, IC-24426; File No. S7-11-00 “Use of Electronic Media” (May 4, 2000) at n. 59 [hereinafter, “2000 Release”].
Recognizing that the envelope theory contains ambiguities, the SEC attempted to clarify its position on hyperlinks in a Release issued in early 2000. In this Release, the SEC set out a number of factors to assist in a determination of whether an issuer is liable for hyperlinked information. These factors include: the issuer’s level of pre-publication involvement in the preparation of the information; whether the issuer approved the hyperlinked information; the layout of the screen containing the hyperlinked information; and the risk of investor confusion. The SEC also clarified instances in which hyperlinked documents will not be deemed part of a prospectus.

The SEC’s guidance on the use of hyperlinks in disclosure documents indicates that the analogy to paper sits uneasily with respect to hyperlinks. The analogy to paper cannot work effectively when two fundamentally different media forms – one paper and one electronic – are the subjects of the analogy. The analogy to paper is a short-sighted response to the fact that market participants use the Internet to communicate with each other. Unfortunately, the approach gives little consideration to whether the paper-based system will continue to be applicable in the Internet age.

Although the SEC was the original proponent of the regulate-by-analogy approach, it has recognized shortcomings of the approach and has attempted to liberalize its application. The SEC has stipulated that where documents (such as a prospectus) filed with the SEC contain graphic, audio and video material or other multimedia features, the issuer must provide a fair and accurate description, tabular presentation or transcript of that material. The issuer can provide this material either at the point in the text

46. As explained by the SEC in the 2000 Release, *ibid.* at n. 60, underlining is similar to framing but there is no visible border surrounding the hyperlinked text. Information from an issuer’s website and the hyperlinked website are visible at the same time. The user may not be aware that the hyperlinked information is actually from a different website.


48. *Ibid.* Note that the CSA has provided relatively little guidance on the use of hyperlinks on websites and in disclosure documents. *Supra* note 4, s. 3.3.
where the omission occurs or in an appendix to the electronic filing.\textsuperscript{49} However, the SEC has also stipulated that these documents may be delivered in different versions, some with multimedia materials and others without. The only requirement is that every version of the document must contain all information necessary to comply with statutory requirements. In text-only versions of the document, the issuer is not required to describe the multimedia material but must at least indicate how investors can obtain other versions of the document.

Similarly, the ASIC also permits issuers to distribute prospectuses which contain multimedia features. However, in order to do so the document must contain “the same information in the same sequence as the paper prospectus lodged with ASIC except for differences allowed by ASIC . . .”\textsuperscript{50} These differences include: a facility for searching defined expressions; immaterial changes to the order in which information is presented; prompts to assist readers to find information in the electronic prospectus; hypertext links within the prospectus and to documents incorporated by reference; and a zoom facility so that investors may enlarge or reduce the information displayed.\textsuperscript{51} The ASIC does not go as far as the SEC in endorsing multimedia materials. Yet it does stipulate that electronic prospectuses should convey information that is material to the investment decision predominantly in text because “[a]udio or video presentations of prospectus information may give rise to additional issues.”\textsuperscript{52}

The CSA has adopted an even more restrictive approach than the ASIC to regulating Internet communication. For example, the CSA recommends that statutory disclosure documents should not include multimedia communications unless the information presented through this material can be reproduced identically in


\textsuperscript{50} ASIC Policy Statement 107, supra note 36, s. 67.

\textsuperscript{51} Ibid.

\textsuperscript{52} Ibid., at s. 5.
non-electronic form.\textsuperscript{53} This suggests that the CSA is concerned about ensuring that all recipients receive the same statutorily required information.\textsuperscript{54} The underlying rationale for this concern is that it would be unfair if some investors had the capability to receive multimedia information containing audio and video clips when other investors did not.\textsuperscript{55}

The upshot of NP 11-201 is that at present multimedia materials can only be included in statutory disclosure documents if the materials can be reproduced identically in non-electronic form. In practice, this means that graphics, charts and pictures can be included in disclosure documents only if such information can be provided in both electronic and paper formats. Videos, animation and audiostreams cannot be readily reproduced in non-electronic formats. Thus, the CSA have stated, “it is not appropriate for issuers to incorporate these types of multimedia communications into statutorily mandated disclosure documents.”\textsuperscript{56} The result of the CSA’s “hands off” approach is likely to suppress the use of multimedia materials by Canadian issuers. Issuers lack guidance concerning permissible forms and methods of disclosure. Thus they may avoid creating versions of documents with multimedia capabilities for fear of increasing their liability.

Why has the CSA adopted such a narrow interpretation of “regulating by analogy”? At present, it is well known that not all investors can communicate on-line or print downloaded documents. In contrast, the present system is more effective because every investor has a mailing address. Until communication via the Internet is universal, it would be unreasonable to supplant current legislation with requirements that assume that all shareholders receive documents electronically.

\textsuperscript{53} Supra note 4, s. 3.4(1).

\textsuperscript{54} Ibid. s. 3.4(1) states that “all recipients [should] receive the same statutorily required information, regardless of their multimedia capabilities.”

\textsuperscript{55} See CSA Notice, supra note 38. This statement was contained in the CSA’s response to s. 5b under “Other Related Issues”.

\textsuperscript{56} CSA Notice, ibid. This statement was contained in the CSA’s response to specific comment 10 regarding multimedia communications.
In other words, paper-based communication is the “lowest common denominator”.

However, the concern that some investors do not have access to the Internet may be short-lived. Statistics from Industry Canada indicate that 49 percent of Canadians had access to the Internet in 1999, a rise of three percent from the year before. More recent data indicates that Internet usage has continued to rise. It is reasonable to assume that virtually all investors will have access to the Internet in the near future.

Assuming the Internet will continue to revolutionize the way we communicate, can we simply apply existing regulation to an electronically formatted document? The National Policies suggest that the CSA is unprepared to look beyond a restrictive interpretation of the analogy to paper. Rather than viewing the Internet merely as a medium to be tolerated, regulators should adopt an approach which is flexible enough to accommodate and encourage electronic communication.


59. Stéphane Rousseau has raised a similar point in his paper entitled “Internet-based Securities Offerings: Attractions and Challenges.” This paper was delivered at the 30th Annual Workshop on Commercial and Consumer Law held on October 20-21, 2000 at the Faculty of Law, the University of Toronto. See (2001) 35 Can. Bus. L.J. 226 and my comments on Professor Rousseau’s paper at 274 in same.
IV. Adopting a New Approach: The “Internet Initiative”

Many experts have stated that the current impact of the Internet is only the “tip of the iceberg.” As a result, it is difficult for regulators to describe how the Internet will evolve in the next decades. Nevertheless, there are some technological changes that may limit the effect of current regulation. In the future, Internet access will be as common as the telephone in homes, businesses and public places. Owning a home computer will not be a prerequisite to having readily available access to the Internet. In fact, the Cisco Systems’ website predicts that “the Internet is the next essential home utility where high-speed, always-on Internet access is available throughout the home.”

In certain areas of business law, legislation has already been reformulated to account for the emergence of the Internet. Recent amendments to the Business Corporations Act (Ontario) under the Red Tape Reduction Act sought to remove impediments to the proxy-solicitation and shareholder voting process. Under these amendments, shareholder meetings can be held by telephonic or electronic means and an effective electronic signature by a shareholder or proxy can be completed according to certain requirements.

60. John Chambers, CEO of Cisco Systems Inc. stated recently “there will be a ‘New World Network’ [which] will seamlessly blend the technology of the Internet with high-speed optical fibres, cable and wireless systems to carry voice and data everywhere. Voice calls will be free, and people will think nothing of zipping off huge chunks of data for everything from video e-mails to movies on demand.” See “Meet Cisco’s Mr. Internet” online: BusinessWeek Magazine Homepage (13 September 1999) <http://www.businessweek.com/1999/99_37/b36466c01.htm> (date accessed: 10 November 2001). See also the entire issue of Fortune magazine 9 October, 2000 and particularly A. Diha, “Tip of the Iceberg” Fortune (9 October 2000) 58.


63. S.O. 1999, c. 12.
Bill S-11\textsuperscript{64} implements similar changes to the \textit{Canada Business Corporations Act}.\textsuperscript{65} The purpose of Bill S-11 is to enact measures that will facilitate electronic communications among and between shareholders and corporations, including holding meetings and voting by electronic means. Bill S-11 also permits shareholder meetings to be held by telephonic, electronic or other communication facility that permits all participants to communicate adequately with each other during the meeting.\textsuperscript{66}

In the securities law domain, the National Policies are two of the main statutory instruments that govern issuers’ conduct on the Internet\textsuperscript{67} and, as I have argued, these policies are based on the regulate-by-analogy approach. However, this approach is restrictive in terms of the extent to which it allows issuers to take advantage of technological advances afforded by the Internet. In order to be applicable in the long-term, securities regulation must facilitate use of the Internet by participants in the capital markets. I propose that regulators adopt a new approach which may be called the “Internet Initiative” and which would consist of at least three components.

\begin{itemize}
\item \textsuperscript{64} Bill S-11, \textit{An Act to Amend the Canada Business Corporations Act and the Canada Cooperatives Act and to Amend Other Acts in Consequence}, 2001 (assented to 14 June 2001) [hereinafter “Bill S-11”].
\item \textsuperscript{65} R.S.C. 1985, c. C-44.
\item \textsuperscript{66} See also \textit{Re Newbridge Networks Corporation} (2000) 186 D.L.R. (4th) 188. In this case, Newbridge made an application for an interim order approving an arrangement involving its security holders. As part of the proposal, Newbridge sought to use an electronic procedure for notice and voting for its option holders. The procedure allowed the option holders to receive notice electronically and to vote by electronic proxy. The proxy would be transmitted via the corporation to the corporation’s registrar and transfer agent. Password integrity was built into the procedure. The governing legislation and the corporation’s by-laws were silent on such a procedure. In the Ontario Superior Court of Justice, Farley J. granted the application. He held that the electronic procedure was appropriate and should be approved as part of the arrangement.
\end{itemize}
A. Re-evaluation of the National Policies

Under this prong of the Internet Initiative, the CSA would re-evaluate NP 11-201 and NP 47-201. In particular, as the Internet becomes the preferred method of communication, the relevance of the requirements for delivering documents under NP 11-201 will be called into question. To begin, recipients of documents will not need to receive notice that the document will be sent or made available electronically - it will be presumed. As a result, it may eventually become a requirement that all shareholder documents be made available in electronic format unless a shareholder specifically requests to receive a paper copy. In addition, as the Internet and e-mail become increasingly reliable, evidence of delivery will not be required.

Another aspect of NP 11-201 that is deficient is the provision relating to hyperlinks. As noted above, issuers are encouraged to clearly distinguish between documents that are governed by statutory disclosure requirements and documents that are not. Despite highlighting issues of concern, the Policy offers little guidance and does not elaborate on the instances in which, for instance, hyperlinked information in a prospectus may give rise to

68. Supra note 4, s. 2.1(2).
69. The Committee undertaking the Five-Year Review of Securities Regulation in Ontario posed the following question in its Issues List:

The current shareholder communication model reflected in the Act mandates that a reporting issuer deliver to security holders specific corporate information. In light of the communication opportunities presented by the Internet and the availability of corporate disclosure through SEDAR is this communication model still appropriate?

For example, should securities regulators go further than National Policy 11-201 'Delivery of Documents by Electronic Means' and shift the onus on to shareholders to request information, in the absence of which they will be deemed to have requested that such information not be delivered? See "Five Year Review of Securities Legislation in Ontario - Advisory Committee's Request for Comments" (2000) 23 O.S.C.B. 3047. This question deserves more consideration than can be afforded in this paper.
70. Supra note 4, s. 3.3.

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liability on behalf of the issuer. The Policy merely states that "[t]he use of hyperlinks within a document may not be appropriate . . . the existence of hyperlinks in a document delivered by electronic delivery to a separate document raises the question of which documents are being delivered . . .".

By contrast, ASIC Policy Statement 107 allows hypertext links within an electronic prospectus. However, it only allows hyperlinks to documents incorporated by reference "if no reasonable person would be likely to confuse the linked documents with the electronic prospectus." The Policy Statement also provides that the investor must always be able to return to the point in the electronic prospectus where the investor entered the link so that continuity in reviewing the document is preserved. The Policy Statement further stipulates that issuers will be restricted from linking to promotional material.

Given the interpretive difficulties inherent in the term "reasonable", one may question the usefulness of importing a "reasonableness" standard in an evaluation of whether a hyperlink is permissible in a disclosure document. Nonetheless, the ASIC's approach is instructive because it attempts to offer guidance to issuers as to the circumstances in which hyperlinks will be permitted. Canadian issuers would benefit from more detailed guidelines concerning the use of hyperlinks. The CSA could stipulate that issuers must ensure that a "warning page" pops up if a reader clicks on a hyperlink and is about to exit the main document. In addition, the CSA could invoke a requirement that a hyperlinked window must be smaller or a different colour than the window in which the prospectus appears. At the very least, it would be beneficial to issuers if the CSA clarified its position regarding the use of hyperlinks.

71. Ibid., s. 3.3(3).
72. Ibid., s. 3.3(2).
73. ASIC Policy Statement 107, supra note 36.
74. Ibid., s. 67(d)(ii).
75. Ibid.
76. Ibid.
Notwithstanding these recommendations, it may still be necessary to retain some of the original provisions of NP 11-201. In particular, regulators may choose to continue to ensure that an electronic document received by a shareholder is not different from the original document delivered by an issuer. This requirement has “staying power” because electronic documents will always be susceptible to corruption or alteration. It will likely be cumbersome to ensure that an electronic document is not tampered with during the delivery process, the advancement of Internet software and the development of improved practices may alleviate this concern. For instance, similar to recording the number of pages on a fax cover sheet, the number and order of transmitted data packets could be verified during transmission over an IP network.

NP 47-201 also contains provisions relating to the trading of securities on the Internet that require further regulatory attention. For instance, the Policy requires issuers distributing securities under a prospectus to record the name and addresses of all persons who have received a paper or electronic copy of the preliminary prospectus. Some individuals who commented on NP 47-201 stated that such information should be maintained for those persons who download a prospectus and not those who merely view it on a website. Other commenters recommended eliminating the requirement altogether, given that such documents can be accessed through the System of Electronic Data and Retrieval (SEDAR).

These comments highlight the difficulty in analogizing Internet communication to usual paper-based practices. By definition, the Internet is a medium which allows many persons to view posted documents at any given time. Although regulators have embraced this aspect of Internet communication in establishing SEDAR, they unfortunately retreat from embracing these advantages of

77. Supra note 4, s. 2.5(1).
Internet disclosure in the National Policies: why should paper-based requirements - such as the requirement to maintain a list for persons who have received a preliminary prospectus - be maintained in NP 47-201 if SEDAR precludes the usefulness of having such requirements in the first place? These questions must be addressed when attempting to alleviate the difficulty in analogizing electronic communication to paper-based practices.

B. Integration

A second component of the Internet Initiative calls for regulators to indicate how issuers can utilize the Internet to comply with their obligations under a proposed legislative instrument. Regulators would “integrate” an analysis of the Internet into proposed legislative instruments. For instance, the CSA published a Multilateral Instrument in September, 2000,79 that proposes to harmonize various exemptions from the prospectus requirements for a distribution of securities to purchasers not in the local jurisdiction.80 The accompanying Companion Policy provides some guidance to issuers and selling security-holders regarding the potential application of securities legislation to a distribution to purchasers not in the local jurisdiction.

In particular, the Companion Policy sets out a number of factors to be considered when determining whether a trade would be subject to local securities legislation: the primary location of the issuer’s mind and management whether a significant percentage of the outstanding securities of the class being distributed are directly or indirectly held on record by residents

80. In recent years, however, the Ontario Securities Commission has attempted to clarify its position regarding circumstances in which the Securities Act will apply to distributions of securities outside of Ontario. Currently, an Interpretation Note, entitled “Distribution of Securities outside Ontario”, was implemented to replace Ontario Securities Commission Policy 1.5.
of the local jurisdiction; the location of the principal register of the equity securities of the issuer; and where the operations of the issuer are principally conducted. The CSA states that not all of these connecting factors are of equal weight and stipulates that if the jurisdictional connection of the distribution to the local jurisdiction is merely incidental, then the distribution would not be subject to local securities legislation.\(^81\)

However, the Multilateral Instrument does not discuss the issue of jurisdiction as it arises in the context of Internet-based offerings. Arguably, there may be no need to insert provisions regarding Internet disclosure in the Multilateral Instrument, since NP 47-201 already addresses this issue. However, the Policy presents only broad guidelines for advising issuers as to whether they will be considered to be trading in another jurisdiction.\(^82\)

The CSA has commented that decisions regarding whether a particular securities commission will assert jurisdiction is to be made "on a case by case basis, with due regard to the legal tests ordinarily applied in such circumstances."\(^83\) This means that the Commission would continue to review the nature of the parties’ conduct inside and outside Ontario to determine whether it should assert jurisdiction.\(^84\) In addition to the factors enumerated in the Companion Policy, the developing case law would also be

\(^81\) Supra note 79, s. 2.2.

\(^82\) Specifically, under the Policy, a person will be considered to be trading in securities in a particular jurisdiction within Canada if the person posts a document on the Internet that offers or solicits trades of securities and is accessible to persons in Canada. However, such a posting will not be considered to be a “trade” or “distribution” under the relevant provincial securities statute if two requirements are met. First, the posted document must contain a prominent disclaimer that identifies the only jurisdictions within Canada or outside Canada in which the offering or solicitation is qualified to be made (excluding the local jurisdiction). Secondly, reasonable precautions must be taken by all persons or companies offering or soliciting trades of securities through the document posted on the Internet not to sell to anyone resident in the local jurisdiction. See NP 47-201, s. 2.2 discussed supra note 4.


\(^84\) Ibid.
relevant in such a determination, since the CSA has stated that the ordinary legal tests will be applied to an Internet-based dispute.

Under an integrated approach, the CSA would be more proactive in identifying specific factors that are relevant to an Internet-based dispute. For instance, factors such as the location of the issuer’s Internet service provider and the place of business or residence of the issuer’s principals may be particularly relevant in a dispute concerning jurisdiction of Internet-based offerings. In *Re World Stock Exchange*, the Alberta Securities Commission considered whether it had jurisdiction over an Internet-based stock exchange called the World Stock Exchange (WSE). The venture originated in Alberta but was incorporated in the Cayman Islands and used an Internet server in Antigua. The Alberta Securities Commission applied the common law “real and substantial connection” test and asserted jurisdiction over the WSE because of its tangible affiliation with Alberta. In particular, the company was established and operated in Alberta by principals who were resident there and the WSE website was accessible through an Internet service provider whose computer was located in the same province.

Securities regulators should clarify the way in which a legislative instrument applies to communication, disclosure and offerings made on the Internet when they issue new policies or rules. In this way, regulators could facilitate use of the Internet by market participants and perhaps lessen the need for litigation.

86. This principle was adopted by the Supreme Court of Canada in *Morguard Investments Ltd. v. De Savoye*, [1990] 3 S.C.R. 1077 and upheld subsequently in *Hunt v. T & N plc*, [1993] 4 S.C.R. 289. See also *Libman v. the Queen* [1985] 2 S.C.R. 178 in which the Supreme Court of Canada held that a Canadian court will have personal jurisdiction (i.e., the authority to decide a dispute and bind the defendant by its decision) if: i) the defendant is served with originating process within the legal unit; ii) the defendant submits to the jurisdiction of the court by previous agreement or subsequent attornment; or iii) the defendant is served ex *jurs* in accordance with the provincial rules of civil procedure and there is “a real and substantial connection” between the province and the subject matter of the dispute.
C. Disclosure Reform

A third prong of the Internet Initiative advocates actively facilitating Internet-based disclosure over and above the provisions of NP 11-201. I will discuss this reform proposal with reference to primary market and then to secondary market disclosures. This distinction must be drawn since the Securities Act imposes statutory civil liability on issuers and certain other parties for misrepresentations made in a prospectus but not for continuous disclosures. 87

(i) Primary Market Disclosure

In discussing disclosure on the Internet, a distinction should be drawn between web and paper-based documents. A "webversion" of a document is the version which is posted on the Internet such as the cyber-prospectus discussed below. A webversion is one that has been created in HTML or some other format suitable for posting on the Internet. It is the webversion which can be enhanced to take advantage of multimedia materials. An electronic version may be a webversion but it may also simply be a paper version of a document in electronic form (like a letter to be sent by mail which has been typed but not printed off one's computer). This distinction is significant because a webversion cannot be e-mailed or printed off the Internet easily, and it may contain audio and video clips which obviously cannot be printed. The document, however, can be accessed and viewed using a browser over the Internet.

The CSA has stipulated that certain multimedia material (such as graphics, charts and photographs) can be included in disclosure documents as long as the material can be provided in electronic and paper format. 88 If the communication cannot be reproduced in paper format, issuers cannot incorporate these types of material

87. Supra note 1, s. 131.
88. Supra note 57.
into their disclosure documents. Videos, animation and audio clips would likely fall under this restricted list of multimedia material. Thus, webversions of a document must be identical to their printed versions. By contrast, the SEC allows different versions of documents (i.e., some containing multimedia materials and others which do not) to be delivered to investors. All that is required is that each version comply with statutory disclosure requirements, and in the paper version of the document, an issuer must indicate that there are other versions of the prospectus and how investors can obtain them.

In the long term, it would be a mistake to limit the cyber-version of a prospectus to one that could be printed with unsophisticated printers through commonly used word-processing software. Web-versions which contain a variety of multimedia materials should be permitted. Regulating by analogy should be viewed as a “stop gap” method of regulating until such time as Internet access is universal. In the meantime, if a document contains graphic, audio and video material, the issuer should provide a fair and accurate description, tabular presentation or transcript of that material in the printed version of the document.

In order to promote the practical use of the cyber-document for disclosure purposes, regulators may wish to consider the development of a specific template for the cyber-prospectus. Under the recently implemented Rule 41-501 and the accompanying Form 41-501F1, issuers are required to include certain information in a prospectus. This new Form replaces Forms 12, 13 and 14 of the Securities Act, which previously set forth the information required in prospectuses for various types of issuers, namely industrial companies, finance companies and natural resource companies. Similarly, Form 41-501F1 requires issuers to provide information concerning the issuer that an

investor needs to know in order to make an informed investment
decision. Like the old Forms, the new Form requires issuers to set
forth items such as the corporate structure, general development
of the business, narrative description of the business, use of
proceeds, and description of securities distributed.

Once issuers make their prospectuses available in electronic
form as a matter of course, regulators will need to contemplate
whether the electronic content of the cyber-prospectus should be
regulated. In particular, it may be useful to establish a "cyber-
form" which outlines particular items which 
an issuer must
disclose and the way in which such items can be disclosed. The
cyber-form would replace the Forms that currently exist, since
these forms contemplate printed documents only and are ill-
equipped to deal with the introduction and use of a cyber-
prospectus.

In particular, the presentation of information in a cyber-
prospectus will need to be regulated. The ability of an investor
who has reviewed one cyber-prospectus to review other cyber-
prospectuses quickly and easily will depend greatly on the degree
of uniformity in the presentation and logic behind their design.
While site maps and search tools might assist readers in accessing
individual features of cyber-prospectuses, they would not be as
useful as a uniform approach to the organization and presentation
of the cyber-prospectus.

What might the cyber-form contain? The form could set forth
the sections of the prospectus in which an audio or video clip
could be used. For instance, under the heading "description of
business", the issuer should be able to insert a picture of the CEO
of the company on which the reader can click to hear a
description of the business. In addition, an issuer should be made
aware of any restrictions surrounding the use of streaming videos,
3-D graphics, pop-up windows, charting, linking, touch screen
and computer reading technologies. The issuer should be made
aware of the extent to which it can use hyperlinked information.
(ii) Secondary Market Disclosure

Under Ontario securities law, there is civil liability for misrepresentation in a prospectus but there is no such liability for secondary market or continuous disclosure.\(^90\) Liability for disclosure imposes a discipline on issuers, management and other interested persons to ensure that the statements they make meet a certain standard of truth.\(^91\)

The Internet has enabled issuers to disseminate vast amounts of information to investors instantaneously. While this facet of Internet communication is commendable, the downside is that the information itself may contain inaccurate or misleading statements. In Re American Technology Exploration Corporation,\(^92\) for example, two individuals posted misleading promotional descriptions on a corporate website about the mineral properties and affairs of the company. The website contained misrepresentations that indicated that the company had the largest gold deposit in the world, even larger than the 71 million

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\(^91\) The current standard as it relates to disclosure in a prospectus is “full, true and plain disclosure of all material facts relating to the securities being issued or proposed to be distributed.” See the Securities Act, supra note 1, s. 56. For background on this issue, see P. Anisman et al., Proposals for a Securities Market Law for Canada, vol. 3. (Ottawa: Consumer and Corporate Affairs Canada, 1979) 135; Final Report of the Toronto Stock Exchange Committee on Corporate Disclosure, Responsible Corporate Disclosure: A Search for Balance (March 1997); and TSE/OSC Mining Standards Task Force Setting New Standards: Recommendation for Public Mineral Exploration and Mining Companies (February 2, 1999).

ounce gold deposit that was falsely reported to be contained in the Bre-X Busang property.93

Continuous disclosure documents on the Internet should, like prospectuses, be able to contain multimedia materials. Despite the potential for misleading and inaccurate continuous disclosure, these materials have the ability to enhance disclosure in terms of an individual’s understanding of the company in which she or he holds shares, the individuals associated with the company, and as the company’s business activities. For instance, shareholders could benefit from video clips explaining the rationale for a take-over bid or merger with another company in an online circular. Similarly, a target company’s shareholders would likely benefit from a video clip describing the acquirer’s operations and how the target company will be incorporated into its business. In other words, multimedia materials have the ability to assist investors to understand the nature of their investment and the activities of the company in which they have invested. All too often shareholders are unsure about decisions that they are being asked to make because they do not have sufficient or clear information. The Internet has the potential to alleviate this problem.

However, I make this point with one large caveat. If regulators allow issuers to use multimedia materials, they must also ensure that issuers will bear liability for any misrepresentations made in these documents. Unless there is liability for continuous disclosure documents on the Internet, it would not be in the interests of investor protection to relax the rules relating to the manner in which that disclosure occurs.

93. British Columbia Securities Commission Decision, January 23, 1998. ATEC was incorporated in Nevada and traded over-the-counter in the U.S. on the OTC Bulletin Board. There was no public trading market in Canada. However, the company maintained an office in British Columbia. The individuals who posted the material were well-known stock promoters in Vancouver and were found responsible for setting up the website. The B.C. Securities Commission invoked jurisdiction on the basis that the promotional statements were accessible to anyone, in B.C. and elsewhere, who had access to the Internet and the website contained nothing to suggest that it was not directed at investors in B.C.

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The CSA has published draft legislative amendments which would create a statutory civil liability regime for continuous disclosure documents.\textsuperscript{94} If implemented, these amendments would enable investors in the secondary market to sue any company or responsible party for making public oral or written misrepresentations about the company.\textsuperscript{95} Although the legislative amendments do not specifically refer to the Internet, they nonetheless refer to documents that are transmitted in electronic form and would presumably catch statements made in a document posted on an issuer’s website. For instance, if an annual information form posted on the website were to contain a speech by a company executive that contained a misrepresentation, then liability would likely arise under the proposed legislation.

The draft amendments are not at present useful for investors, since provincial governments have made no decision to implement them.\textsuperscript{96} However, a number of industry reports and at least one commission proposal issued in the last 20 years or so have endorsed the concept of liability for secondary market disclosures and it appears that support for such a proposal is widespread. Thus, it would not be unreasonable to predict that liability for continuous disclosure will be embedded in Ontario securities law in the near future.\textsuperscript{97}

\textsuperscript{94} CSA Notice 53-302 “Proposal for a Statutory Civil Remedy for Investors in the Secondary Market” (2000) 23 O.S.C.B. 7383. The draft legislation contains a definition for “public oral statements” being “an oral statement made in circumstances in which a reasonable person would believe that information contained in the statement will become generally disclosed.”(See s. 1)

\textsuperscript{95} Ibid.

\textsuperscript{96} Ibid.

\textsuperscript{97} Supra note 91. See also Final Report of the TSE Committee on Corporate Governance in Canada, Where are the Directors? Guidance for Improved Corporate Governance in Canada (December 1994). Final Report of the Toronto Stock Exchange Committee on Corporate Disclosure Responsible Corporate Disclosure: A Search for Balance (March 1997). In 1984, the Ontario Securities Commission recommended the adoption of a liability regime for continuous disclosure following the publication of “Proposals for a Securities Market Law for Canada”. These recommendations are contained in “Civil Liability for Continuous
Although I advocate changes to the rules governing the manner in which issuers make disclosure, I would argue that current requirements relating to the content of disclosure are comprehensive. Notwithstanding the benefits afforded by the Internet, these requirements should remain constant because the rationale that underpins the securities law regime, and particularly its emphasis on an issuer’s disclosure record, continues to be applicable. To be sure, disclosure provides equality of opportunity to investors by ensuring that all investors have access to the same information at relatively the same time in order to make an informed investment decision. In this way, disclosure underpins the integrity of the capital markets and contributes to the confidence that the public has in those markets. Furthermore, the information base that is created by the disclosure regime increases the efficiency of the capital markets since “securities are evaluated on the basis of complete and current information [and thus] the pricing mechanisms of the capital markets operate in a more rational and accurate fashion.”

However, an exception should be made for the time periods within which such information should be disclosed based on the efficiencies that the Internet provides. For instance, the CSA’s proposed National Instrument regarding electronic insider information will make selected data on insiders available to the public through a website. The objective of this Instrument is to allow insiders of reporting issuers to securely file insider reports in electronic format over the Internet using commonly available web browsers. This will result in faster dissemination of reported

99. Ibid.
information and an increase the ability of regulators to monitor compliance with insider reporting requirements.\textsuperscript{101}

Notwithstanding the fact that insider reports can be accessed through the Internet, the time periods in which insiders must report insider trades have not been changed by the CSA. In Ontario these reports must be filed within 10 days of the date of the trade.\textsuperscript{102} In other jurisdictions, insider reports do not have to be filed until 10 days after the end of the month in which the trade occurred. Given the apparent ease with which insiders can report their trades through the Internet, these time periods should be consolidated.

\section*{Conclusion}

The argument in this paper has been that the regulate-by-analogy approach is restrictive in that it prevents participants in the capital markets from taking advantage of the Internet. Arguably, the approach protects investors by maintaining a level playing field - no one investor is left out because of a predisposition not to use the Internet. Yet the approach will "over-protect" investors as the Internet becomes as commonplace as the telephone and the post. The Internet Initiative proposed in this paper enables issuers and investors to benefit from developments in information technology which make information clearer, more understandable and more meaningful to the average investor.

\textsuperscript{101} Ibid.
\textsuperscript{102} Supra note 1, s. 107.