Globalisation of Securities Markets: Prospectus Disclosure for Equity Offerings in Perspective

A thesis submitted to the University of Manchester for the degree of Doctor of Philosophy (PhD) in the Faculty of Social Sciences and Law

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Muhammad Anowar Zahid

School of Law
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Part V

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With the trend of globalisation there have by now taken place two regional integration of securities markets in the European Union and North America. The former is composed of 15 (going to be 25 in May) European States and the latter of Canada and the United States. Both are expansive by object. In this thesis an endeavour is made to explore the possibilities of integration between these two regional alliances, which may, in turn, facilitate further integration throughout the globe.
DECLARATION

No portion of the work referred to in the thesis has been submitted in support of an application for another degree or qualification of this or any other university or other institute of learning.
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DEDICATION

To my beloved wife, AFSANA.
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ABBEVITIONS AND ACRONYMS

Journals and Case Reports

ABR- Accounting and Business Research
AJCL- American Journal of Comparative Law
AJIL- American Journal of International Law
ALR Fed.- American Law Reports Federal
Alta.L.Rev.- Alberta Law Review
B.C.L. Rev.- British Columbia Law Review
BJIBFL- Butterworths Journal of International Banking and Financial Law
Bus. Law.- Business Lawyer
Brooklyn J.Int L.- Brooklyn Journal of International Law
Can. L. T.- Canadian Law Times
Can. Pub. Adm.- Canadian Public Administration
ICCL Rev.- International Company and Commercial Law Review
Co.Law.Digest- Company Lawyer Digest
CMLR- Common Market Law Reports
CML Rev.- Common Market Law Review
Co.Law.- Company Lawyer
CPS- Comparative Political Studies
CYELS- Cambridge Yearbook of European Legal Studies
Denv. J. Int. L. and Pol.- Denver Journal of International Law and Politics
EBLR- European Business Law Review
EC Bull.- European Community Bulletin.
EA Rev.- European Accounting Review
ECL Rev.- European Competition Law Review
EFSL Rev.- European Financial Services Law Review
EFSR- European Financial Services Regulation
EIPIL Rev.- European Intellectual Property Law Review
EL Rev.- European Law Review
Harv.L.Rev.-Harvard Law Review
HJL- Harvard Journal on Legislation
ICCL Rev.- International Company and Commercial Law Review
ICLQ-International and Comparative Law Quarterly
IHL- In-House Lawyer
Int Fin. L. Rev.- International Financial Law Review
Int. Fin. Man. and Acct.- International Financial Management and Accounting
Int L. Practicum- International Law Practicum
Int. Law.- International Lawyer
Int TLR- International Trade Law Review
JA- Journal of Accountancy
JBL- Journal of Business Law
ICCLJ-International and Comparative Corporate Law Journal
JCCLSR-Journal of Comparative Corporate Law and Securities Regulation.
JCMS-Journal of Common Market Studies
JEIH- Journal of European Integration History
J.Env.L.&Pract- Journal of Environmental Law & Practice
JIBL- Journal of International Banking Law
JIEL- Journal of International Economic Law
LIA- Legal Information Alert
LQR- Law Quarterly Review
Manag. Fin.- managerial Finance
ML Rev.- Modern Law Review
NLJ- New Law Journal
Nw. J. Int’l. L. and Bus.- Northwestern Journal of International Law and Business
OSCB- Ontario Securities Commission Bulletin
RJT-Revue Juridique Themis
Sask. L. Rev.- Saskatchewan Law Review
Sec. & Corp. Reg. Rev.- Securities and Corporate Regulation Review
Sec. Reg. L. J.- Securities Regulation Law Journal
SJ- Solicitors’ Journal
SJLBF- Stanford Journal of Law, Business and Finance
SSHEPS- Stanford Studies in History Economics and Political Science
Stat LR- Statute Law Review
QLJ- Queen’s Law Journal
Tex.L.Rev.- Texas Law Review
Tulane J. Int. & Comp. L.- Tulane Journal of International and Comparative Law
U.W.O.L.Rev-University of Western Ontario Law Review
Vand. L. Rev.-
YLJ- Yale Law Journal
Wash. L. Rev.- Washington Law Review
World Comp.- World Competition

Others

All E.R.- All England Reports
Bull Suppl.- (European Community) Bulletin Supplement
COM- (European) Commission Documents
CSA- Canadian Securities Administrators
C.T.C.- Canada Tax Cases
ECJ- European Court of Justice
ECR- European Court Report
ECSC- European Coal and Steel Community
EEC-European Economic Community
EFSL- European Financial Services Law
EIPA- European Institute of Public Administration
EP- European Parliament
F.2d- (US) Federal (court report) Second series
F. 3d- (US) Federal (court reports) Third series
F.Supp.- (US) Federal (court reports) Supplement
FEE- Federation des Experts Comptables Europeens
MJDS- Multijurisdictional Disclosure System
OJ- Official Journal (of the European Community)
OSC- Ontario Securities Commission
S.C.R.- (Canada) Supreme Court Reports
UNTS- United Nations Treaty Series
US- United States (Reports)
S.Ct- Supreme court
W.W.R- Western Weekly Reports
I, the author, am an Assistant Professor of Law (on leave) in the University of Dhaka, Bangladesh. I am also enrolled as an advocate with the Bangladesh Bar Council. I entered the academic profession as a Lecturer in 1991 and was elevated to the present position in 1998. With excellent academic feats I completed my LLB Honours and LLM in 1987 and 1988 respectively from the University of Dhaka. Further I did an LLM (corporate law) in the Dalhousie University, Canada, in 1999. There I was a (student representative) member on the Graduate Studies Committee. By now I have a number of publications. Of them the following two have been published in the recent past in two western journals.

Globalisation of Securities Markets: Prospectus Disclosure for Equity Offerings in Perspective

PART I

INTRODUCTION

Economic activities and commerce were long considered a purely domestic matter because of the narrow and stringent attitude towards national sovereignty. Even in the twentieth century ‘international trade and investment was viewed by many as potentially threatening activities.’ Laws were tailored accordingly to serve a slavish role. Too much nationalism and selfish attitudes are alleged to be responsible for the two World Wars:

(T)he closed markets and competitive drive for national economic primacy that prevailed earlier in the (twentieth) century, and pursued through high tariffs and other border barriers, may well have triggered the Great Depression, and in turn the desire for national supremacy that led Nazi Germany and Japan to unleash their aggression on others.

In order to save the peoples of the world from such devastating wars and to improve their economic and social life standards the founders of the United Nations (UN), by going beyond the nationalistic narrow confines, felt the need of promoting economic and social advancement of all peoples of the world by employing international

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1 In this work the word “equity” refers to equity securities which are defined by the International Organisation of Securities Commissions (IOSCO) to include ‘common or ordinary shares, preferred or preference shares, options or warrants to subscribe for equity securities, and any securities, other than debt securities, which are convertible into or exercisable or redeemable for equity securities of the same company or another company.’ IOSCO, International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers (Sept. 1998) excerpted in Marc Steinberg, International Securities Law: Contemporary and Comparative Analysis, (London: Kluwer Law International, 1999), at p. 57.


3 Ibid.
machinery. As a part of the fulfilment of this commitment in the period of 1947-1948 under the auspices of the UN a Charter for an International Trade Organisation (ITO) was prepared, but ultimately the organisation did not come into existence. A component of the Charter, the General Agreement on Tariffs and Trade (GATT), did, however. As such, though ‘for the most part international economic activity remained regulated almost exclusively through national laws and regulations’, the long legacy of hindrance to cross-border trading was, to some extent, eased thereby. This was a partial success of the UN first initiative in the arena of internationalisation of business. Also at the regional level states tried to bridge economic/business union in second half of the twentieth century. For example, in the European Coal and Steel Community (ECSC) was created in 1951 to which even Second World War rivals (France and Germany) were parties. This was followed by the European Atomic Energy Community- Euratom (1957) and the European Economic Community- EEC (1957). These formed the foundation of the European Union (EU) of today. In North America an trade agreement, North American Trade Agreement (NAFTA), was reached in 1994 among the US, Canada and Mexico to remove hurdles on the way to economic integration. Thus peoples of the world, in the post-World War period, became increasingly eager and arduous for cross-border business and economic activities. Technological innovations have added a surging force to it. As result, during this time the world
trade rose up to 15-fold with a total of over US $6000 billion in 1995. In the same period world investment increased 5 times and production 6 times. As such ‘(m)ore and more countries are finding both their current prosperity and their future economic hopes dependent on the global market place.’

Particularly in securities ‘the world is becoming a global market place’ exceeding the domestic boundaries. This market is not a single market, rather ‘a collection of capital markets, which are becoming increasingly integrated and global in scope, with an increasing amount of freedom of movement between the markets.’

The typical examples of such integrated markets are those taking place within the European Community (EC) created by the EC Treaty, and within North America (US-Canada) under the Multijurisdictional Disclosure System (MJDS) founded on an agreement described below. In this thesis an attempt has been made to further integrate these two regional markets as a part of globalisation which is defined by the Encyclopaedia of Business and Management as ‘the process of increasing integration in world civilization’.

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12 Fried, supra note 2, at para. 16.
13 Ibid.
14 Ibid.
16 Fingleton recorded the traditional nature and operational aspects as follows:

> Twenty years ago, almost all activity on capital markets was domestic, and regulation was extremely restrictive and differed widely across national boundaries. In general, different activities such as banking and securities trading were clearly separate, the range of available financial instruments was relatively narrow, and many markets did not exist. Today the picture is vastly different.

17 Sackman and Coltman, supra note 15.
18 For details, see chs. 1.2-1.3, infra.
19 ‘(T)he MJDS is not an international legal agreement, but rather parallel sets of domestic rules (between the US and Canada).’ Douglas W. Arner, ‘Globalisation of financial markets: an international passport for securities offerings?’ 35(4) (Winter 2001) Int.Law. 1543, at p. 1551. For details, see ch. 6.1, infra.
The EC securities market started slowly with the adoption of company and securities directives in during 1960s to 1980s, for example, First Company Law Directive (1968)\(^{21}\), Fourth Company Law Directive (1978)\(^{22}\), Seventh Company Law Directive (1983)\(^{23}\), Listing Particulars Directive (1980)\(^{24}\) and Public Offer Prospectus (POP) Directive (1989)\(^{25}\). The adoption of these directives took much time ranging normally from two to 30 years.\(^{26}\) Their implementation in the national jurisdictions of the Member States has not been uniform and the securities markets have not been well integrated.\(^{27}\) In other words, no “passport legislation” (i.e., uniformly applicable throughout the EC) was in place. As a result, the securities regulation remained in a ‘Cinderella-like existence’\(^{28}\) in Europe until 1993 when the Investment Services Directive (ISD)\(^{29}\) was adopted. This Directive provides for a “single passport” for the EC securities firms to carry on cross-border operations throughout the Community with a single authorisation and supervision by the home Member State.\(^{30}\) Securities regulation continued to possess a priority on the Community agenda in view of the wealth and job creating role of the securities industry.\(^{31}\) Accordingly the EC

\(^{21}\) First Council Directive (68/151/EC) of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of art. 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, [1968] OJ Spec Ed (I) 41.


\(^{26}\) For example, adoption of the fourth and third company law directives took seven and eight years respectively while European Company Statute took 31 years.


\(^{28}\) Ibid., at p. ix.


\(^{30}\) Ibid., preamble.

\(^{31}\) See Moloney, supra note 27, at p. 28.
Commission floated a Financial Services Action Plan (FSAP)\textsuperscript{32} in 1999 setting out substantive measures with the aim of effecting more integration.\textsuperscript{33} Further in July 2000 the Council formed a Committee of Wise Men headed by Baron Alexandre Lamfalussy basically to evaluate the state of integration of the securities and investment services markets in Europe. The Committee delivered its report\textsuperscript{34} (called Lamfalussy Report after the name of the Chair) on the 15 February 2001. Reaffirming the importance of the integrated financial markets in the economic development\textsuperscript{35} the report revealed its findings including absence of Europe-wide regulation on different issues (e.g., prospectuses), inefficiency of the regulatory system, existence of a large number of clearing and settlement systems with the effect of fragmenting liquidity and increasing costs.\textsuperscript{36} The major problem it identified with the legislative and implementation system, in effect, that legislation was convoluted and time consuming and implementation of law was uneven among the Member States.\textsuperscript{37} The report then recommended measures, detailed later,\textsuperscript{38} for reformation of the EC law making and implementation procedure with respect to securities and investment services. The Stockholm European Council of March 2001 approved the report and urged for implementing the key steps for the achievement of the integrated securities market by the end of 2003.\textsuperscript{39} On 5 February 2002 the European Parliament accepted the same report.\textsuperscript{40} This has paved ‘the way for a more efficient system for EU institutions to

\begin{itemize}
\item \textsuperscript{32} COM(1999)232.
\item \textsuperscript{33} See, for the complete list of measures taken/underway under the FSAP, http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm
\item \textsuperscript{34} Final Report of the Committee of Wise Men on the regulation of European Securities Markets, (Brussels, 15 Feb. 2001).
\item \textsuperscript{35} Ibid., at p. 9.
\item \textsuperscript{36} Ibid., at p. 10.
\item \textsuperscript{37} Ibid., at pp. 13 and 14.
\item \textsuperscript{38} See ch. 3.3.2, infra.
\item \textsuperscript{39} See Moloney, supra note 27, at p. 31.
\end{itemize}
prepare, adopt and implement new financial services legislation.\textsuperscript{41} The first legislation enacted under this system is the Market Abuse Directive (MAD) of 2003\textsuperscript{42}. There are other measures underway to create “passport legislation” and thereby integrate more effectively the existing securities markets in Europe. For example, the Community is working on a prospectus directive\textsuperscript{43} that will enable issuers to offer securities in all Member States through one prospectus approved in the home country. This will replace the POP Directive\textsuperscript{44} and the listing particulars provisions (previously Listing Particulars Directive\textsuperscript{45}) as contained in the Admission and Information Directive (AID) of 2001\textsuperscript{46}. Again, the accounting directives (4\textsuperscript{th} and 7\textsuperscript{th} Company Law Directives), mentioned above, will be amended to uniformly apply international accounting standards throughout Europe. Thus at present there exist laws relating to prospectus disclosure in Europe, namely listing particulars provisions of the Admission and Information Directive (AID), and 4\textsuperscript{th} and 7\textsuperscript{th} Company Law Directives relating to accounting, which stand good until the prospective legislative changes take effect. In the incumbent work these laws will, in particular, be compared with their counterpart laws under the MJDS.

On the other hand, the MJDS is a special kind of alliance in securities area between Canada and the US. Based on a bilateral agreement the MJDS is a “first step” towards a further unity beyond North America.\textsuperscript{49} It is a solely security based arrangement unlike the EC which is a supranational organisation having its own

\textsuperscript{41} Ibid.
\textsuperscript{43} COM(2002)460final.
\textsuperscript{44} Supra note 25.
\textsuperscript{45} Supra note 24.
\textsuperscript{47} Supra note 22.
\textsuperscript{48} Supra note 23.
legislative, executive and judicial organs. Its partners, the US and Canada, are very similar from politico-socio-legal perspectives while the EC is ridden with the divergences of languages, laws, and political systems of the Member-States. But the uniqueness of the EC lies in the fact that in spite of these diversities it has been able to assemble 15 states so far under one umbrella with another 10 joining in May this year.\footnote{The European Union has a Europe-wide enlargement programme as part which ten more countries are joining on 1 May 2004 with the prospective assent by the European Parliament on 9 April 2004. Those ten countries are: Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Czech Republic, Slovakia and Slovenia. Negotiations are on with another three, namely Bulgaria, Romania and Turkey. http://europa.eu.int/comm/enlargement/docs/newsletter/weekly_080403.htm visited on 15 March 2004.} Both alliances are expansive by object, though the EC wants Europe-wide enlargement.\footnote{Ibid.} Keeping this in mind, as a part of the process of globalisation it may be possible to bring about an integration between them in the particular area of securities. Therefore, the present study has been undertaken to look for possible ways and means of integration between the MJDS and the EC securities markets and thereby to establish a transatlantic securities market.

EC companies the US has far and away a bigger securities market compared to Canada. The EC is also a vast market for the American companies. But why should Canada be ignored? Within the MJDS arrangement, as of February 2000, dozens of Canadian companies have made public offerings of securities raising US $153 billion from the US.\(^{53}\) Such Canadian companies are “world class”\(^{54}\) companies and hence qualify to extend their offerings across the Atlantic in addition to the US, if a further integration between the MJDS and the EC is established. In that case similarly the EC companies may offer their securities in the US and Canada. Instead of fragmenting the MJDS by linking the US and the EC only and ignoring Canada, such an approach would strengthen both the alliances. Besides, since the securities laws of Canada and the US are almost similar, the comparison between Canada and the EC would apply to the US and also to the MJDS as a whole. Based on this reason the present work will compare Canadian securities law concerning prospectus disclosure to that of the EC.

A note may be added here that, as the title says, in this study prospectus disclosure requirements for equity offerings, instead of the whole bunch of securities\(^{55}\), will be compared. The reason is that equity is the most common type of securities and the most part of the disclosure requirements relative to equity offerings are similar to other securities (debt securities).

The forthcoming parts of the thesis has been divided into different broad themes. In Part II a general discussion of the nature, organisation, function of the EC, etc has taken place with special focus on the securities regulation. Part III deals with a review of the MJDS. As the US securities law and Canadian securities law are closely


\(^{54}\) The Securities Exchange Commission (SEC) and the Ontario Securities Commission (OSC) have agreed to fix the amount of public float to US $250 billion for issuers desiring to make public offerings in either or both jurisdictions of Canada and the US under the MJDS. This amount is yet to be finally fixed by formal legal measures. When finally approved, companies offering securities in the said amount will be close to a world class issuer that is defined as an issuer which has a public float of US $300 million. Lorenz, supra note 52, at p. 800.

\(^{55}\) For the definition of securities, see the text accompanied by notes 999-1013, *infra*. 22
similar, a brief summary has been given of both laws showing how far they are similar and whether choosing Canada for comparison with the EC is justified in the sense that the comparison would fairly apply to the US law as well. One thing should be made clear that in both parts (II&III) securities laws relating both to the primary market (prospectus disclosure, regulatory review of prospectus, etc) and the secondary market (continuous disclosure, insider trading, etc) have been briefly summarised while comparison has been made only of prospectus disclosure requirements. In view of the ultimate focus on prospectus disclosure the review of secondary market requirements may seem to be irrelevant. The general purpose of the thesis is to display how globalisation in the sense of integration of securities markets (both primary and secondary) has occurred in the two regions in question. Hence gleaming on the secondary markets laws would not be out of place. Apart from that, some part of them would be relevant to comparison. For example, corporate annual reporting would be touched while discussing annual accounts. Then comes the prime part of the thesis (Part IV) that compares the prospectus disclosure laws of Canada and the EC with particular reference, as example, to the UK in most of the cases. Reason behind choosing the UK is that compared to other European countries most of the foreign companies are listed here and, therefore, highest foreign equity turnover takes place here.\textsuperscript{56} Besides, in the UK most of the EC legislation in company and securities area have been implemented rightly by the deadlines.\textsuperscript{57} At the end conclusion on the study follows in Part V.

\textsuperscript{56} For example, in May 2002 in Europe the total foreign equity turnover was 298808.3 million euros while on the London Stock Exchange alone turnover was 219432.0, which is 74\% of the total. Source: The Federation of European Securities Exchanges, at http://www.fese.be/statistics/monthly_statistics/tables/table3b.htm visited on the 5 July 02 (hard copy on file).

\textsuperscript{57} See Gillian Holgate, ‘European law over here’, (March 1997) 48 IHL 34, at p. 37.
PART II:
AN OVERVIEW OF EUROPEAN SECURITIES REGULATION

1 INTRODUCTORY

1.1 FOUNDATION OF THE EUROPEAN COMMUNITY

Europe, as a concept, is a family of nations that share ‘cultural heritage’ and ‘historical tradition’. Since 14th century the unification of Europe had been thought as a preventive to wars, which was confirmed by intellectuals after the

58 The origins of the European lineage go back to unavailable pagan history. Only the 4th century BC history says that a major part of Europe were populated by the Celtic tribes. Skilled in metal works, astronomy, etc., they were warmongers, but at the same time they fathered certain human values and ideologies even surviving today, e.g., democracy, equality of the sexes, protection of the sick and the weak. On the other hand, the Greeks used to respect rationality and individual autonomy. And the Romans developed an ever-known law and order system. ‘These contrasting traditions of civilised life met a new force which would come to dominate European thought and spirituality. That force was Christianity.’: Roy N. Pedersen, One Europe- 100 Nations (Clevendon, Philadelphia and Adelaide: Channel View Books, 1992) at p. 11. When in the 7th century Islam started expanding in Europe, the European Christendom principally formulated the concept (of European Christianity) to fight off the succeeding marches of Islam for the whole period of the Middle Ages. This conceptualisation did not continue intact during the following centuries. From the 15th century the Christendom was losing mastery on European politics and consequently the idea started going beyond the religious confines and entered into shell of humanism and secularism with the advent of the Renaissance, the Reformation and the Enlightenment. During the 19th and 20th centuries Europe was swept by the nation-state concept and the world witnessed imperial hegemonies in Germany and Italy, and two ruinous World Wars. Europe broke up into two rival blocs- democratic West and communist East. In 1989 the rivalry disappeared and the communist bloc turned to capitalism and liberal democracy. As of today Europe may, as a concept, be typically characterised by secularism, human rights and democracy, which has evolved through political, philosophical and strategic contradictions and changes over centuries. See Philippe de Schoutheete, The Case for Europe- Unity, Diversity, and Democracy in the European Union, (London: Lynne Rienner Publishers, 2000), at p. 4. Delanty has aptly put this as follows: ‘No coherent idea runs through European history from the earliest time to the present…: the European idea has been more the product of conflict than of consensus.’ Delanty, Inventing Europe, above, at p. 2.

60 For example, a French lawyer, Pierre Dubois, in a Treatise on the Way to Shorten Wars, proposed that, ‘in order to prevent an outbreak of hostilities, a Council should oversee all monarchies and cities in Europe.’ In 1693 William Penn, the English Quaker, suggested in his An Essay Towards the Present and Future Peace of Europe that ‘[A] European Parliament should be established consisting of representatives of the Member States. The purposes of this Parliament were to prevent wars breaking out
First World War, but no organisation took place due to the practice of the ‘countervailing idea of the nation-state’. It was the ‘cathartic effect’ of the Second World War that the policy-makers came to ‘rediscover their institutional imagination’. For example, immediate after the War (on 19 September 1946) Winston Churchill, ex-Prime Minister of the United Kingdom, called for the formation of a “United States of Europe” under the leadership France and Germany. The first stride towards the proposed union was the formation of the Council of Europe on 5 May 1949, which was a ‘confederation of states and Federal State’. But ‘the economic gains of integration became the chief motive for continuing the process’ of establishing peace in the place of war. Therefore, the Community founders initiated institutionalisation in the economic area. On 9 May 1950 Robert Schuman, the ex-Foreign Minister of France, put forward a proposal for creating a supranational organisation with sovereign powers in the area of French and German coal and steel...
His main purpose was to bring France and Germany, Second World War enemy of each other, to a friendly relationship and thereby to base the European Community on it. The coal and steel were the war-generating industries and, therefore, bringing them under common authority could end strife between France and Germany. His proposal for the coal and steel Community was thus primarily meant for economic integration, but the ultimate goal was political. However, Schuman’s plan was followed through the establishment of the European Coal and Steel Community (ECSC) in 1951 by a treaty with the purpose of creating a common market in coal and steel. Thus with the ECSC ‘the Community started basically as an economic organisation, although the final objectives were clearly political.’

Next, a supranational organisation may be defined as an independent entity composed of a number of States to which powers have been transferred from national level. Edmund Dell, The Schuman Plan and the British Abdication of Leadership in Europe (Oxford: Oxford University Press, 1995)

Weberill, supra note 69, at p. 7.

This two-fold objective of the Schuman Plan can be expressed in his own words:

The pooling of coal and steel production should immediately provide for the setting up of common foundations of Europe... The solidarity in production thus established will make it plain that war between France and Germany becomes not merely unthinkable, but materially impossible.

: quoted in Weatherill, supra note 69, at p. 8.

Schuman received encouragement from Jean Monnet in formulating his plan. Hence it is called “Monnet-inspired Schuman Plan”: Werner Feld, Book Review (Merry and Serge Bromberger, Jean Monnet and the United States of Europe- tr. Elain P. Halperin, New York: Cward-McCann, 1969) 11 JCMS 158.

Treaty Instituting the European Coal and Steel Community (ECSC Treaty), signed on 18 April 1951 at Paris, No. I.3729, (1957) 261 UNTS 140. It came into force on 23 July 1952 with validity for 50 years (until 30 July 2002), 261 UNTS 150 at p. 143. The signatories to the treaty were Belgium, Netherlands, Luxembourg, Italy, Germany and France. They ‘resolved to substitute for historical rivalries a fusion of their essential interests; to establish, by creating an economic community, the foundation of a broad and independent community among peoples long divided by bloody conflicts; and to lay the bases of institutions capable of giving direction to their future common destiny.’ Preamble to the Treaty (emphasis added), 261 UNTS 140 at 143. ‘The European Coal and Steel Community has fully accomplished this task. It has made a key contribution to bringing about and consolidating peace in Europe and promoting political and economic integration, thereby laying the foundations for further progress towards European unification.’ ‘Opinion of the Committee of the Regions of 13 April 2000 on the ‘Expiry of the ECSC Treaty’ (hereinafter ‘Opinion of the committee of regions’), O.J. C226, 08/08/2000 p. 50 (para 1.2). In this respect the role of the High Authority, the executives of the ECSC, is of particular importance. ‘It had set out the institutional principles, it provided a bold initial impulse for European integration by pooling Member States’ production of coal and steel, and it created a climate of trust between former enemies on the basis of economic co-operation in a specific sector, which became a model of political farsightedness.’ Henriette C. Pience, Book Review,(Dirk Spierenburg and Raymond Poidevin, History of the High Authority of European Coal and Steel Community: Supranationality in Operation, (London: Weldenfeld & Nicholson, 1994) ) (1995) ECL Rev. 16(2) 130 at 130.

based on the Spaak Report (named after the Belgian politician Paul-Henrie Spaak) negotiation for further integration was agreed upon by the Foreign Ministers of ECSC’s six founder Member States when they met in Messina on 1 and 2 June 1955. Accordingly two treaties were negotiated in 1957. One is the European Atomic Energy Community (Euratom) Treaty and the other is European Economic Community (EEC) Treaty. The former was meant to bring about development in the nuclear industry in the six Member States. The latter was designed to cover general economic fields falling outside the folds of the ECSC and Euratom Treaties. Thus these three were the founding organisations of the European community, having the same (institutional) structure.

1.2 QUEST FOR A “COMMON MARKET”- COMMUNITY’S COMMITMENT TO FOUR FREEDOMS

Of the said three institutions the EEC was the leading one. Its main task was ‘to promote throughout the Community a harmonious, development of

76 Weidenfeld, supra note 67 at p. 9.
77 298 UNTS 167. This Treaty was signed on 25 March 1957, 298 UNTS 3 at p. 5. It came into force on 1 January 1958, 298 UNTS 167 at p. 169.
78 298 UNTS 11. The EEC Treaty was signed on 25 March 1957, 298 UNTS 3 at p. 5. Its became operative on 1 January 1958, 298 UNTS 11 at p. 11.
79 Euratom Treaty, art. 2 lays down the aim the Euratom Community as ‘to contribute to the raising of the standard of living in Member States and to the development of commercial exchanges with other countries by creation of conditions necessary for the speedy establishment and growth of nuclear industries.’ 298 UNTS 167 at p. 172.
80 Initially all the three institutions, ECSC, EEC and Euratom, had separate Councils and Commissions. On 8 April 1965 a Merger Treaty was signed and the institutional structure of the organisations was simplified in that they had one Council, one Commission, one Court of Justice and one Assembly.: Christopher Vincenzi, Law of the European Community, 2nd ed. (London, San Francisco, Kuala Lumpur and Johannesburg: Financial Times Management, 1999), at p. 6.
economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it’.82 As this provision reads, the Community aimed, among others, at economic development and at the same time at closer relations among the Member States. The former confirms its economic character and the latter political, but the economic development ‘was always planned with grander aspiration’83, because, for some theorists, economic integration ‘inevitably begets political integration too, even without any explicit initiatives directed at the political sector.’84 A two-fold means was envisaged to achieve these goals, namely establishment of a common market, and progressive approximation of the economic policies of the Member States.85 But the economic success as a goal and common market as a means to reach that goal received prominence in the Community propaganda and activities.86 Even the common market and the Community were the interchangeably used jargons in the United Kingdom for many years.87

It may be noted that in the present context Common Market means ‘a market in which every participant within the Community in question is free (from any obstacle) to invest (capital), produce (goods), work, buy and sell, supply or obtain services under conditions of competition which have not been artificially distorted wherever economic conditions are most favourable.’88 Here the expression ‘conditions of competition which have not been artificially distorted’ means that the conditions of competition have not been made unequal among the participants of the common

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82 The EC Treaty, art. 2, 298 UNTS 11 at p. 15. (emphasis added))
83 Wheatherill, supra note 69, at p. 6.
84 Ibid. at p. 8.
85 Supra note 82.
86 Weatherill, supra note 69.
87 Ibid.
market.\textsuperscript{89} In other words, the common market comprises unfettered\textsuperscript{90} four freedoms, namely the free movements of goods\textsuperscript{91}, persons\textsuperscript{92}, services\textsuperscript{93} and capital\textsuperscript{94} under equal conditions of competition.\textsuperscript{95} The materialisation of these freedoms requires harmonisation of the national laws\textsuperscript{96} so that no discrepancies remain between such laws, which might distort the equal conditions of competition.\textsuperscript{97} Thus harmonisation would facilitate the appropriate functioning of the market.\textsuperscript{98}

The Common Market supposed to have been established by 1969\textsuperscript{99} failed to have a “snowball effect”.\textsuperscript{100} However, by the end of 1970s remarkable progress was made, e.g., removal of principal obstacles to free movement of goods, introduction of a common custom, harmonisation of laws facilitating intra-Community trade, etc.\textsuperscript{101} Yet there were other objectives unfulfilled, e.g., still there remained customs formalities, and free movement was limited\textsuperscript{102}. On the other hand, the world economic crises of Mid-1970s (e.g. oil crisis of 1973-74 and 1978-79, failure of international monetary system) had adverse impact on European peoples who ‘very quickly retreated back to

\textsuperscript{89} Ibid. at p. 123 note 45.
\textsuperscript{90} See EC Treaty, art. 3(a) and 3(c), 298 UNTS 11 at p. 16 (present art. 3.1(a) and 3.1(c) )
\textsuperscript{91} EC Treaty, arts. 9-37, 298 UNTS 11 at pp. 18-29 (present arts. 23-31).
\textsuperscript{92} Ibid. arts. 48-51, 298 UNTS 11, at pp. 36-37 (present arts. 39-48).
\textsuperscript{93} Ibid. arts. 59-66, 298 UNTS 11, at pp. 40-42 (present arts. 49-55).
\textsuperscript{94} Ibid. arts. 67-73, 298 UNTS 11, at pp. 42-44 (present art. 56-60).
\textsuperscript{95} See EC Treaty, art. 3(f), 298 UNTS 11 at p. 16 (present 3.1(g) )
\textsuperscript{96} This has been confirmed by the European Court of Justice (ECJ) in Commission \textit{v} Council (case C-300/89) [1991] ECR I-2867 at 2899.
\textsuperscript{97} See EC Treaty, art. 3(h), 298 UNTS 11 at p. 16 (present art. 3.1(h) ). In this context it is relevant to mention that in the EC Treaty three different terms, namely “to approximate”, “to coordinate”(art. 44(2)(g)) and “to harmonize” have been used in a synonymous sense with the same objective of abolishing obstacles to interstate movement of person, good, capital and services. : Hans Claudius Ficker, ‘The EC Directives on company law harmonisation’ in Clive M. Schmitthoff, (ed.), The Harmonisation of European Company Law (London: UKNCCCL, 1973), pp. 66-82 at pp. 67-68.
\textsuperscript{98} See Commission \textit{v} Council, ibid.
\textsuperscript{100} EC Treaty, art. 8(1), 298 UNTS 11.
\textsuperscript{101} Ward, \textit{supra} note 58, at p. 17.
\textsuperscript{102} Weidenfeld, \textit{supra} note 67, at p. 12.
into the shells of their nation state mentalities.\textsuperscript{103} To add to this, the Member States were hardly ready to comply with the Council’s legislative measures and thereby to concede national sovereignty any more.\textsuperscript{104} As well, there were troubles in the institutional functioning of the EC. For instance, the Treaty provided for Council’s decision-making by unanimity in certain matters, e.g., confirmation of the completion of each stage of transitional period.\textsuperscript{105} At the same time, it allowed qualified majority voting (QMV\textsuperscript{106}) in respect of particular situations\textsuperscript{107}. But after the Luxembourg compromise\textsuperscript{108} even in the latter cases the Council used to demand unanimity where Member States’ “vital interests” were involved. ‘As a consequence, many promising lines along which a dynamic integration policy would have developed were cut off in the Council of Ministers.’\textsuperscript{109}

The aforementioned shortcomings and crises outweighed the success of the integration programme. Europe was suffering from ‘a very complicated illness’ in its

\textsuperscript{103} Ward, \textit{supra} note 58, at 17.


\textsuperscript{105} The 12-year transitional period for the completion of the Common Market was divided into three stages of four years each. At the completion of each stage a confirmatory statement was required to be made by the Council, on the report of the by Commission by a unanimous vote. see EC Treaty, original art. 8.

\textsuperscript{106} Qualified Majority Voting is a ‘method of calculating the result of a vote based on the votes having to be at a statutorily fixed threshold above an absolute majority (more than half of the votes). …. The votes are weighted also to take into account the population sizes of the Member States.’ Francois Gondrand, \textit{Eurospeak- A User’s Guide: The Dictionary of the Single Market} (London: Nicholas Brealey Publishing, 1992) at p. 224. At present the Member States’ voting carries the following weights : 10 for France, Germany, Italy and the UK; 8 for Spain; 5 for Belgium, Greece, the Netherlands and Portugal; 4 for Austria and Sweden; 3 for Denmark, Finland and Ireland; 2 for Luxembourg. :Anne Ramsay FLA(ed.) (compl. Jackie Woollam and Lillian Stevenson), \textit{Eurojargon: A Dictionary of European Union Acronyms, Abbreviations and Sobriquets} (Chicago and London: Fitzroy Dearborn Publishers, 2000) at p. 293.

\textsuperscript{107} For example, the right of establishment, liberalization of capital, competition law, common agricultural policy, etc. See Gondrand, \textit{ibid}.

\textsuperscript{108} Since 1 July 1965 France had been abstaining from the Council meetings in protest to the Commission’s plan of expanding the number of issues requiring qualified majority voting (QMV). This is known as French ‘empty chair policy’, which created a deadlock situation in the functioning of the Council. In order to pacify France it was agreed in a Luxembourg meeting that while deciding a matter subject to QMV the Council would postpone it if it were claimed to have harmed ‘vital national interests’ of the Member States. If such a claim were made, it would mean that no decision in that matter could be made without unanimity. If an attempt were made to decide by QMV, the result would be blocked by veto. Thus after 1966 there evolved a “veto culture” in the Council decision-making. John Peterson and Elizabeth Bomberg, \textit{Decision Making in the European Union} (New York: St. Martin’s Press, 1999) at p. 49.

\textsuperscript{109} Weidenfeld, \textit{supra} note 67, at p. 10.
socio-economic and political life. At the international plane it was lagging behind its competitors like Japan and USA. As a consequence, by the start of 1980s the Member States began to lose faith in national solutions to their economic problems, rather they were preferring European solutions. At this backdrop, there was a need to ‘re-ignite the European idea’. To this end, “A Single Market by 1992”, ‘an ambitious programme’ was proposed by the EC Commission in its White Paper in 1985. The European Council (of Ministers) lent approval to this proposal in the same year. This was followed by the adoption of the Single European Act (SEA) in 1986, by which amendments, formally effective from July 1987, were wrought to the EC Treaty with a view to accomplishing the internal market programme. It (SEA) ‘aimed to give the completion of the Common Market a new boost by setting a target for creating a new Single Market by removing all the remaining legal, technical and physical obstacles to the free movement of goods, persons, capital and services.’ The competences of the

110 P. Dankert, ‘The European Community- Past, Present and Future’, 21 JCMS 3, at 8. The symptoms of the “illness” were ‘unemployment, social unrest, growing insecurity and sense of alienation on the part of our young people.’ Dankert, above.


112 Ibid., at 37

113 Ibid. Recent research shows that states took part in the integration process because they would benefit from it. Gilbeert Trausch, ‘Introductory Words’, (1995) 1:1 JEIH 3 at p. 3. Thus in particular, the UK and France joined the EEC to “preserve” or “secure” their (strategic and economic) world interest. Alan S. Milward, ‘Allegiance: The past and the future’, (1995) 1:1 JEIH 7 at pp. 9-10. To quote another author, ‘Uppermost in British minds was always the desire to preserve their own influence over allies, such as US and Germany in a period when reduced funding impinged upon all strategic thinking.’ : G. Wyn Rees, ‘British strategic thinking and Europe’, (1999) 5(1) JEIH 57 at 71. Similarly, as to whether it has been justifiable for Ireland to ratify the Single European Act one author came up with the finding that the ‘the assessment of the costs and benefits of membership strongly suggests that there has been a considerable balance of advantage to Ireland from the integration to date and that further economic benefits can be expected as a result of the SEA.’: Dermot MacLeese and Alan Mathews ‘The single European act and Ireland: Implications for small member states’, (Sept. 1987) JCMS 39 at 57.

114 Jones, supra note 104 at p. 464.


117 Vincenzi, supra 80, at p. 7. The SEA has, however, been criticised as that ‘The work of creating the European internal market is characterized by a peculiar logic. The aim is to simplify the economic, social and political life of the peoples of Europe yet the associated methods are becoming increasingly complex- at least as regards their institutional structure.’ : Roland Bieber, ‘Legislative procedure for the establishment of the single market’, (1988) 25 CML Rev. 711, at 711. Another author has termed the act as ‘fundamentally deceptive’ because, among others, it has ignored the achievements gained previously under the common market program as it implied in new art. 8A of the EC Treaty that everything should
EC as envisaged by the SEA were further extended to include common foreign and security policy, and home and justice affairs through the formation of the European Union (EU) by the Treaty of Maastricht signed on 7 February 1992. Thus the common market continued by the internal market programme, primarily an economic programme, has ultimately led the EC to a political organisation. Since the EC is the basic organisation and the EU is an extension of it both referring to the same Community of European States, in this thesis EC, EU, Community and Union would be interchangeably used.

1.3 RECAPITULATION AND RELEVANCE OF SECURITIES MARKET IN CONTEXT

As seen above, originally launched in 1958, the “Common Market” programme could not fully achieve its goal by the end of 1970s. Here the goal supposed to have been fully achieved refers to a “single integrated market” for all the be re-started, and secondly, the ‘well-balanced’ concept of ‘common market’ has been replaced by the ‘one-sided’ concept of ‘internal market’. Pierre Pescatore, ‘Some critical remarks on the single European act’, 24 CML Rev. 9, at p. 11.

For the draft of the Treaty, see (1984) OJ C77/33. For the text of Treaty, see Belmont European Policy Centre, The New Treaty on European Union, v. 1 (Boulevard Charlemagne, Belgium: Belmont European Policy Centre, 1991) at p. 75. This treaty and the EC Treaty were amended by the Treaty of Amsterdam in 1997 by way of simplification, eliminating the obsolete text and renumbering their art.s. For the present amended texts of the two treaties after Amsterdam, see Bernard Rudden and Derrick Wyatt (ed.) Basic Community Laws, 7th ed. (Oxford: Oxford University Press, 1999) at pp. 97-113 and at pp. 3-95 respectively. As to what factors led to the negotiation of the Treaty of Maastricht, see Paolo Mengozzi, European Community Law, transl. Patrick Del Duca (The Hague, London and Boston: Kluwer Law International, 1999) pp. 4-7. The Maastricht Treaty contains two principal sets of provisions. The first set of provisions revised the EC, ECSC and Euratom Treaties either by amendment of then existing provisions or by addition of new provisions. The second set of provisions, by way of supplementation to the said treaties, established a broad framework for intergovernmental co-operation in the field of foreign and political security and also in the field of justice and home affairs. The said treaties are called the first pillar, the foreign and political security the second, and the home and justice the third pillar of the European Community. See Paul Demaret, ‘The treaty framework’, in D. O’Keeffe and P. Twomey, (ed.), Legal Issues of the Maastricht Treaty (London, New York, Chichester, Brisbane, Toronto and Singapore: Wiley Chancery Law, 1994) pp.3-11, at p. 3.

Recently one author has observed that ‘(s)ince the foundational Treaty of Rome in 1957, the main objectives of the E.U. have evolved from what was originally a purely commercial perspective to acquire other interests such as military, cultural and social ones.’ Julian Rodriguez -Pardo, ‘Highlights of the origins of the European Union law on copyright’, (2001) EIP Rev. 23(5) 238 at 238. Thus single market is not simply a technocratic program to remove the remaining obstacles to the free movement of all factors of production. It is at the same time a highly politicised choice of ethos, ideology, and political culture, and the culture of ‘the market’…’: J. H.H. Weiler, “The Transformation of Europe” (1991) YLJ 2403, at 2477.

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Members States. 120 This was reiterated by the European Court of Justice that the Common Market ‘involves the elimination of all obstacles to intra-Community trade in order to merge the national markets into a single market bringing about conditions as close as possible to this of a genuine internal market.’ 121 In other words, the Common Market was supposed to look like a ‘domestic market of a single state’. 122 In order to attain this goal by removing the remaining obstacles to it the “Internal Market” programme was renewed in 1985. It reasserted its commitment to “four freedoms”, namely free movement of goods, persons, services and capital. 123 Thus capital market including related services (both securities market and money market) is one of the components of the internal market where it would be ensured that resources, among others, capital and investment, ‘flow into the areas of greatest economic advantage’. 124

2 THEORETICAL BASES AND METHODS OF MARKET INTEGRATION

Single market, in general, and single securities market, in particular, seem to be based on economic integration theory propounded by Scitovsky. 125

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120 EC White Paper, supra note 115, at p. 4.
122 Kepteyn and Themaat, supra note 30.
123 art. 8a of the Single European Act, supra note 116, provides that ‘(the) internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this (EEC) Treaty.’
124 EC White Paper, supra note 115, at p. 5.
125 Geoffrey Fitchew, ‘Political Choices: Report’ in Richard M. Buxbaum et al (ed.), European Business Law- Legal and Economic Analyses on Integration and Harmonization (Berlin, New York: Walter de Gruyter, 1991) pp. 1-34, at p. 4. B. For economic integration theory in general and without particular reference to Europe, see Bela Balassa, ‘Theory of Economic Integration’, supra 68, and Bela Balassa, The Theory of Economic Integration (London: George Allen & Urwin Ltd., 1962). For two important critiques of the economic integration theory and their refutation, see Fitchew, above, at 4-6. ‘Common Market’ is a programme for the common good of the European peoples. As such in spite of the fact that the Common Market operates through the exchange of private interests, it is carried out as an institution in the interest of all the nations of the EC. This collective interest is not purely economic, rather political. Thus economic integration meets the conditions of political representation. : Hans Lindahl and Bert van Roermund, ‘Law without a state? On representing the common market’, in Zenon Bankowski and Andrew Scott (ed.), European Union and its Order: the Legal Theory of European Integration (Oxford: Blackwell, 2000) pp. 1-16 at pp. 12-16. However, the political character of the EC does not amount to that of a State and so it lacks in State sovereignty. Legal theorising, which presupposes the existence of a sovereign State for making law, encounters the EC situation as a novel phenomenon challenging the
According to him European economic integration can take place through ‘the abolition of restrictions on the movement of products and, …on the movement of labour and capital.’¹²⁶ This will generate competition among the national economies of the Member States under equal conditions. Such competition may produce ‘unfavourable effects’ on any particular sector of any national economy. For example, small business firms that a particular Member State had been fostering with subsidy, even to the disadvantage of the big ones, may not survive the competition.¹²⁷ In such a situation Scitovsky suggests for adopting measures to remove the ‘unfavourable effects’ or to convert them into ‘favourable ones’ and thereby to bolster the integrated market.¹²⁸ On the similar line of hypothesis the European Commission sought to completely establish the integrated single market free from ‘barriers of all kinds’¹²⁹. In doing so it, of course, recognised that ‘many of the changes …will present considerable difficulties for Member States and time will be needed for the necessary adjustments to be made.’¹³⁰ As to why such adjustments should be made the Commission maintains that

The benefits of an integrated community economy of the large, expanding and flexible market are so great that they should not denied to its citizens because of difficulties faced by individual Member States. These difficulties must be recognised, to some degree they must be accommodated, but they should not be allowed permanently to frustrate the achievement of the greater progress, the greater prosperity and the higher level of employment that economic integration can bring to the Community.¹³¹

¹²⁷ Ibid. at p. 134.
¹²⁸ Ibid. at p. 16.
¹²⁹ EC While Paper, supra note 115 at p. 4.
¹³⁰ Ibid. at 7.
¹³¹ Ibid.
Now what are the barriers to the establishment of the integrated market? How can they be overturned? The Commission identified three kinds of barriers: (a) physical barriers, e.g., national customs posts; (b) fiscal (or taxation) barriers; and (c) technical barriers. Of these the last category was ‘most extensive and included all national measures that restricted market access for non-domestic products’, for example, ‘different standards for individual products adopted in different Member States for health or safety reason or for environmental or consumer protection’. With regard to capital and financial market technical barriers refer to different ‘regulatory and prudential standards applied in particular to operators and providers of services’. However, in order to eliminate the barriers the Commission moved away from its erstwhile only-harmonisation approach to an amphibious approach of harmonisation and mutual recognition. The reason behind was that despite ‘unprecedented progress’ by 1985 harmonisation had a number of shortcomings, e.g., detailing technical specifications which was subject to unanimity in the Council caused much delay. As well, relying solely on harmonisation would have been ‘over-regulatory’. On the other hand, resorting to only-mutual recognition would have been insufficient given the increasing size of the competitive market of Europe.

At this point it is relevant to focus on the nature and function of harmonisation and mutual recognition with regard to market integration. As observed above, the internal market programme aims at establishing a market without frontiers. In other words, the intended market will look like a domestic market where goods and related production factors (person, capital and services) can freely move. But the

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132 Ibid.
134 Ibid. at p. 6.
135 Fitchew, supra note 125.
136 White Paper, supra note 115, at pp. 18-19.
137 Ibid. at p. 18.
138 Ibid.
Member States, with a variety of diversities\textsuperscript{139}, have different legal and administrative requirements, e.g., varying standards for products, qualifications for professionals and regulations for services. These differing requirements stand in the way of the said four freedoms. Therefore, there was a need of laying down essential requirements instead of detailed ones so that the Member States could incorporate them in the domestic laws or amend necessary legal provisions. In this way harmonisation would be achieved.\textsuperscript{140} Article 94 (ex-Article 100a) of the EC Treaty provides for harmonisation mainly through EC Directives issued by the Council. The member states are supposed to adopt means to comply with the Directives. The means adopted by the states may differ, but the ends must be the same.\textsuperscript{141} In this system, so far the securities market is concerned ‘issuers can be certain of the results in each participating country, but may still have to comply with various sets of rules’\textsuperscript{142} A derogation from the harmonisation provision may be available to a Member State on certain grounds like health, safety, environmental protection etc.\textsuperscript{143} Member States are allowed to legislate in such cases with varying standards or regulations.\textsuperscript{144}

\textsuperscript{139}The EC member states have a variety of diversities with regard to language, legal system, economic strength, and geographical size and position and so on. In spite of this they sought cohesion based on the common economic and political goals. This is unique of the integration process of Europe. To quote Schoutheete, ‘In reality, the entire European integration process is marked by a dialectical relationship between the necessary cohesion of the Union and the equally necessary diversity of the parts.’: \textit{Supra} 58, at p. 64. Both cohesion and diversity are “necessary” and neither of them can be undermined at the cost of the other, otherwise that will prompt ‘a contrary reaction’. :Schoutheete, above, at p. 64. In the integration process the diversities and cohesion go hand in hand.

\textsuperscript{140}Gondrand, \textit{Eurospeak, supra} note 106, at 158.


\textsuperscript{142}\textit{Ibid}.

\textsuperscript{143}EC Treaty, art. 95 (old art. 100a)

\textsuperscript{144}\textit{Ibid}. These varying standards are possible to be mutually recognised by the Member States. This has encouraged innovation at national level and at the same time integration at the Community level, which was missing in the Pre-SEA Europe. For detailed discussion on this issue, see Stephen Weatherill, \textit{Beyond Preemption? Shared Competence and Constitutional Change in the European Community’ in David Keeffe and Patrick Twomey (ed.), \textit{Legal Issues of the Maastricht Treaty} (London, New York, Chichester, Brisbane, Toronto and Singapore: Wiley Chancery Law, 1994) 13-33. At one place in this art. he wrote, ‘In casting aside total harmonization as a model which cannot reflect the diversity of interests in the modern Community, one is welcoming flexibility and innovation and enshrining greater sensitivity to national preferences.’ at p. 22.
In the areas where harmonisation of technical standards or regulations is not essential from health, safety and other well-defined grounds law requires, for the purpose of market integration, ‘(r)ecognition by a state of the validity on its own territory of rules made by one or more other states’. This is known as the principle of mutual recognition, which was first established by the ECJ in the famous case of *Cassis de Dijon.* Apropos securities law its basic purpose is ‘to keep the amount of supplemental information as small as possible.’ If the issuers’ home country administration reviews the necessary documents, that will do; they need not experience regulatory hassles in other jurisdictions. The method of mutual recognition operates in a dual fashion: removing barriers to intra-Community market, and setting common

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145 Gondrand, *Eurospeak,* supra note 106 at p. 196. Also see Johnston and Rockwell, *supra* 141, at 316. After the European Communities had adopted mutual recognition as a method of economic integration to remove technical barriers, it 'has played a leading role in the process of European integration, in particular, promoting the free movement of goods, services and persons'. Den-Chin Horng, 'The principle of mutual recognition: the European Union’s practice and development', (1999) 22(2) World Comp. 135 at p. 153. The principle has also become popular with other regions and at the international plane. In this regard, see John Clarke, 'Mutual recognition agreements' (1996) 2(2) Int TLR 31 at 35. Behind such large scale acceptance principally lies the following rationale:

- Mutual recognition is perceived as a simple, low-cost and low-maintenance mechanism for overcoming regulatory impediments to trade. It also represents a cost-effective alternative to harmonisation of regulations and standards. While harmonisation requires costly and time-consuming negotiation among nations to achieve a consensus on mutually acceptable standards, mutual recognition achieves a similar effect more rapidly and without the associated costs.

146 *Rewe v Bundesmonopolverwaltung fur Branntwein (Cassis de Dijon),* case 120/78, [1979] ECR 649. In this case the plaintiff importing French wine, Cassis de Dijon, with alcohol content of 15%-20%, was barred by the concerned German authority on the ground that it had to contain a minimum alcohol content of 25% as provided for by German law. It was contended that in absence of common rules German prohibition amounted to a quantitative restriction to free movement of goods within the Community according to art. 30 (present art. 28) of the EC Treaty. The ECJ upheld the contention. It said that it could have been accepted if it were necessary ‘to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer.’ at p. 662. In other words, the Court for the first time established that in absence of harmonised Community law goods produced and marketed legally in a Member State must be recognised in other Member States unless it contravenes mandatory requirements rules. at p. 664. The *Cassis de Dijon* formula is an invention by the ECJ with a view to keeping atop the objective of common market as enshrined in the EC Treaty. The formula is not found in the Treaty. The Court has just filled up the gap.: Weatherill, *supra* note 69, at p. 236. Of course the “seeds” of the *Cassis de Dijon* formula was sown five years ago in *Dassonville,* case 8/74, ECR 837.: Rene Barents, ‘New developments in measures having equivalent effect’, (1981) 18(3) CML Rev. 271 at 296.

standards. For example, in the financial services area each Member State (host State) has to allow the financial services providers based in other Member State(s) (home State) free entry to its market subject to the condition that a minimum degree of protection for the investors or creditors is offered under the regulatory regime of the base country. Secondly, the EC issues Directives/Regulations setting common minimum standards, which will be mutually recognised by both the home State and host State(s). In absence of such EC legislation the national laws of the Member States will be applicable. It means the application of mutual recognition principle is not automatic, it requires EC legislative measures.

3. HARMONIZATION AND MUTUAL RECOGNITION UNDER THE EC CONSTITUTIONAL FRAMEWORK: LAW AND POLITICS

3.1 INTRODUCTION

As said above, harmonisation and mutual recognition are the two methods of economic integration in Europe. At this stage it is expedient to look at how these methods work within the EC constitutional framework and how its application is affected by the centre-periphery relationship existing within the quasi-federation of the

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148 Johnston and Rockwell, supra 141, at 316 n. 79.
151 Hertig, supra note 149, at p. 353. (footnote omitted). In this connection, see the ISD provisions, at ch. 4.4.4., infra.
152 Ibid., at p. 353. (footnotes omitted).
155 The EC Treaty is said to be the constitution of the Community, e.g., see Costa v ENEL, Case 6/64, [1964] ECR 585 at 605. However, the EC is not a State and so it does not have any constitution in the sense of a State constitution. Though it is not a State, it is not an international organisation either. It is something else characterised by three main features: exclusive competence (e.g. with regard to commercial agreements), lawmaking capacity that binds State legislatures and directly applicable to the citizens, and international personality represented through diplomatic agencies. : Schoutheete, supra note 58, at p. 24. It is ‘neither a federation nor a confederation of States. It is an ensemble sui generis which has characteristics of both’. Jacques Santer, ‘Some reflections on the principle of subsidiarity’, in European Institute of Public Administration (EIPA), Subsidiarity: The Challenge of Change (Maastricht: EIPA, 1991) pp. 19-30, at pp. 26-27. However, the EU is establishing a constitution for
EC. The central institutions (e.g., Council, Commission, and Parliament together) constitute the centre and the Member States form the periphery. The centre has exclusive powers in particular matters (e.g., common economic policy) and also shared powers (jointly with the periphery) in other matters. In the matters of shared jurisdiction the power to legislate primarily vests in the periphery. But when the Community can better achieve the objectives of a particular matter, it can foreclose the matter for legislation. But there is no standard to measure if it is better to be legislated by the Community. It is a matter of political consideration, not legal. Therefore, such a situation sometimes gives rise to political tussle between the centre and periphery when the ECJ is invoked for judicial determination. This generates serious questions about the legitimacy of the Court in dealing with a political bickering. Besides the decision-making process of the EU institutions concerning harmonisation or mutual recognition is topical. Much delay occurs in this process. Again, the decision-making is hindered, or at least delayed by the interest groups in the business arena. Lastly, implementation of the EC legislative measures is thwarted or faltered or delayed at the national level because of insincerity of the Member States. The Member States’ diverse politico-legal-cultural traditions and their inclination to retain them are liable for their insincerity. All these aspects involved in the process of economic integration of Europe in general are relevant before going into the particular area of discussion on securities market integration.

3.2 TOOLS OF HARMONIZATION AND MUTUAL RECOGNITION

3.2.1 KINDS OF TOOLS
Article 249 (Ex-Article 189) of the EC Treaty names five kinds of tools: regulations, directives, decisions, recommendations and opinions. A regulation is a Community legislation, which is addressed to all the Member States in general. It becomes a part of the national legislation and thus is directly applicable, in its entirety, in the Member States without any need of enacting national laws. A directive is also addressed to all Member States, but it does not automatically become a part of the national legislation. It lays down an objective to be achieved and the Member States are required to take legislative measures for its implementation. A decision may be directed towards Members States or, natural or legal persons or group of persons. It is also binding on the addressees. The EC implements treaties or regulations by means of decisions. A recommendation or opinion is merely a suggestion or view of the EC and does not, therefore, have any binding force.

In this connection it is worth mentioning that the actual nature of the aforementioned tools depends on their contents and not on their label. To quote the ECJ, ‘The determination of the legal nature of a measure emanating from the Council or Commission does not depend only on its official designation, but should first take into account of its object and content.’ Thus when an act formally labelled as “regulation” was challenged alleging that it was, in effect, a decision, the Court held it as a regulation and said that

A measure which is applicable to objectively determined situations and which involves immediate legal consequences in all Member States for categories of persons viewed in general and abstract manner cannot be considered as constituting a decision, unless it can be proved that it is of individual concern to certain persons within the meaning of the second paragraph of Article 173 (now 230).

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156. These are the secondary legislation of the EC. While the primary legislation, i.e. treaties, set forth the objectives of the Community activities, the secondary legislation lays down the detail of how those objectives are to be attained.
158. Ibid. at p. 479.
In another case the Court disregarded the official title of a regulation and adjudged it as a decision because it was addressed to particular undertakings.

Regulation and directive are the principal tools of integration in the EC and as such they deserve a bit more focus. The basic feature of a regulation is that it is ‘applicable not to a limited number of persons, defined or identifiable, but to categories of persons viewed abstractly and in its entirety’, which include ‘Member States, Community institutions, and private or public legal actors’. Second, it is ‘binding in its entirety’ and, therefore, the Member States to which it is addressed have no choice but to obey its provisions in toto. In this respect regulation differs from directive in that Member States have the choice as to how they will implement the objectives of a particular directive. Third, a regulation is of direct applicability in the Member States. This means that a regulation becomes a part of the national legal systems of the Member States and as such its application is not subject to incorporation into national laws of the Member States. National courts must enforce the rights created by it.

Directives have three characteristics. First, they are not generally applicable, they can only be addressed to one or several or all the Member States. They may not of themselves create obligations for an individuals and, therefore, provisions cannot be relied upon as against such individuals. Thus directive provisions may only be relied upon by natural or legal persons as against Member State(s) authorities that include custom authority, health authority, home office, tax office, and administrative authority.

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160 Confederation nationale des fruits et legumes, supra note 157.
161 Mengozzi, supra note 118, at p. 123.
162 EC Treaty, art. 249.
164 Ibid.
167 Van Duyn, case 41/74, [1974] ECR 1337.
authority. Second, they are binding on the addressees to the extent of the result to be achieved. In other words, unlike regulations they are not binding in their entirety. Third, unlike regulations directives are not directly effective. They are only effective by virtue of implementation by Member State(s). Of course, the implementation must be completed by the deadline usually set in the directives. While implementing the Member States must respect other Treaty obligations. Also they must comply with any other particular obligations imposed on them in relation to the directive implementation, e.g. reporting to the Commission about the measures adopted.

Although under Article 249 of the EC Treaty in general, as aforesaid, directives become effective upon implementation by the addressee Member States, it has been established by the ECJ that directives may have direct effect where they confer rights on individuals in sufficiently precise and unconditional terms. It means in such a case individuals can invoke those rights before national courts. To quote the Court:

Whenever the provisions of a directive appear, as far as their subject matter is concerned, to be unconditional and sufficiently precise, those provisions may be relied upon before the national courts by an individual against the State where that State has failed to implement the directive in national law by the end of the period prescribed or where it has failed to implement the directive correctly.

A provision is unconditional when obligations created by a directive are subject to no condition nor is their implementation subject to adopting of any measures by any Community institution or Member States. It is sufficiently precise where it imposes

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170 Mengozzi, supra note 118, at p. 125.
171 Ibid.
172 Ibid.
174 Ibid.
obligations in definite or unambiguous terms.\textsuperscript{175} Thus in \textit{Van Duyn}\textsuperscript{176} the Court of Justice held Article 3(1) of Council Directive No. 64/221 of 25 February 1964 to have conferred rights on individuals, which are enforceable by them in the national courts. This provision was intended to limit the discretionary powers of the particular national authorities. It laid down an unqualified obligation leaving no scope of interference either by the Community institutions or by the Member States. Such being the nature of obligation, it was held, the individuals must have the right of enforcement in national courts, otherwise the effect of the obligation would be impaired. In another case a Directive containing an ‘unconditional and sufficiently precise’ State obligation was held to have direct effect even though it (Directive) was not interposed in the domestic law before the implementation deadline had expired.\textsuperscript{177} Thus it has become a trend of the day in the EC legislative practice that the binding effect of directives are not limited ‘as to the result to be achieved’, rather they impose specific obligations on the Member States so that legislative measures incorporating them into national laws become redundant.\textsuperscript{178} They lay down the provisions in so detailed fashion that the Treaty requirement of the Member States’ choosing the form and methods of implementation has become meaningless.\textsuperscript{179} In this manner ‘the dichotomy (between regulation and directive) is increasingly uncertain’.\textsuperscript{180}

The rationale behind the direct effect provision lies in the fact that if the individual rights conferred by a directive do not receive legal protection in the national courts independent of their implementation, the Member States may undo its purpose by not executing it within the time-limit. In this way, opposed to the “clean-hand”

\textsuperscript{175} Ibid.
\textsuperscript{176} \textit{Van Duyn} case, supra note 167.
\textsuperscript{177} \textit{Pubblico Ministero v Ratti}, case 148/78, [1979] ECR 1629.
\textsuperscript{179} Ibid.
\textsuperscript{180} Ibid.
doctrine, the Member States may try to benefit out of their own fault, \textsuperscript{181} which is necessary to be prevented.\textsuperscript{182} Thus in \textit{SACE}\textsuperscript{183} where under Articles 9 (now 23) and 13(2) (now repealed) of the EC Treaty exacting charges having an effect equivalent to customs duties on imports were clearly and precisely prohibited. Later a timetable of the abolition of such charges was set by Directive No. 68/31. Italy levied customs duties on the plaintiff, which brought an action before the President of the Tribunale, Brescia, claiming repayment of the money it had paid as customs duties to Italian State. The President sought the ECJ’s opinion as to whether the Treaty provision and the Directive had direct effect in Italian legal system. The ECJ answered in the affirmative and observed:

Directive No 68/31, the object of which is to impose on a Member State a final date for the performance of a Community obligation, does not concern solely the relations between the Commission and that State, but also entails legal consequences of which both the other Member States concerned in its performance and individuals may avail themselves when, by its very nature, the provision establishing this obligation is directly applicable.\textsuperscript{184}

In this case the Court postulated the principle that in assessing the effect of a directive ‘it is necessary to consider not only the form of the measure at issue but also its substance and its function in the system of the Treaty.’\textsuperscript{185}

\subsection*{3.2.2 DIRECTIVE- THE MOST USED TOOL OF INTEGRATION}

Of all the integration tools directive is the most important one because of its double-ended role: it integrates the market on the one hand and respects the Member States’ sovereignty on the other.\textsuperscript{186} It is principally used for the Community’s

\begin{itemize}
\item \textsuperscript{181} Mengozzi, \textit{supra} note 118, at p. 128.
\item \textsuperscript{182} Marshall, \textit{supra} note 166, at p. 749.
\item \textsuperscript{183} \textit{SACE}, \textit{supra} note 165.
\item \textsuperscript{184} \textit{Ibid.}, at p. 1223.
\item \textsuperscript{185} \textit{Ibid.}, at p. 1223.
\item \textsuperscript{186} Buxbaum \textit{et al}, \textit{supra} note 125, at p. 143.
\end{itemize}
‘legal harmonization (so-called functional or liberal integration)’ whereas regulation is used to bring ‘legal unification only in special areas that require stronger intervention (so called institutional or authoritative integration)’\(^{187}\), for example, customs for imported goods. The ECJ recognised regulation as the last-resort mechanism of legal harmonization under Article 308 (ex 235) when no other tools are deemed to be of sufficient effect.\(^{188}\) Such a situation arises only when there is a need of unification of law throughout the Community: ‘[Directive] are an intrinsically federalist instrument, therefore preferable to regulations which are much more supranational by nature. [Regulations] are appropriate intended to introduce a uniform body of rules throughout the Community.’\(^{189}\) However, in particular, under Articles 44(2)(g) and 94 of the EC Treaty directives remain the predominant means of company and securities market law integration.\(^{190}\)

As seen before, a directive is adopted by the Community and applies to Member State(s) to which it is addressed. The latter is, in turn, obliged to take up measures to transpose its provisions into national laws with a view to achieving the goal aimed at by the directive. In the following it would be looked at how the Community adopts a directive and also how the Member State(s) implements it into national legal system.

3.3 ADOPTION OF DIRECTIVES:
3.3.1 COMMUNITY COMPETENCE TO ADOPT DIRECTIVES

3.3.1.1 CONETXTUALIZATION OF COMMUNITY COMPETENCE

As already mentioned, the Community has two ‘blocks of competence’\(^{191}\): exclusive and subsidiary competences. The Community may adopt a


\(^{189}\) Buxbaum, *et al*, *supra* note 125, at p. 143.

\(^{190}\) Buxbaum and Hopt, *supra* note 187, at p. 232.

directive in either of the competences. Before formal decision for adopting a directive, the Community needs to determine the area of competence depending on its subject matter. In this sub-section discussion will be made on the nature and scope of the Community competences and their limits in the process of harmonization.

3.3.1.2 EXCLUSIVE COMPETENCE

The EC Treaty does not enumerate the matters falling into its exclusive or subsidiarity powers.\textsuperscript{192} Within the Treaty framework the Community can exercise exclusive power when it is needed to act for the establishment of the internal market.\textsuperscript{193} The Commission, however, enlists the following as coming within the ambit of this power:\textsuperscript{194}.

(1) the removal of barriers to free movement of goods, persons, services and capital (Article 18, old Article 8a);
(2) the common commercial policy (Article 133, old Article 113), which guarantees the unity of the internal market;
(3) the general rules on competition, which guarantee a level playing field in the internal market;
(4) the common organization of agricultural markets, a precondition for the free movement of agricultural products;
(5) the conservation of fisheries resources and the common organization of the fishery markets;
(6) the essential elements of transport policy.

\textsuperscript{192} See ibid. and also Weatherill, ‘Beyond Preemption?’, supra note 144, at p. 13.
\textsuperscript{193} See EC Treaty, art. 14.
\textsuperscript{194} ‘Subsidiarity principle’, supra note 191, at 121.
This list is not a ‘frozen’ one, it will expand with the need of integration of the European market. However, the Community exercise of this power will not ‘deprive the Member States of the right to act.’

The European Court of Justice (ECJ), with a teleological approach to the interpretation of the Treaty, has confirmed the Community’s exclusive legislative power and at the same time upheld the Member States’ power in this regard. Member States can legislate in this area with prior authorization of the Community so that there remain no ‘legal gaps’. In Donckerwolke it held the common commercial policy as a matter of exclusive competence of the Community and said that a Member State act, even if it is a mere formality, ‘capable of hindering, directly or indirectly, actually or potentially, intra-Community trade’ is prohibited by the Treaty. ‘(M) easures of commercial policy of national character’, which are not detrimental to the market integration, are, as the Court continued, ‘only permissible…by virtue of specific

195 Ibid.
196 Ibid., at p. 120.
197 Interpreting a legal provision taking into consideration the socio-politico and economic objectives of it is simply known as teleological interpretation. The ECJ takes this approach in the interpretation of the EC Treaty provisions ‘in part, by declaration of general principles of law, but also, and of no less importance, by the Court’s recognition that specific provisions of the Treaty had to be fleshed out either to make those provisions work effectively or to adapt them to the different situations existing at various stages of the Community’s development’ Gordon Slynn, Introducing a European Legal Order (London: Stevens & Sons/Sweet & Maxwell, 1992) at 41. As to why the ECJ does so, one of its former Presidents explains as follows:

The principle of the progressive integration of the Member States in order to attain the objectives of the Treaty does not only comprise a political requirement; it amounts rather to a Community legal principle, which the Court of Justice has to bear in mind when interpreting the Community law, if it is to discharge in a proper manner its allotted task of upholding the law when it interprets and applies the Treaty. How else should the Court of Justice carry out this function which it has been assigned except by an interpretation of Community law geared to the aims of Treaty, that is to say, one which is dynamic and teleological.


198 Mengozzi, supra 118, at p. 75.
199 Donckerwolcke v Procureur De La Republique, (1976) ECR 1921.
200 Ibid. at 1937.
authorization of the Community.²⁰² Such prior authorization is a must even if it is not expressly required by the Community legislation.²⁰³ Further, even where the Community fails to take any legislative measure with respect to a particular matter of exclusive competence, that will not be an excuse for the Member States to act of their own; they must seek the Community’s approval upfront. Thus in Commission v. United Kingdom²⁰⁴ in absence of the Community action relating to conservation of fisheries, the United Kingdom took measures in this matter. The ECJ held the UK measures invalid and observed that Member States are not ‘entitled to exercise any power of their own in the matter of conservation measures in the waters under their jurisdiction. The adoption of such measures … is a matter … of Community law’.²⁰⁵

From the above it is evident that the Community exclusive competence is not a watertight compartment in which the Member States cannot interfere. The latter can intervene when (1) national measures are needed to implement the Community laws and (2) in cases of the Community inaction there is an urgency to act in the interest of the Community provided prior authorization has been procured from the Community.²⁰⁶ It cannot, however, act contrary to any matter of exclusive competence. Thus in The Queen, ex parte Centro-Com Srl. v H.M. Treasury and Bank of England²⁰⁷, where the United Kingdom refused to release funds from a British bank to a non-Member State as payment for goods exported from Italy instead of itself, the ECJ held the British action violative of the common commercial policy, even though the alleged measure was taken by virtue of national competence in matters of foreign and security policy.

3.3.1.3 SUBSIDIARITY

²⁰¹ Ibid. at 1935.
²⁰² Ibid. at 1937. (emphasis added)
²⁰⁵ Ibid. at p. 1073.
²⁰⁶ Mengozzi, supra note 118, at p. 75.
3.3.1.3.1 THE PRINCIPLE OF SUBSIDIARITY

IN BRIEF

Article 5 of the EC Treaty provides for the exercise of the Community’s legislative competences as follows:

The Community shall act within the limits of the powers conferred upon it by this Treaty (EC Treaty) and of the objectives assigned to it therein.

In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can, therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.

Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty.

Simply stated, this article embodies three general principles of the Community law.

In the first place, referring to two broad ranges of powers, namely exclusive and non-exclusive (also called shared or subsidiary) powers, it emphasises that the Community shall exercise those powers within their associated limits. In this respect it will be guided by the need of attaining the objectives assigned to it by the Treaty. This is known as the principle of conferred powers. Secondly, Article 5 embodies the principle of subsidiarity, which denotes ‘a way of determining whether the Community or the

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208 The principle of subsidiarity was not in the original EC Treaty in an explicit form. art. 5 of the Treaty establishing the Coal and Steel Community impliedly provided for the application of the principle when it said, ‘the Community shall exert direct influence upon production or upon the market only when circumstances so require’. For a conceptual and historical aspect of the principle, see Schoutheete, supra note 58 at pp. 41-44. However, it was inserted in art. 3b (now art. 5) by the Maastricht Treaty. The preamble and art. 1 (ex art. A) of the Treaty of European Union speak about this principle in a wider political sense. The phrase ‘closeness to the citizen’ gives a democratic motif and does not limit only to the division of power between the centre and periphery. Compared to this art. 5 contains ‘a narrower and more legalistic idea’. Grainne de Burca, ‘The principle of subsidiarity and the Court of Justice as an institutional actor’, (1998) 36(2) JCMS 217 at p. 219. Besides, with regard to the present context of market integration art. 5 is relevant to discuss.
209 A general principle of law means ‘chiefly something which is not itself a rule but which underlies a rule, and explains or provides the reason for it. A rule answers the question ‘what’: a principle in effect answers the question ‘why’. In the event of any dispute as to what the correct rule is, the solution will often depend on what principle is regarded as underlying the rule.’ Gerald Fitzmaurice, ‘The general principles of international law considered from the standpoint of the rule of law’, (1997) 11 Collected
Member States should take action in the sphere in which competence is shared rather than exclusive to the Community.²¹⁰ It prescribes that the Community is entitled to exercise its non-exclusive powers with regard to a particular matter when its objective cannot be sufficiently achieved by the Member States, and given its scale or effects that objective can better be achieved by the Community. The last part of the article lays down the principle of proportionality that requires that the Community action must be proportionate to the need of achieving the Treaty objective. It is thus a principle of ‘reasonableness’.²¹¹ Any action beyond necessity is unreasonable and, therefore, invalid.

As aforesaid, the EC Treaty confers two kinds of competences on the Community. The Subsidiarity principle does not determine which are those competences. Rather it concerns how they are to be exercised.²¹² Once a matter is considered to be within the Community competence but not within the exclusive competence, the Community will apply ‘comparative efficiency’ test to assess whether the objectives of the proposed matter can be sufficiently achieved by the Member States’ legislative or administrative measures or other actions.²¹³ If it arrives at a negative conclusion, it will be entitled to legislative intervention as much as is necessary to gain those objectives.²¹⁴ In applying the efficiency test the Community will examine the following factors:

- The effect of the scale of the operation (transfrontier problems, critical mass, etc.), the cost of inaction, the necessity to maintain a reasonable coherence, the possible limits on action at national level (including the cases of potential distortion where some Member States were able to act and others were not able to do so) and

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²¹⁰ Burca, supra note 208 at p. 218.
²¹¹ Ibid. at p. 15.
²¹³ Ibid. Also see Burca, supra note 208, at p. 219.
²¹⁴ Ibid.
the necessity to ensure that competition is not distorted within the common market.215

3.3.1.3.2 SUBSIDIARITY AS A BONE OF CONTENTION BETWEEN THE CENTRE AND PERIPHERY

The principle of subsidiarity is a political concept as it involves the assessment of comparative efficiency of a proposed action, which is a subjective matter. While the Community deems the objectives of the proposed action can be better achieved by its legislation, the Member State(s) may differ. Likewise, the efficiency test may give different results at different times. For example, environment or terrorism216 was not a matter of Community concern at the beginning of the Community, but today the Community intervention in these areas can hardly be questioned.217

The Community action based on subjective assessment is not only theoretically debatable; it faces serious criticism in practice as well. The following are the often-cited examples of this.218:

1. The French car manufacturers were encountering difficulties in their business because they had to produce yellow-headlight cars for the French market and simultaneously white-headlight cars for non-French markets. On their request for a Community provision making white headlights mandatory for vehicles, the European Council adopted a Directive 219 accordingly effective from 1 January 1993. The desirability of this Directive is questioned in that the subsidiarity principle should allow the manufacturers to produce cars with headlights of any colour.

2. Because they produced cheeses from raw milk, French cheeses contained high level of bacteria, which created a problem concerning the hygiene regulations of

217 Schoutheete, supra note 58, at p. 46.
218 Ibid., at pp. 47-49.
particular countries. On the other hand, Northern European cheeses made from pasteurised milk and as such contained less or no bacteria had almost the same appearance and taste as the raw milk cheeses, and also complied with the said regulations. As such there was a risk for the French cheeses to be replaced by Northern European ones but the consumers liked the former. Given this circumstance the French cheese producers invoked the Community interference, which responded with a Directive laying down rules for the production and marketing of raw milk, pasteurised milk and milk related products. 220 In proposing the Directive the Commission had in mind the purpose of protecting the public health and ensuring the free movement of milk products throughout the Community. 221 The Directive is criticised as a misuse of the subsidiarity by the Community, though it is defended that the Community did so to maintain and protect diversities of cheeses, particularly French cheeses. 222

3. Another allegation against the Community action is that it breached the subsidiarity principle by issuing directives 223 concerning quality of beach water. Water quality is a common concern of the Europeans and, therefore, ‘the provisions concerning water for bathing should be extended by the Community measures to improve quality….‘ 224 Broadly speaking, this represents ‘an effective means of realizing the Community’s quality objectives of an improved standard of living and harmonious a development of economic activities.’ 225 Thus compared to Member States the Community was in the right position to intervene. 226

In this respect it is relevant to inquire about why the Member States contend the Community interference while they have partially transferred their sovereign powers to it. The answer may be the lack of States’ political wills triggered

221 COM(89) 667 final at p. 2; COM (91) 420 final at p. 1.
222 Schoutheete, supra note 58, at p. 48.
225 Ibid. at p. 14.
by balance of socio-economic inconvenience likely to result from the Community measures, which are binding on them. If they can legislate in such matters, they can suit their own choices and needs without any obligation to concede to the supranational authority, which normally nation-state “ego” does not permit. However, in the present context an attempt may be made to zero in on the basic principles of Community law concerning its binding character putting them in interaction with subsidiarity.

**Primacy of the Community Law:**

If a Member State’s law conflicts with the Community law, which one will prevail? There is no Treaty provision in this regard. The European Court has, however, established, by ruling, the supremacy of the Community law over the national law. It has deduced the principle from the principle of Member States’ primary obligations under the Treaty. In *Costa v ENEL* the European Court declared the provisions of Italian legislation inconsistent with the Community law invalid and confirmed the primacy of the Community law in its following judgement:

By contrast with ordinary international treaties, the EEC Treaty has created its own legal systems which, on entry into force of the Treaty, became an integral part of the legal systems of the Member States and which their courts are bound to apply.

By creating a Community of unlimited duration, having its own institutions, its own personality, its own legal capacity and capacity of representation on the international plane and, more particularly, real powers stemming from a limitation of sovereignty or a transfer of powers from the States to the Community, the Member States have limited their sovereign rights, albeit within limited fields, and have thus created a body of law which binds both their nationals and themselves.

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226 Schouheete, *supra* 58, at p. 49.
227 Vincenzi, *supra* 80, at p. 58.
228 *Supra* note 155.
Thus the Community law is independent of and supreme over the domestic law of the Member States, be it the national constitution.\textsuperscript{230} As such the Community law is directly applicable in the national jurisdiction.\textsuperscript{231} The Community supremacy is not limited to the Treaty provisions; it is rather extended to Community Regulations, and, in particular cases, to Community Directives.\textsuperscript{232} Therefore, for example, a UK court is obliged to override a rule of national law that is not commensurate with the Community law, and the Parliament brings necessary amendments to the law to comply with the Community Directives.\textsuperscript{233}

Given the primacy and direct applicability principle when the Court of Justice is invoked to decide a conflict between the Community law and the Member State law made on the basis of the subsidiarity principle, it will be required to consider both the principles of supremacy and subsidiarity. Of course question of subsidiarity as a competence issue will take precedence over that of supremacy.\textsuperscript{234}

**The Principle of Direct Effect**

The central idea of this principle is: ‘(N)ationals of Member States can claim individual rights, which must be protected by national courts on the sole basis of Community law rules, provided these rules are sufficiently clear, precise and

\textsuperscript{231} *Simmenthal*, case 106/77, [1978] ECR 629. Direct applicability means that “rules of Community law must be fully and uniformly applied in all the Member States from the date of their entry into force and for so long as they continue in force.” *Simmenthal*, above, at p. 643.
\textsuperscript{232} MacLean, supra note 81, at p. 94.
\textsuperscript{233} *R v Secretary of State for Transport, ex parte Factortame Ltd.*, [1990] 3 CMLR 375 at p. 380. Judicial recognition and application of the direct effect principle has ascribed the Community law the ‘status of quasi-federal law’ Eric Stein, ‘Lawyers, judges, and the making of a transnational constitution ’ (1981) 75 AJIL 1 at p. 24. With the prospective adoption of the EU Constitution the Community law will have federal status and direct effect. For discussion on this issue, see the text accompanied by notes 358, 366-637, infra
unconditional as to their application."\(^{235}\) In *Van Gend en Loos* the principle was established as follows:

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\text{(T)he Community constitutes a new legal order of international law … the subjects of which comprise not only Member States but also their nationals. Independently of the legislation of the Member States, Community law therefore not only imposes obligation on individuals, but is also intended to confer upon them rights which becomes part of their legal heritage.}\(^{236}\)
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Thus Community law creating individual rights can be challenged at the Community level principally by the Commission under Article 169 (now Article 226), and at the national courts by individuals.\(^{237}\) At the same time a Member State can impugn the validity of the Community law before the Court of Justice grounding on the principle of subsidiarity. In other words, it can assail that in view of the effects or scale the Community has unduly legislated in the subsidiary area of competence. In such a case the Court will have to, as in the supremacy principle, accommodate both the issues of subsidiarity and direct effect.\(^{238}\)

**Principles of Conferred Powers, centrality and Cooperation**

The Community is entrusted with the responsibility to establish an internal market.\(^{239}\) To this end Article 308\(^{240}\) (ex Article 235) has entrusted the

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\(^{235}\) Iglesias, *supra* note 209, at p. 4. Like the principle of primacy direct effect principle is also a product of judicial interpretation of the Treaty objectives from the teleological perspective. The significance of these two principles lies in Professor Weatherill’s words: ‘It would be impossible to create the structure envisaged by the Treaties unless the law is supreme and directly effective.’ (emphasis original) Stephen Weatherill, *Cases and Materials on EC Law*, 5th ed. (London: Blackstone Press, 2000) at p. 82.

\(^{236}\) *Van Gend en Loos*, [1963] ECR 1 at 12. The principle established in this case were subsequently applied in *Van Duyn, supra* note 167, and in *Defrenne v SABENA*, case 43/75, [1976] ECR 455.

\(^{237}\) *Van Gend case, ibid.* at p. 13. ‘(T)he principle of direct effect is not merely a technical device which regulates the relationship between Community law and national law. It is the expression of the nature of the European Community as a legal Community of states, peoples and citizens.’ Iglesias, *supra* note 209, at p. 5.

\(^{238}\) Cass, *supra* note 234, at pp. 1130-1131.

\(^{239}\) EC Treaty, art. 14.

\(^{240}\) art. 308, EC Treaty, provides:

If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this (EC) Treaty has not provided the necessary powers, the Council shall, acting unanimously on a
Community with a blanket power to legislate on any necessary matter even if the EC Treaty does not specifically provide for it.\textsuperscript{241} This provision was being very loosely used ‘as a ‘competence to round-off the Treaty’ as a whole’.\textsuperscript{242} The German Federal Constitutional Court observed that Article 308 had limits inasmuch as the very sovereign powers exercised by the Community under this Article was conferred for limited purposes only.\textsuperscript{243} Therefore, the EU Treaty could not be extended by interpretation, which could be done only by amendment by Member States.\textsuperscript{244} Subsidiarity is a further restriction on Article 308.\textsuperscript{245} In the same vein the ECJ sketched the limited purview of Article 308. It said,

That provision (present Article 308), being an integral part of institutional system based on the system of conferred powers, cannot serve as a basis for widening the scope of Community powers beyond the general framework created by the provisions of the Treaty as a whole and, in particular, by those that define the tasks and the activities of the Community. On any view, Article 235 cannot be used as a basis for the adoption of provisions whose effect would, in substance, be to amend the Treaty without following the procedure which it provides for that purpose.\textsuperscript{246}

While Article 308 empowers the Community to take measures to fulfil its objectives absent any express or implied powers in the Treaty, Article 10\textsuperscript{247} (ex

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\textsuperscript{241} But ‘art. 235 (now art. 308) could not be used to adopt provisions that would effectively amend the (EC) Treaty.’ (1996) AJIL 664 at p. 665 referring to the Court of Justice.

\textsuperscript{242} Brunner and others v The European Union Treaty, [1994] 1 CMLR 57 at p. 105.

\textsuperscript{243} Ibid.

\textsuperscript{244} Ibid.

\textsuperscript{245} Ibid. at p. 105-106.


\textsuperscript{247} art. 5, EC Treaty, reads thus:

Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of the (EC) Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the
Article 5) of the EC Treaty imposes an obligation on the Member States to extend cooperation to the Community so that the Community action can be put into practice. In other words, the Member States must incorporate the Community law in the domestic law because the Community is the supranational authority. The reverse aspect of the principle is that the Community must ‘cooperate loyally with the member States’. A version of the Community cooperation may be non-interference in the Member States’ action based on subsidiarity. Thus subsidiarity is also a limitation on the Community power under Article 10, which ‘contributes to the respect for the national identities of Member States and safeguards their powers.’ This circumscribing effect of subsidiarity also ‘could influence the Court’s interpretation of Articles (308 and 10) and therefore ultimately affect the scope of Community power.’

As it appears from above, incorporation of the principle of subsidiarity into the EC Treaty ascribes constraints both to the Community and Member States as it works in a two-way style: non-interference in the area of non-exclusive competence, and intervention in such area when it is called for by the objective of a particular act. As Community interference stemming from a comparative efficiency assessment is obviously a political matter, a conflict situation between the Community and Member States is most likely to be ever present. Nonetheless, at the same time, subsidiarity cannot be disposed of as rubbish. Its presence is a must in the quasi-federal structure of the EC. What is needed is to apply it wisely. To quote Weatherill,

It is not feasible that the multi-functional activities of the modern Community, characterized by close interdependence with its Member States, could be

250 Cass, supra note 234, at p. 1131.
251 Schoutheete, supra note 58, at p. 50.
252 Ibid.
reduced to a neat set of legal rules dictating who does what. Sector by sector, close attention must be devoted to planning the respective contributions of the Community and national laws Community and national implementation and administration of law and policy. If subsidiarity, as a question rather than an answer, has stimulated a more intensive, thoughtful examination of how the evolving European market should be regulated, then it will have fulfilled a valuable function.  

3.3.1.3.3 JUSTICIABILITY AND INTERPRETATION OF SUBSIDIARITY

As seen above, subsidiarity is prone to give rise to conflict between the centre and the periphery. How can this conflict be settled? Is subsidiarity justiciable? Politicians and political scientists favour its justiciability while lawyers and jurists oppose it. For example, the European Parliament maintained during the preparatory periods of the Treaty on European Union that ‘the Court of Justice should be given jurisdiction as a constitutional body, with the task of ensuring in particular that the division of competences between the European Community and the Member States is respected.’ It further underlined the need of legally guaranteeing respect of the principle ‘by endowing the Court of Justice with the appropriate powers and allowing the Community institutions and the Member States to refer matters to it when they arise.’ The European Council said that ‘interpretation of this principle, as well as review of compliance with it by the Community institutions are subject to control by the Court of Justice.’ Before subsidiarity was formally inserted into the EC Treaty, Delors Colloquium had been held where Jacques Santer, former President of the European Council, defined it as a politico-legal concept. He said that

253 Weatherill, Law and Integration in the European Union, supra note 69, at pp. 172-173.
254 Here “justiciability” means determinability by the Court of Justice whether the principle of subsidiarity is breached by the Community or the Member States.
Initially subsidiarity seems like a political principle likely……to form an interpretative guideline for those charged with implementing or controlling the use of Union competences.

However, subsidiarity may also seem like a legal rule conditioning the launching of Community action, i.e. its conformity to rules. From such a perspective the subsidiarity principle is a rule of reference whose observance should be ensured by a judge- the Court of Justice.  

Put simply, according to Santer, while the principle of subsidiarity controls the exercise of Community competences by political authorities, the Court will adjudge whether it has been respected. In other words, Santer suggested that subsidiarity was justiciable.

Lawyers oppose the above view held by the politicians. Lord Mackenzie-Stuart, former Chief Justice of the European Court of Justice, got dismayed at the suggestion that the Court of Justice should determine the justiciability of subsidiarity. He said, ‘To decide whether given action is more appropriate at Community level, necessary at Community level, effective at Community level, is essentially a political topic. It is not the sort of question that a Court should be asked to decide.’ He then quoted the House of Lords Select Committee on the European Communities as follows:

One new role, which is being proposed for the Court, is that of interpreting the principle of subsidiarity. The Committee do not believe that subsidiarity can be used as a precise measure against which to judge legislation. The test of subsidiarity can never be wholly objective or consistent overtime. Different people regard collective action as more effective than individual action in different circumstances. Properly used, subsidiarity should determine not whether Community legislation is necessary or appropriate at all, but the extent to which it should regulate or harmonize national divergencies, and how it should enforced. But to leave the legislation open to annulment or revision by the European Court on such

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260 Ibid., at pp. 40-41.
However, it is the reality of today that the principle has been embodied in the EC Treaty. Unlike a former Judge, Lord Mackenzie-Stuart, a sitting Judge cannot just criticise it; he has to apply it.262 Given this practicality Professor Toth, who was originally against the insertion of subsidiarity in the EC Treaty263, maintains that being a part of the treaty ‘the principle of subsidiarity is, to some extent, justiciable and, what is more, that certain aspects of it can only be resolved by the Court of Justice and no other institution.’264 Now, how much of subsidiarity is justiciable? The key issue involved in a subsidiarity case is whether the objective of the Community act or national legislation can be better or sufficiently achieved at the Community or national level. This is a political issue and cannot, therefore, be determined by the Court.265 Such a matter falls within the discretionary powers of the Council and Commission. The Court can only determine whether the Council or Commission has committed a manifest error or misuse of powers or has clearly exceeded the limits of its discretion.266 If beyond these limits the Court goes to look into whether the objective of an impugned action/measure taken by the Council and Commission could be better or

261 Ibid. at p. 41. emphasis added by Lord Mackenzie-Stuart.
262 Iglesias, supra note 209, at p. 15.

That subsidiarity could be invoked in annulment proceedings against Community acts is beyond doubt. …..subsidiarity, being mentioned in the body of the Treaty, is to be regarded as binding on all Community institutions. Any violation of the principle could therefore serve as a basis for an annulment proceeding based on art. 173 (now 230) of the EC Treaty.”: R. Dehouse, ‘Community competences: Are three limits to growth?’, in R. Dehouse (ed.), Europe after Maastricht-An Ever Closer Union (Munchen: Law Books in Europe, 1994) 103- , at 112.

265 Toth, ibid., at 282-83.
sufficiently achieved at the Member State level, that ‘would interfere with the legislative process by replacing the institutes’ discretion by its own view’.  

In reviewing a subsidiarity matter within the aforesaid limits the ECJ will take into account the statement of reasons contained in the preamble of an act and also the legal basis of the same. ‘This is the main means whereby the Court can control the institutions’ discretionary powers.’

However, so far in a few cases the Court of Justice has just touched upon the principle of subsidiarity. Its scope has not been fully explored. In United Kingdom v Council the United Kingdom sought judicial review of the Working Time Directive, based on Article 118a (now Article 138), which provided, among others, for a maximum working time. It submitted, *inter alia*, that Article 118a should have been interpreted in the light of the subsidiarity principle because ‘the extent and nature of legislative regulation of working time vary very widely between Member States’. It also argued that the legislature had not fully considered or sufficiently exhibited that the result intended to be obtained by the Directive (protection of health and safety of workers) was such as could not be attained by measures by Member States. The Court pointed to that once the Council had deemed it necessary to take measures for the protection of health and safety of the workers by harmonising the working time, that would suffice to meet the subsidiarity test. Thus it did not apply the comparative efficiency test, rather relied on whether the legal conditions had been fulfilled. This is

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267 Toth, ‘A legal analysis of subsidiarity’, *ibid.*.
268 The preamble of a treaty is like a general principle of law acts as the guideline for the judiciary in the interpretation of its provisions. Unlike the provisions themselves it does not have any binding force. While talking about where the subsidiarity should be placed in the Maastricht Treaty, in the preamble or body, Lord Mackenzie-Stuart writes, ‘The Preamble and the General Principles are of some use to the Court of Justice when they are weighing up in trying to interpret other provisions of the Treaty- it gives them a line.’ *supra* note 259, at p. 40.
269 Toth, *supra* 264 at 284.
270 Iglesias, *supra* note 209, at p. 15.
273 *Supra* note 271, at p. 5808.
274 Burca, *supra* note 208, at p. 223.
further clear from the following words: ‘(I)t is not the function of the Court to review the expediency of measures adopted by the legislature. The review exercises under Article 173 (now Article 230) must be limited to the legality of the disputed measure.’

Thus in *Bosman* a sporting associations made rules effecting transfer fees for players moving from one club to another. The ECJ held the rules incompatible with Article 48 (now Article 39) of the EC Treaty which provides for free movement of workers. German Government pleaded that sport was, in effect, similar to culture diversity of which must be respected by the Community under Article 128(1) (now Article 151(1)) of the EC Treaty. It also argued that since sporting associations enjoyed freedom and autonomy under national law, the Community (which includes the Court) intervention should, with regard to the subordinarity principle, be limited to what was strictly necessary. The Court refuted the sport-culture similarity argument on the ground that football player’s engagement in the given case involved remuneration and hence it was an economic activity coming within the purview of Article 48 (now Article 39) of the EC Treaty. It dismissed the next argument in that private organisation’s freedom to adopt rules should not go so far so that it hampers the rights (of free movement) conferred by the Treaty. In other words, the Court seemed to interpret that the transfer fees had impeded free movement of workers and, therefore, were subject to abolition. In this case the Court avoided expediency test and held on to determining the legality of the sporting federation’s rules. Thus from the reading of the above cases it can be gathered that invoked to employ the subsidiarity principle the ECJ has so far applied the legality test instead of expediency test. Of course, at the same time it made law by way of interpretation keeping constant view on the teleology of integration.

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275 *Supra* note 208 at 5802.
However, the Court’s approach towards subsidiarity is not above question. For example, with regard to its judgement in *Bosman* Burca comments as follows:

Arguably, the Court might more satisfactorily have addressed the subsidiarity issue along the lines suggested in Article 3b (now Article 5), by looking at the aim which would be served by giving Article 48 (now Article 39) a particular kind of interpretation and whether that aim was best pursued, this way, by the Community.”

This statement suggests that the Court should have applied the comparative efficiency test, but according to legal scholars and the Court itself this is not a judicial task to accomplish. The legislature is the right authority to do it. By doing so the Court is trying to preserve its identity distinct from the legislature. In this consideration the Court cannot be condemned for not resorting to the expediency test.

Further Burca criticises the Court’s law making function. He comments that ‘(t)he outcome in *Bosman* was not self-evident from the text of Article 48.” In other words, he seemed to mean that the Court’s ruling to the effect of abolishing the transfer fee was a far-fetched innovation by the Court, which could only be done by the legislature. But, as he argues, the ECJ as a judicial institution does not equate to a political institution and, therefore, cannot make laws. At the same he acknowledges

277 Burca, *supra* note 208, at p. 228.
278 E.g. Professor Toth, *supra* note 264.
279 See the text accompanied by note 271, *supra*.
281 Burca delineates the characteristic features of the Court as a judicial institution distinct from the legislature. The Court of Justice is distinct from the legislature principally in respect of its composition, manner of functioning and legitimacy of its role. Unlike the legislature the members of the Court are appointed and thus do not represent the people. These are the institutional constraints of the Court. Second, the Court works under ‘textual constraints (such as are imposed by the Treaty) and practical constraints (the limits of the adjudicative forum)’ which require it to ‘adhere to a mode of reasoning and a set of considerations which differ from that which is open to the Community legislature when it explains why one particular policy choice is to be preferred over another’. Third, ‘the legitimacy of the judicial role- generally based on its autonomy, independence, impartiality and expertise- has a different foundation from the legitimacy of political institutions.’ This may be called value constraints. *Ibid.*, at p. 232.
the role of the Court’s law making as the Community’s constitutional court.\textsuperscript{283} The contradiction between the non-legislative character on the one hand, and the law-making capacity of the Court on the other, has made it difficult to answer whether and how the subsidiarity should be dealt with by it.\textsuperscript{284} In order to remove the tensions and difficulties in the functioning of the ECJ within the EC constitutional framework the author has suggested for laying circumscriptions on its interpretative authority.\textsuperscript{285}

As noticed above, the ECJ is accused of overexercising its interpretative power and making laws thereby. But it should not be disputed that interpretation is one of the fundamental functions of the Court as a judicial institution. As the Community constitutional court the ECJ interprets the EC Treaty with a teleological approach, which is of course inalienably essential for carrying out the integration programme. Erecting atop the common market objective it has laid a number of decisions that form milestones in the Community history and thereby has contributed to building up the Community legal order. For instance, in order to fortify the EC foundation as a supranational entity it was a must to ascribe its law with supremacy over the national laws.\textsuperscript{286} Devising the doctrine of direct effect did further strengthen that foundation. These two doctrines thus preserved ‘the Community from ruin’.\textsuperscript{287} Additionally, in the past the Court proffered directions to the Community when it was in need.\textsuperscript{288} Most

\textsuperscript{283} Ibid., at p. 232.
\textsuperscript{284} Ibid.
\textsuperscript{285} See ibid., at pp.232-234.
\textsuperscript{286} ‘Without that basic hierarchy, disintegration would follow. Even one breach in the dam would be too many, for one fissure would inevitably breed others.’ Weatherill, \textit{Law and integration in the European Union}, supra note 69, at p. 104.
\textsuperscript{288} At national level judicial law-making in need is ever present. For example, in Britain judges, as a part of their function, make new laws because parliament cannot legislate for every possible combination of human affairs, and it can be difficult to discover the will of parliament when absence of legislation shows that parliament, as such, has given no thought to the point at issue. If there is a statute on the subject, the best that can be done is to interpret it in a way that seems to make sense of its declared intention. If there is not, then the courts must look for some old legal principle on which to base a new legal point.
importantly, for instance, when during the seventies the Community integration by total harmonisation was faltering and the people were losing confidence in the Community solution, the Court came forward with the *Cassis de Dijon* decision, which, as discussed before, invented mutual recognition as a method of integration side by side harmonisation. This decision provoked\(^\text{289}\) the Commission to adopt a policy proposal\(^\text{290}\) to the Council as a supplementation to the 1969 General Programme on the Removal of Technical Barriers to Trade\(^\text{291}\). Before this it wrote to the governments and EC Parliament on the impact of the said judgement.\(^\text{292}\) Ultimately mutual recognition as a method of integration came into being in the EC integration process. This is how the Court stirs the ‘political waters’\(^\text{293}\) and indirectly contributes to the Community legislation.\(^\text{294}\) But this does not mean that the Court legislates. Rather it has declined to interpret the Treaty to make such a rule as could only be done by the legislative amendment.\(^\text{295}\) It has also refrained from assessing comparative expediency involved in the application of the principle of subsidiarity\(^\text{296}\), because it is a matter for the political forum to do. So the Court should not be flatly attacked as having trespassed the arena of legislation or legislative politics. Of course it is true that the Court exploits its power of interpretation to the fullest possible extent, when necessary, to promote the common market objective. This may have the effect of political provocation, but that is not

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\(^{289}\) The Commission was moved by the judgement in that the guidelines laid down in it ‘can only strengthen the Commission’s efforts to safeguard the Community’s achievements and to promote the growth of the internal market.’ (1980) OJ C105/7.

\(^{290}\) OJ C253.

\(^{291}\) (1969) OJ C76.


\(^{294}\) Thus are the Court and the Commission engaged ‘in a double act- the Court able to push out the boat of integration and steps on toes in the process in ways the Commission could never dare to do.’ Kuper, *supra* note 287, at p. 60.

\(^{295}\) See the text accompanied by note 246, *supra*.

\(^{296}\) See the text accompanied by note 271, *supra*. 

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unbecoming of it, because being the interpreter of the Community constitution and
being composed of sensible human beings the Court should not be unmoved by the
need of the Community especially when the legislature fails to act. In this form
‘judicial politics in the EC is here to stay, a fact that European politicians have
recognized.’  

3.3.2 COMMUNITY PROCEDURE OF ADOPTING DIRECTIVES

Because of subsidiarity wrangling between the centre and the periphery
(Member States) the Commission feels comfortable to put forward directives. In the
area of company and securities law, in particular, directives are used on the basis of
Article 44(2)(g) [ex Article 54(3)(g)] of the EC Treaty with a view to making
safeguards necessary for the protection of companies’ members and others
equivalent throughout the Community. But directive making is a roundabout process
within the Community “maze”299, which takes a long period of time. Recently the
Community has simplified the law-making method in the securities area on the basis of
the Lamfalussy Report.300  Before glancing at that the previous method of law-making
with particular reference to securities may be briefly stated in the following (using
present tense).

A draft directive is prepared by the Commission301 after consulting
many representatives from business and trade unions, professional bodies (e.g.,

297 Alter and Meunier-Aitsahalia, supra note 293 at p. 558
298 art. 48 defines companies or firms as ‘companies or firms constituted under civil or commercial law,
including cooperative societies, and other legal persons governed by public or private law, save for those
which are non-profit-making.’ One author has argues that commercial undertakings without legal
personality also come within the purview of this art.. Jane Welch, ‘Companies and firms in EEC law’,
299 This word has been used with regard to the Community by Stanley A Budd and Alun Jones in their
300 Supra note 34.
301 The Community is centrally composed of the European Commission, the Council of Ministers, the
European Parliament, the European Court of Justice, and the Court of Auditors. The task assigned to the
Community is accomplished by them. : the EC Treaty, art. 7 (ex art. 4). In the legislative process the
Commission acts as the initiator. Headed by a President it consists of 20 members nominated by the
accountants)\textsuperscript{302}, and even individuals.\textsuperscript{303} Then the proposal is passed on to the national expert groups of the Member States, who express their opinions/comments thereon in light of their respective national law. After this, once the Commission has approved the proposal, according to Article 251 of the EC Treaty it is formally presented to the European Parliament (EP)\textsuperscript{304} and the Council of Ministers\textsuperscript{305}. The Council consults the Economic and Social Committee (ECOSOC) in this regard.\textsuperscript{306} Both the EP and the ECOSOC are required to give their opinions on the proposal. At the EP level the company law (and securities law) proposals are first examined by the Committee on Economic and Monetary Affairs and Industrial Policy.\textsuperscript{307} This Committee then reports to the Committee on Legal Affairs and Citizens Rights, where further examinations of the Commission proposal will take place.\textsuperscript{308} The EP will forward its opinion to the Council with or without a proposal of amendments to the Commission proposal. The Council may approve, by qualified majority, all the amendments and adopt the proposal


\textsuperscript{303} Budd and Jones, \textit{supra} note 299, at 57.

\textsuperscript{304} Called the ‘democratic conscience of the European Community’ the European Parliament consists of members directly elected by the citizens of the EC Member States. Ian Thomson, \textit{The Documentation of the European Communities-A Guide}, (London: Mansell, 1989), at p. 213. The Parliament shares with the Council the power of law making in the EC.

\textsuperscript{305} Distinct from the European Council (composed of the heads of the Member States) “the Council” refers to the Council of Ministers, the central decision-making body of the European Community. It consists of ministers from the Member States, who represent their respective country. The meetings of the Council are periodically held being attended by ministers concerned with the subject-matter of the agenda. The presidency of the Council is rotated amongst the Member States every six months. : Thomson, \textit{ibid}., at p. 203.

\textsuperscript{306} The Economic and Social Committee (ECOSOC) is a socio-economic body which represents the social and economic interest groups within the Community. Those interest groups represent employers’ group, workers’ group and other groups, e.g., agriculture, consumers, small firms, professions, environmental protection. The members of the ECOSOC are nominated by the governments of the Member States. The function of this Committee is ‘to advise the Commission and the Council of the views of the interest groups involved on Community proposals and matters of its own concern.’ Though in the decision-making process its view is not binding on the Commission or Council, it carries weight ‘as a means of formalized expression of the views of powerful interest groups within the Community.’ : Thomas, \textit{ibid}., at p. 228.

\textsuperscript{307} Watcher, \textit{supra} note 302, at p. 15.
so amended.\textsuperscript{309} If no amendments have been proposed, the Council may adopt the proposed legislation.\textsuperscript{310} If, however, it adopts otherwise a “common position”, it shall communicate that to the EP along with the underlying reasons.\textsuperscript{311} The Commission shall also inform the EP of its position in full.\textsuperscript{312}

Where the EP is apprised of the Council’s common position, it may approve, reject or amend the Council’s position within a period of three months from the date of such communication. If approved, the act in question will be deemed to have been adopted according to that common position.\textsuperscript{313} In case of rejection of the common position (which requires absolute majority), the proposed act shall be deemed not to have been adopted.\textsuperscript{314} If the EP, however, proposes amendments by absolute majority, it shall forward the amended text to the Council and the Commission.\textsuperscript{315} The Commission is required to provide its opinion on such amendments.\textsuperscript{316} If the Council approves, by qualified majority, the amendments proposed by the EP within three months from the date of reference of the matter, the amended common position shall be deemed to have been adopted.\textsuperscript{317} The Council needs to act by unanimity where the Commission has given a negative opinion on the EP’s amendments.\textsuperscript{318} If the Council does not approve all the amendments proposed by the EP, the matter shall be deferred to be dealt with by the Conciliation Committee.\textsuperscript{319} Within a period of six weeks from the date of its meeting being convened the Conciliation Committee shall make an

\begin{itemize}
  \item \textsuperscript{308} \textit{Ibid.}
  \item \textsuperscript{309} EC Treaty, art. 251(2).
  \item \textsuperscript{310} \textit{Ibid.}
  \item \textsuperscript{311} \textit{Ibid.}
  \item \textsuperscript{312} \textit{Ibid.}
  \item \textsuperscript{313} \textit{Ibid.}, art. 251(2) cl.(a).
  \item \textsuperscript{314} \textit{Ibid.}, art. 251(2) cl.(b).
  \item \textsuperscript{315} \textit{Ibid.}, art. 251(2) cl. (c).
  \item \textsuperscript{316} \textit{Ibid.}
  \item \textsuperscript{317} \textit{Ibid.}, art. 251(3).
  \item \textsuperscript{318} \textit{Ibid.}
  \item \textsuperscript{319} \textit{Ibid.} The Conciliation Committee consists of the members of the Council or their representatives, and an equal number of representatives of the European Parliament. : \textit{Ibid.}, art. 251(4).
\end{itemize}
attempt to reach an agreement on a joint text of the Council and the Parliament. The Commission will also take part in this endeavour and adopt initiatives to reconcile the stands of the Council and the EP. If the Conciliation Committee approves the joint text, each of the Council (by absolute majority) and the EP (by qualified majority) is required to adopt the act in question in accordance with the said text within another six weeks from that approval. In the event of the failure of either of these two institutions to approve the proposed act it will be deemed that it has not been adopted. The same will be the consequence if the Conciliation Committee does not approve the joint text.

The above paragraphs confirm that the EC directive making is a lengthy and hazardous process. The Committee of Wise Men in its report (Lamfalussy Report) finds that the EP-Council co-decision procedure takes more than two years to reach a final agreement on the Commission proposal. In the financial services area this time is longer. It cited the Takeovers Directive as an example.

Further problems arise in the implementation of directives by Member States under Articles 249 and 10 of the EC Treaty. Implementation may be through direct incorporation or transposition. Direct incorporation means verbatim reproduction of directive provisions into national jurisdiction while transposition means that the

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320 Ibid., art. 251(4).
321 Ibid.
322 Ibid., art. 251(5).
323 Ibid.
324 Ibid., art. 251(6).
326 Ibid.
327 Ibid. The European Commission first presented in 1988 a ‘Proposal for a Thirteenth Council Directive on Company Law concerning Takeovers and Other General Bids’, which was followed submission of amendments in 1990, 1996 and 1997. The Council took a Common Position in June 2000, which was welcomed by the Council. The EP voted on the Common Position on 13 December 2000 and adopted a number of amendments to it. The Council did not agree to those amendments. As a result the matter went to a Conciliation Committee which was convened in April 2001. With slow progress negotiations were being made with the brokerage of the Commission. On 6 June 2001 the Conciliation Committee agreed on a compromise text. Though both the Council and the EP were expected to formally adopt the proposed directive in July 2001, the EP rejected the proposal on 4 July 2001. Thus the Commission’s proposal roamed about within the concerned forums for 13 years and ended up with
directive provisions are turned, in effect, into national legislation. However, experience shows that Member States do not respect the deadlines set in the directives. For example, the Community Council adopted Directive 89/298/EEC in 1989 coordinating the requirements for drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public. It set the deadline as 17 April 1991 for Member States to take necessary measures for implementation. But the UK implemented the Directive after nine years of the deadline through adopting the Official Listing of Securities (Change of Competence Authority) Regulations, 2000. As of December 1999 the rate of implementation of directives by Member States was on average 94.53%, slightly down that of 1998 which was 95.70%. Although the average delay in transposal (less that 6% of the directives) ‘is not highly significant, it has important consequences for functioning of an integrated economic area’.

For the above reasons the Lamfalussy Report called the European Union’s regulatory framework ‘too slow, too rigid, complex and ill-adapted to the pace of global financial markets’ and proposed a new four-level law-making and

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328 Alec Samuels, ‘Incorporating, translating or implementing European Union law into UK law’, (1998) 19(2) Stat LR 80. The Court of Justice dismissed the Commission’s claim that Italy had failed to transpose Community Directive 80/502/EEC on the ground that the then existing law of Italy was, in substance, the same as that was in that Directive. Commission v. Italy, Case 363/85, [1987] ECR 1733.

329 Supra note 302, at p. 16. Hence, the Commission has to extend the date with a transitional period meant for entry into force of the implementing enactment. For example, the transposition date of the Directive of 21 December 1988 was extended from 28 December 1991 to 31 December 1992. Hans Molijn et al, Harmonisation Directive and Its Implementation in the Member States, (European Communities Trade Mark Association Conference, 1993) 15-24 at p.21

330 Supra note 25.

331 SI 2000/968.


333 Ibid.

334 Lamfalussy Report, supra note 34, at p. 7.
implementation system for securities market. As said earlier, the Community has approved the new system which is discussed below.

**Level 1: Framework Principles**

The Committee of Wise Men suggests that in the securities, with no change in the EC Treaty, new regulations or directives be developed, which will contain the framework principles delegating implementation powers to the second level. The “framework principles” will ‘reflect the key political choices to be taken by the European Parliament and the Council of Ministers on the basis of a proposal by the European Commission.’ Those principles will clearly define the nature and extent of the technical measures to be adopted in detail by the second level. For example, with regard to the proposed prospectus directive the framework principles will set out ‘all the relevant Articles concerning the type of a single passport’ (e.g., definition of public offer, role and powers of a competent authority, the language regime, etc.). And the task of providing all technical details and defining the implementing contents of the prospectus is delegated to the Level 2. Simply stated, the Level 1 will give the basics of each legislation while Level 2 the technical details. This would speed up the law-making process in that the Commission, the Parliament and the Council would only confine to giving the essential elements of a directive or regulation without touching on the technical details. Also, as the ambit of the implementing powers of Level 2 being defined by the Parliament and the Council by co-decision on a case by case basis the legislative process would be democratic.

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335 Supra note 39.
336 Lamfalussy Report., supra note 34, at p. 22.
337 Ibid.
338 Ibid., at p. 23.
339 Ibid.
340 Ibid.
341 Ibid., at p. 24.
addition, the EU institutions would benefit from expertise of European regulators in this process.\textsuperscript{342}

**Level 2: Implementation of the Technical Details**

The Committee of Wise Men proposes for the constitution of two technical committees: an EU Securities Committee (ESC) and an EU Securities Regulators Committee (ESRC). The former will render a regulatory functions and the latter advisory.\textsuperscript{343} There will be a network among the ESC, ESRC and the Commission ‘to define, propose and decide on the implementing details of framework Directives and Regulations’ coming from Level 1.\textsuperscript{344} Throughout the process the Parliament will be kept informed.\textsuperscript{345} The main tasks to be accomplished by the Commission, the ESC and ESRC at this level may be stated as follows:\textsuperscript{346}

1. In addition to its right of initiative the Commission will, after consulting the ESC and in view of the results of Level 1 co-decision, ask the ESRC to work on the technical details of the subject and decide, by agreement, a timetable for accomplishing the task.

2. The ESRC will consult the markets and end users by fixed deadlines and deliver its technical advice to the Commission in due time.

3. The Commission will consider the ESRC’s technical advice without prejudicing its right of initiative.

4. After considering the ESRC’s work the Commission will forward a proposal to the ESC. At the same time the Commission will keep the Parliament informed of all proposals - agenda/documents etc. The

\textsuperscript{342} Ibid., at pp. 24-25.
\textsuperscript{343} Ibid., at p. 28.
\textsuperscript{344} Ibid.
\textsuperscript{345} Ibid.
\textsuperscript{346} Ibid., 28.1
ESC will then vote on the Commission’s proposal. If the voting result (qualifying majority) goes in favour of the proposal, the Commission may make the legislation.

**Level 3: Implementation**

The main objective of this level is ‘to greatly improve the consistency of the day to day transposition and uniform implementation of Levels 1 and 2 legislation.’\(^347\) The ESRC is to play the decisive role in this level. On it, for this purpose, there will be one representative for each Member State designated by the national supervisory authority(ies).\(^348\) The ESRC will make their decisions by unanimity.\(^349\) It will do the following:

- setting consistent guidelines for the administrative regulations, which would be adopted at the domestic jurisdictions of the Member States;
- issuing joint interpretative recommendations and setting common standards concerning matters falling outside the EU legislation;
- comparison and reviewing of regulatory practices in order to make sure that effective enforcement throughout the Union take place;
- defining best regulatory practice in addition to above comparison and review;
- conducting peer reviews of the administrative regulation and regulatory practices in the Member States and thereafter

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\(^348\) *Ibid.*
\(^349\) *Ibid.*
reporting the results of the reviews to the Commission and the ESC.

**Level 4: Enforcement**

All participants should play their roles at this level to strengthen the enforcement of the EC rules. Particularly the Commission will take the major responsibility as the guardian of the EC Treaty. Regulators will bring to the notice of the Commission any potential infringement of the Community rules. The Parliament will do the same when there is, in its belief, any actual breach of the Community law.

The Commission should, in a bolder fashion, enforce the Community law (e.g., by opening a case against an offending Member State) and check the accurate transposition of the agreed legislation.

### 3.3.3 Recent Developments

Given the successive progress and the future enlargement of the European Union the European Council met in Laeken, Belgium, on 14 and 15 December 2001 and convened the European Convention on the Future of Europe. The Convention was entrusted to draw up proposals on the methods of bringing 'the citizens closer to the European design and European institutions', organising European politics in an extended Europe and making the Union a 'stabilising factor and a model in the new world order'. The Convention distilled the responses to the questions raised in the Council’s declaration into four items: (i) better division of the competences of the centre and the Member States, (ii) merger of the Treaties and conferring legal personality to the EU, (iii) increased democracy, transparency and

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350 Ibid., at p. 40.
351 Ibid.
352 Ibid.
353 Ibid.
efficiency of the EU, and (vi) improvement of the structure and enhancement of the role of the Union’s institutions taking the effects of its enlargement in consideration.\textsuperscript{356}

Eventually the Convention drew up a draft Treaty establishing a Constitution for Europe and presented it to the European Council on 20 June 2003. The proposed Constitution seeks to establish the European Union that will exercise competences conferred on it by the Member States and will also coordinate their policies to achieve their common objectives.\textsuperscript{357} The Constitution and the laws adopted by the Union shall be supreme over the national laws.\textsuperscript{358} ‘Every national of a Member State shall be a citizen of the Union’ in addition to national citizenship with a particular right and duties.\textsuperscript{359} There shall be five institutions of the Union having specific powers and functions: the European Parliament, the European Council, the Council of Ministers, the European Commission and the Court of Justice.\textsuperscript{360} Thus the Union having one Constitution that defines competences between the centre and the Member States, grants rights and duties to the citizens, and allocates powers and functions among the institutions will look more a federation-like organisation.

In this proposed quasi-federation the Union will exercise exclusive competence conferred on it by the Constitution ‘to establish the competition rules necessary for the functioning of the internal market’ and in defined areas, e.g., monetary policy (for those Member States that have adopted the euro), common commercial policy, and customs union.\textsuperscript{361} It will have competence also ‘to define and implement a common foreign and security policy, including the progressive framing of a common defence policy.’\textsuperscript{362} Competences not conferred on the Union will be

\textsuperscript{355} Ibid.
\textsuperscript{356} Ibid.
\textsuperscript{358} Ibid., art. 10(1).
\textsuperscript{359} Ibid., art. 8.
\textsuperscript{360} Ibid., 18(2).
\textsuperscript{361} Ibid., art. 12(1).
\textsuperscript{362} Ibid., art. 11(4).
exercised by the Member States subject to interference by the Union under the principle of subsidiarity.\textsuperscript{363} The Union’s act under the subsidiarity principle must be exercised according to the principle of proportionality.\textsuperscript{364} If the former principle is infringed, the ECJ shall have jurisdiction to hear actions on it brought by Member States.\textsuperscript{365} As regards the law-making procedure the proposed Constitution classifies the Union’s legislation as European laws, European framework laws, European regulations, European decisions, recommendations and opinions.\textsuperscript{366} A European law and a European framework law are legislative acts.\textsuperscript{367} They are to be adopted jointly by the Parliament and the Council of Ministers on the basis of the Commission’s proposal. If they cannot agree on such an act, it shall be abandoned.\textsuperscript{368} Regulations, decisions, recommendations and opinions all are non-legislative acts.\textsuperscript{369} A regulation shall be of general application for implementing legislative acts and certain provisions of the Constitution.\textsuperscript{370} It may be binding in its totality and directly applicable in the Member States.\textsuperscript{371} Alternatively, it may be binding only to the extent of the result to be achieved.\textsuperscript{372} Member States to which it will be addressed will choose the form and means of implementation.\textsuperscript{373} A decision shall be binding on the Member State(s) to which it will be addressed.\textsuperscript{374} Recommendations and opinions shall have no binding force.\textsuperscript{375} Respecting implementation of the Union laws the Constitution proposes that Member States shall take necessary measures to implement them.\textsuperscript{376} Where uniform

\begin{thebibliography}{99}
\bibitem{363} Ibid., art. 9(1)-(3).
\bibitem{364} Ibid., art. 9(3) and (4).
\bibitem{366} Draft Constitution, \textit{supra} note 357, art. 32(1).
\bibitem{367} Ibid., 32(1).
\bibitem{368} Ibid., 33(1).
\bibitem{369} Ibid., 32(1).
\bibitem{370} Ibid.
\bibitem{371} Ibid.
\bibitem{372} Ibid.
\bibitem{373} Ibid.
\bibitem{374} Ibid.
\bibitem{375} Ibid.
\bibitem{376} Ibid., 36(1).
\end{thebibliography}
conditions are necessary for implementation, the Commission or in particular cases (viz., common foreign and security policy) the Council of Minister shall exercise the implementing powers by issuing regulations or decisions. The Constitution proposes to establish the Court of Justice consisting of the European Court of Justice (ECJ), the High Court (HC) and specialised courts. The ECJ shall comprise one judge from each Member State, and the HC at least one judge per Member State. The Court of Justice shall, among others, rule on actions that will be brought by a Member State, an Institution (e.g., action for non-implementation of Union law by any Member State), or a natural or legal person.

3.3.4 Conclusion

At present the European Community is a quasi-federation. It enjoys sovereignty transferred by the Member States. This theoretically enables the centre to compel the latter to comply with its law. The Member States concede to this supranational primacy of the centre in consideration of the balance of the politico-economic benefits they reap from being integrated. In order that the centre can maintain its supranational status its architects have equipped it with exclusive powers in which domain the periphery does not have any share. At the same time the periphery has been given autonomy conditioned by an upper-hand check by introducing subsidiarity principle. The centre can press the brake on the speed of the peripheral action when it deems it necessary for the sake of the Community as a whole. This, being a subjective decision on the part of the centre, is prone to give rise to conflict between the centre and periphery when the latter feels unhappy with the former’s interference because its “balance of interests” is in danger. This political tug of war is an ever-present scenario.
within the Community constitutional latticework in general right from the start of
directives making up to their implementation. Of course, the ECJ has a limited role to
play. It cannot and should not engage in deciding the balance of expediency with regard
to any matter of legislation. In spite of this it indirectly can influence the legislative
actions as it did with respect to devising mutual recognition as a means of integration.381

Although the general law-making procedure is complex and time-
consuming, apropos securities regulation it has become better with the adoption of the
2-Level system recommended by the Committee of Wise Men. This would ‘make legal
changes a lot easier, especially since changing market conditions in most cases
presumably can be addressed in the Level 2 legislation.’382 Of course, still there
remains scope of political differences between the Commission and the Parliament in
framing the basic principles of a proposed legislation. Therefore, ‘in any case changing
Level 1 legislation will still be difficult and troublesome.’383 At Level 3 the decision is
to be made by consensus (for example, on interpretative recommendation) among the
ESRC members representing the Member States, which may not be an easy task
because members from difference legal systems (viz., common law and continental)
may have divergent views on a particular matter. Political elements might also be there.
Last, it is questionable how quicker an enforcement action would be taken against a
recalcitrant Member State. For example, implementation date for the Investment
Services Directive384 was over on 1 July 1995, whereas Luxembourg was held liable

380 Ibid., 28(3).
381 See the text accompanied by notes 289-294, supra.
383 Ibid.
for non-implementation on 3 July 1999. Thus although the new 4-Level regulatory device is a ‘progressive welcome to the harmonization process’, a few basic problems will still be there, which are, to a great extent, related to the Community approach to harmonisation featured with law-politics interplay. Of course, the Community cannot disown that interplay; it has to live with that: ‘although the rule of law is essential to the Union, it is not the structure’s only source of strength. Law and politics mingle and are mutually supportive.’

Under the proposed Constitution the broad structure of the Community will remain the same. The problems existing in the shared power area under the subsidiarity principle will continue to last. Those may escalate with the expansion of the Union because an increased number of Member States may give rise to an increased number of objections against the centre’s interference with the domestic law-making areas. And the ECJ will have to rule on them, which is basically a political exercise. Although it has not indulged yet in determining the relative expediency involved in legislation in the shared jurisdiction, how long will it be able to do so? It is a matter to wait for and see. However, the Constitution will become the fundamental law of the European Union and will prevail over national laws. Other laws of the Union will receive similar primacy. This principle of primacy was developed by case law. For the first time this is going to be constitutionally mandated. The Constitution is introducing the Union’s citizenship with certain right and duties. Principally this will make the Union closer to a federation of European States making it a “model of integration” on the globe.

4 INTEGRATION OF SECURITIES MARKET-

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386 Anderson, supra note 382, at p. 322.
387 Schoutheete, supra note 58, at p. 40.
4.1 INTRODUCTION

As a measure of establishing a common market in financial services the EC initially adopted directives effecting liberalisation of capital movement. Those directives enabled individuals and firms to invest capital across the national frontiers. Although investors, taking advantage of this freedom, could invest in foreign securities, the securities issuers could not establish business and solicit capitalisation in foreign jurisdictions within the EC. Therefore, the EC underscored the need of ‘a level playing field’ both for the securities issuers and the investors. This led to the adoption of a number of directives facilitating the offering and trading of securities within the EC. Those directives can be mainly categorised into company law directives and securities law directives.

Although today company law is separate from securities law, there is still some interrelation between them. For example, when a company needs large-scale capitalisation, it offers securities to the public for sale through the publication of a prospectus. This is the principal method of corporate fund-raising. But inducing the public to invest in a company’s securities requires two incentives: the limited liability of the investors, and the existence of a secondary market in which they can liquidate their investment. The latter necessitates a company offering securities to join a

390 Ibid.
391 Ibid.
393 Karmel, supra note 389, at p. 6.
395 It means that the investors’ liability for the financial liability (e.g., corporate debts) of the company is limited to the proportion of the value of the shares they hold. This advantage is available in a company limited by shares. Professor N.M. Butler said in this regard, ‘The limited liability corporation is the greatest single discovery of modern times. Even steam and electricity are less important than the limited liability company’. A.L. Diamond in Orhnial (ed), Limited Liability and the Corporation (Law Society of Canada, 1982 at p.42) quoted in Janet Dine, Company Law, 3rd ed. (Houndmills, Basingstok, Hampshire and London: Macmillan Press Ltd., 1998) at p. 1.
stock market in order to attract the potential investors to the opportunity of liquidity. In Britain such a company gets its securities listed on the London Stock Exchange in compliance with the Listing Rules. A company which does not qualify for listing gets its securities admitted to dealings on the Unlisted Securities Market presently called Alternative Investment Market (AIM) according to the Public Offers of Securities Regulations 1995. Thus an initial public offering (IPO) of securities is essentially related to the secondary market, though they involve ‘in principle separate activities’. The former, being a matter of corporate capitalisation, is regarded as a company law subject and the latter exclusively forms a part of securities regulation. But because of the interrelation of the two markets a company law book while dealing with the former cannot ignore the latter nor can securities regulation ignore the former. To the context of British Law Gower puts this matter as thus- ‘(T)he Listing Rules of the Stock Exchange constitute in many respects a specialist set of company laws for the largest of our companies, namely those listed on the London Stock Exchange.’ An ample example is an issuer’s duty of continuous disclosure of inside information. A takeover bid is a matter of this kind. When some other company offers to acquire sufficient number of shares of an issuer company so as to gain control in it, it is known as a takeover bid. The bidder company may make such a bid for a variety of reasons,

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396 Farrar, supra 394, at p. 538.
397 Shares of companies of big size and having trading record are subject to listing on a Stock Exchange while those of new and smaller companies are required to be admitted to dealings on the Unlisted Securities Market. In the United Kingdom, for example, former types of companies must have at least a three-year trading record (r 3.3, Listing Rules), its shares to be listed must be freely transferable and normally at least 25% of shares listed must be distributed to the public (rr. 3.18-3.21).
399 Ibid.
400 Ibid. at p. 393.
401 In the UK inside information is defined as information which:

(i) relates to particular securities or to a particular issuer of securities or to particular issuers of securities, and it must not relate to securities generally or to issuers of securities generally;
(ii) is specific and precise;
(iii) has not been made public; and
(iv) if it were made public would be likely to have a significant effect on the price of any securities. The Criminal Justice Act, s. 56(1)
such as the incumbent management of the offeree company is not apt to utilise its resources and, therefore, fails to make good profits, which results in the low price of its shares in the secondary market.\textsuperscript{402} Whatever may be the motives behind a takeover bid, information in this regard must be disclosed to the shareholders in full so that they may determine the merit of the offer and make their decision to sell their shares and exit the company.\textsuperscript{403} Withholding any such information and trading on that amounts to insider trading which is illegal.\textsuperscript{404} This merits inclusion of insider dealing within company law, though it pertains to the secondary market of securities. Thus because of this close interrelation between company law and securities regulation, the directives adopted in these two areas of law would be overviewed in this chapter.

\textbf{4.2 AN HISTORICAL AND THEORETICAL MEMORANDUM}

The EC securities law directives are based on the theory of disclosure that advocates for providing the investing public with information relating to securities so that they can make sober decisions on investment in them. This theory will be focused on with more details later elsewhere.\textsuperscript{405} Here in the following a historical outline of the adoption of this theory at the Community level is being given because theoretical knowledge is incomplete without history:

The law embodies the story of a nation’s development through many centuries and it cannot be dealt with as if it contained only the axioms and corollaries of a book of mathematics. In order to know what it is, we must know what it has been, and what it tends to become. We must

\begin{footnotesize}
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\item Such information relates to takeover bid, increase in profits, failure of contract, etc. : Farrar, \textit{supra} 394, at 421.
\item \textsuperscript{402} R.R. Pennington, \textit{The Investor and the Law}, (London: Macgibbon & Kee Ltd., 1968) at p. 398.
\item \textsuperscript{403} For example, City Code, General Principle 4.
\item \textsuperscript{404} An insider of a company (e.g., a director, officer, employee or any other person who has access to such information.) is prohibited to trade (i.e., buy or sell securities) on an inside information that is known to him by virtue of his or her position. Farrar, \textit{supra} at p. 421. The rationale behind is that potential investors ‘will come to feel that investing on such markets is like playing poker with opponents who know the backs of the cards as well as the fronts.’ Stephen Griffin, \textit{Company Law- Fundamental Principles} (London: Pitman Publishing, 1994), at p. 116.
\item \textsuperscript{405} See chapter 7.2.2.1.2.2, \textit{infra}.
\end{itemize}
\end{footnotesize}
alternately consult history and existing theories of legislation.\textsuperscript{406}

The EC adopted the disclosure policy for the first time on the recommendation of a Committee of Experts appointed in 1964 with the task of examining and recommending ‘the factors conducive to the creation of a viable European capital market’.\textsuperscript{407} That Committee in its report, \textit{Development of a European Capital Market} (popularly called Segre Report) published in 1966 recommended that the investors ‘have at their disposal sufficient and reasonably homogeneous information on securities dealt in other markets’.\textsuperscript{408} It recommended for disclosure both at the time of issue and at subsequent stages on continuous basis.\textsuperscript{409} The Committee’s recommendations came at the backdrop of a situation in which information provided by the issuers of securities varied in quality and quantity from one country to another. As a result, in this respect the investor protection was not uniform throughout the EC.\textsuperscript{410} The Commission took the Committee’s recommendations into consideration because there was an ‘overwhelming advantage in attempting to set a bare minimum of public disclosure for each market when corporate securities are first brought to that market’.\textsuperscript{411} Accordingly it drafted a directive relating to prospectus disclosure for admission of securities to the official listing of a stock exchange of a member country.\textsuperscript{412} In 1969 the Commission set up another committee of experts headed by Mr. de Barsy who was the then president of the Belgian Banking Commission.\textsuperscript{413} The recommendations put forward by this committee and the Segre Report were followed, to a large extent, in

\begin{thebibliography}{99}
\bibitem{408} \textit{Ibid}.
\bibitem{409} \textit{Ibid}.
\bibitem{410} \textit{Ibid}.
\bibitem{411} \textit{Ibid}.
\end{thebibliography}
subsequently adopting three disclosure directives, namely Listing Particulars\textsuperscript{414}, Interim Reports\textsuperscript{415}, and Public Offer Prospectus\textsuperscript{416} Directives.\textsuperscript{417}

The disclosure philosophy was further advocated as a prescription for the development of the EC securities market in 1977 when the Commission published a Recommendation concerning a European code of conduct relating to transactions in transferable securities \textsuperscript{418}. Before this a committee of experts drafted a European code of conduct relating to transactions in transferable securities. The Commission did not issue the code as an obligatory instrument in consideration of the regulatory disparity in EC member states, rather decided to publish it as a recommendation, which does not have any binding force. However, both the committee of experts and the Commission underscored the need of furnishing information to the public to bolster their confidence in the securities market. The committee laid down, as a general principle, in the code that ‘(i)nformation should be available to the public which is fair, accurate, clear, adequate and which is given in good time’. It proposed for publication of a prospectus by an issuer offering securities and also for periodic disclosure of information to the investors. In its explanatory memorandum to the recommendation the Commission termed ‘lack of full information’ as a factor hindering integration of securities markets in Europe. Therefore, directives adopted or proposed in the 1980s gave effect to the disclosure provisions laid down in the code. The recommendation thus ‘firmly established the principle of disclosure, the bedrock of the subsequent legislation’.\textsuperscript{419}

It is worth mentioning that before the EC’s underlining of the importance of the disclosure philosophy it had been already underpinning both the

\textsuperscript{414} Supra note 24.  
\textsuperscript{416} Supra note 25.  
\textsuperscript{417} Supra note 413, p. 229.  
\textsuperscript{418} [1977] OJ L212/37.
continental European and English company laws.\textsuperscript{420} Of course, in continental countries it had not been in wide practice because there the companies (except the Dutch companies) are mainly financed by government, banks and families (“insiders”).\textsuperscript{421} By contrast, English companies\textsuperscript{422} are mainly share financed.\textsuperscript{423} The shareholders do not have direct access to inside information of the companies. Large number of those shareholders are institutions that can wield pressure on the corporations to disclose information, whereas there is little pressure on the continental companies from the “insiders” who can influence the companies to a great extent.\textsuperscript{424} However, as a result of the Community legislative steps continental countries have recognised their responsibility with regard to corporate disclosure.\textsuperscript{425}

\textbf{4.3 COMPANY LAW DIRECTIVES}

\textbf{4.3.1 Overview}

(a) The First Directive\textsuperscript{426}

This directive was adopted\textsuperscript{427} having regard to the general purpose of removing barriers to freedom of establishment.\textsuperscript{428} Particularly it sought coordination of national provisions relating to disclosure, the validity of obligations entered into by limited liability companies, and nullity of such companies, for the purpose of protection of interests of third parties.\textsuperscript{429} It chose limited liability companies for such coordination

\textsuperscript{419} Supra note 413, at p. 230.
\textsuperscript{420} See Arthur K. Kuhn, \textit{A Comparative Study of the Law of Corporations}, (New York: Columbia University, 1972), at pp. 116-120, 126-132, 139-140, 142, and 144-146.
\textsuperscript{422} Here English companies refer to companies of England and Wales as they are operated by common law. Scottish companies are excluded because they are governed by Scottish law patterned on civil law.
\textsuperscript{423} Nobes, supra note 421.
\textsuperscript{424} \textit{Ibid.}, at pp. 5 and 7.
\textsuperscript{425} \textit{Ibid.}, at p. 7.
\textsuperscript{426} Supra note 21.
\textsuperscript{428} First Company Law Directive, supra note 21, preamble, recital 1.
\textsuperscript{429} \textit{Ibid.}, recital 2.
because ‘the activities of such companies often extend beyond the frontiers of national territories’. 430

With regard to disclosure the national laws of the original six Member States (Germany, France, Belgium, Luxembourg, Netherlands, and Italy) contained varying provisions. 431 The Directive undertook to coordinate these laws, which is its ‘major achievement’ 432. In doing this it had the purpose to enable third parties to learn about the contents of the basic documents of companies and other information concerning them. 433 It requires the Member States to take measures for compulsory disclosure of at least the following documents and particulars:

(1) The constitutional documents (e.g., memorandum and articles of association in English law) and statutes (by-laws), if they are separate, accompanied by the amendments thereto, and also statements of the current state of such documents after amendment. 434

(2) The appointment, termination of office and particulars of the persons who, as a body or members of a body, are ‘authorised to represent the company’ or ‘take part in the administration, supervision or control of the company’ 435. The body authorised to represent may consist of a single or several members. Whatever may be the case, ‘the power of representation …is required to be made known expressly’. 436

430 Ibid., recital 1.
431 For a brief idea about how the Member States’ disclosure laws differ, see Stein, supra note 427, at p. 238-9 n. 4.
434 First Company Law Directive, supra note 21, art. 2(1)(a), (b) and (c).
435 Ibid., art. 2(1)(d).
(3) At least every year, the amount of subscribed capital, where the constitutional documents or statutes name an authorised capital, unless an increase in the subscribed capital requires an amendment to the statutes.437

(4) The balance sheet, and the profit and loss account for every financial year.438

(5) Any transfer of the company’s seat.439

(6) Information about winding up of the company, a declaration of its nullity by the court, particulars of its liquidators, and its striking-off the register.440

Secondly the Directive lays down provisions concerning the company’s obligations arising from actions accomplished on its behalf. For example, with regard to pre-incorporation contracts it provides for the liability of those persons who acted in the company’s name where the company does not assume the contractual obligations.441 It restricts the doctrine of ultra vires in that acts done by the company’s organs442, even if inconsistent with the object clause, are binding on it, unless they exceed the powers that law grants them.443 Lastly the Directive enumerates the grounds of nullification of the company’s incorporation. It also prescribes the procedure that nullity must be declared by a court’s decision.444

This Directive is an example of integration of the EC company law by harmonisation. All Member States have implemented the First Directive.445 Of them the

437 First Company Law Directive, supra note 21, art. 2(1)(e).
438 Ibid., art. 2(1)(f).
439 Ibid., art. 2(1)(g).
440 Ibid., art. 2(1)(h),(i),(j) and (k).
441 Ibid., art. 7.
442 Here the acts of the company’s organs are interpreted, by reference to art. 2(1)(d) of the Directive, “as acts of the board or of those members authorised to act for the board, either alone or jointly”. Derrick Wyatt, ‘The first directive and company law’ (April 1978) 94 LQR 182 at p. 183.
443 First Company Law Directive, supra note 21, art. 9.
444 Ibid., art. 11.
445 Eurolaw (visited on 27 February 02). The United Kingdom initially implemented the Directive by Sec. 9 of the European Communities Act 1972446, which was later included into the Companies Act 1985 provisions, namely Sec.s 10, 18, 35, 35A, 38A, 36C, 42(1), 287, 341, 363, 380 and 711. For implementation in Italy, see Bruno L. Cova, ‘Implementation of EC company law directives in Italy’, (1992) 3(1) ICCL Rev 31.
UK did not have to face any difficulty in incorporating its disclosure provisions in the company law because ‘English companies are already obliged to make public most of the matters dealt with by the …directive.’ 446

(b) Second Directive447

The Second Company Law Directive is ‘a major step towards the harmonisation of company law in the European Economic Community and towards the achievement of an economic union.’ 448 It was adopted, as its title says, to bring about equivalence among the national laws of the Member States with regard to the formation of public limited liability companies and maintenance and alteration of their capital.

Like the First Directive its ultimate purpose was to abolish impediments to the freedom of establishment.449

This Directive seeks coordination among national laws in two ways. Certain articles lay down minimum requirements and allow the Member States to derogate even by way of adoption of stricter rules.450 There are other provisions that are detailed and as such leave no ‘margin of discretion’.451 For example, Articles 2 and 3 provide minimum information to be disclosed by a public company, which complements the method of disclosure prescribed in Section I of the First Directive.452

Article 2 requires the statutes or the instrument of incorporation of a company to furnish at least the following information:

1. the type, name, objects and duration of the company;

447 Second Council Directive (77/91/EEC) of 13 December 1976 on coordination of safeguards which, for the protection of interests of members and others, are required by Member States of companies within the meaning of the second paragraph of art. 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, [1976] OJ L26/1.
451 Ibid., at 4907-4908.
2. the amount of its subscribed capital and, if it has an authorised capital, the amount of that and of the subscribed capital at the time of incorporation or authorisation to commence business, and also at the time of any change in the authorised capital;

3. the rules governing the number of and procedure for appointment of members of the bodies responsible for representing the company with regard to third parties, administration, management, supervision or control of the company and the allocation of powers amongst those bodies ‘in so far as they are not legally determined’.  

Article 3 requires at least eleven things to be contained in a company’s statutes or instrument of incorporation or any other separate document. They include the company’s registered office, the number and nominal value of the shares subscribed, conditions, if any, on the transfer of shares, classes of shares and rights attached to them, and the amount of the subscribed capital paid up at the time of incorporation or authorisation to commence business. On the other hand, for example, while Article 6 requires that a company must have a minimum subscribed capital before incorporation or authorisation to commence business, Article 7 provides that such capital must be formed of ‘assets capable of economic assessment’, and not of ‘undertaking to perform work or supply services’.

Like the First Directive the Second Directive is a harmonisation attempt by the EC. It has been implemented in all Member States, which triggered changes to national legislation. For example, with regard to the UK implementation it was suggested that where its ‘law is in accord with the Directive but only by virtue of case-law decisions, which may be overturned by successive cases, it may well be decided

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452 Edward, supra note413, at p. 57.
453 For the meaning of the phrase ‘the bodies responsible for representing the company…supervision or control of the company’ with respect to the continental law and British law, see Edward, ibid., at 58.
that codification is necessary.\textsuperscript{455} Accordingly, effect has been given to the Directive by addition of new provisions to and also by amendment of the existing provisions of the Companies Act where appropriate.\textsuperscript{456} Of them worth mentioning is the addition of minimum subscribed capital requirement provisions\textsuperscript{457}, which is the ‘most important, but expressly postulated, contribution’ of the Directive\textsuperscript{458}. The company laws of UK, Ireland and Belgium did not require minimum capital for public company before.\textsuperscript{459}

(C) Third\textsuperscript{460} and Sixth\textsuperscript{461} Directives

After the First and Second Directives had been adopted, there was going on a discussion on a draft Convention on international mergers of public companies based on Article 293 (ex Article 220) of the EC Treaty. It was felt that international merger presupposed measures at national level; the latter could serve as a ‘bridge head’ for the former.\textsuperscript{462} Then five of the original six Member States had merger laws in their national jurisdictions, the only exception was the Netherlands.\textsuperscript{463} Therefore, side by side of the draft Convention a proposal for a Directive was being prepared by the Commission with an aim to harmonise the national laws on merger and also to introduce this concept in Member States like Netherlands lacking laws in this regard. In 1970 the Commission came up with the Proposal for a Directive on Mergers between

\textsuperscript{454} EuroLaw (visited on 27 February 02)
\textsuperscript{455} Geoffrey Morse, ‘The second directive: raising and maintenance of capital’, (1977) EL Rev 126, at p. 127.
\textsuperscript{456} The Second Directive has been implemented in the UK by the Companies Act 1980, and the Companies (Share Allotment and Capital Maintenance) Ordinance 1998. EuroLaw (visited on 27 February 02)
\textsuperscript{457} The Companies Act (CA) 1985, ss. 117-18.
\textsuperscript{458} Schmitthoff, supra note 448, at p. 46.
\textsuperscript{459} Ibid., at pp. 46-47.
\textsuperscript{462} Stein, supra note 427, at p. 378.
\textsuperscript{463} Edward, supra note 413, at p. 92.
Joint-Stock Companies.⁴⁶⁴ Though the title indicates that the proposed Directive concerned mergers, it was in fact intended to apply to other transactions, including divisions, which are ‘in many respects similar to mergers’.⁴⁶⁵ Mergers and divisions were the main transactions covered by the proposal. The former ‘connote any arrangement by which the business formerly conducted by two companies become the business of a single company’⁴⁶⁶, whereas the latter refer to ‘splitting-up of a company and transfer of its assets to more than one acquiring companies….⁴⁶⁷ Despite their similarity mergers and divisions differ in that ‘in a merger there is only one (acquiring or new) beneficiary company, whereas a division involves more than one recipient company.’⁴⁶⁸ The Council took this matter into consideration and underlined the need of more work on divisions ‘in view of the extra risks involved in one company’s assets being distributed among several others’⁴⁶⁹ As such the Council dropped “divisions” off the Directive to be legislated on separately. Accordingly it adopted the Third Directive on Mergers in 1978, and the Sixth Directive on Divisions in 1982.

The Third Directive is meant for coordination of safeguards under national laws for the protection of company members and others with regard to domestic mergers.⁴⁷⁰ As such it obliges the Member States to lay down uniform rules for (a) merger by acquisition of one or more companies by another,⁴⁷¹ (b) merger of several companies into a new company,⁴⁷² and (c) merger of wholly-owned subsidiaries

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⁴⁶⁶ Stein, supra note 427, at p. 364 n. 120. For detailed discussion on the concept under the Third Directive, see Frank Wooldridge, ‘The third directive and the meaning of mergers’, (1980) 1 Co. Law. 75.
⁴⁶⁷ Ibid.
⁴⁶⁸ Edward, supra note 413.
⁴⁷⁰ Ibid.
⁴⁷¹ Ibid., art. 3(1).
⁴⁷² Ibid., art. 4(1).
into their parent company.\textsuperscript{473} On the other hand, the Sixth Directive, instead of imposing such obligations, requires the Members States to observe the Directive’s safeguards only where they permit companies to carry out division operations,\textsuperscript{474} which may be either by acquisition of such companies’ assets and liabilities by more than one existing companies,\textsuperscript{475} or by newly formed companies.\textsuperscript{476} The said Directives provide for disclosure of the draft terms of mergers and divisions respectively in the manner prescribed by the laws of each Member State in compliance with Article 3 of the First Directive for each of the companies involved in the merger or division process at least one month ahead of the general meeting, which will decide thereon.\textsuperscript{477}

All Member States have implemented both of the Third and Sixth Directives.\textsuperscript{478}

\textbf{(d) Annual Accounting Directive}\textsuperscript{479}

Accounting that is, in general, the ‘recording and reporting of transactions’\textsuperscript{480} is the ‘universal language of business’.\textsuperscript{481} But the “language” is spoken with different accents following different rules of grammar. This triggers accounting records of one country looking different from those of another country. Hence differing

\begin{thebibliography}{99}
\bibitem{473} Ibid., art. 24.
\bibitem{474} Sixth Company Law Directive, \textit{supra} note 461, preamble, recital 5.
\bibitem{475} Ibid., art. 2.
\bibitem{476} Ibid., art. 21.
\bibitem{477} Third Company Law Directive, \textit{supra} note 460, art. 6, and Sixth Directive, \textit{supra} note 461, art. 4.
\bibitem{478} EuroLaw (visited on 27 February 02) The UK has transposed their provisions into the Companies (Mergers and Divisions) Regulations 1987 and the Companies (Mergers and Divisions) Ordinance 1998. For discussion on implementation in Italy, see Cova, \textit{supra} note 445, at pp. 31-33.
\bibitem{479} \textit{Supra} note 22.
\bibitem{480} Eric L. Kohler, \textit{A Dictionary for Accountants}, (NY: Prentice-Hall Inc., 1952), at p. 8. In particular, accounting refers to
\begin{itemize}
\item[(a)] the devising internal controls and recording methods (system design),
\item[(b)] the maintenance of transactions records (bookkeeping),
\item[(c)] the continuous testing of the operating effectiveness of controls and of the accuracy and propriety of records (internal auditing),
\item[(d)] the periodic reviewing of transaction summaries (external auditing),
\item[(e)] the making known to others of the information revealed in and implications derived from such summaries (reporting).
\end{itemize}
\bibitem{481} Ibid., at pp. 8-9.
\bibitem{481} EC Commission, \textit{The Fourth Accounts Directive of 1978 and the Accounting Systems of the Federal Republic of Germany, France, Italy, the United Kingdom, the United States of America and Japan} (1986).
\end{thebibliography}
accounting practices were ‘(h)igh on the list of problems faced by integrated European multinationals’.

In order to remove this impasse a proposal for a directive on accounting, prepared by a working group formed in 1969, was put forward by the Commission to the Council in 1971.

That was founded on the creditor-oriented prescriptive continental approach prevalent in Germany and France, which requires accounting reports and information to be prepared according to a standard format defined by law in detail.

In the same year the Groupe d’Etudes (the EEC Accountants’ Study Group) invited the representatives of the United Kingdom, Ireland and Denmark, the then would-be members of the EC, to discuss the proposal. Those representatives explained their Anglo-Dutch accounting philosophy that is distinguished from the Franco-German counterpart in that in the former financial statements are to be prepared according to the rules defined by law (statutory provisions) and accounting standards recommended by the professional bodies (may be called customary rules of accounting).

The Groupe was persuaded of many Anglo-

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484 See Edward, *supra* note 413, at p. 117.

485 The Groupe was an informal committee of accountants from each of the EC Member States. Based in Brussels it was constituted in 1966 at the request of the EC Commission, but was not an official organ of the EC. The participating professional bodies contributed towards its budget. The Groupe liaised between the EC Commission and Parliament, and spoke in one voice on matters like draft directives on company law. It was, however, replaced by the Federation des Experts Comptables Europeens (FEE) which was founded in 1987 by a merger of the Groupe and the Union d’Experts Comptables (1951).


488 Accounting standards set by professional bodies (e.g. Accounting Standards Board- ASB in the UK) do not have binding force unlike legal accounting provisions, e.g., the (UK) Company Act 1985 provisions regulating accounting. The courts of law, however, accord recognition to them to the effect that the accounting firms should follow them in the preparation of financial statements. Disregarding them amounts to the breach of professional duty unless there is sufficient explanation for it. In this process such standards receive customary law status in practice. *Lloyd Cheyham and Co. Ltd. v. Littlejohn & Co Ltd.*, [1978] BCLC 303 at p. 313 (Woolf J.)
Dutch concepts, principally the “true and fair view” (TFV)\(^{488}\) concept briefly described below.

There is no unanimous definition of the TFV.\(^{489}\) Parker and Nobes have distilled two broad juxtapositions of reflections.\(^{490}\) One thought argues that the TFV results out of detailed compliance with the generally accepted accounting principles comprised in law and accounting standards (as in the UK). At the other end, many perceive that the presentation of financial information should be free from ambiguities, blurs and distortions of the corporate financial standing, which may not be possible by blind application of law. In other words, corporate accounting should not restrict itself only to the compliance with the statutory rules and profession-made standards only, rather should take cognisance of economic realities so that the users of financial statements are not misled.\(^{491}\) For example, a decades old company “X” has taken loans from its promoters at the time of its formation and has not been able repay them yet. It has been paying interests on the loaned money from its income. This fact must be included in the corporate liabilities even if law or accounting standards do not require so, otherwise the accounts will delineate a distorted picture of the company’s financial position. The TFV seeks to arrest such perversion. This allows flexibility in the preparation of financial statements beyond those accounting rules and standards, if needed, based on professional (accountants’) judgement in view of given economic

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\(^{488}\) This expression was first used in the (English) Companies Act 1947 (afterwards consolidated into 1948 Companies Act). “True and correct view” was immediately before in use. As to why the replacement was proposed one of the Amendment Committee members said, as regards accounting ‘the word “correct” is rather too rigid.’ By way of example, he continued that ‘depreciation of fixed assets only represents the best estimate that one can make of the amount which should be provided; some other person might take a different view. It might be as near the right figure as one’s own estimate.’ Thus “fair” is less rigid but provides ‘the same kind of general impression as ‘correct’ ‘. Minutes of Evidence, 25 February 1994, Q. 6704 (Thomson Robson), cited in R.H. Parker and C.W. Nobes, An International View of True and Fair Accounting, (London and New York: Routledge, 1994), at pp. 1-2.

\(^{489}\) For how variously the concept has been defined and explained, see Parker and Nobes, ibid., at pp. 13-17. As to whether the TFV is a legal concept instead of purely an accounting one, see Andrew McGee, ‘The True and Fair View debate: a study in the legal regulation of accounting’, 54:6 (Nov. 1991) ML Rev. 874.

\(^{490}\) Parker and Nobes, supra note 488, at pp. 19-22.

\(^{491}\) See, for further detail, Parker and Nobes, ibid., at pp. 19-22.
situation subject to confirmation by auditors, the “watch-dog” for accountants.\textsuperscript{492} Thus the TFV is likened to equity\textsuperscript{493} which fills gaps in law.

However, the Groupe’s persuasion to concepts like the TFV results in a compromise\textsuperscript{494} between the Franco-German and Anglo-Dutch accounting paradigms, which was a ‘complex and politically sensitive issue’.\textsuperscript{495} This led to significant changes to the proposal of the Annual Accounting Directive accommodating the Anglo-Dutch concepts. The amended proposal was published in 1974. By that time the UK, Ireland and Denmark joined the EC, which was followed by the adoption of the Directive on 25 July 1978. Its objective was to ‘establish minimum equivalent legal requirements as regards the extent of the financial information that should be made available to the public by companies that are in competition with one another.’\textsuperscript{496}

The Directive prescribes the minimum requirements for the contents and presentation of financial statements, methods of valuation, and audit. In the first place, the Directive requires that the annual accounts, which comprise the balance sheet, the profit and loss account and the notes on the accounts, be drawn up clearly and in accordance with the Directive provisions and that they shall give a TFV of a company’s financial condition.\textsuperscript{497} As said in Tomberger v Gebruder von der Wettern\textsuperscript{498}, the TFV is

\begin{itemize}
\item \textsuperscript{492} In most of the cases UK company directors depend on auditors’ view in the presentation of “true and fair” financial statements. See a survey in ‘True and Fair: UK auditors’ view’ in Parker and Nobes, \textit{ibid.}, pp. 39-60. Auditors provide their opinion on the truth and fairness of financial statements based on their subjective judgement. One author contends that auditors’ view should not be the only yardstick for determination of a true and fair view. He advocates for subscribing legal contents to the requirement which is not, however, possible ‘without imposing an unacceptable straitjacket on the necessary exercise of discretion by auditors.’ McGee, ‘The True and Fair debate’, \textit{supra} note 489, at p. 885.
\item \textsuperscript{493} M. Fowle, ‘True and fair— or only fairly true’, \textit{June Accountancy} (1992) cited in Parker and Nobes, \textit{supra} note 488, at p. 13.
\item \textsuperscript{494} The compromise was an unequal one. The Anglo-Dutch approach received predominance in it. This necessitated larger changes in the Franco-German law than the UK law. See C.W. Nobes, ‘Harmonisation of company law relating to the published accounts of companies’, (1980) ELR 38, at pp. 41-42. However, through that compromise the “true and fair view” has turned into a European concept and needs to be defined by the Community court, namely the European Court of Justice. K.P.E. Lasok and E. Grace, ‘Fair accounting’, JBL, May 1988, at p. 236, and also McGee, ‘The ‘True and Fair View debate’, \textit{supra} note 489, at p. 877.
\item \textsuperscript{495} Edward, \textit{supra} note 413, at p. 118.
\item \textsuperscript{496} Annual Accounting Directive, \textit{supra} note 22, preamble, recital 3.
\item \textsuperscript{497} \textit{Ibid.}, art. 2(2) and (3).
\item \textsuperscript{498} Case C-234/94, [1996] ECR I-3133 at para 17 p. 3153.
\end{itemize}
the primary objective of the Directive. It is presumed that annual accounts prepared according to the Directive provisions will meet the TFV requirement. If, however, the Directive provisions do not present a TFV because they do not give sufficient information, the Directive allows overriding them by furnishing extra information. Overriding is further permitted even by departure from any of the provisions of the Directive, where, in exceptional cases, the application of such a provision results in a distorted view. The phrase, “exceptional circumstances”, signifies that overriding is not an omnibus provision to avail of. As such a company cannot depart from the Directive provision(s) merely because it does not like it or because compliance with it incurs additional costs. Rather it has to assign, in notes, the reasons of such departure with their effects on its (company’s) state of affairs or, profits or loss. In short, overriding is permitted to that extent to which the Directive fails to meet the TFV requirement and the rest of its provisions must be complied with. Thus overriding is an exception and should not create ‘alternative rules to those contained in the Directive, (because in that case) harmonisation would become impossible.’ It may be pointed out in this connection that the Directive seems to have made a compromise between the two extremes of thought on the TFV in that it emphasises primarily on the compliance with its provisions and at the same time allows deviation where necessary. Second, the Directive lays out strict rules of valuation methods. Subject to departures available under exceptional circumstances it requires the items contained in the annual

500 Annual Accounting Directive, supra note 22, art. 2(4).
501 Ibid., art. 2(5). The TFV override displays its essence in the context of the EC accounting, namely ‘analysing a transaction or arrangement in terms of its substance rather than its form’. Lasok and Grace, supra note 494, at p. 239.
503 Annual Accounting Directive, supra note 22, art. 2(5).
505 Annual Accounting Directive, art. 31(2).
accounts to be valued in accordance with particular general principles of accounting,\textsuperscript{506} such as the following (of English origin\textsuperscript{507}): 

(a) \textbf{Going concern}: The Directive presumes that a company preparing accounts is a going concern.\textsuperscript{508} This means that the company is deemed to be in ‘operational existence for the foreseeable future’\textsuperscript{509}, which necessitates continued publication of financial statements from one period to another\textsuperscript{510}. In the UK the ‘foreseeable future’ may ‘extend to a minimum of six months from the date of the audit report, or one year after the balance sheet date, whichever period is longer.’\textsuperscript{511} This presumption does not apply when, for example, the company is unable to pay its debts or is undercapitalised.\textsuperscript{512}

(b) \textbf{Consistency}: The valuation methods must be consistently applied from year to year,\textsuperscript{513} otherwise ‘inconsistency from one year to the next may destroy comparability of financial statements and it may even result in misleading the users of these financial statements.’\textsuperscript{514} If there is any change in the application of the methods, the change and its effects need to be disclosed in notes and financial statements normally presented showing comparative figures for the present and previous years.\textsuperscript{515}

\textsuperscript{506} Ibid. art. 31.
\textsuperscript{507} This shows the British dominance on the drafting of the Directive in addition to the “true and fair” philosophy. Only one general principle was taken from German accounting, namely “assets and liabilities must be valued separately”. See Nobes, supra note 421, at p. 48.
\textsuperscript{508} Annual Accounting Directive, art. 31(a). For the similar UK provision, see Companies Act (CA) 1985, Sch. 4, para. 10.
\textsuperscript{509} Bough, supra note 499, at p. 40.
\textsuperscript{510} Annual Accounting Directive, art.31(b). For the similar UK provision, see CA 1985, Sch. 4, para. 11.
\textsuperscript{511} Auditing Practice Committee, ‘The auditors’ consideration in respect of going concern’ (UK: August 1985) cited in Bough, supra note 499, at p. 40.
\textsuperscript{512} Bough, Ibid.
\textsuperscript{513} Ibid. note 510, at p. 9.
(c) **Prudence:** An item on the financial statements must be determined on a prudent basis.\(^{516}\) The Directive does not define the concept, but refers to how profits and, liabilities and loss are to be determined according to it. In determining profits for the profit and loss account the Directive provides for inclusion of only profits made at the balance sheet date.\(^{517}\) An accounting dictionary defines such profit as ‘a profit in the form of cash or some asset which at the time the transaction was consummated could have been converted into cash or other current asset’.\(^{518}\) Second rule of prudence laid down by the Directive is to take into account all foreseeable liabilities and potential losses arising during the present or previous financial year even if they become apparent only between the balance sheet date and the date on which it is drawn up.\(^{519}\) The third rule is to take account of all depreciation, no matter the result of the financial year is a loss or profit.\(^{520}\)

(d) **Accrual Method of Accounting:** It is a fundamental principle of accounting is to match the income and charges aimed at determining the net income or loss for the financial year. The Directive requires accrual method of accounting for the proper matching. According to this method account is taken of income and charges regardless of the date of receipt or payment of such income or charges.\(^{521}\)

In addition to the above-mentioned general principles, the Directive specifies the historical cost method for determining the value of items under Articles 34 to 42 (fixed or current assets) shown in the annual accounts. According to this method

\(^{515}\) Bough, *supra* note 499, at p. 41 referring to Statement of Standard Accounting Practice (SSAP) 6 adopted by the UK Accounting Standards Committee.

\(^{516}\) Annual Accounting Directive, *supra* note 22, art. 31(c). For the UK provision, see CA 1985, Sch. 4, para. 12.

\(^{517}\) Annual Accounting Directive, *ibid.*, art. 31(c)(aa).

\(^{518}\) Kohler, *supra* note 480, at p. 355.

\(^{519}\) Annual Accounting Directive, *supra* note 22, art. 31(c)(bb).

\(^{520}\) *Ibid.*, art. 31(c)(cc).

\(^{521}\) *Ibid.*, art. 31(d).
the valuation of items must be made according to the purchase price or production cost.\textsuperscript{522}

Last, the Directive obliges companies to have their annual accounts audited by auditor(s) duly authorised by national law.\textsuperscript{523} It enjoins the auditor(s) to compare the annual accounts with annual report.\textsuperscript{524} It allows Member States to exempt small companies from the audit requirement.\textsuperscript{525}

The Annual Accounting Directive has been implemented in all Member States.\textsuperscript{526} Though true or full implementation may not have been attained yet\textsuperscript{527}, given the varied accounting systems of the Member States\textsuperscript{528} its achievement ‘in imposing certain common minimum reporting and disclosure requirements should not be underestimated.’\textsuperscript{529} It has at least provided ‘an important basis and initial step in the harmonization of accounting practices\textsuperscript{530} and financial reporting within the Community.’\textsuperscript{531}

\begin{itemize}
  \item\textsuperscript{522} \textit{Ibid.}, art. 32. See, for further detail on the concept, Langhout, \textit{supra} note 510, at p. 7.
  \item\textsuperscript{523} Annual Accounting Directive, art. 51(1)(a).
  \item\textsuperscript{524} \textit{Ibid.}, art. 51(1)(b)
  \item\textsuperscript{525} \textit{Ibid.}, art. 51(2). This provision has been given effect in the UK by the Companies Act (Audit Exemptions) Regulations 1994, SI No. 1994/1935.
  \item\textsuperscript{527} For the problems of application of the Directive to annual accounts, see EC Commission, \textit{The Accounting Harmonization in the European Countries: Problems of Applying the Annual Accounting Directive on the Annual Accounts of Limited Companies} (1990). The most discussed difficulty is the application of the concept of “true and fair view” which, ambiguous in itself, is variably interpreted in the Member States. As a result it tends to create ‘divergences between Member States regarding the implementation of the Fourth and Seventh Directives’. K.P.E. Lasok and Edmond Grace, ‘Fair accounting’, (1988) JBL 235 at p. 238. With regard to its implementation in German, for example, K.J. Hopt commented that despite its incorporation in German Commercial law statute, ‘not much has changed. Everything is more or less like before’. Buxbaum et al, \textit{supra} note 125, at p. 299.
  \item\textsuperscript{528} For the factors liable for the differences in the accounting and reporting systems, see EC Commission, \textit{supra} note 481, at pp. 14-19. Also see Nigel Savage, ‘Law and accounting-the impact of EEC Directives on company law’, (1980) 1 Co.Law. 24 and 91.
  \item\textsuperscript{529} Edward, \textit{supra} note 413, at p. 117
  \item\textsuperscript{530} ‘Harmonisation of accounting is a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation’. EC Commission, \textit{supra} note 481, at 13.
  \item\textsuperscript{531} EC Commission, \textit{The Fourth Company Law Directive Implementation by Member States} (1987), p. 4 (Introduction). While it is true that the accounting Directives (including the Fourth) have established ‘certain fundamental principles’ between the Member States, ‘on the detailed application of the basic principles they are moving apart.’ Justice Arden, ‘A true and fair view: do the Member States of the EU approach the company accounting directives in different ways?’, (July-August 1995) BJIBFL 295
\end{itemize}
Proposed in 1976\(^{533}\) the Consolidated Accounting Directive was adopted on 13 June 1983 as a complement to the Annual Accounting Directive, which envisaged the need of legislation on consolidated accounts.\(^{534}\) The adoption of the Directive took so much time because there was serious conflict between the Member States respecting its subject matter, namely consolidated accounts.\(^{535}\) Even several Member States did not have a specific regulation in this matter.\(^{536}\) The adoption of the Consolidated Accounting Directive is, therefore, an innovation in such jurisdictions, which has been possible because of an ‘extensive interpretation’ of the Community’s harmonisation power.\(^{537}\) The underlying philosophy of the Directive is that ‘all persons connected with an undertaking belonging to a group have an interest in being properly informed of the structure, assets, financial position, and profits and losses of the group to which undertaking belongs.’\(^{538}\)

Subject to exemptions\(^{539}\) the Consolidated Accounting Directive lays down conditions for the preparation of consolidated accounts. For example, a parent undertaking governed by national law of a Member State is required to prepare consolidated accounts and a consolidated report if, \textit{inter alia}, (a) it has a majority of

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(Editorial). The author suggests that this problem can be avoided if ‘the European Commission devises some method of updating the directives quickly in response to new problems or establishes some supranational standard-setting body which can reach solutions which are appropriate in all member states’. above, at p. 295.

\(^{532}\) Supra note 23.

\(^{533}\) EC Bull. Supp. 9/76.

\(^{534}\) Annual Accounting Directive states that ‘when a company belongs to a group, it is desirable that group accounts giving a true and fair view of the activities of the group as whole be published.’ supra note 22, preamble, recital 8.

\(^{535}\) See Edward, supra note 413, at p. 131.


\(^{537}\) Ibid.

shareholders’ or members’ voting rights in a subsidiary undertaking, and (b) it is a member of the subsidiary and also has the right to appoint or remove the members of its (subsidiary’s) administrative, management or supervisory body. Secondly, it requires that the consolidated accounts composed of the consolidated balance sheet, the consolidated profit and loss account, and notes to the accounts must give a true and fair view of the assets, liabilities, financial position, and profits and losses of the undertakings included therein taken as a whole. Without prejudicing the Consolidated Accounting Directive, the consolidated accounts must be prepared in accordance with the format provided for in the Annual Accounting Directive, and also applying necessary valuation methods (e.g., uniform methods). Lastly, the Directive requires the consolidated accounts to be audited by auditors authorised by national laws of the Member States.

The implementation deadline was 1 January 1990. All Member States have by now implemented this Directive. Its implementation will ensure uniform preparation of accounts and comparable disclosure of information throughout the Community. Of course, there remain many options that the Member States may exploit to continue their existing practices. ‘To this extent the Directive must be

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540 Ibid., art. 1(1)(a).
541 Ibid., art. 1(1)(b).
542 Ibid., art. 16(1).
543 Ibid., art. 16(3).
544 Ibid., art. 17.
545 Ibid., art. 29(1).
546 Ibid., art. 37.
549 Ibid.
viewed as a start of the process of harmonisation rather than the end product.\footnote{Ibid.}

‘Within its scope, however, doors remain open to inevitable evolution of the concepts of accounting law, at national, community and international level.’\footnote{Michel Petit, ‘The conditions for consolidation under the 7\textsuperscript{th} company law directive’, (1984) 21 CML Rev 81 at p. 121.}


As seen above, both the Annual Accounting and Consolidated Accounting Directives require accounts to be audited by duly authorised auditors. The Eighth Directive on auditors is, therefore, a supplement to them. Proposed in 1978\footnote{[1978] OJ C112/6.} it was adopted in 1984. It is meant to ensure that in all Member States auditors have equivalent qualifications. It significance lies in that ‘if the qualifications of auditors were not harmonized by regulating their professional competence and by stipulating for their integrity and independence, the two (Fourth and Seventh) Directives…would not have a uniform effect throughout the Common Market.’\footnote{Frank Wooldridge, \textit{Company Law in the United Kingdom and the European Community: Its Harmonization and Unification}, (London and Atlantic Highlands, NJ: The Athlone Press, 1991) at pp. 73-74. (omitting footnote)}

The Directive seeks harmonisation of the laws, regulations and administrative provisions of the Member States, which are concerned with statutory auditors’ responsibilities for conducting audits of annual accounts of companies and firms, or consolidated accounts of group of companies in so far as they are required by the Community law.\footnote{Auditing Directive, \textit{supra} note 552, art. 1.} The auditors in question must be those who are approved by authorised bodies of the Member States.\footnote{\textit{Ibid.}, art.2(1).} Then the Directive enumerates various conditions for granting such approval.\footnote{\textit{Ibid.}, arts. 2-22.} The auditors so approved and the natural
persons acting on their behalf must act with independence and professional integrity to be defined by the Member States.\textsuperscript{558} A Member State can accomplish this task by ‘requiring compliance with rules of professional practice, justified by the public interest, relating to the integrity and independence of auditors and applying to all persons practising as auditors within the territory of that State.’\textsuperscript{559} Further the Directive requires the Member States to ensure publicity of the names and addresses of all natural persons and firms of auditors, their members or shareholders and administrative staff.\textsuperscript{560}

1 January 1988 was set as the last date for implementation. It has been incorporated in all Member States.\textsuperscript{561} Still, however, there remain differences between Member States. There is a need of greater harmonisation for intra-European trade. At the same time features unique of each Member State’s auditors’ regulation cannot and should not be denied given the socio-economic factors moulding them.\textsuperscript{562} Market pressures may bridge up the gaps overtime, though.\textsuperscript{563}

After discussing the three directives on accounting it can be maintained here that they mark a great success for the Community’s harmonisation efforts in two respects in spite of critiques about their effectiveness (e.g., difficulty in interpreting some provisions of the Consolidated Accounting Directive\textsuperscript{564}). First, they reconcile the conflicts between national accounting systems of the Member States. Second, they have

\textsuperscript{558} Ibid., arts. 23-25.
\textsuperscript{559} Ramrath v Ministre de la Justice, case C-106/91, ECR I-3351 at pp. 3385-86 para. 35.
\textsuperscript{560} Auditing Directive, supra note 552, art. 28.
\textsuperscript{561} EuroLaw (visited 27 February 02). In the UK the Directive has been implemented by the Companies Act of 1989.
\textsuperscript{563} Ibid.
an immense impact on the harmonisation of international accounting, such as on the work of the International Accounting Standards Committee (IASC).

(g) Eleventh Directive

As viewed before, the First, Fourth, Seventh and Eighth Directives provide for disclosure of information by companies. A subsidiary company, being a legal entity separate from its parent company, is subject to the disclosure requirements of those Directives. Contrasted with a subsidiary company a branch of a company in other Member State is not a legal entity and therefore not bound by those Directives. As such people dealing with a branch do not have any opportunity to gather information from the branch. Nor can they have direct access to the (Master) company’s disclosures. This creates a certain discrepancy between protection of shareholders and others of a company that operates through a branch and that which operates through a subsidiary. Added to this, certain Member States have subjected branches to disclosure requirements with sharp differences. The Eleventh Directive

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565 In a Green Paper (OJ C321/1 of 1996) the EC Commission underlined the need of international harmonisation of accounting standards. Elsewhere it tipped of its steps to accelerate the EC influence on this process which would ‘allow global players in Europe to obtain capital on international capital market without having to comply with different requirements of financial reporting’. COM(95)508 at para. 2.9.

566 Hulle, supra note 536, at p. 140. The IASC (now IASB) is composed of representatives from all countries of the world. Given the diversity of accounting practices throughout world this Committee, established in 1973, works to minimise the differences in two ways:

1. to formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance; and
2. to work generally for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements.


568 For distinctions between a subsidiary company and a branch, see The Explanatory Memorandum on the Commission’s Proposal for an 11th Council Directive Based on art. 54(3)(g) of the Treaty Concerning Disclosure Requirements in Respect of Branches Opened in a Member State by Certain Types of Companies Governed by the Law of Another State, (23 July 1986) COM (86) 397 final at p. 2 para. 4.

569 Edward, supra 413, at p. 212.

570 Explanatory Memorandum, supra note 568, at p. 4 para. 8.

571 Ibid., at p. 4 para. 7.
was proposed in July 1986 to eliminate such discrepancies⁵⁷² and was finally adopted in December 1989.

As aforesaid, the Eleventh Directive concerns disclosure by a branch of a foreign company, but it does not define ‘branch’. The Commission has, however, seemingly accepted the following definition as applicable to a branch under the Directive⁵⁷³:

a place of business which has the appearance of permanency, such as the extension of a parent body, has a management and is materially equipped to negotiate business with third parties so that the latter, although knowing that there will if necessary be legal link with the parent body, the head office of which is abroad, do not have to deal directly with such parent body but may transact business at the place of business constituting the extension.⁵⁷⁴

Such a branch may be an extended “arm”⁵⁷⁵ of a company incorporated in a Member State or in a non-Member State. Section I of the Directive sets out disclosure requirements for branches of the former kind while Section II for branches of the latter kind. A branch of either kind is required to disclose, among others, the following⁵⁷⁶:

(a) address and activities of the branch;
(b) the names of the parent company and the branch if they are different;
(c) particulars of the persons authorised to represent the parent in dealings with third parties and legal proceedings, and also the extent of their powers;
(d) accounts of the parent company in compliance with the Fourth and Consolidated Accounting Directives; and
(e) in respect of liquidation the details of the winding-up of the company and appointment of liquidators.

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⁵⁷² See COM(86) 397 final. For comment on this proposal, especially from the UK perspective, see Janet Dine, ‘Company law directives: a protective proposal’, (January 1989) 133(2) SJ 30.
⁵⁷³ See Explanatory Memorandum, supra note 568, at p.1 note 3 to para. 3.
1 January 1992 was set as the last date of implementation of the Directive.\textsuperscript{577} It was expected that its implementation would ensure uniformity as regards disclosure requirements from foreign companies in the Member States.\textsuperscript{578} By now the Directive has been given effect in all Member States.\textsuperscript{579}

(h) Twelfth Directive\textsuperscript{580}

In 1988 the Commission brought a proposal for the Twelfth Directive on single-member private limited companies\textsuperscript{581} and adopted the Directive in 1989. At that time some Member States like Denmark, Germany, France and the Netherlands had provisions in their national laws for business by single-member companies.\textsuperscript{582} In some other Member States, e.g. Italy, Ireland and the UK, the provisions of “single member” company were not in existence.\textsuperscript{583} Apart from this, the Member States that recognised the concept were at variance in practice. For example, while Denmark, Germany, and the Netherlands allowed both natural and artificial persons to form such a company, Belgium did not allow a natural person to do so, Netherlands having an intermediary

\begin{footnotes}
\textsuperscript{576} 11\textsuperscript{th} Company Law Directive, \textit{supra} note 567, arts. 2,3, 7 and 8 read together.
\textsuperscript{577} \textit{Ibid.}, art. 16(1).
\textsuperscript{578} Michael Reynolds, ‘EC briefings-company law’, (July 1989) 8(7) IFL Rev 45.
\textsuperscript{579} EuroLaw (visited on 27 February 02). The UK has implemented the Directive by the following:
2. The Overseas Companies and Credit and Financial Institutions (Branch Disclosure) Regulations 1992, SI 3179 of 1992;
\textsuperscript{582} \textit{Ibid.}, at p. 16.
\textsuperscript{583} \textit{Ibid.}
\end{footnotes}
practice.\textsuperscript{584} The Commission took this initiative to remove these divergences.\textsuperscript{585}

Though this objective is unlikely to be much achieved,\textsuperscript{586} the real significance of the Directive lies in its opening the door of small or medium-sized enterprises’ (SMEs) business in the EC countries.\textsuperscript{587}

The coordination measures provided for by the Directive apply to the laws, regulations and administrative provisions of the Member States relating to private limited companies\textsuperscript{588} with a view to encouraging SMEs enterprises.\textsuperscript{589} They also apply to single-member public companies permitted under the law of some Member States,\textsuperscript{590} e.g. the Netherlands. A company may consist of a single either by original formation or by reduction of membership.\textsuperscript{591} Thus the fall of membership of a private company below two will not trigger its nullity.\textsuperscript{592} Where a company becomes a single-member company by the decline of membership, that fact, together with the identity of the single member, must be disclosed,\textsuperscript{593} which ‘may be of interest to those dealing with it.’\textsuperscript{594} The sole member is required to record the decisions taken in the company’s general meeting,\textsuperscript{595} and also the terms of contracts entered into by him with the company represented by him.\textsuperscript{596}

The Directive was expected to be widely transposed into Member States’ laws because ‘the principle contained in (it) would seem to be of generally worthy of support’\textsuperscript{597} as it ‘allows the genuine individual entrepreneur to limit his or

\textsuperscript{584} Ibid. at p. 16-17.
\textsuperscript{585} Twelfth Company Law Directive, supra note 580, preamble, recitals 4 and 5.
\textsuperscript{588} Twelfth Company Law Directive, supra note 580, art. 1.
\textsuperscript{589} Edwards, supra note 586, at p. 212.
\textsuperscript{590} Twelfth Company Law Directive, supra note 580, art. 6.
\textsuperscript{591} Ibid., art. 2(1).
\textsuperscript{592} Wooldridge, supra note 554, at p. 99.
\textsuperscript{593} Twelfth Company Law Directive, supra note 580, art. 3.
\textsuperscript{594} Explanatory Memorandum, supra note 581, at p. 18.
\textsuperscript{595} Twelfth Company Law Directive, supra note 580, art. 4.
\textsuperscript{596} Ibid., art. 5.
\textsuperscript{597} Wooldridge, supra note 554, at p. 100.
her liability. But this significance depends on how the Directive would be used; ‘it must not be used as a weapon of fraud: it should be a shield and not a sword.’ However, by now all Member States have given effect to it.

(i) European Company Statute Regulation and Employees Involvement Directive

Originally proposed in 1970 and subsequently amended several times, the Regulation for establishing a European Company Statute was adopted on 8 October 2001 along with a Directive on employees’ involvement in such a company. This is a public limited liability company of ‘new type’, also called Societas Europaea (SE), with minimum share capital of Euro 1,20,000, which can be established at the EC level governed by the EC law directly applicable in national jurisdictions of the Member States. Within the uniform legal framework provided by the Regulation companies from more than one Member States can form such a company through re-organisation of their business on the EC scale. The re-organisation may take place by merger of such companies, or by creating a holding company, or by formation of a joint subsidiary. A single company may transform...

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598 Power, supra note 587, at p. C45.
599 Ibid.
600 Ibid., supra note 587, at p. 45.
606 SE Regulation, supra note 601, art. 4(2).
607 Directive on Employees’ Involvement, supra note 602, preamble, recital 2.
608 SE Regulation, supra note 601, art. 2(1).
609 Ibid., art. 2(2).
into an SE provided it has had a subsidiary in another Member State at least for two years.\textsuperscript{611} A company, though based outside of the Community, may join in the formation of such an SE provided it, having been incorporated under the law of a Member State, has its registered office there and a ‘real and continuous link’ with that State’s economy.\textsuperscript{612} Apart from the incorporation provisions, the Regulation also provides for, among others, general meeting,\textsuperscript{613} annual and consolidated accounts,\textsuperscript{614} share capital,\textsuperscript{615} and winding up and liquidation.\textsuperscript{616}

As said above, the employees’ involvement Directive has been adopted by the Community as an integral part of the company statute in order to ensure that ‘the establishment of an SE does not entail the disappearance or reduction of practices of employees’ involvement existing within the companies participating in (its formation)’.\textsuperscript{617} Here “employees’ involvement” means ‘any mechanism including information, consultation and participation through which employees’ representatives may exercise an influence on decisions to be taken within the company.’\textsuperscript{618} When companies map out a plan to establish an SE, they must start negotiations with the representatives of the employees on arrangement for the employees’ involvement in the SE.\textsuperscript{619} A special negotiating body (SNB) representatives of the employees and the competent organs of the participating companies negotiate to reach an agreement on the matter.\textsuperscript{620} They may agree on, among others, how the employees’ representatives will involve in the decision making process of the SE. This may be of three forms, namely information, consultation and, if appropriate (e.g., in respect of SE formed by

\begin{footnotes}
\item[610] Ibid., art. 2(3).
\item[611] Ibid., art. 2(4).
\item[612] Ibid., art. 2(5).
\item[613] Ibid., arts. 51-60.
\item[614] Ibid., arts. 61-62.
\item[615] Ibid., art. 4.
\item[616] Ibid., arts. 63-66.
\item[617] Directive on Employees’ Involvement, preamble, recital 3. Also see EU Bull. 12/2000, point 1.3.35.
\item[618] Ibid., art. 2(h).
\item[619] Ibid., art. 3(1).
\end{footnotes}
transformation), participation. This means the competent organs will inform the representative body (RB) of matters concerning the SE, on the basis of which the RB can express their views on the matters in respect of which the SE needs to make decisions. The RB may be granted a right to board-level participation, which will entitle them to elect or appoint some of board members, and also to recommend or oppose the appointment of all or some of such members. If, however, the SNB and the competent organs fail to reach such an agreement, employees’ involvement must be determined by the standard rules set out in the annex of the Directive.

The Directive took effect on 10 November 2001 and the Regulation will come into force on 8 October 2004 by which time the Member States are required to implement the Directive. It may be hoped that the Member States will be able to meet the deadline to implement the Directive as it has been adopted concomitantly with the Regulation after breaking 30-year deadlock created by Member States’ disagreement over employees’ involvement in an SE. The European Company Statute together with the Directive will ease functioning of an SE on the Community plane under a single legal and administrative framework instead of 15 different national systems. This is a European breakthrough in the its single market programme which could ‘do away with a lot of psychological problems linked to the unavoidable nationality of a company’ and also could pioneer global integration eventually.

4.3.2 Conclusion

620 For a description of the negotiation procedure, see ‘European company statute adopted’, supra note 505, at pp. 22-23.
621 Ibid. art. 4(2)(c), (f).
622 Ibid., art. 4(2)(g).
623 Ibid. art. 7.
The above discussion shows the Community’s achievement in company law harmonisation based on Article 44(2)(g) [ex 54(3)(g)]. The Community aspired for this, lest “Delaware effect” might prevail, which would have baffled the single market goal. However, it is noticed that final adoption of directives (say, the


628 Edwards, supra note 413, at p. 3. Here the author means that if a harmonised system is not established in the EC, there will usher national company laws, which will create an unequal competition among the nations and companies will throng to countries with loose company law just as it happens in the state of Delaware of the United States of America. Also see Clive M. Schmitthoff, ‘The future of the European company law scene’ in C.M. Schmitthoff (ed.), Harmonisation of European Company Law, (London: The United Kingdom National Committee of Comparative Law, 1973) pp. 3-27 at p. 9. In the mid-nineteenth century different states of the United States of America gave, in general, the method of creating corporation by special act. In 1896 New Jersey adopted the first modern corporation statutes of liberal type. The leading industrial states joined this trend, which was regarded by Justice Brandeis as the race of laxity and not of diligence. (Liggett Co. v. Lee, 288 U.S. 517, at 558-59). Delaware mostly copied the New Jersey act and introduced its own statute. Thereafter in 1913 New Jersey changed its liberal approach and ‘drastically tightened’ its corporation laws. But Delaware did not amend its liberal position and since then remained the leading state in this regard. : William L. Cary, ‘Federalism and corporate law: reflections upon Delaware’, (1974) 83(4) Yale L. J. 663, at pp. 663-65. The features of its liberality included:

(G)reater freedom to pay dividends and make distributions; greater ease of charter amendment and less restrictions upon selling assets, mortgaging, leasing, and merging … ; freedom from mandatory cumulative voting; permission to have staggered boards of directors; lesser pre-emptive rights for shareholders; [and] clearer rights of indemnification for directors and other…


The laxity of Delaware law is still continuing. As a result, every year a dominant number of companies throng into Delaware for incorporation, though it is the 49th state among 50 in size. For example, in 1987 56% of the 500 largest corporations of the United States were incorporated in this State. In this way it earns huge revenue every year.: Watcher, supra note 302, at pp. 37-39.

629 Edwards, ibid. In this respect Gisbert Wolff is also worth quoting,

(T)he justification for harmonisation based on art. 54(3)(g) lies in the need to facilitate the effective use by companies of the Treaty right to establishment. Indeed, unharmonised national safeguards may make establishment too burdensome or even impossible. It can be argued that each Member State could unilaterally provide for the protection of its own public but that directives based on art. 54(3)(g) are needed to ensure that the Treaty right to establishment is not hampered by a lack of equivalence between unco-ordinated national safeguards.

accounting directive\textsuperscript{630}) took long time. Political wrestling between Member States, or between the Community and Member States in negotiating draft directives is responsible for this.\textsuperscript{631} Furthermore, as they have been adopted through ‘complex compromises’, they may be interpreted variedly and may thereby ‘produce very different results because of differing national circumstances’.\textsuperscript{632} As such lack of uniformity in the application of the directives is an unavoidable phenomenon.\textsuperscript{633} Moreover, except the European Company Statute in the company law legislation a “European outlook” is absent.\textsuperscript{634} Despite these shortcomings it should be admitted that the Community’s success, in fact, lies in welding the differing national systems at a minimum level of uniformity through compromise. This may lead to further uniformity.

In the recent past the Community adopted a regulation to apply international accounting standards throughout Europe from 1 January 2005 and to amend the accounting directives to this effect\textsuperscript{635}, which is an ample example in this respect.

\textbf{4.4 SECURITIES LAW DIRECTIVES}

\textbf{4.4.1 Introduction}

The EC securities legislation may be categorised as follows:

(a) The Directive on the admission of securities and information on such securities\textsuperscript{636} (hereinafter Admission and Information Directive-AID) which is the replacement of the

\textsuperscript{630} Also see in this connection, for the case of the overturned 13\textsuperscript{th} draft Directive on takeovers, Klaus J. Hopt, ‘Company law in the European Union: harmonisation and/or subsidiarity’, (1999) 1(1) ICCLJ 41, at pp. 48-49 and 52-55.

\textsuperscript{631} See, in this regard, \textit{ibid.}, at p. 42.

\textsuperscript{632} \textit{Ibid.}, at p.56.

\textsuperscript{633} See, for disparate implementation of 1\textsuperscript{st} and 2\textsuperscript{nd} company directives, Mads Andenas, ‘The European court of justice and company law’, (1993) 14(4) Co.Law.Digest 73.

\textsuperscript{634} Dine, \textit{supra} note 626, at 127.

\textsuperscript{635} See further text accompanying notes 877-881 and 1850-1861, \textit{infra}.

Admission Directive\textsuperscript{637}, the Listing Particulars Directive (hereinafter LPD)\textsuperscript{638}, Interim Reports Directive\textsuperscript{639} and Major Shareholding Directive\textsuperscript{640}. Previously the Admission Directive provided for the conditions of listing securities on a stock exchange, the Listing Particulars Directive for the information to be furnished by a company applying for such listing, the Interim Directive for the after-listing disclosure requirement on continuous basis in general and the Major Shareholding Directive for post-listing information in particular when majority shareholders transfer their shares. These Directives, amended substantially several times, remained ‘scattered’\textsuperscript{641} and hence gave rise to the need of codification for ‘clarity and rationality’ purpose\textsuperscript{642}. The AID was adopted in May 2001 to supersede the said four Directives, but their contents have been retained in full.\textsuperscript{643} The AID will not, however, prejudice the Member States’ obligations to comply with the time limits for transposition of the provisions of the repealed Directives.\textsuperscript{644}

(b) The second category, namely Public Offer Prospectus (POP) Directive\textsuperscript{645}, defines information to be published when securities, not listed before, are offered to the public for the first time.

(c) Though the Interim Reports Directive required continuous disclosure of information gathered subsequent to the listing of securities, it did not cover all types of such information especially meant for market transparency. To complement this the EC

\textsuperscript{638} Supra note 24.
\textsuperscript{642} AID, supra note 636, preamble, recital 1.
\textsuperscript{643} Explanatory Memorandum, supra note 641.
\textsuperscript{644} AID, supra note 636, art. 111(1).
\textsuperscript{645} Supra note 25.
adopted the last category of directives, namely the Major Shareholding Directive\textsuperscript{646} and the Insider Dealing Directive\textsuperscript{647}. As said above, the Admission and Information Directive (AID) has replaced the Major Shareholding Directive. And the Insider Dealing Directive has been replaced by recently adopted Market Abuse Directive (MAD).\textsuperscript{648} In addition, coming within the present category of directives, Transparency Directive\textsuperscript{649} is underway.

(d) Last, directive relating to firms providing investment services in securities, namely Investment Services Directive (ISD)\textsuperscript{650}, which, adopted in 1993, is said to be the first “passport” directive in securities.

The Directives grouped above are discussed below with special focus on prospectus disclosures.

\textbf{4.4.2 Admission and Information Directive (AID)}

\textbf{4.4.2.1 As Regards Admission to Listing\textsuperscript{651}}

The AID, in the first place, seeks coordination of conditions for the admissions of securities to official stock exchanges in the Community.\textsuperscript{652} This is a “first step” towards greater integration in the chosen area of legislation.\textsuperscript{653} Because the Member States have varied the structures of securities markets, this initial go is limited to minimum harmonisation of the conditions for admissions of securities to listing

\textsuperscript{646} Supra note 640.
\textsuperscript{648} Supra note 42.
\textsuperscript{650} Supra note 29.
\textsuperscript{651} This matter was the subject of the Admission Directive which was proposed in 1976 and adopted in 1979, [1976] OJ C56/2 and supra note 637. For a summary of the Directive, see Geoffrey Morse, ‘Directive on the admission of securities to official stock exchange listing’, (1979) 4 ELR 201.
\textsuperscript{652} AID, supra note 636, arts. 5-19, 42-69 and 78-84,..
\textsuperscript{653} Ibid., preamble, recital 7.
without granting, however, the issuers any right to listing. The purpose of this part of the legislation is to provide equivalent investor protection and facilitate cross-border access to stock exchanges all over the Community, which will contribute to the promotion of the European capital market.

The Directive requires every Member State to ensure that the securities admitted to the stock exchange listing must comply with the conditions set out in Articles 42-51 and 52-63, and that the issuers of such securities, after the securities have been admitted to listing, fulfil their obligations defined in Articles 64-69 and 78-84. Articles 42-51 lay down the conditions for admissions of equity securities and Articles 52-63 for admissions of debt securities. Articles 42-51 require, among others, that

(a) the issuing company must be formed and operating according to the laws and regulations to which it is subject,

(b) it must have a certain amount of foreseeable market capitalisation for the shares,

(c) the issuer must have published or filed its annual accounts for last three years,

(d) its shares must be freely negotiable,

(e) a non-EC company that is not listed either in the home country or the country where its majority shares are owned, may not be listed if such non-listing is not due to the need to protect investors.

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654 Ibid., recital 6.
655 Ibid., recital 2.
656 The issuers’ obligations provision applies to both those issuers whose securities are already listed before the implementation of the original Admission Directive and to those whose securities are listed after the implementation of the Directive. See Edwards, supra note 413, t p. 243 n. 48.
657 AID, supra note 636, art. 42.
658 Ibid., art. 43(1).
659 Ibid., art. 44.
660 Ibid., art. 46(1)
661 Ibid., art. 51.
Articles 64-69 define the obligations of share issuers while Article 78-84 the obligations of debt securities. Articles 64-69 require, *inter alia*,

(a) the issuer must ensure equal treatment for all shareholders in the same position;\(^{662}\)

(b) the issuer must make necessary facilities and information available to the shareholders enabling them to exercise their rights;\(^{663}\)

(c) it must furnish the public with annual financial statements and reports;\(^{664}\)

(d) it must inform the public of new developments in its activities having impact on the share prices;\(^{665}\)

(e) an issuer’s whose shares are listed in more than one stock exchanges must provide equal information to the market at each of those exchanges.\(^{666}\)

The conditions for the admissions of debt securities contained in Articles 52-63 and the obligations of their issuers defined in Articles 78-84 are in general similar to those their counterparts in Articles 42-51 and Articles 64-69 referred to above. Of course Member States have the discretion to subject the admission of securities and the issuers to more stringent or additional conditions and obligations respectively than those laid down in the schedules unless they grant derogations from these conditions or obligations under particular situations.\(^{667}\) They are not, however, allowed to subject any company of any other Member State to the condition that its securities must have already been listed in one of the Member States.\(^{668}\) It is another condition of listing that for the protection of investors in compliance with the disclosure theory underpinning the EC securities legislation the issuers must publish in newspapers the information they are bound to disclose under certain provisions of the Directive, such as Articles 67 and 68 referred to

\(^{662}\) *Ibid.*, art. 65(1).

\(^{663}\) *Ibid.*, art. 65(2).

\(^{664}\) *Ibid.*, art. 67(1).

\(^{665}\) *Ibid.*, art. 68(1).

\(^{666}\) *Ibid.*, art. 69(1).

\(^{667}\) *Ibid.*, art. 8(1)-(3).
As well the Member State may require such issuers to make continuous disclosure of their financial position and the general course of their business. Every Member State is required to designate a competent authority or authorities with due powers to decide on admission of securities in compliance with the aforementioned conditions. The authorities may reject an application for admission if the issuer’s situation seems, in their view, to be detrimental to investors’ interests. They may also refuse admission if the applicant listed in another EC securities exchange has failed to comply with its obligations in that respect. In the event of an issuer’s failure to comply with the obligations after admission, the competent authorities may publicise this fact without prejudice to any other action by it. In the interest of investor protection or smooth market operation the competent authorities may ask the issuer for information deemed by them to be appropriate, which may also be published either by the issuer or the authorities. The authorities may suspend the listing of a security if required for smooth market operation or investor protection. Even discontinuation of listing is possible where circumstances so demand. Such actions are, however, subject to judicial review. The Directive

668 Ibid., art. 7.
669 Ibid., art. 102.
670 Ibid., art. 8(4).
671 For example, the Financial Services Authority (FSA) is the principal financial services regulator in the UK, which authorises securities to be admitted to the Official List in the UK. Previously the listing authority was vested in the London Stock Exchange (LSE) until 1st May of 2000. This change was brought by the Official Listing of Securities (Change of Competent Authority) Regulations 2000 (SI 2000/968) made under the European Communities Act 1972, s. 2. See Allen & Overy, Equity Capital Markets: Legal and Regulatory Frequently Asked Questions, (London: Allen & Overy, March 2001) at p. 65 and footnote 9.
672 AID, supra note 636, arts. 11(1) and 105.
673 Ibid. art. 11(2).
674 Ibid., art. 14.
675 Ibid. art. 17.
676 Ibid., art. 16(2).
677 Ibid., art. 18(1).
678 Ibid., art. 18(2).
679 Ibid., art. 19. As to who has locus standi to apply for judicial review under this art. came for determination in R. v International Stock Exchange ex p ELSE, [1993] 2 CMLR 677, where the Court decided that it was the company whose listing had been cancelled and not the shareholders, who can challenge the cancellation decision. For comments on this case, see Catriona Munro, Case Comment:
imposes an obligation on the competent authorities to extend cooperation needed for carrying out their duties and also to exchange any information required therefor.\textsuperscript{680} In the matter of multiple listing the competent authorities are required to cooperate with each other in order to expedite the procedure and simplify the formalities and any additional conditions required for the admissions of securities.\textsuperscript{681} The Directive provides for formation of a Contact Committee that will, among others, facilitate the harmonised implementation of the Directive in the Member States.\textsuperscript{682}

With regard to confidential information received by the former or present employees of the competent authorities in course of their duties the Directive provides for the professional secrecy save by virtue of law.\textsuperscript{683} The communication between competent authorities is, however, permitted.\textsuperscript{684} The information exchanged in this process may be used only for the performance of their duties.\textsuperscript{685}

The original Directive on admission allowed two years from the date of notification for implementation by the Member States. This date was later extended to 30\textsuperscript{th} June of 1993.\textsuperscript{686} By the time the Admission Directive has been repealed its provisions that are contained in the Admission and Information Directive had been implemented by all Member States.\textsuperscript{687}

\textbf{4.4.2.2 As Regards Listing Particulars for Admission}

\textbf{4.4.2.2.1 Background Information}

\textsuperscript{680} AID, supra note 636, art. 106.
\textsuperscript{681} Ibid., art. 13(1).
\textsuperscript{682} Ibid., art. 108(2)(a).
\textsuperscript{683} Ibid., art. 107(1).
\textsuperscript{684} Ibid., art. 107(2).
\textsuperscript{685} Ibid., art. 107(3).
As said earlier, Admission and Information Directive (AID) provisions relating to listing particulars for admission were originally laid down by the Listing Particulars Directive (LPD) which was initially proposed in 1972, and adopted by the Council on 17 March 1980 based on Articles 44(2)(g) [ex 54(3)(g)] and 100 of the EC Treaty. This is, for the first time, crystallisation of the disclosure theory which is, as discussed before, forms the foundation of EC securities legislation. The said provisions seek coordination of the national laws of the Member States relating to listing particulars, an information sheet, required of an issuer to make available to the public and also to submit with a stock exchange where it applies for listing of its securities. Although such information was subject to disclosure in most of the Member States, there existed differences among them ‘both as regards the contents and the layout of the listing particulars and the efficacy, methods and timing of the check on the information given therein’. These differences created (a) difficulties for the issuers to have admission of their securities in several Member States, (b) hindrance for the investors to acquire securities listed on stock exchanges of foreign Member States, and (c) inhibition of the financing of the issuers and investment all over the Community. The listing particulars provisions of the Admission and Information Directive would remove these differences and thereby introduce an adequate degree of equivalent, though not totally uniform, information regime throughout the EC. In this way the Directive has brought the disclosure requirements of the EC countries ‘into line with requirements in the more developed markets of Europe and the U.S.A.’.

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688 For discussion on the proposal, see Samuel Suckow, ‘The European prospectus’, (1975) 23 AJCL 50.
689 Supra ch. 4.2.
690 Edwards, supra note 413, at p. 252.
691 AID, supra note 636, preamble, recital 10. For how the disclosure requirements among the Member States varied, see Suckow, supra note 688, at pp. 52-54.
692 Supra note 691.
693 AID, supra note 636, preamble recital 11.
694 Suckow, supra note 688, at p. 67. Moreover, as the pioneer of multi-jurisdictional listing system the Directive had gone one step forward of the USA which had been influenced by it to tailor disclosure forms for foreign issuers. Manning Gilbert Warren III, ‘Regulatory harmony in the European
The LPD was an attempt to harmonise the Member States’ law to a minimal extent and thus had ‘not so far contributed much to cross-border listing’.\(^{695}\) This gap was bridged by subsequent amendments in 1987\(^{696}\), 1990\(^{697}\) and 1994\(^{698}\). The first two amendments introduced mutual recognition of listing particulars throughout the EC while the latest amendment provided for cross-border listing of blue chip company’s securities on publication of a minimum set of information instead of listing particulars proper. The provisions introduced through these amendments have been given space in the Articles 38-40 of the Admission and Information Directive.

\textbf{4.4.2.2 Basic Rules of Disclosure}

The document of listing particulars is the key to stock exchange listing in any EC country as the listing of securities is conditional upon the publication of this document.\(^{699}\) Article 21(1) of the Directive requires the document to contain, depending on the nature of the issuer and the securities for which listing is sought, as much information as can be necessary for the investors and their investment advisers to ‘make an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the issuer and of the rights attaching to such securities.’ This is the general requirement to be fulfilled by the persons responsible for listing of securities (e.g., issuer, and auditor).\(^{700}\) In particular, without prejudicing this general requirement obligation the Directive specifies information items in Schedules A, B and

\begin{footnotes}
\item[699] AID, \textit{supra} note 636, art. 20.
\item[700] \textit{Ibid.}, art. 21(2)
\end{footnotes}
C of Annex I, which at least\textsuperscript{701}, according to the type of securities involved, must be contained in the listing particulars ‘in as easily analysable and comprehensible a form as possible’.\textsuperscript{702} Schedules A, B and C prescribe the layout and minimum contents\textsuperscript{703} of the listing particulars for shares, debt securities and certificate representing shares respectively for their admission to the official listing of the Stock Exchange of a Member State.

However, the Directive provides also for exemptions, complete or partial, from the above requirement of listing particulars mainly in two broad sets of circumstances\textsuperscript{704}: exemptions under the Directive itself,\textsuperscript{705} and exemptions granted by the competent authority that administers the listing affairs within the domestic jurisdiction of a Member State.\textsuperscript{706} The former includes, among others, situations

(a) where securities that have already been issued to the public, or in connection with a takeover offer, or a merger, and a document equivalent to the listing particulars has been published in last 12 months\textsuperscript{707};

(b) where the securities are bonus shares, converted shares, shares created from share warrants, and shares issued in substitution for shares already listed on the same stock exchange;\textsuperscript{708}

(c) where the securities amount, in number or value, to less than 10\% of the same class of those already listed on the same stock exchange;\textsuperscript{709}

\textsuperscript{701} The use of the expression, “at least”, has made the Listing Particulars Directive a minimum standards legislation. See Edwards, \textit{supra} note 413, at p. 253 n. 117.

\textsuperscript{702} AID, \textit{supra} note 636, art. 22(1).

\textsuperscript{703} This minimum information requirement has been described as “material facts” requirement elsewhere. Samuel Wolff, ‘Securities regulation’ in Ralph H. Folsom \textit{et al.}, \textit{European Community Law after 1992: A Practical Guide for Lawyers Outside the Common Market} (Denver and Boston: Kluwer Law and Taxation Publishers, C1993) 501-529 at p. 505.

\textsuperscript{704} Apart from these broad or general exemptions there are also a number of particular exemptions and omissions available under situations dealt with in art.s 25-34 of the AID, \textit{supra} note 636.

\textsuperscript{705} AID, \textit{supra} note 636, art. 23.

\textsuperscript{706} \textit{Ibid.}, art. 24.

\textsuperscript{707} \textit{Ibid.}, art. 23(1).

\textsuperscript{708} \textit{Ibid.}, art. 23(2).
(d) where the securities consist of shares allotted to employees, provided
the shares of the same class have already been listed on the same
stock exchange; 710

(e) where the securities are already listed on another stock exchange in
the same Member State. 711

In addition to the above, as already mentioned, exemptions may be granted by the
competent authorities in the following cases:

(a) The competent authorities of a Member States may authorise omission of any
information which is of minor importance, or disclosure of which would be
contrary to the public interest or seriously detrimental to the issuer, provided such
omission will not affect the investors’ informed assessment of the financial position
and prospect of the issuer. 712

(b) There is another provision in the Directive that allows the competent authorities to
apply their discretion with regard to the listing of debt securities. Where debt
securities admission coincides with their public issue and some of the terms of the
issue are not finalised until the last moment, the said authority may permit
publication of listing particulars without the information as to those terms. But they
must indicate how it will be given; in general it is required to be published prior to
the start date of listing. 713

(c) The competent authorities may exempt a company from the listing particulars
requirement where its shares have been dealt with for previous two years on a
second-tier market in the same Member State and the information required by this

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709 Ibid., art. 23(3)(a).
710 Ibid., art. 23(3)(d).
711 Ibid., art. 23(3)(e).
712 Ibid., art. 24.
713 Ibid., 99(3).
Directive is, in the competent authorities’ judgement, already available to the investors.\textsuperscript{714}

\section*{4.4.2.2.3 Contents of Listing Particulars}

As already mentioned, while the Admission and Information Directive binds the issuer to furnish necessary information to enable the investors to make informed investment decision, it prescribes three sets of particular information to be disclosed in offering shares (Schedule A), debt securities (Schedule B) and certificates representing shares respectively. Each set of information is the minimal requirement for the respective type of securities. Of them the information required of shares has ‘a fairly close correspondence’ to that of debt securities.\textsuperscript{715} Shares are the most commonly offered type of securities. In consideration of this fact information subject to disclosure in respect of a share offering is being briefly described in the following.

\section*{4.4.2.2.3.1 Non-Financial Matters}

\textbf{Persons Responsible for Listing Particulars and the Auditing of Accounts}\textsuperscript{716}

The listing particulars shall state the name and function of natural persons (e.g., directors), and also the name and registered office of legal persons responsible for the listing particulars (e.g., company’s advisers) or parts of them. Such persons must make a declaration that the listing particulars are conform to facts and free from any omissions ‘likely to affect the import of the listing particulars’. The Directive requires the listing particulars to disclose the names, addresses and qualifications of the official auditors who have audited the issuer’s accounts for the last

\textsuperscript{714} \textit{Ibid.}, art. 23(5). This sub-art. was added to the repealed Listing Particulars Directive by an amendment brought about by the Directive 94/18/EC of 30 May 1994, \textit{supra} note 698.

\textsuperscript{715} Frank Wooldridge, ‘Some recent Community legislation in the field of securities law’, (1985) 10 ELR 3 at 12.
three years according to national law. A statement must be made confirming the annual accounts having been audited. If the audit reports have been refused by the official auditors or if they have any qualifications, the listing particulars must disclose such fact of refusal or qualifications along with reasons therefor.

**Official Listing and Shares** 717

The listing particulars must provide the information about admission to official list and stock exchange trading, e.g. information as to when the admission is being or will be sought to listing. They must also give details about shares which are the subject of listing. These include the nature of the issue, number of shares, rights attaching to the shares, entitlement to and limits of dividends, rights to pre-emption, and restriction or withdrawal of pre-emption together with reasons, and the procedure for exercising such rights, profile of underwriters, remuneration of financial intermediaries including underwriters’ commissions, any stock exchange on which same class of shares are already listed, any public takeover offers received or made by the issuer during previous and present financial years.

**The Issuer and its Capital**718

The Directive calls for general information about the issuer like its name, registered office, date of incorporation, and objects as contained in the memorandum of association. It also requires disclosure of the amount of the issuer’s issued capital, the number and classes of shares of which it is composed, description of paid up and unpaid up shares, conditions, as contained in the memorandum and articles of association, regarding the changes in the capital and in the respective rights of

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717 Ibid., ch. 2.
718 Ibid., ch. 3.
various classes of shares, indication to the persons having control over the issuer along
with particulars of the proportion of voting capital held by them, indication to the
holders of substantial shares (maximum 20% of the capital), and if the issuer is a
component of a group of undertakings, a short description of the group and the position
of the issuer in it.

**Issuer’s Activities**

The listing particulars must describe the issuer’s main activities
including its products or services, the breakdown of net turnover during the past three financial years by categories of activity and into geographical markets in so far as,
in view of how the sale of products and services are organised, these categories and
markets differ, in essence, from one another. The listing particulars must also furnish
information about material contracts, patents and licenses, legal or arbitration
proceedings, or interruptions, having or having had significant on the issuer’s financial
position, and the issuer’s investment policy.

**Issuer’s Administration, Management and Supervision**

In this category of information are included the names, addresses and
functions, interests of members of the administrative, management supervisory bodies
of the issuer. Also included is information about, for the last financial year, the
remuneration paid and benefits in kind granted to and shares held by members of the
administrative, management and supervisory bodies by the issuer; any interests of such

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720 The Directive does not define the word, “turnover”. The Commission, however, defines it in the EEC proposal of 16 November 1971 for a directive on the structure of accounts in the EEC as “the receipts from the sale of products, merchandise and services corresponding to the usual activities of the company, after deduction of discounts and taxes directly related to turnover” quoted in Suckow, *supra* note 688, at p. 61. The requirement of divulging turnover was prevalent in three original Member States law only, namely Germany, France and Luxembourg, and as such was a fundamental innovation for the other three, above.
members in any transactions effected by the issuer which are unusual during the last and present financial years; and scheme involving them in the issuer’s capital.

**Issuer’s Recent Development and Prospects**

Save derogation granted by the competent authorities the listing particulars must contain information about the recent trend in the issuer’s business with particular reference to production, sales, stock and the state of the order book, and cost and selling prices. Information about the issuer’s prospects at least for the current financial year is also required.

**4.4.2.2.3.2 Financial Matters**

The Admission and Information Directive lays the following provisions for the disclosure of financial matters:

(a) The listing particulars must contain the last three balance sheets, and profit and loss accounts of the issuer together with notes on the annual accounts for the preceding financial year. These requirements similarly apply where the issuer prepares consolidated accounts only. Where it prepares both its own and consolidated accounts, it shall include both accounts in the listing particulars unless the competent authorities waive either of them. Where more than nine months have elapsed since the end of the financial year to which the last published accounts relate, an interim financial statement with coverage of at least six months must be included. If there has fallen out any significant change (in the financial or business life of the

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721 *Ibid.*, ch. 6
issuer) since the last financial year or of the preparation of the interim statement, this fact must be disclosed in a note inserted in or appended to the listing particulars.

(b) The accounts are to be prepared in compliance with the Council Directive and hence must be true and fair. If, however, they are tailored accordingly, more detailed or additional information about the issuer’s assets and liabilities, financial position, and profits and losses.

(c) The listing particulars must include the profit or loss and the dividend per share for the last three financial years.

(d) The listing particulars must describe the sources and application of funds over the past three financial years.

(e) Where the issuer has a proportion in the capital of other undertakings which is ‘likely to have a significant effect on the assessment of its own assets and liabilities, financial position or profits and loss’, the listing particulars must provide the details including the name and registered office of such undertakings, field of activity, proportion of capital held, amount of dividends received financial years, amount of debts owed to and by the issuer in connection with the undertakings.

4.4.2.2.4 Vetting and Publication

The listing particulars are required to be approved by the competent authorities of a Member State, after which they shall be published. Where an issuer applies for admission of the same securities to official listing in two or more Member

\[724 \text{ Ibid., art. 35(1).}\]
States simultaneously or within a short interval, it must draw up the draft listing particulars according to the legislation implementing the Directive in the Member State in which its registered office is situated (hereinafter home State) and the competent authorities of that State shall scrutinise them for approval purpose.\footnote{Ibid., art. 37. This provision has been inserted in the repealed Listing Particulars Directive (LDP) by the amending Directive 87/345/EEC, [1987] OJ L185/81. (herein after the First Mutual Recognition Directive).} If, however, the issuer’s registered office is not situated in one of those Member States, the issuer must draw up the draft listing particulars according to the law of one of those States which it must choose (hereinafter chosen State).\footnote{Ibid.} The competent authorities shall vet the draft listing particulars and approve their publication only if they are satisfied that the particulars fulfil all the requirements of the AID.\footnote{Ibid., art. 35(2).} The same approval procedure applies to a supplement, if required, to listing particulars.\footnote{Ibid., art. 100.} Though the Directive does not provide for delivery of the listing particulars to the investors,\footnote{This gap has been filled by art. 9 of the POP Directive, supra note 25.} it requires them to be published by quoting in one or more newspapers circulated throughout or at least widely in the Member State in which the admission to official listing of securities is sought.\footnote{AID, supra note 636, art. 98(1)(a).} Alternatively, the listing particulars may be made available free of charge, in the form of a brochure, to the public at the Stock Exchange(s) concerned, the registered offices of the issuer and its paying agents.\footnote{Ibid., art. 98(1)(b).} In addition, by way of ventilating the whole listing particulars or notice in a publication designated by the Member State in which admission to the official listing is sought, the public must be informed of where they (listing particulars) have been published and where they may be available.\footnote{Ibid., art. 98(2).}
Furthermore, publication of the listing particulars must take place within a reasonable time to be prescribed by the national legislation or by the competent authorities.\footnote{Ibid., art. 99(1).}

### 4.4.2.2.5 Implementation

The Contact Committee set up for admission purpose is also entrusted with the responsibility of facilitating the implementation of the provisions of listing particulars.\footnote{Ibid., art. 108.} Though the Listing Particulars Directive (LPD) originally allowed 30 months from the date of notification for implementation by the Member States, later this was later extended to 30\textsuperscript{th} June of 1993.\footnote{Council Directive 82/148/EEC, arts. 1 and 2.} By now all Member States have implemented the listing particulars provisions through national legislation.\footnote{EuroLaw, visited on 2 March 02. The UK has implemented the Directive by the Stock Exchange (Listing ) Regulation 1984, SI 716 of 1984, and the Financial Services Act, 1986 (Single Property Schemes) [Exemptions Regulations, 1989 SI 28 of 1989.]

### 4.4.2.2.6 Mutual Recognition

From the foregoing discussion it is clear that the AID lays down the minimum disclosure requirements with the aim of establishing an equivalent EC-wide disclosure system. This means the Member States have the liberty to add further disclosure requirements to those set out by the Directive\footnote{See Wooldridge, supra note 715, at p. 19.} which may differ from one another and may tend thereby to hinder achieving the single market goal. In view of this, as mentioned before, the EC inserted the mutual recognition provisions in it.\footnote{This provision was first inserted in the repealed Listing Particulars Directive in 1987 by the First Mutual Recognition Directive Supra note 725. Before this Directive art. 24 of the original Listing Particulars Directive required the competent authorities to cooperate and to make endeavours to agree to a single text for the listing particulars for use in the Member States where admission of securities were to be sought to official listing.} According to those provisions, when multi-jurisdictional listing, described above\footnote{Text accompanied by to note 725, supra.}, is sought and the listing particulars are approved in the home country or in a chosen
country, they must be recognised, subject to necessary translation, by other Member States (hereinafter host States). There is no need of further approval of the competent authorities in the host States nor can those authorities ask for further information to be included in the listing particulars except information particular to the markets of those States concerning, for example, income tax system, paying agents of the issuer. The competent authorities that recognise listing particulars must do so even if partial exemption or derogation has been granted by the approving competent authorities subject to the conditions that such exemption or derogation and the conditions therefor are recognised in the recognising States’ laws. Of course, provided the recognising Member States allow their competent authorities, they may extend recognition even if these conditions are not fulfilled. The competent authorities of the home or chosen State, as the case may be, must provide the host authorities with the certificate of approval and the concerned issuer must communicate the latter with the draft listing particulars. In practice, however, the issuer supplies both the certificate and approved listing particulars to the host authorities.

The mutual recognition is not limited to listing particulars as listing particulars only; it extends to public offer prospectuses as listing particulars. Where application is made for admission of securities to official listing in one or more Member States and the securities have been the subject of a public-offer prospectus drawn up and approved according to Articles 7, 8 or 12 of the Public Offer Prospectus (POP) Directive in three months before the application for admission, the public-offer prospectus shall be recognised as listing particulars in the Member State(s) in which

740 AID, supra note 636, art. 38(1).
741 Ibid.
742 Ibid., art. 38(2).
743 Ibid., proviso to art. 38(2).
744 Ibid., art. 38(3) and (4).
application for admission to official listing is so made.\textsuperscript{746} The concerned Competent Authorities may, of course, ask for information specific to the country of admission.\textsuperscript{747}

It may be mentioned here that the contents and the approval procedure of public-offer prospectuses and listing particulars are all the same. As such there was a practical possibility to interchangeably use the two documents for listing and public offer purposes. But there was no legal mandate to this effect. The above mentioned provision has filled this vacuum and has contributed to ‘a heretofore non-existent integrated disclosure system for the listing and distribution of securities in the Member States.’\textsuperscript{748}

Lastly, the AID provides for the EC recognition, by means of agreements, of listing particulars drawn up and approved under non-Member States’ laws subject to two conditions:

(a) that the non-Member States must give investor protection equal to that available under this Directive; and

(b) that they must grant reciprocity to the listing particulars prepared according to the EC Member States’ laws.\textsuperscript{749}

\textbf{4.4.2.2.7 Cross-Border Listing of Blue Chip Companies’ Securities}

In addition to mutual recognition provision the AID lays down requirements and procedure of cross-border listing of securities of European leading companies (blue chip companies). According to Article 23(4), when a company seeks listing of its securities in a Member State(s) and those securities have been officially listed in another Member State for at least last three years, on the confirmation by the

\textsuperscript{746} AID, \textit{supra} note 636, art. 39(1). This provision was added to the repealed Listing Particulars Directive by art. 2 of Council Directive 90/211/EEC of 23 April 1990, [1990] OJ L112/24. (usually called the Second Mutual Recognition Directive). This provision was ‘a useful step forward in the creation of an internal securities market for the Community.’ COM(89)133 final, Explanatory Memorandum, at para. 7.

\textsuperscript{747} AID, \textit{ibid}.

competent authorities of the latter State that during the period company has been listed
it has complied with all the requirements of information and admission to listing, the
former State(s) may allow the concerned competent authorities to accept the listing
application provided the issuer-company publishes the following simplified
information instead of fresh listing particulars:

(1) the latest annual report, the latest audited annual (and consolidated) accounts and,
where already published, half-yearly statement for the year in question;

(2) any listing particulars, prospectus or equivalent document published by the issuer
in 12 months prior to the application for listing;

(3) a document containing (i) a statement about the fact of application for listing, a
description of the securities including the number and class of the securities, and
the rights attaching to them, (ii) details of any significant change or development
since the date to which information given in (1) and (2) above relate, (iii)
information specific to the market of the country in which admission is applied for,
such as in particular information about income tax, the issuer's paying agents and
the manner in which notices to investors are published, and (iv) a responsibility
statement about the veracity of the information contained in the document in
question; (v) specified information about the company's administration,
management and supervision, its capital, major shareholding and reports
concerning accounts.

As to what should be the criterion for determining the eligibility of issuer-companies to
avail of this exemption from the requirement of listing particulars proper the AID lays
down a guideline that Member states may 'establish non-discriminatory minimum
quantitative criteria, such as the current equity market capitalization', or the competent
authorities may grant the same treatment to smaller companies in consideration of the

749 AID, art. 41.
ever escalating integration of securities markets.\textsuperscript{750}

The provisions of cross-border listing of blue chip companies’ securities are of great import in the securities market integration process in the Community. While the mutual recognition can facilitate simultaneous listing of transferable securities, it allows cross-border listing of already listed securities in one or more Member States. The latter types of securities having undergone market and regulatory test are more viable and as such may qualify for complete or partial exemption from the requirement of listing particulars. They may also qualify for admission to the Eurolist.\textsuperscript{751}

\textbf{4.4.2.3 As Regards Interim Reports}

After companies have admitted their securities to official listing they are required of making disclosure of information on regular basis. Previously continuous disclosure provisions were contained in the Interim Reports Directive\textsuperscript{752} which is now repealed. While the listing particulars provisions aim to ensure investor protection the interim disclosure provisions of the Directive seek to fortify that protection by providing for regular disclosure of information for the post listing period, which, in turn, contributes to the establishment of a Community market in securities.\textsuperscript{753}

\begin{flushleft}
\textsuperscript{750} \textit{Ibid.}, preamble, recital 22. Also see Edwards, \textit{supra} note 695, at p. 55.
\textsuperscript{751} The Eurolist is a project of the Federation of European Stock Exchanges. It eggs on admission to its official listing of the securities of European leading (blue chip) companies side by side their listing in the home State stock exchanges. It oversees admission of securities of nearly 250 large European companies. Lambrecht, \textit{supra} note 745, at 730.
\textsuperscript{752} \textit{Supra} note 639. Originally continuous disclosure provisions formed a part of the Admission Directive, \textit{supra} note 637. The Member States differed with regard to the ambit of that provision and as a result the adoption of the Directive was delaying. They considered the matter worthy of being the subject of a separate directive and ultimately kept it outside of the Admission Directive. However, in January 1979 the Commission put forward a proposal for a Council Directive on the continuous disclosure of information by listed companies. [1979] OJ C29/5. After the Economic and Social Committee and European Parliament had delivered their opinions in October 1979 ([1979] OJ C53/54) and March 1980 ([1980] OJ C85/69) respectively, the proposed Directive underwent amendment and the Council adopted the amended Directive on regular information disclosure in 1982.
\textsuperscript{753} \textit{AID}, preamble, recital 25.
\end{flushleft}
This Directive applies to companies the shares of which are admitted to official listing on a stock exchange before or after its coming into force.\textsuperscript{754} It does not, however, apply to investment companies other than those of the closed-end type.\textsuperscript{755} In this context, “investment companies other than those closed-end type” mean investment companies *(i)* the object of which is the collective investment of capital provided by the public and which operate on the principle of risk spreading, and *(ii)* shares of which are, at the holders’ request, repurchased or redeemed, directly or indirectly out of those companies’ assets.\textsuperscript{756} In addition, Member States may exclude central banks from the application of this Directive.\textsuperscript{757} It is required of the Member States to ensure that the companies whose shares are listed in their territory publish half-yearly reports on their activities and profits and losses for the first six months of each financial year.\textsuperscript{758} Member States may, however, impose more stringent obligations than those provided for by this Directive equally applicable to all companies or all companies of given class.\textsuperscript{759}

The Directive requires companies to publish the half-yearly report containing the figures and explanatory statement concerning their activities, profits and losses for every six-month period as mentioned above.\textsuperscript{760} The figures shall indicate, as a minimum, the net turnover, and profit and loss, within the meaning of the company accounts Directives, before or after deduction of tax.\textsuperscript{761} Those figures shall be accompanied by figures shown against them for the corresponding period in the previous period.\textsuperscript{762} An explanatory statement is required where there is an information significant for the investors to make an informed assessment of the trend of the

\textsuperscript{754} Ibid., art. 4(1).
\textsuperscript{755} Ibid., art. 4(2).
\textsuperscript{756} Ibid., art. 1(c).
\textsuperscript{757} Ibid., art. 4(3).
\textsuperscript{758} Ibid., art. 70.
\textsuperscript{759} Ibid., art. 71.
\textsuperscript{760} Ibid., art. 73(1).
\textsuperscript{761} Ibid., art. 73(2).
companies’ activities and profit or losses with further reference to any special factors that influence those activities and profits or losses.\textsuperscript{763} It must also contain reference to the companies’ prospective development in the current financial year.\textsuperscript{764} Such a report must be published in newspaper(s) or in the national gazette or made available to the public otherwise.\textsuperscript{765}

Member States are required to appoint competent authorities for the purpose of this Directive and also to legally equip them to exercise their powers.\textsuperscript{766} The competent authorities are required to cooperate wherever necessary for accomplishing their duties, and to exchange information to that end.\textsuperscript{767} Where it is essential to publish the half-yearly report in more than one Member State, the competent authorities are required to accept as a single text the text that fulfils the requirements of the Member State in which shares were admitted to official listing for the first time, or the text that approximates most closely to it.\textsuperscript{768}

The Contact Committee set up for the purpose of admission and listing particulars provisions discussed before will work to facilitate the implementation of the interim reports provisions.\textsuperscript{769} By now all Member States have given effect to the interim reports provisions.\textsuperscript{770}

\textbf{4.4.2.4 As Regards Major Shareholding}

It is evident from above that the core requirement of the AID provisions vis-à-vis admission, listing particulars and interim reports is a call for disclosure of

\textsuperscript{762} Ibid., art. 73(5).
\textsuperscript{763} Ibid., art. 73(6).
\textsuperscript{764} Ibid.
\textsuperscript{765} Ibid., art. 102(2).
\textsuperscript{766} Ibid., art. 105(1) and (2).
\textsuperscript{767} Ibid., art. 106.
\textsuperscript{768} Ibid., art. 77.
\textsuperscript{769} Ibid., art. 108(2)(a).
information. The provisions concerning disclosure of major shareholding aim ‘at
reinforcing at Community level the (same) information policy.’\textsuperscript{771} Central requirement
of these provisions is that when a natural person or legal entity acquires or disposes of a
holding in a company and because of that acquisition or disposal the proportion of
voting rights of that person or entity reaches, exceeds or declines below one of the
thresholds of 10\%, 20\%, 1/3, 50\% and 2/3, he or it shall notify, within seven days, the
company and simultaneously the competent authority(ies)of the proportion of voting
rights he or it holds following that acquisition or disposal.\textsuperscript{772} The company that receives
the notification is obliged in turn to disclose it to the public in each of the Member
States in which its shares are officially listed on a stock exchange. It shall make the
disclosure as soon as possible but not exceeding nine calendar days from the day it
receives the notification.\textsuperscript{773} The competent authorities may, however, exempt the
company from this obligation when they consider such disclosure would be contrary to
the public interest or seriously detrimental to the company, provided, in the later case,
the omission would not be lead the public to deception with regard to the facts and
circumstances which they should know essentially to assess the securities in
question.\textsuperscript{774} Of course the Member States may require, instead of the company, the
competent authorities to make disclosure to the public ‘possibly in cooperation with
that company’.\textsuperscript{775}

4.4.3 Public-Offer Prospectus (POP) Directive

4.4.3.1 Background Information

\textsuperscript{771} Explanatory Memorandum, Proposal for the Major Shareholding Directive, COM(85) final, 23
discussion on the Directive and its effect on the UK company law, see Venessa Edwards, ‘The Major
\textsuperscript{772} AID, supra note 636, art. 89(1).
\textsuperscript{773} Ibid., art. 91.
\textsuperscript{774} Ibid., art. 95.
\textsuperscript{775} Ibid., art. 91.
In 1980 the Commission submitted a proposal for a directive coordinating the information to be disclosed when unlisted securities are offered to the public for the first time (whether they are subsequently listed or not). The Economic and Social Committee passed its opinion in September 1981 and the European Parliament in April 1982. As a result the Commission amended the proposal and submitted it in July 1982. This, however, did not end the controversy over the proposal, e.g., whether there should be uniform disclosure for listed and unlisted securities, whether the principle of mutual recognition should be contained in the proposed Directive. However, eventually on 17 April 1989 the Directive was adopted. Its adoption cost important compromises which ‘have substantially reduced (its) scope and effect’. In spite of this, it is regarded as ‘a major achievement by the EC in the establishment of regional regulatory harmony for multijurisdictional securities offerings.’

Since disclosure of information has a great role to play in the protection of investors, increasing confidence in transferable securities and proper functioning and development of transferable securities markets, the EC has been pursuing an information policy. The listing particulars provisions were an ‘important step’ in the execution of this policy. The Public-offer Prospectus (POP) Directive is an addition to that. It provides for information disclosure through prospectus when transferable

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776 COM(80)893 final.
780 Supra note 25.
781 Warren, supra note 694, at p.33.
782 Ibid., at p. 33.
784 Ibid., recital. 5.
securities are offered to the public for the first time, irrespective of whether they are
subsequently listed or not.\textsuperscript{785}

\textbf{4.4.3.2 Scope of the Directive in General}

According to Article 1(1) the Directive applies to

(a) transferable securities which are

(b) offered to the public for the first time in a Member State

(c) provided they are not already listed in any stock exchange.

It is relevant to look at the meaning of each of the three components of the
Article 1(1) with a view to clearly understanding its scope.

\textbf{(a) Transferable securities:}

‘Transfer securities’ mean

shares in companies and other transferable securities
equivalent to shares in companies, debt securities having
a maturity of at least one year and other transferable
securities equivalent to debt securities, and any other
transferable security giving the right to acquire any such
transferable securities by subscription or exchange\textsuperscript{786}

From the purview of this definition the following transferable securities are excluded:

1. transferable securities offered in individual denominations of at least ECU
   40,000;\textsuperscript{787}

2. transferable securities offered in connection with a takeover bid\textsuperscript{788} or a merger\textsuperscript{789};

3. transferable securities offered by an issuer in exchange of its own shares if the offer
   of new securities does not increase the issued share capital;\textsuperscript{790}

\textsuperscript{785} Ibid., recital 6.
\textsuperscript{786} Ibid., art. 3(e).
\textsuperscript{787} Ibid., art. 2(2)(a).
\textsuperscript{788} Ibid., art. 2(2)(d).
\textsuperscript{789} Ibid., art. 2(2)(e).
\textsuperscript{790} Ibid., art. 2(2)(g).
4. transferable securities offered to or for the benefit of existing or former employees;\footnote{791}{Ibid., art. 2(2)(h).}

5. transferable securities resulting from conversion of convertible debt securities or from the warrant rights, or shares offered in exchange of exchangeable debt securities, provided that a public offer prospectus or listing particulars relating to the convertible or exchangeable debt securities or warrants were published in the same Member State;\footnote{792}{Ibid., art. 2(2)(i).}

6. transferable securities issued by unit trusts and investment companies,\footnote{793}{Ibid., art. 2(2)(b) reading together with art. 3(a) and (b).} or by the public sector,\footnote{794}{Ibid., art. 2(2)(c).} or by non-profit-making bodies\footnote{795}{Ibid., art. 2(2)(j).};

7. bonus shares;\footnote{796}{Ibid., art. 2(2)(f).}

8. shares entitling the holders to services or membership of building societies and other similar bodies;\footnote{797}{Ibid., art. 2(2)(k).} and

9. Euro-securities\footnote{798}{“Euro-securities” are defined as follows: \footnote{799}{Ibid., art. 2(2)(l).} Transferable securities that are to be underwritten and distributed by a syndicate at least two of the members which have their registered offices in different States, and are offered on a significant scale in one or more States other than that of the issuer’s registered office, and may be subscribed for or initially acquired only through a credit institution or other financial institution. \textit{Ibid.}, art. 3(f).} that ‘are not the subject of a generalized campaign of advertising or canvassing.’\footnote{799}{Ibid., art. 2(2)(l).}

The exclusion of the last category of securities was ‘hard fought’, which, among other main reasons, delayed the adoption of the Directive.\footnote{800}{Edwards, \textit{supra} note 413, at p. 272. The International Primary Market Association (IPMA) and the United Kingdom regulators were the principal opponents of applying the Directive to Euro-securities,}
argument that the Directive does not apply to non-public offerings one authors concludes that the Euro-securities must be public offerings whether or not they are the subject of a generalised campaign. If the Euro-securities were not public offerings, their exclusion from the ambit of the Directive would have been ‘unnecessary’. 801 As to the meanings of other two terms, namely “advertising” and “canvassing” there is no well acceptable clarification. 802 The definitional problems associated with these terms ‘confound efforts to understand and apply the Eurosecurities exclusion.’ 803 Besides, the exclusion itself is questionable. With regard to the Eurosecurities so excluded the investors have been deprived of the disclosure safeguards provided for in the Directive and thus the regulatory harmony in Europe has been marred. 804 As well, non-Member States might have been discouraged for ‘international reciprocity’. 805

In addition to the above there optional exemptions are available under Article 5. Member States may provide for complete or partial exemption from the requirement of a prospectus where debt securities or securities equivalent to debt securities of specified types are offered to the public.

(b) Offer to the public for the first time

The second component of Article 1(1) is that the transferable securities offered through a prospectus have never been a subject of public offer before. The Directive does not, however, define “public offer”. At the raw stage the Commission, Economic and Social Committee and the European Parliament have attempted to define the term. 806 But the final version of the Directive dropped the matter as it ‘proved

which include Euro-bonds and Euro-equities. For the reasons and, nature and course of opposition, see Warren, supra note 694, at pp. 38-42.
801 Warren, ibid., at p. 44, and also see Edwards, supra note 413, at p. 272-273.
802 See Warren, ibid., at pp. 44-45.
803 Ibid., at p. 45.
804 Ibid., at p. 46.
805 Ibid.
806 For details, see Edwards, supra note 413, at pp. 273-275.
impossible to furnish a common definition. Article 2(1), however, provides some guidance as to public offer through enumerating the following to which the Directive is not applicable:

(a) offers to persons in the context of their trades, professions or occupations, or
(b) offers to a restricted circle of persons, or
(c) where the maximum total selling price of the securities offered is ECU 40,000, or
(d) where the minimum consideration to acquire the securities offered is ECU 40,000 per investor.

From this exemption provision it may be understood the offers enumerated are public offers but have been kept out of the purview of the Directive. If they were something other than public offers, there would have been no need of exemption.

(c) Securities not already listed

It is another condition for the application of the Directive that the securities, which are subject of the public offer, must not have been listed at the time of the offer. The Directive applies to securities unlisted at the time the offer is made, but may or may not be listed subsequently.

It may be recapitulated that the POP Directive will apply when an issuer makes a public offer (other than the exempted types) of transferable securities (except the excluded ones) which have not been sold before in course of a public offer. It will apply regardless of whether those securities are subsequently listed or not. The prospectus disclosure requirements for such public offerings will be discussed below.

4.4.3.3 Prospectus Disclosure Requirements for Securities Both to be Listed and Unlisted

Both Articles 7 and 8 of the POP Directive require that when a public offer relates to transferable securities for which listing is sought at the time of the offer, the contents, procedure of scrutiny, and distribution of prospectus are to be determined in accordance with the Listing Particulars Directive-LPD (presently the listing particulars provisions of the AID discussed above), ‘subject to adaptations appropriate to the circumstances of a public offer’. Besides, even if securities subject of a public offer are not sought to be listed, Article 12(1) allows the Member States to provide that the person making such an offering may draw up the prospectus, in terms of the contents, according to the listing particulars provisions, ‘subject to adaptations appropriate to the circumstances of a public offer’. This provision applies where the issuer seeks mutual recognition of the prospectus.  

Thus the listing particulars, in addition to their disclosure role with respect to secondary market, act as a prospectus for offering securities in the primary market. For this dual role one author calls the listing particulars provisions (previously LPD) ‘the core of a supranational disclosure system …within the common market.’

Where no listing of securities is sought and also where no mutual recognition of prospectus is wanted, the POP Directive requires that the prospectus be prepared according to the requirements of Article 11 that is especially meant for small and medium-sized issuers. Article 11(1) provides for the basic disclosure requirement which is same as that laid down by the listing particulars provisions of the Admission and Information Directive, viz., information necessary to enable investors to make an informed assessment of the assets and liabilities, present and future state of the issuer’s business and also of the rights attaching to the securities offered. Then Article 11(2) proceeds to prescribe the specific items to be contained in a prospectus. Again

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808 Edwards, supra note 413, at p. 282.
809 Warren, supra note 748, at p. 689.
810 See ibid., at p. 698 n. 45
these items reflect, in substance, those prescribed by the listing particulars provisions, although they are less detailed than the latter. They include, among others, the following information: (a) the names and functions of, and declaration about the veracity of the information by, the persons responsible for the prospectus; (b) amount and purpose of the issue; (c) number and nature of the securities issued and the rights attaching to them; (d) details of the issuer and its capitalisation; (e) the issuer’s principal activities and factors influencing them (e.g. material contract, legal proceedings); (f) the annual and interim financial statements of the issuer showing its assets and liabilities, financial position, and profits and losses; (g) the auditors who have audited the issuer’s accounts; (h) issuer’s administration, management and supervision; and (i) the issuer’s recent development and prospects in the business. The Member States or bodies designated by them may, however, authorise, in general, omission from the prospectus of information on certain grounds similar to those laid down by the listing particulars provisions described above, e.g., when the information is of minor import. The issuer is required to publish a supplementary prospectus when there is a new significant development after the original prospectus has been published.

4.4.3.4 Scrutiny and Publication of Prospectuses

Where under Articles 7 or 8 of the POP Directive, discussed above, a prospectus is required to be drawn up for a public offer according to the listing particulars provisions, its prior scrutiny by the concerned competent authorities is mandatory. Announcement of an offer is to be communicated in advance to the same authorities mentioning that there is a prospectus or, if such authorities allow

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812 POP Directive, art. 13(1).
813 Ibid., art. 18.
announcement before the prospectus is available, that a prospectus will be published. It must also mention the place of publication and availability of the prospectus. Publication of the prospectus must be by insertion in newspapers or in the form of a brochure.

The prospectus prepared under Articles 11 and 12 must be communicated, before publication, to authorities designated in each Member State where the securities are offered to the public for the first time. These authorities must scrutinise Article 12 prospectus, but not Article 11 prospectus. Both Articles 11 and 12 prospectuses must be published or made available to the public at the time when the offer is made to the public. Announcements of the offer must tell about the present or future existence of the prospectuses, and must also indicate about the place of their publication and availability. The announcing documents must be communicated in advance to the authorities to which the prospectus is communicated so that they can determine, in respect of Article 12 prospectus, if these documents should be checked prior to publication.

4.4.3.5 Mutual Recognition of Prospectuses

The POP Directive provides for mutual recognition of public-offer prospectuses, which is similar to that of listing particulars under the Admission and Information Directive. It provides for mutual recognition of a public-offer prospectus prepared under Articles 7, 8 or 12 according the listing particulars provisions of the Admission and Information Directive, when a multi-jurisdictional public offering of

814 Ibid., art.s 7 and 8.
815 Ibid., art. 10(1) and 10(2).
816 Ibid.
817 POP Directive, art. 10(3) and 10(4).
818 Ibid., art. 14.
819 Ibid., art. 12(2).
820 Ibid., art. 16.
821 Ibid., art. 17(1).
transferable securities is made under Article 20. According to Article 20 when an issuer makes a public offer of securities simultaneously or within a short interval of one another in more than one Member State, a prospectus drawn up according to Articles 7, 8 or 12 must be scrutinised and approved by the competent authorities of the Member State in which the issuer’s registered office is situate, or, by the competent authorities of some other Member State, where offer is made, chosen by the issuer. Article 21 provides for recognition of that prospectus by other Member States, where the public offer is made simultaneously or within a short interval of one another, as complying with their laws in this respect. No further approval of any form is required there. Nor can any additional information be asked for except the information specific to their respective markets particularly concerning the income tax system, paying agents for the issuer and publication of notices to investors.

In addition to the mutual recognition of a prospectus as prospectus, the listing particulars provisions of the Admission and Information Directive, as already discussed, provide for mutual recognition of a prospectus as listing particulars in a Member State(s) where the prospectus was approved in some other Member State three months before the listing application. Thus because their contents are same, listing particulars and public-offer prospectus scrutinised and approved by competent authorities in a single Member State are ‘entitled to interchangeable mutual recognition in other Member States.’

Like the listing particulars provisions of the AID the POP Directive provides for recognition, by agreement concluded according to the EC Treaty, of prospectuses drawn up and scrutinised in non-Member States in the EC countries as complying with this Directive provided

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822 Ibid.
823 Warren, supra note 748, at p. 711.
(a) that the non-Member States reciprocally recognise the EC prospectus, and
(b) that they extend investor protection equivalent to that available under the POP Directive.\footnote{POP Directive, \textit{supra} 25, art. 24.}

\textbf{4.4.3.6 Implementation of the POP Directive}

The Directive set 17 April 1989 the deadline for the implementation of its provisions in the Member States’ jurisdictions. By now all Member States have implemented them. As such the POP Directive has emerged as the ‘common market prospectus’ law of which the listing particulars provisions of the Admission and Information Directive form the ‘core’.\footnote{Warren, \textit{supra} note 748, at p. 689.}

\textbf{4.4.4 Investment Services Directive (ISD)\footnote{Supra note 29. This Directive is under revision, see COM(2003)138, Explanatory Memo., sec. 3.1, n. 8.}}

Proposed in 1989 by the European Commission\footnote{\cite{1989} OJ C43/7 and \cite{1990} OJ C42/7} the European Council adopted this directive on 10 May 1993 as an ‘essential to the achievement of the internal market…from the point of view both of the right of establishment and of the freedom to provide financial services, in the field of investment firms.’\footnote{Investment Services Directive (ISD), \textit{supra} note 29, preamble.} It enables investment firms to provide their services across the borders in Europe based on home country license. Here “investment firm” typically means ‘any legal person the regular occupation or business of which is the provision of investment services for the third parties on professional basis’.\footnote{[1989] OJ C43/7 and [1990] OJ C42/7} And “investment services” means reception and transmission of orders, or execution of such orders, or dealing in, or managing portfolios of investments, or underwriting, in respect of specified kinds of instruments.
including transferable securities and other financial instrument (e.g., money-market instruments). Relevan
t to the present study, “transferable securities” are defined as to mean the following:

(a) company shares and other equivalent securities;
(b) bonds and other types of debt securities;
(c) any other securities ‘normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement excluding instruments of payment.’

The ISD mainly provides, among others, for the following:

(1) Authorisation or licensing requirements common to all Member States, e.g., the investment firms must have its head office in the Member State where it has its registered office; the firm must have sufficient initial capital as required by Directive 93/6/EEC, and the persons directing business of investment firm are ‘of sufficiently good repute and are sufficiently experienced’.

(2) Recognition of the investment firms’ license granted by the home country in other countries (host countries).

(3) Prudential rules to be drawn up by Member States requiring, inter alia, (a) that investment firms have sound administrative and accounting procedures; (b) that they make arrangements for safeguarding the investors’ ownership right to financial instruments and funds, and (c) that they make arrangements for the maintenance of transaction records.

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829 Ibid., art. 1(2).
830 Ibid., Annex sec.s A and B read together.
831 Ibid., art. 1(4).
832 Ibid., art. 3(2).
833 Ibid., art. 3(3).
834 Ibid., art. 3(3).
835 Ibid., art. 14.
836 Ibid., art. 10.
(4) Rules of conduct to be set by the Member States, which will implement the principles of (a) honest and fair conducting of business by the firms, (b) due skill, care and diligence in the best interests of their clients and the integrity of the market, and (c) adequate disclosure of relevant material information while dealing with the clients, etc.  

(5) Host Member States’ obligation to grant investment firms authorised by home States access to their markets on the condition of fulfilment of capital adequacy requirement mentioned above and compliance with the rules of the regulated markets concerning constitution and administration of the regulated markets, transactions on the markets, professional standards and clearing and settlement, etc.  

4.4.5 Market Abuse Directive  

The FSAP of 1999 underscored the need of a directive against market abuse, which was followed by the Commission proposal for the Market abuse Directive in 2001. This became a directive on the 28 January 2003 and took effect on 12 April 2003 replacing the Insider Dealing Directive of November 1989. “Market abuse”, which this Directive targets to fight, consists of insider dealing and market manipulation. “Insider dealing” means ‘buying or selling financial instruments (e.g.,

\[837\] *Ibid.*, art. 11.  
\[838\] “Regulated Market”, in effect, means a securities trading market that appears in a Member State’s list of such markets, functions regularly, operates according to the regulations issued by the concerned competent authorities and requires compliance with all reporting and transparency requirements (e.g., keeping data of transactions done by the investment firms, etc) required under art.s 20 and 21. *Ibid.*, art. 1(13).  
\[839\] *Ibid.*, art. 15.  
\[840\] *Supra* note 42.  
\[841\] Market Abuse Directive (MAD), *supra* note 42, preamble, para. (3).  
\[843\] *Supra* note 647.  
\[844\] MAD, preamble, para. 12.
transferable securities as defined under the ISD mentioned above⁸⁴⁵), or getting someone else to do so, when in possession of inside information or disclosing inside information.⁸⁴⁶ “Inside information”, in this context, means in essence undisclosed information relating to financial instruments or their issuers, which, if it were disclosed to the public, would have impact on the prices of those instruments or related derivative financial instruments.⁸⁴⁷ And “market manipulation” refers to ‘creating a ‘false or misleading impression’ about financial instruments or their issuers or distorting the market, typically by positioning prices at an artificial levels.’⁸⁴⁸ By prohibiting these two evils the Directive intends ‘to ensure the integrity of Community financial markets and to enhance investor confidence in those market.’⁸⁴⁹ Keeping these objectives ahead the Directive requires the Member States to, among others,

1. prohibit persons in possession of inside information from using it to acquire or dispose of financial instruments to which it relates;⁸⁵⁰
2. prohibit such persons from disclosing inside information (unless they are exempted on employment or profession grounds) to anybody else;⁸⁵¹
3. prohibit such persons from recommending or inducing any other persons to own or dispose of the aforementioned instruments;⁸⁵²
4. prohibit any person from embarking on market manipulation;⁸⁵³
5. ensure that inside information directly concerning the issuer be disclosed to the public as soon as possible;⁸⁵⁴

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⁸⁴⁵ For other financial instruments for the purpose of the MAD, see ibid, art. 1(3). The MAD applies to those financial instruments which are ‘admitted to trading on a regulated market in at least one Member State, or for which a request for admission to trading on such a market has been made, irrespective of whether or not the transaction itself actually takes place on that market.’ Ibid., art. 9.
⁸⁴⁷ MAD, art. 1(1).
⁸⁴⁸ Abrams, supra note 846.
⁸⁴⁹ MAD, preamble, para. 12.
⁸⁵⁰ Ibid., art. 2.
⁸⁵¹ Ibid., art. 3(a).
⁸⁵² Ibid., art 3(b).
⁸⁵³ Ibid., art. 5.
⁸⁵⁴ Ibid., art. 6.
6. appoint a competent authority, with all supervisory and investigatory powers, to ensure that the Directive provisions implanted at the national level are applied,\(^{855}\)

7. ensure that measures or sanctions are taken against persons liable for non-compliance with the Directive provisions adopted at national level,\(^{856}\)

### 4.4.6 Legislative Changes/Measures Underway

#### The Proposed “Passport” Prospectus (PD)\(^{857}\)

In August 2001 the Commission proposed a Directive on the prospectuses to be published when securities are offered to the public or admitted to trading. This will replace both the listing particulars provisions of the AID (previously Listing Particulars Directive) and the POP Directive. It will broaden the disclosure requirements uniform throughout the EC both for public offering and listing of securities. In this way it moves towards for a pan-European harmonised disclosure regime, replacing the existing minimum harmonisation of disclosure requirements, and mutual recognition methods of integration. Under the proposed regime the disclosure requirements being harmonised the home State of the issuer must scrutinise and approve a prospectus or listing particulars, and other Member States, whether the offering is made or listing is sought, must accept them without any further requirements specific to their markets. Thus the proposed Directive envisages a Europe-wide domestic market which was the ultimate goal of integration.

#### Transparency Directive (TD)\(^{858}\)

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\(^{855}\) Ibid., arts. 11 and 12.  
\(^{856}\) Ibid., arts. 14 and 15.  
\(^{858}\) Supra note 649.
One of the priority actions under the 1999 FSAP is the proposed directive on transparency purpose of which is, as the title reads, ‘to harmonise the transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market’.\textsuperscript{859} This will improve investor protection, market efficiency, openness and integrity.\textsuperscript{860} As a part of the ‘disclosure and transparency agenda’ of the EC\textsuperscript{861} the proposed TD will be brought in lines with other FSAP initiatives, namely the ISA-Regulation, the MAD, the proposed PD and proposed revision of the ISD, in that it will concern issuers whose securities are admitted not only to official listing, but also to regulated markets, as defined under the ISD\textsuperscript{862}, including second tier markets (e.g., Alternative Investment Market in London- AIM).\textsuperscript{863} Thus this intends to provide for publication of periodic financial reporting (annual, half-yearly and quarterly), information concerning major changes to shareholdings and ongoing information with respect to securities admitted not only to official listing, but to regulated markets as well.\textsuperscript{864} The annual financial reports comprising audited financial statements, the management report and responsibility-for-the-information statements by ‘persons responsible within the issuer (e.g., directors)’ shall be disclosed to the public at the latest three months after the end of financial year.\textsuperscript{865} They shall also be kept publicly open.\textsuperscript{866} The half-yearly financial reports include condensed financial statements, an update of the last management report and statement of responsibility by responsible persons with the issuer.\textsuperscript{867} They are required to be published at the latest two months after the relevant year end.\textsuperscript{868} The quarterly financial statements comprise

\textsuperscript{859} Ibid.
\textsuperscript{860} Explanatory Memo., \textit{ibid.}, sec. 1.2.
\textsuperscript{861} Ibid., sec. 1.1.
\textsuperscript{862} Supra note 838.
\textsuperscript{863} Explanatory Memo., supra note 649, sec. 3.1.
\textsuperscript{864} Ibid.
\textsuperscript{865} Proposed Transparency Directive, supra note 649, art. 4.
\textsuperscript{866} Ibid.
\textsuperscript{867} Ibid., art. 5.
\textsuperscript{868} Ibid.
consolidated figures showing net turnover and profits/losses, an explanatory statement on the issuer’s activities and the profits/losses for the relevant quarter and an voluntary statement on the issuer’s likely development for the rest of the financial year. They are to be ventilated at the latest two months after the end of the relevant quarter. The issuer’s administrative, management or supervisory bodies will be responsible for all these financial statements. They will be civilly liable for any misstatement. As a part of ongoing disclosure obligation the TD requires notification to the issuer by a securityholder when there is a major change in his/her/its holdings. The issuer must notify the public of changes in rights attaching to equity and debt securities, etc. In addition, the TD is introducing the concept of ‘a language customary in the sphere of international finance’, which allows an issuer to disclose the regulated information in a language accepted by the Member States where its securities are admitted to trading or, where appropriate, in the customary language, i.e., in English.

**International Accounting Standards (IAS) Regulation**

This regulation mandates application of IAS, as from 1 January 2005 (from 2007 in some limited exceptional cases), in the preparation of consolidated accounts for all companies who has securities admitted to trading on a regulated market in Europe. Member States may, at their option, permit or require the application of

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869 Ibid., art. 6.
870 Ibid.
871 Ibid., art. 7.
872 Ibid.
873 Ibid., arts. 9-11.
874 Ibid., art. 12.
875 Ibid., art 16.
878 Ibid., preamble, recital 17.
879 Ibid., art. 4.
IAS in the preparation of annual accounts of such companies.\textsuperscript{880} They may also apply this provision equally to non-publicly traded companies for drawing up their annual and/or consolidated accounts.\textsuperscript{881}

\section*{5 CONCLUSION}

It has been noticed that the EC company law in general and securities law in particular are based on the disclosure theory. Though in the area of company law the Community has gained tremendous success in setting common standards (e.g., accounting and auditing standards), in the securities law harmonisation was limited to the minimum, which necessitated devising mutual recognition of the differing standards. The two leading Directives, namely the Listing Particulars Directive-LPD (presently listing particulars provisions of the AID) and the POP Directive, contained the dual method in the integration of securities market in Europe. As such it can be said that though based on disclosure theory, these Directives could not create a pan-European uniform disclosure regime. This state will, however, improve when the proposed Directive on prospectus and listing would be adopted. Along with this the uniform application of International Accounting Standards as required by the IAS-Regulation and the adoption of the proposed Transparency Directive would establish a pan-European disclosure regime. Needless to mention that the ISD has already introduced a European “passport” in the financial services area. All these, taken together, would accelerate the EC’s role as ‘the major force for global regulatory harmony’.\textsuperscript{882}

\textsuperscript{880} Ibid., art. 5.
\textsuperscript{881} Ibid.
\textsuperscript{882} Warren, supra note 694, at 53.
PART III:

GLIMPSES ON THE SECURITIES REGULATION IN NORTH AMERICA

6 A BRIEF HISTORICAL AND THEORETICAL OUTLINE

6.1 History

During the period of early to mid-1980s there occurred many large scale multi-jurisdictional equity offerings, for example, the British Telecom offering of 1984 in Canada, the United Kingdom and the United States.\textsuperscript{883} In view of this new phenomenon and its various legal and regulatory complications,\textsuperscript{884} which were likely to mount up in future, the Securities and Exchange Commission (SEC) of the United States felt the need of a system that could ease such multi-jurisdictional offerings.\textsuperscript{885} In 1985 it issued a concept release, “Facilitation of Multinational Securities Offerings”\textsuperscript{886}, asking the public to comment on its feasibility. It proposed two alternative methods of facilitation: “common prospectus” system, and “reciprocal prospectus” system. The former required the development of a prospectus disclosure regime and other related rules (e.g., prospectus review) that would be common to all jurisdictions participating in the proposed system. On the other hand, the latter required a consensus among the participant-States that a prospectus framed and approved in a jurisdiction would be accepted in other jurisdictions on the basis of the principle of reciprocity or mutual recognition. The main advantage of the common prospectus system was ‘the uniformity


\textsuperscript{884} Such complications may erupt from the following uncertainties: the securities offering documents should be prepared according to the law of which country, home or host country; which regulatory authority should review the prospectus; which law should apply in the event of breach of any legal or regulatory requirements, etc.

\textsuperscript{885} Drinkwater, supra note 883, at p. 183.

of disclosure standards (the SEC standards presumably providing a benchmark)’, but this was very difficult to reach.\textsuperscript{887} The public comments, therefore, went against this, but in favour of the reciprocal prospectus system.\textsuperscript{888} As a result, three jurisdictions, Canada, the UK and the US, attempted to build up a reciprocal system.\textsuperscript{889} In course of time, however, involvement of the UK in this process proved impossible mainly because the accounting system of the UK significantly differed from that of the US, and the UK, as a component of the EEC, was establishing a different system.\textsuperscript{890} As such Canada and the United States remained to establish a system between them, called the ‘Multi-jurisdictional Disclosure System’ (MJDS).

The SEC, and the Ontario Securities Commission (OSC) and the Quebec Securities Commission (QSC), as the representatives of the Canadian provincial securities administrators, engaged in negotiations to reach an agreement on the MJDS. Initially the SEC was concerned that the reciprocal prospectus system would produce low disclosure standards which would be discouraging for harmonisation of international disclosure standards.\textsuperscript{891} But in fact Canadian securities law required ‘high level of disclosure’, which assuaged the SEC’s concerns.\textsuperscript{892} Rather both sides agreed that there existed ‘similarity in substantive disclosure requirements, in the process and approach to prospectus review, as well as in the procedures and established history of regulation of capital markets’.\textsuperscript{893} Also, in view of the number of companies, Canadian issuers formed the largest class of foreign issuers in the US securities markets.\textsuperscript{894} However, the Canadian authorities, in order to be acceptable to the US, amended

\begin{footnotes}
\footnotetext{887}{Jordan, \textit{ibid.}, at p. 110.}
\footnotetext{888}{Drinkwater, \textit{supra} note 883, at p. 184.}
\footnotetext{889}{\textit{Ibid.}}
\footnotetext{890}{\textit{Ibid.} As to the question of the UK’s legal limitations to negotiate an international treaty like the MJDS one being a Member of the EU, see Justus Lipsius, ‘The 1996 Intergovernmental Conference’ (1995) 20 ELR 235 at p. 237, and James Kingston, ‘External relations of the European Community-external capacity versus internal competence’, (1995) 44 ICLQ 659 at p. 659.}
\footnotetext{891}{Jordan, \textit{supra} note 886, at 110.}
\footnotetext{892}{\textit{Ibid.}}
\footnotetext{893}{Drinkwater, \textit{supra} note 883, at p. 184.}
\end{footnotes}
securities laws to harmonise them with the US counterpart in the areas of, for example, continuous disclosure liability, shelf registration and management’s discussion and analysis disclosure while the US was ‘unwilling to alter its standards significantly’. Thus Canadian and the US securities laws were harmonised ‘with stricter, more detailed, U.S. norms being adopted’ in Canada. Ultimately on 1 July 1991 the MJDS kicked off as a combination of both harmonisation and reciprocity, though it had been initiated as a reciprocal system. Though, for now, partnered by Canada and the US, this is a ‘test-model’ of integration with an aim to fetch other countries within it.

The Canadian securities administrators have adopted National Instrument 71-101 to implement the MJDS throughout the country. As well, the SEC has adopted necessary rules, forms and schedules to the same end. For implementation at the (US) state level where there is application of blue sky law, the North American Securities Administrators Association (NASAA) has adopted model rules and several states have taken action for the accommodation of the MJDS. Of course, most of Canadian offerings under the MJDS arrangement are eligible for exchange listing exemption from state registration. And as such blue sky laws should not be great problems for such offerings.

896 Ibid., at p. 320.
898 ‘SEC adopts a Multijurisdictional Disclosure System with Canada, supra note 894."
900 For the concept of blue sky law, see notes 982-986 and text accompanied thereby, infra.
902 For discussion on the matter, see Harold Bloomenthal, Securities and Federal Corporate Law, 2nd edn., (Paul, Minn.: West Group, c1998 (securities law series) at pp. 27-570-576.
903 ‘SEC adopts a Multijurisdictional Disclosure System with Canada, supra note 894.
Canada is a small securities market compared to the US. For many years Canadian issuers had been longing for entry into US securities markets for raising funds, but high costs and comprehensive US continuous disclosure requirements hindered their entry. 904 The MJDS removed that impasse and opened the door to cross-border securities offerings. As of February 2000, as mentioned earlier, dozens of Canadian companies had raised capital of US $153 billions from the US securities market since 1991905 whereas a few US companies sought capitalisation in Canada. 906 Furthermore, in 1990s some Canadian issuers committed accounting malpractices, like fraud and overstatement of net assets. 907 As a result the SEC was not happy with Canadian accounting and regulatory standards and doubted if there was any reason to show ‘favoritism’ to Canada through the MJDS agreement. 908 In 2000 it unveiled its disgust and hinted at its desire to discontinue the agreement and thereby to stop giving the Canadian issuers ‘unfair advantage over other foreign issuers, especially given increasingly global environment’. 909 However, the Canadian securities authorities, particularly the OSC, ‘the de facto national regulator’ had made untiring efforts to keep the agreement in place. 910 It had taken stern position against companies’ accounting irregularities and improved its accounting and regulatory standards. 911 All these positive steps had been able to soothe the SEC and made it agree to drop the idea of discontinuing the MJDS. 912 Of course, both parties have agreed to bring some

904 Johnston and Rockwell, supra note 895, at p. 320.  
905 Supra note 53.  
906 See, for example, http://www.altheimer.com/what/group.asp?groupid=23, (visited on 8 June 02)  
911 Ibid.  
912 Supra note 907.
significant changes to it. Most worth mentioning is the substantiality requirement of the issuers—market capitalisation of US $250 million up from US $75 million.\footnote{Richard Blackwell, ‘MJDS pact still on SEC’s back burner’, \textit{The Globe and Mail}, 8 January 2001, at p. B3} This new deal will come into force provided a rule is made to this effect after favourable public comments.\footnote{Ibid.} Thus the MJDS survived a dreadful jerk and is still continuing as a regional securities markets alliance.

\section*{6.2 Theory}

As it appears from the historical outline, the MJDS has taken place as a mini-economic integration in North America for the time being limited to the US and Canada within only securities area. To make it happen both the member countries have brought about changes to their domestic laws, though mainly Canada. In this way they removed restrictions to free flow of capital across the border. They continued this efforts further when the MJDS was likely to end in 2000 because of the US’s dissatisfaction about the accounting and regulatory standards of Canada evidenced by some Canadian issuers’ malpractices. All these seem to have given the MJDS a Scitovsky-like theoretical foundation. Though Scotivsky’s theory is particularly applicable to the EC as discussed before, its key premise, namely abolition of restrictions to the free movement of economic factors including capital, underlies the MJDS arrangement.\footnote{This might have been an impetus to the broader economic alliance in North America, called North American Free Trade Agreement (NAFTA), which had, of course, political basis and goal. See, in this context, ‘North American economic integration: Trial by fire’, in Clement \textit{et al}, supra note 10, at pp. 253-277.} As a result, companies of the US and Canada can freely make cross-border offerings of securities. Thus a competitive market has taken place. Of course some unfavourable effects resulted from raising huge money by Canadian companies from the US, and also from low accounting standards or malpractices of
some of them as seen above. Concerted efforts of the partners, especially Canada, have overcome these problems by making the amount of public float higher. Thus Scitovsky’s suggestion to remove unfavourable effects has been followed in practice.

7 OPERATION OF THE MJDS

7.1 Registration Requirements: Offerings by Qualified Issuers

Under the MJDS certain eligible issuers of the US and Canada are allowed to make offerings of different securities and tender offers both at home and in the other jurisdiction, or only in the other jurisdiction in compliance with the home country disclosure and other regulatory requirements. Offerings, as provided for in the (Canadian) National Instrument 71-101, and the (US) Securities Act 1933 Forms, include rights offerings, exchange offers and business combinations, investment grade debt or preferred securities offerings, and equity offerings. For each type of offerings the both the Instrument and the Forms set forth certain eligibility requirements for the issuers. For example, with regard to an equity offering Section 3.1(c), read together with Section 3.1(a)(iii), of the Instrument, and Form F-10 require in common that the issuer must have a 12-month reporting history, and also a public float of at least US $75 million, which is called substantiality requirement. The purpose of the latter

916 National Instrument 71-101, sec.s 3.1(a), 3.1(b), 12.1, 13.1 and 3.1 (c) respectively provide for investment grade debt securities or preferred shares, rights offering, exchange bids, business combinations, and any other offering of securities (e.g. equity offerings). And the (US) SEC Forms F-7, F-8, F-9 and F-10, respectively to rights offering, exchange offer and business combination, investment grade debt securities or preferred stock offered for cash, and any kind of offerings including equity offering.

917 Previously 36 months’ reporting history was required for offering equity, and debt offerings. The reduction was done by an amendment in 1993. See Drinkwater, supra note 883, at p. 190.

918 “Public float” means the ‘securities held by persons other than affiliates of the issuer’, Form-10, General Instructions I-B, Instruction 3, and National Policy Statement No. 45, sec. 2(36). In 1993 an amendment was made to the MJDS, which deleted the minimum market capitalisation requirement of CN $180 million and retained the public float requirement. See Drinkwater, supra note 883, at p. 190., and also Harold Bloomenthal et al, Emerging Trends in Securities Law, (Deferfield, NY and Rochester: Clark Boardman, 1993) at p. 9-88.
requirement is ‘to single out issuers whose size is such that there is a large market following for them and the marketplace can be expected to have set a price for their securities based on all publicly available information.’\textsuperscript{919} To reiterate, recently the OSC and the SEC have agreed to a compromise deal that the said amount of market capitalisation would be increased to $250 million. As such start-up and small/medium sized (SMs) companies are precluded from taking advantage of the MJDS. Only world class issuers\textsuperscript{920} will qualify to make MJDS offerings. In addition, an issuer qualifying the above tests must be a Canadian “foreign private issuer”\textsuperscript{921} (and in particular cases a crown corporation\textsuperscript{922}) or a US “foreign issuer”\textsuperscript{923} in order to offer securities in the US and Canada respectively. “Foreign private issuers” are defined in the US securities laws to include all foreign issuers save

(1) foreign governments, and

(2) foreign issuers

(i) that have more than 50\% of their outstanding voting securities held of record by US residents,

(ii) whose majority officers or directors are citizens or residents of the US,

(iii) whose more than 50\% of assets are located in the US, or

(iv) whose business is mainly administered in the US.\textsuperscript{924}
A US “foreign issuer”, for the Canadian MJDS purpose, means an issuer incorporated or organised under the laws of the United States or any state or territory of the United States or the District of Columbia. The following issuers are not, however, included in this definition:

1. Issuer whose more than 50% of voting securities are held by persons or companies whose last address as appear on books of the issuer is in Canada,

2. Issuer whose majority of the senior officers or directors are citizens or residents of Canada; or whose more than 50% of assets are located in Canada; or whose business is administered by principally in Canada.

Further, such a US issuer must not be an investment company under the US law nor a commodity pool issuer.

7.2 Means and Procedure of the MJDS Offerings

7.2.1 The Core Idea

An eligible issuer can make an MJDS offering normally by publication of a prospectus prepared according to its home country disclosure requirements. Except in respect of investment-grade debt or preferred shares, financial statements must, of course, be reconciled with the host country’s Generally Accepted Accounting Principles (GAAP). Issuers of both countries are required to add legends or particular forms to their respective prospectuses, though ‘these are routine and do not go to the substance of the document or disclosure’.

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925 National Instrument 71-101, sec. 1.1 ("US issuer").
926 Ibid., sec. 1.1 ("foreign issuer").
927 Ibid., sec. 3.1(a)(iv) and (v).
928 In case of an exchange offer and business combination the offering documents are takeover bid circular/issuer bid circular, and information circular respectively. These securities are to be offered by prospectus, however, when they are offered under sec. 3.1(c) of the National Instrument 71-101, or SEC Form F-10 as “other securities”.
929 Drinkwater, supra note 883, at p. 185.
930 Ibid., at p. 186.
931 Ibid., at p. 185.
with a provincial securities commission and at the same time file a copy of it with the SEC. A US issuer does vice versa.\textsuperscript{932} After filing, the home securities regulator reviews the prospectus and the securities regulator of the foreign jurisdiction does not do it in general.\textsuperscript{933} When the review process is over, the latter authority is notified about it, with which the prospectus comes into effect in the foreign jurisdiction.\textsuperscript{934} After securities have been offered, the issuer is required to file home continuous disclosure documents with the securities regulator of the other jurisdiction.\textsuperscript{935}

### 7.2.2 United States Multijurisdictional Disclosure System (US MJDS)

#### 7.2.2.1 Prospectus

**7.2.2.1.1 Prospectus to be Prepared according to Canadian Requirements**

As said above, under the MJDS prospectus is the typical document for offering securities. As required by Form F-8, however, an exchange offer and a business combination are made by takeover bid or issuer circular bid, and an information circular respectively. There are particular conditions to register securities under this Form, e.g. the issuer must have a class of securities listed on the Montreal or Toronto Stock Exchanges or the Senior Board of the Vancouver Stock Exchange for at least 12 months preceding the offer, and also must have been subject to the continuous disclosure requirements of any securities commission or equivalent regulatory authority in Canada for at least 36 months immediately preceding to the filing of this Form in addition to its present compliance with the obligations resulting from such listing and reporting.\textsuperscript{936} If, however, the required conditions are not met and as such these securities cannot be registered in Form F-8, they can be registered in Form F-10 that

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\textsuperscript{932} Ibid.
\textsuperscript{933} Ibid.
\textsuperscript{934} Ibid.
\textsuperscript{935} Ibid., at p. 186.
\textsuperscript{936} SEC Form F-8, General Instruction II.A.3.
applies to securities of any kind. Form F-10 allows offering of securities by prospectus which is based on (Canadian) home jurisdiction documents. For securities of conventional type (i.e. securities other than exchange offer, business combination, and rights offering) the home jurisdiction in question is one of the provincial securities commissions, which is called “principal jurisdiction”. In this respect, the prospectus must include the documents that are mandatory to be delivered to the purchasers in accordance with the law of the principal jurisdiction of Canada. It does not have to include any documents that are incorporated therein merely by reference. On the other hand, prospectuses for exchange offer, business combination and rights offerings, will consist of entire disclosure documents used respectively to offer securities, to solicit votes, and to offer rights and underlying securities, in any Canadian jurisdiction. In all cases, the documents are to be prepared according to the disclosure requirements as ‘interpreted and applied’ by (Canadian) home jurisdictions.

Now it is clear that a Canadian issuer offering securities in the US must draw up the prospectus according to the securities law of Canadian jurisdiction(s) (principal or other). This is based on the assumption that ‘there are appropriate disclosure requirements required under Canadian law that can be used as the basis for the registration statement filed with the SEC’. Prospectus is the basic component of the registration statement.

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937 See also note 928, supra.
938 SEC Form F-10, Part I, Item 1.
940 Where information is inserted by reference, the prospectus must state the name, address and telephone number of an officer from whom copies of the incorporated document may be available without any fees. SEC Form F-10, Part I, Item 4.
941 Ibid. Form F-10, Part I, Item 1, and Form F-7, Part I, Item 1.
942 Ibid., Forms F-7, F-8, F-9, F-10 and F-80, Part I, Item 1.
944 Registration Statement consists of prospectus, exhibits, and undertakings and signature page. Among the exhibits are included all reports or other information, as regards the nature of securities proposed to offer, required by the home jurisdiction, consent of accountant, engineer or any other expert, and power
7.2.2.1.2 Canadian Prospectus Disclosure Requirements

7.2.2.1.2.1 Introduction

In Canada there is no federal securities law. Each province and territory\(^{945}\) has its own securities law with ‘large areas of overlap’.\(^{946}\) In other words, the securities laws of all the provinces and territories are, to a great extent, similar, though not uniform or harmonised\(^{947}\). In recent years harmonisation efforts are being carried out by the Canadian Securities Administrators (CSA), which is composed of representatives of provincial securities commissions.\(^{948}\) However, of all the provinces and territories Ontario is the biggest securities market in Canada, which has ‘a pivotal role in the capital formation and wealth creation process …(generating) significant jobs in the financial services sector’\(^{949}\). Its law and policy with respect to securities regulation are basically followed in other provinces and territories.\(^{950}\) As such Ontario can be said to be representing Canada in the field of securities industry. Given this fact in the present Sub-Chapter of Canadian law Ontario securities regulation, its underlying theory, and policy, etc. will be overviewed, and throughout the work Ontario and Canada would be interchangeably used.

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\(^{945}\) Canada has ten provinces and two territories.


\(^{947}\) Johnston and Rockwell, supra note 895, at p. 250.

\(^{948}\) By now the CSA have issued national instruments governing uniform short form, shelf and PREP prospectuses. They are presenting working to harmonise, among others, the long form prospectus regimes and continuous disclosure requirements. CSA Staff Notice 41-303- Harmonisation of prospectus requirements across the CSA. (April 5, 2002) 25 O.S.C.B. 2203, in Paul G. Findlay and Borden Ladner Gervais, Consolidated Ontario Securities Act, Regulation and Rules 2002 (Scarborough, Ontario: Carswell, 2002) at p. 648.


\(^{950}\) See Stephane Rousseau, ‘The future of capital formation for small and medium sized enterprises: rethinking initial public offering regulation after the restructuring of Canadian stock exchanges’, (2000) 34 RJT (Revue Juridique Themis) 661, at para. 9 n. 18 (QuickLaw:RJT, visited on 20 June 02). For example, the OSC’s prospectus rule is copied in the majority of other Canadian jurisdictions. . CSA Staff Notice 41-303, supra note 948.
7.2.2.1.2.2 Theoretical and Historical Underpinnings

Two theories, disclosure theory and merit review ("blue sky") theory, borrowed from the UK and the US respectively, amalgamate to form the footing of the securities regulation in Canada. As already stated, the disclosure theory propounds that securities be sold by a corporation providing the prospective investors with full information concerning the securities with a view to making them independent in making their investment decision in light of the information. The securities market authority (e.g. securities commission) will not interfere in this matter. It must only ensure that disclosure of information is made. In other words, it does not, in a paternalistic manner, judge the merit of the offerings and thereby not decide for the investors as to whether investment should be made or not. To quote Gordon:

[A]dministrators focus on whether the registration statement is misleading in any material respect or whether it omits any material information. They may demand that the issuer change the level of disclosure but may not affect the terms of the offering. Once the information contained in the registration statement is complete, accurate, and not misleading, the administrators must approve the registration statement, regardless of their opinion of the terms of the offering.

Thus the whole idea of the philosophy is to insist that every issue of new securities ‘shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public…(and thereby) ‘to protect the public with least possible interference to honest business’. In this way an equality of opportunity is offered to all investors in the

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954 Chapter 4.2, supra.
956 77 Cong. Rec. (March 29, 1933), at 955 (Message from President Franklin D. Roosevelt at the time of passage of the Securities Act of 1933 (15 U.S.C. 77a (1995))).
market place, be sellers or buyers. This creates a competitive market where the potential investors, in order to own a security, would compete with each other to reach an ‘equilibrium price’ (also called ‘accurate price’), which ‘should reflect as nearly as possible the security’s ‘intrinsic value’. Such a reflection of price ensures that the (investment) ‘capital is properly allocated, and this is good for society in general’. 

The blue sky theory, on the other hand, postulates that the merit of securities be assessed by the concerned securities authority before the securities are offered to the public for sale. On its judgement it may refuse permission for sale if it considers that the sale will be detrimental to the public interest. To quote one author, this theory requires ‘examination of the proposed security by the regulatory agency to determine the economic viability of the security and underlying enterprise before allowing the issue to be offered to the public’. Unlike the disclosure law the blue sky legislation aims to protect the investors, but in a “paternalistic” manner.

As Canadian securities legislation is based on the above discussed theories, it provides for disclosure of information to the investing public and at the same time arms the securities regulator with the power of precluding any securities from coming to the market if, despite the disclosure, it seems to the regulator that in the public interest such preclusion is essential.

Since history and theory in law are intertwined with each other, a brief view of how and when Canada resorted to its theoretical stances would help

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960 Robertson, supra note 958, at p. 468.
962 For the grounds on which the regulatory authority can refuse approval to prospectus, see text accompanied by notes 1090-1103, infra, and Zahid and McGee, supra note 951, at pp. 191-192.
963 Text accompanied by note 406, supra.
understand its link historically to its counterpart, namely the EC, which in turn would facilitate comparing them at a later stage of this work. The following account is devoted to that purpose.

Though disclosure philosophy is a European phenomenon, it was imported in Canada, being a commonwealth country, as a base of English company law. This philosophy crept in English law in the 19th century actually with the passage of *Joint Stock Companies Act of 1844*.\(^{964}\) This Act was first to provide for the ‘modern prospectus requirement’\(^{965}\) and thereby to introduce a mechanism of disclosure as a ‘safeguard against fraud’.\(^{966}\) Through this legislation ‘(m)odern securities regulation began in England’\(^{967}\). For the next four decades no significant development took place. In 1889, when a question arose as to a director’s liability for misstatement in a prospectus, the House of Lords held that it was a good defence for the director that he (the director) believed, in good faith, in the truth of the statements, however unreasonable.\(^{968}\) In the following year the *Directors’ Liability Act* \(^{969}\), which was passed to respond to the said liability decision, provided for liability of directors and promoters for any loss, resulting from an untrue statement in a prospectus, sustained by any subscriber of securities on the faith of the prospectus.

In 1894 England examined the rationale of “merit review” of securities and eventually rejected because it would ‘demand a very numerous staff of trained officers, and lead to great delay and expense, while an incomplete or perfunctory

\(^{964}\) 7 & 8 Vict. C. 110 & 111.

\(^{965}\) Luis Loss, *Fundamentals of Securities Regulation*, (Boston and Toronto: Little, Brown and Company, 1983), at p.2. The Bill of the 1844 act was prepared by William Gladstone, then President of the Board of Trade, who can be called the father of modern company law as it introduced three basic principles. First, it provided for incorporation by registration instead of special act or charter. Second, it distinguished company from private partnership requiring companies consisting of more than 25 members to register. Third, it provided for full publicity of information. : See L.B.C. Gower, *Principles of Modern Company Law*, 5th ed., (London: Sweet and Maxwell, 1992) at p. 39.

\(^{966}\) Gower, *ibid.*

\(^{967}\) Williamson, *supra* note 952, at p. 4.

\(^{968}\) *Derry v. Peek* (1889), 14 A.C. 337 (H.L.).

\(^{969}\) 53 & 54 Vict. C. 60.
investigation would be worse than none.\textsuperscript{970} Besides ‘(i)t would be an attempt to throw what ought to be the responsibility of the individual on the shoulders of the State, and would give a fictitious and unreal sense of security to the investor, and might also lead to grave abuses.'\textsuperscript{971} By this rejection England leaned further toward the disclosure premise and passed the \textit{Companies Act of 1900}\textsuperscript{972} with greater disclosure requirements. This Act, after amendment in 1907, was replaced by the \textit{Companies (Consolidation) Act of 1908}\textsuperscript{973} further widening the scope of disclosure. To quote Mulvey:

\begin{quote}
The purpose of the legislation is not to regulate or supervise the actions of directors of companies, but to afford the investing public a means of ascertaining the true inwardness of flotations and by means of annual statements and reports of directors and auditors to disclose to the shareholders from time to time the methods by which the affairs of the company are conducted.\textsuperscript{974}
\end{quote}

Canadian securities legislation was built on the English experience as outlined above.\textsuperscript{975} Canada started securities regulation in the fashion of corporate legislation in late 1870s.\textsuperscript{976} Particularly, Ontario introduced securities regulation in 1891 by following the English \textit{Directors' Liability Act of 1890}\textsuperscript{977}. In 1897 it required the delivery of financial statements to the shareholders.\textsuperscript{978} In 1907 \textit{Ontario Companies Act}\textsuperscript{979}, based on the English \textit{Companies Act of 1900} was passed. It provided for wider scope of prospectus disclosure compared to the English Act.\textsuperscript{980} In 1912 the Ontario Act introduced, among others, a provision of public offerings by underwriters.\textsuperscript{981} After

\begin{footnotes}
\textsuperscript{971} Ibid.
\textsuperscript{972} 63 & 64 Vict. C. 48.
\textsuperscript{973} 8 Edw. 7, C. 69.
\textsuperscript{974} Mulvey, supra note 970, at p. 45.
\textsuperscript{975} Williamson, supra note 952, at p. 8.
\textsuperscript{976} Goulet, supra note 953, at p. 84.
\textsuperscript{977} Ibid. at p. 85.
\textsuperscript{978} Ibid.
\textsuperscript{979} S.O. 1907 c. 43.
\textsuperscript{980} Goulet, supra note 953, at p. 85.
\textsuperscript{981} Ibid.
\end{footnotes}
1912, the “blue sky” legislation discussed below was added to the disclosure legislation of Canada in general and Ontario in particular.

“Blue sky” law\(^{982}\) was first introduced in the state of Kansas of United States in 1911.\(^{983}\) In *Hall v. Geiger-Jones Co.*\(^{984}\) it was stated that the aim of the law was to stop ‘speculative schemes which have no more basis than so many feet of ‘blue sky;’ ’ or ‘to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines, and other like fraudulent exploitations.’ In Kansas the law required both securities and securities salespersons to be registered with the State Bank Commissioner who was the controlling and supervisory authority with regard to securities. On application for such permission the Commissioner made a detailed examination of the state of affairs of the issuer and its security proposed to be offered. If he or she was satisfied mainly that the issuer, with fraudulent intent, was not solvent and the proposed security was not sound, he or she could refuse the permit and save the people from losing money in fraudulent or “blue sky” concerns. A company, if registered, was obliged to submit semi-annual reports and to maintain various records.

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\(^{982}\) It is not sure when and how the term “blue sky law” did actually originate. But the frequent use of the term in different literature leads to the conclusion that it refers to anti-fraud law. See Mulvey, *supra* note 970, at p. 37. In a study of the primary materials in this connection, Macey and Miller discovered that the earliest use of “blue sky” was from 1910. They quoted a press release issued by then Kansas Banking Commissioner, J.N. Dolley, (who is called the father of Blue Sky Law) as complaining that ‘enormous amount of money the Kansas people are being swindled out of by these fakers and ‘blue-sky’ merchants.’ : Letter from J.N. Dolley (Dec. 16, 1910), *reprinted in Brief for Appellees at 33, Merrick v. N.W. Halsey & Co.*, 242 U.S. 568 (1917) (No. 413) in J.R. Macey and G.P. Miller, ‘Origin of the blue sky law’, (1991) 70 Tex.L.Rev. 347 at pp. 360 n. 59.

\(^{983}\) Kansas is said to be the mother place of the blue sky legislation because in USA it was first to enact the statute of “comprehensive” type. Otherwise, Connecticut would have deserved that credit since it had a blue sky act in 1903, but that was a brief one. : see L. Loss and E. M. Cowett, *Blue Sky Law*, (Boston: Toronto: Little, Brown and Co., 1958) at pp. 5 and 7. The Kansas statute came into force after the Populist Party had won election in 1910. J.N. Dolley, a retired grocer and a bank director, was appointed Bank Commissioner. With the knowledge that many “unsophisticated” investors had lost much money in dealings in fraudulent securities, he advised people intending invest in securities to inquire his office of its soundness. In this process people could be warned beforehand of fraudulent security issuer and thereby could save their hard earned money. The Kansas statute of 1911, titled “An Act to provide for the Regulation and Supervision of Investment Companies and providing penalties for the violation thereof”, was passed to give him legal backing in this endeavour. T. Mulvey, *Canadian Company Law*, (Montreal: John Lovell & Son Ltd., 1913) at 733.

\(^{984}\) 37 S.Ct. 217 (1916) at pp. 221-222.
with the Commissioner who could cancel the registration for “sufficient” cause. Thus the Commissioner ‘fathered the paternalistic approach to state security regulation’.

Later on, the concept of “blue sky law” became popular and entered other jurisdictions of the US and Canada. As of today, it has been borrowed almost in all states of America and all provinces of Canada. Manitoba was first to introduce it through the passage of the Sale of Shares Act of 1912, which was ‘an exhibition of paternalism’ for other provinces of Canada. That “exhibition” impacted on the subsequent legislation of other provinces. Ontario incorporated blue sky provisions in the Security Frauds Prevention Act of 1928. It typically contained provisions concerning deterrence of fraud in security trading, and licensing of traders. It did not cover the issuing aspect of new security, which still remained in the company law area.

However, a landmark development in securities legislation took place in 1945. When in 1940s ‘(f)raudulent stock promotion was getting out of hand and the government was faced …with criticism’ within and without, Ontario passed the Securities Act of 1945 which was, in fact, the first modern security statute for Canada. It followed the Urquhart Report prepared in 1944. The striking feature of the Act is that it adopted full, true and plain disclosure provision on the one hand, and entrusted the Ontario Securities Commission (OSC) with a discretion to enforce

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987 S.M. 1912, c. 75.
988 Mulvey, *supra* note 983, at p. 734.
989 S.O. 1928, c. 24.
992 S.O. 1945, c. 22.
995 OSA, 1945, c.22, s. 49(1).
that provision, on the other,\textsuperscript{996} and thereby to ‘insure from the outset that the public offering is being made on a fair and equitable basis’.\textsuperscript{997} Thus for the first time, through this enactment, the Ontario legislature worked out a compromise between the disclosure and blue sky theories, which has been carried forward to underpin subsequent legislative changes in securities area till today. Thus Ontario securities legislation is not, unlike its UK and EC counterparts, merely a disclosure statute, rather more than that.\textsuperscript{998}

\textbf{7.2.2.1.2.3 The Context of Prospectus Requirement and the Basic Disclosure Rule in Ontario}

A prospectus is generally understood as a document that contains detailed information concerning an offering of security so that the potential investor(s) can make an informed decision on investment in it. Subject to exemptions\textsuperscript{999} Ontario law requires that no person or company can \textit{trade} in a \textit{security} without a prospectus being accepted by the OSC provided such a trade is a \textit{distribution} of such security.\textsuperscript{1000} In brief, here “security” includes an instrument falling within any of the following three groups: (a) common securities (e.g., shares, and bonds and debentures); (b) less common securities (e.g., a certificate of interest in oil, natural gas or mining lease); and (c) non-exclusive securities (e.g., investment contract).\textsuperscript{1001} Secondly, in the present context, “trade” is defined to include-

\begin{itemize}
\item \textsuperscript{996} \textit{Ibid.}, s. 52. For discussion on this provision, see Baillie, ‘The Protection of the Investor in Ontario’, (1965) 8 Can. Pub. Adm. 172 at p. 220..
\item \textsuperscript{998} Baillie, \textit{supra} note 996, at p. 232.
\item \textsuperscript{999} See text accompanying notes 1014-1023, \textit{infra}.
\item \textsuperscript{1000} OSA s. 53(1).
\item \textsuperscript{1001} Mark R Gillen, \textit{Securities Regulation in Canada} (2\textsuperscript{nd} edn, 1998, Carswell) p 107. Sec. 1(1) of the OSA enumerates a list of 16 instruments within the ambit of “security”. This list is not, however, exhaustive. It is broadly interpreted to include instruments beyond the list with an aim to protect the investor interest. For details, see Gillen, above, pp 107-120.
\end{itemize}
(1) ‘any sale or disposition of a security (in the primary or secondary market) for valuable consideration,’

(2) transactions on behalf of others, e.g., participation as a floor trader in a security in any stock exchange”

(3) ‘transfer, pledge or encumbrancing of securities (by control persons) … for the purpose of giving collateral for a debt made in good faith,’ and

(4) ‘any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of ‘any of the above mentioned branches of trades, e.g., an offer to sell. Finally, a trade in security amounts to a “distribution” in any of the following circumstances and gives rise to the need of a prospectus:

1. A trade in securities that have not been previously issued;

2. A trade by an issuer in securities previously issued after they have been redeemed or purchased back by or returned to him or her or it as gifts (e.g., resale or offer for resale);

3. A trade by a control person of an issuer in securities released from his or her or its holdings;

4. A resale of securities by a person who purchased them under an exempt situation that does not need a prospectus to be published.

It may be concluded that if in a given situation a document can be identified as a “security” and a transaction as a “trade” falling within any of the four types of distributions, ‘(t)here can be no question but …the filing of a prospectus,'
(because) its acceptance by the Commission (OSC) is fundamental to the protection of the investing public."  

However, prospectus is not required under certain circumstances defined mainly under OSA sections 72-73 and OSC Rules 45-501, 45-502 and 45-503. In addition the OSC has got discretion to grant exemptions from prospectus requirement under OSA section 74(1). The statutory exemptions include, among others, the following broad types:

(a) where the investors do not need prospectus protection, e.g., accredited investors like banks, trust corporations and insurance companies;

(b) where the securities are of safe nature and do not need securities regulation protection, e.g., bonds, debentures, or other evidences of indebtedness of or guaranteed by the Government of Canada, any province or territory or any foreign government;

(c) where the buyers of securities have alternative protection mechanism in use, e.g., statutory amalgamation, takeover or merger of companies;

(d) where exemptions are granted on particular policy reasons, which include(i) closely-held issuer issuing securities of value of up to 3

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1011 Op cit n 15.
1012 OSA s. 1(1) “distribution” and s. 72(4), (5) and (6).
1014 For detail, see Jeffrey G. MacIntosh and Christopher C. Nicholls, Securities Law (Toronto: Irwin Law, 2002) at pp. 179-192.
1015 OSA, s. 73(1)(a) and 35(2)(1)(a).
1016 OSA, s. 72(1)(i) and Rule 45-501, s. 2.8.
1017 Sec. 2.1 of Rule 45-501 defines a closely-held issuer as an issuer who may transfer shares only with the approval either of the board of directors or shareholders and whose outstanding securities are beneficially owned by not more than 35 persons or companies excluding (a) accredited investors (like banks, insurance companies, trust corporation) defined under sec. 1.1 of the Rule and (b) current or former directors, officers or employees, or present or past consultants defined in Rule 45-503.
million Canadian dollars,\(^{1019}\) (ii) trades to consultants, employees and executives,\(^{1020}\) (iii) government incentive securities defined as securities having link with Canadian exploration, development or oil and gas property expense under the federal Income Tax Act,\(^{1021}\) (iv) prospectors, prospecting syndicates and mining companies,\(^{1022}\) (v) securities issued by issuers organised for the purposes of education, benevolence, charity, religion or recreation without profits.\(^{1023}\)

In respect of a distribution of securities (as defined above) requiring prospectus section 56 of the OSA sets out two basic principles of prospectus disclosure. First, a prospectus must provide “full, true and plain” disclosure of all “material facts” concerning the securities proposed to be distributed, which must be confirmed by certification of the issuer\(^{1024}\) and underwriter(s)\(^{1025}\). A “material fact” means ‘a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of such securities.’\(^{1026}\) The term is of undefined scope because whatever fact has actual significant effect or is likely to have such effect on the price or value of securities must be subject to disclosure. Whether a particular fact has such actual or probable effect depends on the circumstances of every particular case. Though such facts have been specified for disclosure elsewhere,\(^{1027}\) they are not exhaustive. The responsibility lies on the issuer to ensure disclosure of all such facts, specified or not, accurately and in an understandable fashion. Second, the prospectus must comply

\(^{1019}\) OSC Rule 45-501, s. 2.1.  
\(^{1020}\) OSC Rule 45-503.  
\(^{1021}\) OSC Rule 45-503, s. 2.13.  
\(^{1022}\) OSA, ss. 73(1)(a) and 35(2), paras. 11-14.  
\(^{1023}\) Ibid., ss. 73(1)(a) and 35(2), para. 7.  
\(^{1024}\) OSA, s. 58(1).  
\(^{1025}\) OSA, s. 59(1).  
\(^{1026}\) OSA, s. 1(1) “material fact”. The Canadian Securities Administrators (CSA) made an attempt to amend the definitions of “material fact” and “material change”, but dropped it because they did not
with the requirements of the OSA\textsuperscript{1028}, and must contain or be accompanied by financial statements, reports or other documents that are required by the OSA or regulations.\textsuperscript{1029} This means that a prospectus must, in order to fulfil the requirement of full, true and plain disclosure, conform to the prescribed form and contain the facts, information and reports, etc. required by the securities law.\textsuperscript{1030}

7.2.2.1.2.4 Contents of Prospectus

In order to supplement the basic disclosure requirements provision of the OSA the OSC issued rule 41-501\textsuperscript{1031} requiring an issuer to prepare a prospectus according to Form 41-501F1\textsuperscript{1032} and the rule itself.\textsuperscript{1033} The following will state the summary contents of an Ontario prospectus according to that form and the rule, which are followed, through reproduction, in most of other provinces and territories.\textsuperscript{1034}

It is noted in this context that because, an issuer making an MJDS offering must have 12-month reporting history, it qualifies Canadian short form prospectus distributions,\textsuperscript{1035} which entitles it to file a short prospectus instead of a long one containing full detailed categories of information enumerated below. It is a cost-effective method devised to avoid repetition of those matters that are already on the OSC’s file and are inserted in the prospectus by reference, to which the investing public may have access on payment of fees. Although an issuer making an MJDS offering uses a short form prospectus, the following overview is justified in view of the need of receive favourable opinions from commenters. (2000), 23 O.S.C.B. 7383. For the concept of “material change”, see the text accompanied by notes 1192-1200, infra.

\textsuperscript{1027} See Form 41-501F1. See further ch. 7.2.2.1.2.4.1, infra.
\textsuperscript{1028} OSA, s. 56(1).
\textsuperscript{1029} Ibid., s. 56(2).
\textsuperscript{1030} See Victor P. Alboini, Securities Law and Practice, 2nd ed. (Toronto: Carswell, 1984), at p. 15-11.
\textsuperscript{1032} Form 41-501F1 is a replacement of previous forms 12, 13 and 14 applicable to industrial, finance, and natural resources companies respectively.
\textsuperscript{1033} OSC rule 41-501, s. 1.1.
\textsuperscript{1034} Supra note 948.
\textsuperscript{1035} National Instrument 44-101, Short form prospectus distributions, s. 2.2.
facilitating comparison between the typical prospectus requirements of Ontario and those of the EC.

7.2.2.1.2.4.1 Non-Financial Disclosure Requirements

The non-financial information subject to disclosure according to Form 41-501F1 may be grouped into a number of categories. Among others the following categories of information are included:

(1) Securities, Price, Market, Underwriting and Distribution: This category requires, among others, disclosure of selling price, underwriting discounts or commission, proceeds to the issuer\textsuperscript{1036} market for securities,\textsuperscript{1037} the plan of distribution of securities\textsuperscript{1038}, details of securities (e.g., attaching rights and their limitations, if any)\textsuperscript{1039}, information about options to purchase (e.g., purchase warrants or rights) securities of the issuer held by, among others, its executive officers as a group, upon completion of distribution\textsuperscript{1040}, information about sales of securities prior to distribution\textsuperscript{1041}, screwing of securities\textsuperscript{1042}, the description of the principal holders of the voting securities,\textsuperscript{1043} and relationship between the issuer and the underwriter\textsuperscript{1044}

(2) Utilisation of Proceeds: This covers the requirement of furnishing the net proceeds of the securities likely to be received by their sale and also the purposes for which those proceeds will be applied\textsuperscript{1045}

(3) Risk Factors: These include factors that make investment in the securities being offered risky or speculative\textsuperscript{1046}

\textsuperscript{1036} Form 41-501F1, Item 1.4.
\textsuperscript{1037} Ibid., Item 1.7.
\textsuperscript{1038} Ibid., Item 19.
\textsuperscript{1039} Ibid., Items 10.
\textsuperscript{1040} Ibid., Item 12.
\textsuperscript{1041} Ibid., Item 13.
\textsuperscript{1042} Ibid., Item 14.
\textsuperscript{1043} Ibid., Item 15.
\textsuperscript{1044} Ibid., Item 24.
\textsuperscript{1045} Ibid., Item 7.
\textsuperscript{1046} Ibid., Item 20.
(4) **Present Standing and History:** Within this category are included incorporation details of the issuer,\(^\text{1047}\) intercorporate relationship,\(^\text{1048}\) description of the issuer’s business and property with history,\(^\text{1049}\) earnings coverage,\(^\text{1050}\) description of the promoters and gains received from and returns made to the issuer by them,\(^\text{1051}\) legal proceedings to which the issuer is a party or of which its property is subject,\(^\text{1052}\) and material contracts\(^\text{1053}\) (e.g., an underwriting agreement).

(5) **Management:** This category of information includes details (e.g., addresses, backgrounds) of the directors and officers of the issuing company, their executive compensation and indebtedness.\(^\text{1054}\) Also required to disclose are the interests of the company’s management and others in any material transactions to which it (the company) was or will be a party.\(^\text{1055}\)

(6) **Selected Consolidated Financial Information and Management’s Discussion and Analysis (MD & A):** Item 8 of Form 41-501F1 requires consolidated financial data for the last three completed financial years and for any period after the most recent financial year having been over. It also calls for data for each of the eight most recently completed quarters ending with most recently completed financial year. These data are derived from the financial statements incorporated in the prospectus. The management of the issuer makes a discussion on the current financial results, position and future prospects based on the financial statements.

(7) **Purchasers’ Statutory Rights of Withdrawal and Rescission:** Item 31 requires a prospectus to embody a statement of purchaser’s rights enshrined in the OSA,\(^\text{1056}\) which

\(^{1047}\) Ibid., Item 4.1.  
\(^{1048}\) Ibid., Item 4.2.  
\(^{1049}\) Ibid., Items 6.  
\(^{1050}\) Ibid., Item 9.  
\(^{1051}\) Ibid., Item 21.  
\(^{1052}\) Ibid., Item 22.  
\(^{1053}\) Ibid., Item 27. For the definition of “material contract”, see text accompanied by note 1026, infra.  
\(^{1054}\) Ibid., Items 16, 17 and 18.  
\(^{1055}\) Ibid., Item 23.  
\(^{1056}\) OSA, s.60.
include the rights to prospectus delivery\textsuperscript{1057} and withdrawal from a securities purchase agreement,\textsuperscript{1058} and to damages or rescission in the event of misrepresentation in prospectus or in its amendment\textsuperscript{1059}.

(8) Miscellaneous Category: An issuer is obliged to disclose in its prospectus other material facts that are not covered by any of the above categories.\textsuperscript{1060}

### 7.2.2.1.2.4.2 Financial Disclosure Requirements

In addition to the non-financial matters an Ontario prospectus must contain the following financial statement and documents:

(1) Financial Statements: An issuer is required to include in its prospectus statements of income, retained earnings and cash flows, and a balance sheet,\textsuperscript{1061} (both for annual and consolidated accounts) which are prepared according to the generally accepted accounting principles (GAAP) of Canada,\textsuperscript{1062} (which, to the context of MJDS offerings, must be reconciled with the US GAAP described below\textsuperscript{1063}). The OSC Director, responsible for receiving prospectus, may waive the requirement of any of these statements.\textsuperscript{1064} These statements must be audited and the auditor’s reports accompanying them must be prepared according to the generally accepted auditing standards (GAAS) of Canada.\textsuperscript{1065} It may be noted that with respect to MJDS offering the auditor’s independence is governed by the US law.\textsuperscript{1066}

\textsuperscript{1057} Ibid., s. 71(1).
\textsuperscript{1058} Ibid., s. 71(2).
\textsuperscript{1059} Ibid. s. 130.
\textsuperscript{1060} Form 41-501F1, Item 29.
\textsuperscript{1061} OSC Rule 41-501, s. 4.1.
\textsuperscript{1062} Ibid., s. 9.3(1); OSAR, s. 2(5). The Canadian GAAP, like the GAAP, is defined in the \textit{Canadian Institute of Chartered Accountants Handbook (CICA Handbook), National Policy No. 27, sub-pts. 3.1 and 3.2.}
\textsuperscript{1063} OSC Rule 41-501, s. 15.1.
\textsuperscript{1064} See ch. 7.2.2.1.2.4.3, infra.
\textsuperscript{1065} See ch. 7.2.2.1.2.4.4, infra.
To the above financial statements must be added the financial statements of a credit supporter who guarantees all or substantially all of the payments to be made under the securities to be distributed under the prospectus provided the credit supporter were the issuer of the securities being distributed.\(^{1067}\) Such statements must also be accompanied by auditor’s report.\(^{1068}\) In respect of its acquisition or probable acquisition of business an issuer must include additional financial statements plus audit report therefor.\(^{1069}\) Where the issuer has made significant dispositions of business during the current or recently completed financial year, it must include, in addition to the (usual) financial statements, pro forma financial statements (pro forma balance sheet, pro forma income statement, pro forma earnings per share) to give effect to such dispositions.\(^{1070}\)

(2) Financial Forecasts/Projections\(^{1071}\): An issuer, at its option, can add a financial forecast or projection (also called Future-oriented Financial Information-FOFI) to a prospectus, which discloses ‘information about prospective results of operations, financial position or changes in financial positions (of the issuer), based on assumptions about future economic conditions and courses of actions’\(^{1072}\).

7.2.2.1.2.4.3 GAAP Reconciliation

All US MJDS registration forms (except Form F-7) permit preparing of financial statements according to Canadian GAAP with one reservation that the SEC rules of auditor’s independence will apply to auditor’s report for most recent fiscal year

\(^{1067}\) OSC Rule 41-501, s. 5.1.
\(^{1068}\) Ibid., s. 5.3.
\(^{1069}\) Ibid., parts 6 and 7.
\(^{1070}\) Ibid., part 8.
\(^{1071}\) Future-Oriented Financial Information (FOFI) may be either a forecast or a projection. Both of them reflect the issuer’s planned action generally for a maximum period of 24 months. The difference between them is that preparing a project requires “hypotheses” that mean ‘assumptions that assume a set of economic conditions or courses of action that are consistent with the issuer’s intended course of action and represent plausible circumstances’. A projection is less reliable than a forecast. National Policy 48, pt. 2.
\(^{1072}\) Ibid.
for which financial statements have been included. The independence rules also apply to reports for any prior years filed otherwise with financial statement by the registrant with the SEC. For registration on Form F-10 (which applies to any kind of securities) only it is also required that the financial statements must be reconciled from Canadian GAAP to the US GAAP as specified in Item 18 of the SEC Form-F, purpose of which is, among others, ‘to provide protection to US investors and to have one regime for both domestic and foreign registrants’. The reconciliation statement will discuss the material variations between the US GAAP and Canadian GAAP in preparing the financial statements. Such variations must be quantified between these two GAAPs both as to the income statement and the balance sheet. It is also required of a (Canadian) foreign private issuer to provide all other information required by the US GAAP and Regulation S-X. This means that such issuer must make required supplemental disclosures including segmental information, pension information and supplemental financial information for gas and oil producers. While reporting on financial statements included in the MJDS registration forms (except Form F-7) accountants should consider Canadian auditing guidelines with respect to any US-

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1073 SEC Form F-8, General Instructions V-B, Form F-9, General Instructions III-B, Form F-10, General Instructions III-B.
1074 The SA 1933 Regulation S-X defines “registrant” as “the issuer of the securities for which an application or a registration statement or a report is filed”. Item 1-02(t).
1076 This GAAP reconciliation requirement was supposed, originally agreed, to cease in 1993. But by 1993 amendment to the MJDS this sunset provision was rescinded. See Bloomenthal, supra note 902, at p. 27-541.
1077 Company Reporting Limited, SEC Filing by Non-US Companies, (London: International Accounting Standards Committee, c2000), at p. 5. A recent research shows that ‘Canadian and US GAAP numbers are closely substitutes and as such, investors are not likely to be deprived of valuable information either through harmonisation or if Canadian SEC registrants are allowed to report domestically using US GAAP.’ S.P. Bandyopadhyay, and A.S. Hilton, ‘A re-examination of reconciling items between Canadian and United States GAAP’, (2002) 28(3) Manag. Fin. 37, at p. 37.
1078 SEC Form 20-F, Item 17(c)(2)(i)-(ii), as required by Item 18(1).
1079 Ibid., Item 18(2).
1080 Bloomenthal, supra note 902, at pp. 27-470 and 27-540.
Canada reporting conflict as to contingencies and going concern considerations.\textsuperscript{1081} If any comments appropriate under these guidelines for the US readers are not included in the prospectus, those should be added as legends.\textsuperscript{1082}

\textbf{7.2.2.1.2.4.4 Legends}

While a US MJDS prospectus is prepared according to Canadian format and requirements, it must contain legends on the front cover page or on a sticker thereto in order to caution the readers about some important matters as required by the SEC Registration Forms.\textsuperscript{1083} First, it must contain a statement to the effect that the SEC has not approved or disapproved the securities being offered nor has it judged the merit of the prospectus, and any representation to the contrary is a criminal offence. Second, if it is a preliminary prospectus, it must say in effect that a copy of the prospectus has been submitted with the SEC and is subject to completion or amendment and does not constitute an offer to sell or a solicitation of an offer to buy securities. In addition, it must include the following type of informational legends:

1. The issuer is a Canadian one and is permitted to prepare the prospectus according to the home country requirements that are different from those of the US. The financial statements are drawn up following the Canadian GAAP and as such may not be comparable to the financial statements of the US companies.

2. The acquisition of securities offered hereby may have tax consequences both in the US and Canada, and such consequences to a US citizen may not be fully described in the prospectus.

\textsuperscript{1081} SEC Forms F-9 and F-10, General Instructions III-C, and Forms F-8 and F-80, General Instructions V-C.
\textsuperscript{1082} Ibid.
\textsuperscript{1083} SEC Form F-10, Part I, Item 3, and other forms, Part I, Item 2.
3. Civil liabilities enforcement under the federal securities laws may be adversely affected inasmuch as (i) the issuer is incorporated or organised under foreign (Canadian) laws, (ii) some or all of the officers and directors of the issuer, and the some or all of the underwriters and experts may be residents of that foreign country, (iii) all or a substantial portion of the assets of the issuer and such persons may be located outside of the US.

4. The prospectus should also include any legend or information required by the laws of any jurisdiction where the securities are to be offered.

5. In respect of an exchange offer, the prospectus must include a legend to the effect that the registrant or its affiliates may bid for or make purchases of the securities to be distributed or to be exchanged or certain related securities as permitted by Canadian law.

7.2.2.2 Regulatory Review

Where an exemption\textsuperscript{1084} is not available, an issuer must file a preliminary prospectus with the OSC along with requisite documentation like underwriting agreement, financial statements, etc.\textsuperscript{1085} If it seems to substantially comply with the requirements of the securities legislation\textsuperscript{1086}, the Director may issue a receipt right away.\textsuperscript{1087} Thereafter the Director’s office vets the prospectus to determine whether the required items of disclosure have been provided and whether there are any

\textsuperscript{1084} Primarily exemptions from the prospectus requirement are available under Sec.s 72-73 of the OSA, or under sec. 14 of the OSAR. Second, they may be granted by the OSC, under sec. 74(1) of the OSA at its discretion where statutory exemptions are not applicable.

\textsuperscript{1085} See, for example, OSA s. 54, OSAR, ss. 53-55 and OSC Policies, ss. 5.1 and 5.7.

\textsuperscript{1086} OSA s. 54(1).

\textsuperscript{1087} Ibid, s. 55.
gaps in the information that are apparent from the material filed. If it detects any
default, it will ask the issuer to correct it. After correction by the issuer, the Director
may issue the final receipt, which is the key to sale and purchase of securities.

The OSC goes beyond the disclosure requirement and may exercise its
discretion to refuse to receipt a prospectus in “public interest” in general and on
some defined grounds in particular. “Public interest” means, inter alia, ‘(s)omething
in which the public, the community at large, has some pecuniary interest, or some
interest by which their legal rights or liabilities are affected.’ The OSC is
empowered to decide ‘what the public interest is and whether the issuance of the given
receipt is contrary to that public interest.’ It exercised this power first in Rivalda
Investment Corporation Ltd. where a company proposed to seek funds from the
public to invest in purchasing securities of speculative mining companies. The
Directors of the company did not have any experience in the proposed business. The
OSC considered them as the asset or liability of the company because ‘(u)pon their
ability to assess the merits of the securities they propose to purchase will depend the
success or failure of the company’ Therefore, on the public interest ground it
declined to accept the prospectus of the company until qualified directors were
appointed. This decision has been followed in subsequent cases to uphold the public
interest that constitutes ‘the paramount consideration’ for the OSC in the protection of
the investing public.

1089 OSA s. 61(1).
1090 OSA s. 61(1).
1091 Ibid, s. 61(2).
1092 Black’s Law Dictionary, 6th edn., s.v “public interest”.
1093 Ibid, supra note 1030, p 15-29. (Securities Law and Practice (2nd edn, 1984, Carswell))
1095 Ibid, p 3.
1096 See, for example, Great Pines Mines Ltd., [February 1966] O.S.C.B. 7; United Security Fund,
2679.
Apart from the “public interest” the Director is empowered, under s. 61(2) of the OSA, to refuse to receipt a prospectus when

(a) the prospectus or any document required to be filed therewith contains any statement, promise, estimate or forecast that is misleading, false or deceptive\(^{1098}\);

(b) an unconscionable consideration has been paid or given, or is intended to be paid or given, for promotional purposes or for the acquisition of property\(^{1099}\);

(c) the proceeds from the sale of securities proposed to be offered by the prospectus, together with other resources of the issuer, would be insufficient to accomplish the purpose of the issue as stated in the prospectus\(^{1000}\);

(d) ‘it is relatively clear that the persons (like issuer, officer, director or promoter or control person) …are experiencing financial difficulties, or have been subject to disciplinary or enforcement proceedings in securities or criminal matters’\(^{1101}\).

(e) there is a need of escrowing shares, but an agreement to that end has not been executed\(^{1102}\);

(f) any of the professionals like lawyers, engineers, accountants who have prepared or certified any report or valuation used in or in connection with a prospectus is not acceptable.\(^{1103}\)

However, while a prospectus is filed with a Canadian regulatory authority, the issuer is also required to file a copy of it with the SEC. There is no particular time specified for such filing.\(^{1104}\) It is of course recommended that the issuer should not unduly delay the filing because ‘the registration statement cannot become effective until it is filed and no

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1101 Alboini, supra note 1030, p 15-37.


1104 Bloomenthal, supra note 939, at p. 842.
pre-effective selling effort can be undertaken until filed.\footnote{1105} In respect of an offering contemporaneously made in Canada and the US the registration statement and any amendment thereto on any of the forms becomes effective upon its filing with the SEC except where, in the case of a statement on Form F-9 or F-10, it is designated on the cover page as a preliminary material.\footnote{1106} Where an offering is made solely in the US on Form F-9 or F-10, the registrant may name, on the facing page of the registration statement or an amendment thereto, an effective date that is more than seven days from the date of filing of the statement.\footnote{1107} If, however, before the seven-day limit the concerned Canadian regulatory authority issues a receipt or a clearance notification, the statement or amendment thereto will take effect by order of the SEC as soon as practicable from the time of its receiving of such receipt or notification from the registrant or the said Canadian regulatory authority.\footnote{1108} Thus the prospectus and other documents composing the registration statement receive a “no review” status in the US except in the “unusual case” where the SEC staff ‘has reason to believe there is a problem with the filing or the offering’.\footnote{1109} For example, dubious GAAP reconciliation may be a ground of the SEC review. In 1996 the SEC staff selected some offerings on Form F-10 for review and came to find that except one all filings were ‘significantly deficient’ because the Canadian GAAP was not duly reconciled with the US GAAP.\footnote{1110}

\subsection*{7.2.2.3 Continuous Disclosure Requirements}

A Canadian foreign private issuer registering securities on an MJDS form is generally required by Section 15(d) the (US) Exchange Act of 1934 to file

\footnote{1105} \textit{Ibid.}
\footnote{1106} \textit{SA 1933}, rule 467(a).
\footnote{1107} \textit{Ibid.}, rule 467(b).
\footnote{1108} \textit{Ibid.}
\footnote{1109} \textit{MJDS Release, supra} note 919, at p. 0270.
annual and interim reports specified by Section 13(a). If the registrant, at the time of filing any of F-7, F-8 or F-80 Forms, relies on Rule 12g3-2(b) exemption from registration under the Exchange Act, the reporting obligation under Section 15(d) will not arise. Such exemption is not available for registration on Forms F-9 or F-10. However, where Section 15(d) obligation arises for an MJDS registrant, it is required to file annual reports on Form 40-F provided this reporting obligation arises because of such registration. If an MJDS issuer wants to list securities on a US stock exchange, or to quote them on the NASDAQ to be traded, the Rule 12g3-2(b) exemption will not apply. The issuer will have to register the class of securities as required by Section 12 and afterwards file annual reports as specified by Section 13(a) using Form 20-F. But if the securities and issuer meet the eligibility requirements of Form F-9 or F-10, it can register and subsequently report on Form 40-F.

The above paragraph makes it clear that Canadian issuers making MJDS offerings and also certain eligible issuers, who are not entitled to the Rule 12g3-2(b) exemption, must meet annual reporting requirement on Form 40-F. They must file home country information material to making investment decision, which the issuer has, since the beginning of the last fiscal year, made public, filed with a securities exchange or distributed to securities holders. The annual reporting include, among

1111 Sec. 13(a) of the SEA 1934 provides for filing by an issuer of securities registered under Sec. 12 such annual and quarterly reports and other information as may be required by the SEC through rules and regulations promulgated by it.
1112 Rule 12g3-2(b) grants exemption from Sec. 12(g) of the SEA 1934 registration provided, for example, the issuer shall furnish the SEC with (a) the information that it has made or is required to make public pursuant to the law of the country of domicile or incorporation or organisation, or (b) information that the issuer has filed or is required to file with a stock on which its securities are traded and which is made public by such exchange, or (c) information that the issuer has distributed or is required to distribute to its securities holders.
1113 The SEA 1934, Rule 12h-4.
1114 Bloomenthal, supra note 939, at p. 842.
1115 Form 40-F, General Instructions, A(1). Form 40-F can be used by some other Canadian issuers not previously registering securities on an MJDS form provided they fulfil certain specified conditions, see Form 40-F, General Instructions, A(2).
1116 See supra note 1111.
1117 Bloomenthal, supra note 902, at p. 27-561.
1118 SEC Form 40-F, General Instructions, B(1).
others, Canadian Annual Information Form, audited financial statements and accompanying management’s discussion and analysis. The annual financial statements (except for Form F-9 reporting) must include a reconciliation to US GAAP according to Item 17 of Form 20-F. The SEC’s rules of auditor’s independence applies to such statements. In addition, the registrants must furnish Canadian interim reports, for example, interim financial statements and material change reports, on Form 6-K. Thus Forms 40-F and 6-K serve as the wrap-around for annual and interim reports prepared according to Canadian law. Information on Form 40-F must be filed with the SEC on the same day when it is done with the Canadian securities regulatory authority. Information on Form 6-K must be supplied with the SEC “promptly” after they are disclosed to the public, filed or disseminated.

Founded on the (US) Securities Exchange Act of 1934 Canadian continuous disclosure system was adopted in 1966 initially in Ontario through reforming the Ontario Securities Act (OSA) as recommended by the Kimber Report in order to increase public confidence in the securities industry. Provisions requiring periodic disclosure in the form of financial statements, insider reports and proxy circulars thus took place in the securities legislation. By the late 1960s material change reporting requirement was contained in the OSC Policy Statements. Later Merger

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1119 SEC Form 40-F, General Instructions B(3).
1120 Ibid., General Instructions C(2).
1121 Ibid., General Instructions, C(1).
1122 GAAP reconciliation requirement does not apply to such interim statements.
1123 Form 40-F, General Instructions B(3).
1125 Ibid.
1126 By 1968 some other provinces, e.g., Alberta, Manitoba, British Columbia, Saskatchewan, adopted the continuous disclosure provisions in their securities statutes.
1128 Ibid., at para. 1.11.
Report\textsuperscript{1130} recommended some modifications to the continuous disclosure system, which included, among others, requirement for quarterly financial reports. Thus the Ontario continuous disclosure system has developed over time. In the following the disclosure documents required to be filed with the OSC are briefly discussed. Since similar documents are called for by the stock exchange,\textsuperscript{1131} a simultaneous discussion on them has been avoided.

A. Financial Statements:

a. Annual Financial Statements

A reporting issuer\textsuperscript{1132} must file annual financial statements with the securities administrators within 140 days after the end of its financial year.\textsuperscript{1133} They are the key components of annual reports supplied to the security holders summarising the issuer activities during the past fiscal year. These statements include a balance sheet, an income statement, a statement of retained earnings, and a cash flow statement.\textsuperscript{1134} They must contain comparative figures for the preceding financial year.\textsuperscript{1135} Those statements must be delivered to shareholders.\textsuperscript{1136}

(b) Interim Financial Statements

In addition to the annual financial statements, a reporting issuer must file interim financial statements at the end of three, six and nine months of each financial year within 60 days of the end of each period.\textsuperscript{1137} OSC Rule 52-501 requires


\textsuperscript{1131}See Mark R. Gillen, Securities Regulation in Canada, 2nd ed. (Scarborough, Ontario: Carswell, 1998) at pp. 175-176, 193-194. For example, similar to the OSC’s the Toronto Stock Exchange (TSE) requires annual financial statements, interim financial statements and material change reports. See TSE By-laws 19.08, 19.07, 19.09, and TSE Policies part I.

\textsuperscript{1132}According to s. 1(1) of the OSA “reporting issuer” includes an issuer that has issued securities through a prospectus or has securities listed and posted for trading on any stock exchange in Ontario recognised by the OSC regardless of the date of commencement of such listing or posting.

\textsuperscript{1133}OSA, s. 78(1).

\textsuperscript{1134}OSC Rule 52-501, s. 2.1(1).

\textsuperscript{1135}OSA, s. 78(1).

\textsuperscript{1136}Ibid., s. 79.

\textsuperscript{1137}Ibid., s. 77(1).
some additional interim statements.\textsuperscript{1138} These interim statements include a balance sheet, an income statement, a statement of retained earnings and cash flow statement.\textsuperscript{1139} They must present comparative financial information for the corresponding period in preceding financial year.\textsuperscript{1140} They need not, however, accompany an auditor’s report.\textsuperscript{1141} These statements must be delivered to the shareholders\textsuperscript{1142} and filed with the securities administrators.\textsuperscript{1143}

Both types of financial statements, viz. the annual and interim financial statements mentioned above, must contain significant information.\textsuperscript{1144} At the same time ‘the prospectus principle of full disclosure of all material facts equally applies to financial statements’.\textsuperscript{1145} Unless exempted\textsuperscript{1146} they must be prepared according to the Canadian GAAP and also any applicable provisions of the OSA or the OSAR.\textsuperscript{1147} Only the annual financial statements must be audited by independent auditors\textsuperscript{1148} applying Canadian Generally Accepted Auditing Standards (GAAS).\textsuperscript{1149} As mentioned earlier, for the MJDS purpose the auditor must be independent within the meaning the US law, and the annual financial statements must be reconciled with the US GAAP.

B. Annual Information Forms (AIFs) and Management Discussion & Analysis (MD&A)

\textsuperscript{1138} OSC Rule 52-501, s. 2.2(2).
\textsuperscript{1139} Ibid., s. 2.2 (1).
\textsuperscript{1140} Ibid., s. 2.2(1) and (2).
\textsuperscript{1141} Ibid., s. 2.2(10).
\textsuperscript{1142} OSA, s. 79 and OSC Rule 52-501, part 2.2(9).
\textsuperscript{1143} OSA, s. 77(1).
\textsuperscript{1144} OSAR 1015, s. 2(7).
\textsuperscript{1145} Johnston and Rockwell, supra note 895, at p. 91.
\textsuperscript{1146} Where it will not be prejudicial to the public interest, the OSC may grant exemptions from the requirement of financial statements. Those exemptions may be grouped as thus: variation from the GAAP (OSAR, s. 2(4)), particular omissions from disclosure (OSA, s. 80(a), conflict with the laws of some other jurisdiction (OSA, s. 80(b)(i)), distribution of financial information in a form different from that required by the statute (OSA, s. 80(b)(ii)), and general exemptions. See, for discussion, Gillen, supra note 1129, at pp. 150-153.
\textsuperscript{1147} OSAR, s. 2(1).
\textsuperscript{1148} National Policy No. 3 define who are not independent and therefore not acceptable to the securities authorities.
\textsuperscript{1149} Canadian Institute of Chartered Accountants (CICA), CICA Handbook, S. 5100.
OSC Rule 51-501, effective 31 December 2001, provides for an ongoing requirement of filing an AIF and annual MD&A and interim MD & As. The filing obligation is imposed on any reporting issuer, other than a mutual fund, that had an aggregate market value of the outstanding securities of minimum Can $75,000,000 on the last day of the completed financial year. Such an issuer is obliged to file an AIF prepared in compliance with Form 44-101F1 for each financial year within 140 days after the end of the financial year. An AIF is meant ‘to provide relevant background material essential to proper understanding of the nature of the issuer, its operations, and prospects for the future’. It contains, among others, information about the issuer’s business, financial data for the last completed financial years, consolidated financial information, details about the directors and officers. To these, most importantly, is added the MD&A prepared in accordance with Form 44-101F2, which is ‘supplemental analysis and explanation that accompanies, but does not form part of, an issuer’s the financial statements’. Through this the management can explain its present financial position and future prospects, which enables the investors to learn about the issuer’s past and prospective financial performance. The issuer must deliver this annual MD&A to all securityholders concurrently with the sending to them the annual audited financial statements to which it relates.

An issuer that files an AIF for a financial year is required to file in the following year, concurrently with the filing of interim financial statements, an interim MD&A. Such an MD&A is prepared according to section 4.2 of OSC Rule 51-501, which provides that it include

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1150 OSC Rule 51-501, s. 1.2.
1151 Ibid., s. 2.1(1).
1152 Form 44-101F1, Instruction (1).
1153 Form 44-101F2, Instruction (1).
1154 Ibid.
1155 OSC Rule 51-501, s. 3.1.
1156 OSC Rule 51-501, s. 4.1.
(a) an update of the analysis of the issuer’s financial conditions contained in the immediately previous annual MD&A;

(b) an analysis of the issuer’s results from operations and cash flows for the interim period most recently over; and

(c) a comparison of the issuer’s financial condition, results of operations and cash flows of the most recent interim periods and the corresponding periods of the previous year.

The interim MD&A must address changes in results of operations that are material.\(^{1157}\)

A change is material if ‘its omission or misstatement would influence or change an investment decision with respect to the issuer’s securities’.\(^{1158}\) Furthermore, seasonal aspects of the issuer’s business having material impact upon financial condition, results of operations or cash flows must be disclosed.\(^{1159}\) The issuer must send the interim MD&A to the securityholders, concurrently with despatching them interim financial statements to which it relates.\(^{1160}\)

C. Proxy/Information Circular Disclosure

In Canadian securities regulation “proxy” is used to mean a completed and executed form of proxy by means of which a security holder has appointed a person or company as the security holder’s nominee to attend and act for and on the security holder’s behalf at a meeting of security holders’.\(^{1161}\) The nominee must vote as instructed by the security holder. The management or shareholder(s) of a reporting issuer may solicit proxies.\(^{1162}\) In order that the shareholders can make informed

\(^{1157}\) Ibid., s. 4.2(3).

\(^{1158}\) Companion Policy 51-501CP, s. 2.3(3).

\(^{1159}\) OSC Rule 51-501, s. 4.2(3).

\(^{1160}\) Ibid., s. 4.3.

\(^{1161}\) OSA, s. 1(1) “proxy”.

\(^{1162}\) Ibid., ss. 85 and 86(1).
decisions on the proposed resolutions the OSA makes proxy solicitation mandatory\textsuperscript{1163} subject to exemptions\textsuperscript{1164}. It also imposes an obligation for a proxy solicitor to provide an information circular to each securityholder whose proxy has been solicited.\textsuperscript{1165} An Ontario information circulation must carry the information items prescribed in Form 30, which include the following:

(i) material interests of the persons soliciting proxy in the matters to be voted upon (e.g., interests of directors and senior officers where the solicitation is made by the management);\textsuperscript{1166}

(ii) the number of securities outstanding and particulars of voting rights for each security of each class of voting securities of the reporting issuer entitled to be voted at the meeting;\textsuperscript{1167}

(iii) information about persons or companies proposed as directors;\textsuperscript{1168}

(iv) statement of executive compensation;\textsuperscript{1169}

(v) indebtedness of directors, executive officers and senior officers;\textsuperscript{1170}

(vi) interests of insiders of the reporting issuer in material contracts;\textsuperscript{1171}

(vii) where management functions of the reporting issuer or any of its subsidiaries are, to substantial degree, performed by a person or

\begin{itemize}
\item \textsuperscript{1163} \textit{Ibid.}, s. 85.
\item \textsuperscript{1164} \textit{Ibid.}, s. 86(2) and 88.
\item \textsuperscript{1165} \textit{Ibid.}, s. 86(1).
\item \textsuperscript{1166} Form 30, Item 3.
\item \textsuperscript{1167} \textit{Ibid.}, Item 4(a).
\item \textsuperscript{1168} \textit{Ibid.}, Item 5(a).
\item \textsuperscript{1169} \textit{Ibid.}, Item 6.
\item \textsuperscript{1170} \textit{Ibid.}, Item 7.
\item \textsuperscript{1171} \textit{Ibid.}, Item 8.
\end{itemize}
company other than their directors or senior officers, details of the contracts under which such arrangement has been made;\textsuperscript{1172}

(viii) particulars of matters which will be submitted to the meeting of the security holders for action (other than approval of financial statements) to be taken.\textsuperscript{1173}

\textbf{D. Reports of Insider Trading with Disclosed Information}

Ordinarily, insider trading means ‘purchases or sales of securities of a company effected by or on behalf of a person whose relationship to the company is such that he is likely to have access to relevant material information concerning the company not known to the general public’.\textsuperscript{1174} Persons having such kind of advantageous position in an issuer-company are insiders. Section 1(1) of the OSA defines them to mean,

(a) every director or senior officer of a reporting issuer;

(b) every director or senior officer of a company that is itself an insider or subsidiary of a reporting issuer;

(c) any persons or company having direct or indirect beneficial ownership of, or control or direction over the securities of a reporting issuer, which carry above 10\% of the voting rights attached to all outstanding voting securities of the reporting issuer;

(d) a reporting issuer that so long holds its owns securities by purchase, redemption or otherwise.

\textsuperscript{1172} \textit{Ibid.}, Item 10.
\textsuperscript{1173} \textit{Ibid.}, Item 11.
\textsuperscript{1174} \textit{Kimber Report, supra} note 1127, at para. 2.01.
The definition also includes those insiders of an issuer, who become the insiders of a second issuer\(^{1175}\) (by way of organisational change of business, e.g., amalgamation).

Subject to complete or partial exemptions\(^{1176}\) Ontario securities legislation requires reporting issuers’ insider traders to file with the OSC reports on their direct or indirect beneficial ownership of or control or direction over its securities.\(^{1177}\) The purpose of this provision is ‘to deter illegal insider trading and to increase investor confidence in the securities market by providing investors and potential investors with information concerning the trading activities of substantial security holders and other insiders of the issuer.’\(^{1178}\) From this it is understood that insider trading in itself is not illegal. It is illegal only when insiders trade with undisclosed inside information (i.e. undisclosed material fact or material change\(^{1179}\)). In other words, trading by insiders is not illegal in itself. Thus trading with inside information by insiders is subject to sanctions.\(^{1180}\) The liability provision is also extended to any other persons\(^{1181}\) who trade with (undisclosed) inside information,\(^{1182}\)

\(^{1175}\) See OSA, s. 1(8) and 1(9).

\(^{1176}\) National Instrument 55-101 provides for exemption of certain insider reporting requirements. For example, subject to limitations a director or senior officer of a subsidiary or an affiliate of a reporting issuer is exempted from reporting in respect of securities of the reporting issuer, parts 2 and 3. In addition, the OSA empowers the Commission to exempt a person or company from the requirement of an insider trading report on its own or at the application of a person or company. It can grant exemption on such terms and conditions as it deems just and expedient. Secondly, when an interested person applies, it can award relief (a) if there is conflict between securities law requirement and a requirement of issuer’s laws of incorporation, organisation or continuation, (b) if it finds “adequate justification” in light of given circumstances. OSA, s. 121(2). For case law in this connection, see Re British American Oil Company Ltd., (June 1976) O.S.C.B. 9; Re Reeves Macdonal Mines Ltd., (June 1967) O.S.C.B. 11.

\(^{1177}\) OSA, R.S.O. 1990, c.S.5, s. 107, S.O. 1999, c.9, s.214.


\(^{1179}\) As to whether “material fact” and “material change” mean, by substance, the same things, see text accompanied by notes 1192-1200, infra.

\(^{1180}\) OSA, s. 134(1). For exemptions from the liability provisions, see OSAR, s. 175(1) and (2).

\(^{1181}\) These persons include (a) insiders, affiliates or associates of a person proposing to make a take-over bid for the reporting issuer, a person proposing to be a party to a business combination (e.g., amalgamation, merger, etc) with the reporting issuer, (b) a person engaged or proposing to be engaged in any business or professional capacity with the reporting issuer, (c) a director, officer or employee of the reporting issuer and the aforesaid take-over proposer, business combination proposer, business or professional capacity person, and (d) a tippee (a person to whom inside information is released by other person or company of the above description). OSA, s. 76(5).
but they are not required to report; reporting responsibility is on the insiders only. The
OSC publishes the summary of the insider trading reports, which is available to the
public on payment.\footnote{1183}

In Ontario an insider must file his, her or its trading report within ten
days from the day of becoming an insider, or such shorter period as may be prescribed
by the regulations.\footnote{1184} This report must disclose any direct or indirect beneficial
ownership of, or control or direction over, securities of the reporting issuer.\footnote{1185} Where
there is any change in it, the insider shall report on that to the OSC within ten days
from the day on which the change takes place, or such shorter period as may be
prescribed by the regulations.\footnote{1186} It will describe the insider’s beneficial ownership of,
or control or direction over the securities as of the day of occurrence of change plus the
change that has occurred to such ownership, control or direction.\footnote{1187} Where an insider
of one issuer becomes the insider of some other issuer\footnote{1188}, the aforementioned reporting
obligation will continue. Such an insider must file a report for the previous six months
within ten days from the day that he or she becomes insider of the second issuer, or
such shorter time as may be prescribed by the regulations.\footnote{1189}

**E. Material Change Reports**

In addition to the above types of continuous disclosure reporting
requirements, the OSA imposes a duty on a reporting issuer to report on material

\footnote{1182} OSA, s. 134(1). For exemption provisions, see OSAR, s. 175(1) and (2).
\footnote{1183} OSA, s. 120.
\footnote{1184} OSA, s. 107(1). Before 1999 an insider was required to report within ten days of the month’s end
instead of ten days of trade. The statutory change has been brought to ‘ensure that the public has access
to insider trading information on a more timely basis’ than was before. ‘Amendments to Securities Act
receive royal assent’, (1999) 22 O.S.C.B. 8066. But given the technological development the ten-day
limit is ‘too long’. Johnston and Rockwell, supra note 895, at p. 140.
\footnote{1185} OSA, s. 107(1).
\footnote{1186} \textit{Ibid.}
\footnote{1187} \textit{Ibid.}
\footnote{1188} See supra note 1175.
\footnote{1189} OSA, s. 107(3).
changes in its affairs. Its purpose is to provide a level playing field to all securities investors with respect to information and thereby to help them make investment decisions on the one hand, and to prevent the insiders from taking exclusive and abusive advantage of such information on the other.

“Material change”, where used in relation to the affairs of an issuer, is defined by the OSA as

a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer and includes a decision to implement such a change made by the board of directors of the issuer or by senior management of the issuer who believe that the confirmation of the decision by the board of directors is probable.

In effect, this definition has parity with that of “material fact” defined elsewhere because both the concepts focus on their ultimate effect on the price or value of securities. They differ only with respect to the time when their disclosure is called for.

To quote Stevens and Wortley:

[The] duty to disclose all material fact arises when a company enters the public market. Its prospectus must contain certain full, true and plain disclosure of all material facts. … Thereafter, the duty to disclose material facts is really a duty to disclose changes from the basket of facts disclosed originally and from time to time afterwards.

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1190 Ibid., s. 75(2).
1191 See Johnston and Rockwell, supra note 895, at p. 101.
1192 OSA, s. 1(1) “material change”.
1193 See text accompanied by note 1026, supra.
1194 George C. Stevens and Stephen D. Wortley, “Murray Pezim in the Court of Appeal: draining the lifeblood from the securities regulation”, (1992) 26 B.C.L. Rev 331 at p. 338-339 cited in Pezim v. British Columbia (Superintendent of Brokers) [1994] 2 S.C.R. 557 at para. 93. Here the authors focuses on the meaning and context of “material fact” and “material change” within the purview of the British Columbia Securities Regulation, which, as already mentioned somewhere in the text, is, like the securities regulations of other provinces and territories, almost similar to that of Ontario.
The said authors wrote this article after the British Columbia Court of Appeal had confounded the two terms in *Pezim*[^195], the leading case of Canada on “Material fact” and “Material change”. As to whether discovering ore in the ground through planned drilling programme was a material change the British Columbia Court of Appeal said it was a material fact and not a change. The Supreme Court of Canada overturned this decision. It relied on the above quote and held that the information was a material change.

In order to supplement the material change disclosure requirement Canadian Securities Administrators (CSA) adopted the National Policy 40 to provide guidelines as to what matters are to be disclosed.[^1196] It requires that all material information be disclosed. “Material information” means ‘any information relating to the business and affairs of an issuer that results in or would reasonably be expected to result in a significant change in the market price or value of any of the issuer’s securities’.[^1197] It ‘consists of both material facts and material changes to the business and affairs of an issuer’[^1198]. The underlying reasoning may be to stultify any attempt by an issuer to escape disclosure of a matter branding it as a fact and not a change as happened in the *Pezim*.

The said National Policy outlines some principles of timely disclosure, which must be followed by reporting issuers in the matter of reporting of material information. Those include the following[^1199]:

1. Generally issuers need not report impact of external political, economic and social developments on their affairs. If, however, an external development (e.g., change in the government’s policy) has

[^195]: *Pezim v. British Columbia*, *ibid.*
[^1196]: National Policy 40, Timely Disclosure, parts A and D.
[^1199]: *Ibid.*, part D, “Developments to be Disclosed”.

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had or will have any direct effect on the business and affairs of an issuer, which is material and untypical of the effect generally experienced by other issuers engaged in the same business or industry, the issuer should explain such particular effects.

2. Only developments material according to the definition of material information are to be disclosed. For example, issuer’s dividend decisions likely to impact on the price of securities are subject to disclosure.

3. Issuer’s proposed actions (e.g., a plan to embark on a particular business transaction) do not merit disclosure until final decisions are made with respect to them.

4. Financial forecasts need not be disclosed unless there is an indication of significant increase or decrease in earnings in the near future.

The said National Policy sets out, for example, 17 situations suitable for disclosure as material information. The extendable list of those situations include, among others,

1. changes in share owner likely to impact on the issuer’s control;
2. changes in corporate or capital structure;
3. takeover bids or issuer bids;
4. major corporate acquisitions or dispositions;
5. significant borrowing of funds;
6. sale of additional securities;
7. development of new products and developments affecting the issuer’s resources, technology, products or markets;
8. making or loss of significant contracts;
9. significant changes in management;
10. significant litigation.\textsuperscript{1200}

However, whenever there occurs a material change in a reporting issuer’s affairs and business, it must, as said before, report thereon. Initially it must forthwith issue a press release and file it with the OSC.\textsuperscript{1201} Thereafter within ten days of the occurrence it must file a report of such material change with the same authority.\textsuperscript{1202} The report should be prepared according to the requirements of Form 27 which requires for inclusion of the details of the reporting issuer, date of material change, date and place of issuance of the press release, summary followed full description of the material change, etc. If there is a change that is not yet mature and early disclosure is likely to be unduly detrimental to the reporting issuer, or if the change consists of a decision by the senior management, which is subject to be confirmed by the board of directors and there has taken place no insider trading based on such development, the reporting issuer may, instead of a press release, forthwith file a report with the OSC marking it as “confidential” with reasons.\textsuperscript{1203} It must keep renewing the confidentiality request every ten days until a press release is issued with respect to the former, or until, with respect to the latter, the senior management’s decision is rejected by the board of directors.\textsuperscript{1204} If, however, the confidential information or rumours of it is divulged anyhow, the reporting issuer must disclose it immediately.\textsuperscript{1205} Besides, the reporting issuer must, however, keep a vigilant eye on the market activity in its securities. An abnormal activity in the market signals the probability that the “confidential” information has been leaked out. In that case the

\textsuperscript{1200} Ibid.
\textsuperscript{1201} OSA, R.S.O. 1990, c.S.5, s. 75(1).
\textsuperscript{1202} Ibid., s. 75(2).
\textsuperscript{1203} Ibid., s. 75(3), s. 140(2), and National Policy 40, part G, “Confidentiality”.
\textsuperscript{1204} OSA, R.S.O. 1990, c.S.5, s. 75(4).
\textsuperscript{1205} National Policy 40, para. G, “Confidentiality”.

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OSC should be advised promptly and a halt in trading will be imposed until disclosure is made on the matter by the issuer.\textsuperscript{1206}

\textbf{7.2.2.4 Civil Liability}

Although Canadian issuers using the US MJDS can, as seen above, prepare disclosure documents according to Canadian law, they are subject to the US civil liability provisions of sections 11 and 12 of the Securities Act of 1933.\textsuperscript{1207} The purpose underlying these liability provisions is to ‘assure that the information contained in the registration statement is complete and accurate’.\textsuperscript{1208} Section 11 provides for civil liabilities to securities purchasers for material misstatement or omissions. “Purchasers” include both the original purchasers in the primary market and those who have purchased from such purchaser in the secondary market.\textsuperscript{1209} And “material misstatement or omission” means a misstatement or omission of a material fact ‘which if it had been correctly stated or disclosed would have deterred or tended to deter the average prudent investor from purchasing the securities in question’\textsuperscript{1210}. An aggrieved purchaser claiming remedy needs to show that the registration statement contained a material misstatement or omission and that he sustained loss of money.\textsuperscript{1211} Though generally his reliance on such misstatements or omissions is not required to be established, he must prove it where he purchased the security after the issuer had made public an earning statement that covered a period of minimum 12 months kicking off after the effective date of the registration statement.\textsuperscript{1212} However, the purchaser need

\textsuperscript{1206} Ibid.
\textsuperscript{1207} Bloomenthal, supra note 902, at p. 27-554.
\textsuperscript{1209} See, for example, \textit{Joseph v. Wiles}, 223 F.3d 1155 (10th Cir.2000); \textit{Hertzberg v. Dignity Partners}, Inc., 191 F.3d 1076 (9th Cir.1999).
\textsuperscript{1210} \textit{Escott v BarChris Construction Corp.}, 283 F.Supp. 643 (S.D.N.Y. 1968) at p. 681.
\textsuperscript{1211} Ratner and Hazen, supra note 1208, at p. 85.
\textsuperscript{1212} SA 1933, s. 11(a).
not prove that he actually has read the registration statement; reliance on ‘the secondary sources that repeated the misstatement’ will suffice.

As to who may be sued for the aforesaid material misstatement or omission section 11(a) provides the following list: (a) every person who signed the registration statement, (b) every director of the issuer, (c) every person consenting to be named as a director or prospective director, (d) every expert (e.g., accountant, engineer, appraiser, etc) having certified preparation of the registration statement, and (e) every underwriter with respect to such security. Except an expert and an underwriter all these persons are jointly and severally liable to the purchaser-plaintiff. An expert is liable to the extent of his involvement in the preparation or certification of the registration statement. In other words, he is liable for the misstatement or omission in the registration statement, which he prepared or certified. An underwriter is liable for that portion of the public offering price of the securities that it underwrote.

The above categories of persons (including the issuer) subject to liability may plead the following defences:

1. that the alleged false statement are in fact true;
2. that the misstatement or omissions alleged are not material;
3. that the plaintiff purchased securities in spite of his knowledge of the misleading statements or omissions; and
4. that the allegation is barred by limitation.

In addition to the above, those persons (except the issuer who is strictly liable) have “due diligence” defence available under section 11(b). For this purpose the registration

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1213 Ibid.
1215 Sec. 6(a) requires that a registration statement be signed by the issuer, its principal executive, financial and accounting officers, and the majority of its board of directors or persons performing similar functions.
1216 SA 1933, s. 11(f), see Ratner and Hazen, supra note 1208, at p. 87.
1217 Ratner and Hazen, ibid.
1218 Ibid.
statement is divided into “expertised” and “nonexpertised” portions. The former is made on the authority of an expert, e.g., an accountant. Such an expert may plead that he met “due diligence” test with respect to statements made by him, which consists of the following:

(a) that he in fact believed that the statements were true;

(b) that he made the statements out of reasonable belief, which means that he did so after reasonable investigation, through professional expertise, into the facts buttressing those statements.

Here “reasonable investigation” means that the facts conform to professional standards. This investigation will not be enough to protect the expert if he knowingly did not disclose a material fact. As with the experts, nonexperts must also establish the “due diligence” test. Thus they must establish that they believed their statements appearing in the registration statement were true, and their belief was reasonable, meaning based on a reasonable investigation of the facts.

Section 12 of the Securities Act of 1933 provides for civil liability of sellers of securities in two situations. First, the liability arises where securities are sold in breach of section 5, which requires filing of registration statement with the SEC before issuing securities. Second, sale of securities by a prospectus or oral communication lacking disclosure of true or material facts gives rise to liability. In these situations the aggrieved buyer may sue to recover the consideration paid for the securities, with interest, less any income received, or for damages if he has already sold

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1219 Schaumann, supra note 1214, at p. 174.
1220 Ranen and Hazen, supra note 1208, at p. 88.
1221 Schaumann, supra note 1214, at pp. 174-175. See, in this context, Ernst & Ernst v Hochfelder, 96 S. Ctr. 1375 (1976).
1222 Ibid.
1223 Ibid., at p. 175.
1224 Ibid., 12(a)(1).
those securities.\textsuperscript{1227} He need not prove that he relied on the misstatements or omissions.\textsuperscript{1228} The liability in the second situation is limited to public initial distributions. In other words, the liability provision does not extend to a private, secondary sale of a security.\textsuperscript{1229}

\textbf{7.2.3 Canadian Multijurisdictional Disclosure System (CMJDS)}

\textbf{7.2.3.1 Prospectus}

\textbf{7.2.3.1.1 Prospectus to be Prepared according to the US Law}

The Canadian MJDS (CMJDS), like the US MJDS, allows US issuers that meet the National Instrument 71-101 eligibility requirements, mentioned earlier\textsuperscript{1230}, to make offering of following securities in Canada and the US, or Canada only by prospectus\textsuperscript{1231}:

(a) investment grade debt or preferred shares;

(b) certain rights to acquire the issuer’s securities; and

(c) any other securities, if the issuer meets a public float requirement of US $75,000,000.

The first two types of securities and also securities exchange bids and business combinations that are not eligible to be made under sections 3.1(a), 3.1(b), 12.3 and 13.1 of the National Instrument 71-101 respectively can be made as securities of the third category provided the eligibility requirements therefor contained in section 3.1(c), discussed earlier\textsuperscript{1232}, are fulfilled. Such prospectus offerings are made on the basis of documentation prepared according to the US federal securities law in general as if the securities were being offered in the US (regardless of whether the offering is made in

\textsuperscript{1227} Ibid., s. 12(a).
\textsuperscript{1228} Hill York Corp. v American Intern Franchises, Inc, supra note 1226.
\textsuperscript{1230} See ch. 7.1, supra.
\textsuperscript{1231} See National Instrument 71-101, s. 3.1.
\textsuperscript{1232} See text accompanied by notes 916-920, supra.
Canada and the US or only in Canada).\footnote{Companion Policy 71-101CP- To National Instrument 71-101 The Multijurisdictional Disclosure System, ss. 2.2, 2.5 and 3.2(2) read together.} In certain respects Canadian requirements are to be satisfied. For example, the prospectus must provide ‘full, true and plain disclosure of all material facts relating to the securities proposed to be distributed.’\footnote{Companion Policy 71-101CP, s. 3.2(4).}

As well, all CMIDS transactions are subject to the public interest jurisdiction of the Canadian securities regulatory authorities. In other words, a concerned securities commission (e.g., the OSC) can preclude a US issuer from offering securities in Canada in public interest where ‘it is necessary to do so to preserve the integrity of the capital markets or to protect investors.’\footnote{Ibid., s. 3.2(3).} Furthermore, the Canadian provisions (Ontario in particular) relating to purchasers’ right to withdrawal from an agreement to purchase securities within two days after receipt of a prospectus apply to a CMIDS offering.\footnote{National Instrument 71-101, s. 4.3(c).}

In the following a brief discussion is made on the US federal law requirements of prospectus disclosure, with additional reference to Canadian law where necessary.

### 7.2.3.1.2 US Prospectus Disclosure Requirements

It has been indicated before that the Securities Act of 1933 is based on the disclosure philosophy\footnote{See chaps. 4.2 and 7.2.2.1.2.2, supra.} and as such a ‘Disclosure Act’\footnote{Elmer L. Winter, Complete Guide to Making a Public Stock Offering, 2nd ed. (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1972) at p. 111.}. It requires an issuer to file a registration statement with the SEC to register securities with the SEC before it offers or sells them to the public.\footnote{Ibid.} Part I of this statement is the prospectus a copy of which is supplied to every purchaser of securities and as such forms the core of the IPO offerings requirements. Part II contains information and exhibit that need not be
delivered to purchasers; they are available for public inspection in the SEC’s files. With regard to prospectus the SEC is responsible to ensure that the prospectus contain, “full and fair”\textsuperscript{1240} and plain-English\textsuperscript{1241} disclosure of material facts, which is similar in sense to the “full, true and plain” disclosure requirement of Ontario law.\textsuperscript{1242} Unlike the OSC the SEC does not have any authority to judge if a particular security should be offered to the public.\textsuperscript{1243} (Canadian) National Instrument 71-101 requires a US prospectus, for the CMDS purpose, to contain certifications by the issuer and underwriter(s) as to the full, true and plain disclosure of material facts respecting the securities being offered.\textsuperscript{1244}

Originally what information a prospectus must contain is, in general, specified in Schedule A of the Securities Act 1933. Section 7 of the Securities Act 1933 empowers the SEC to require more or less information than is so specified. It decides, by discretion, what information is material and therefore to be included in the prospectus.\textsuperscript{1245} Under this discretion the SEC has prescribed various forms\textsuperscript{1246} for registering and/or trading different types of securities under the Securities Act of 1933 and the Securities Exchange Act of 1934. The disclosure documents required under these two Acts constituted a ‘common core of information, but often were duplicative, overlapping, and presented similar information in different formats’.\textsuperscript{1247} In order to

\begin{itemize}
\item \textsuperscript{1239} SA 1933, s. 5.
\item \textsuperscript{1240} K. Fred Skousen, \textit{An Introduction to the SEC}, (Cincinnati, West Chicago, Dallas and Livermore: South-Western Publishing Co., 1991), 5th ed., at p.23.
\item \textsuperscript{1241} Rule 421. This rule was introduced in 1998. It requires a prospectus to comply with plain English principles that include the use of (i) the active voice, (ii) short sentences, (iii) definite, concrete everyday jargons, and (iv) no legalistic or technical terminology. But the SEC has become ‘grammar police’ to enforce this requirement. Frederick D. Lipman, \textit{The Complete Going Public Handbook}, (Roseville, California: Prima Venture, 2000) at 98.
\item \textsuperscript{1242} See ch. 8.2.1, infra.
\item \textsuperscript{1243} Ratner and Hazen, supra note1208, at p. 34.
\item \textsuperscript{1244} National Instrument 71-101, s. 4.7
\item \textsuperscript{1245} Schaumann, supra note 1214, at p. 62.
\item \textsuperscript{1246} For example, Form 10-K for annual report, Form 10-Q for quarterly reports, Form 8-K for current report, Form 10 for registration of securities under the SEA 1934, Form S-2 for registration of securities by certain eligible issuers,
\end{itemize}
improve this state an integration was proposed between the disclosure systems of the two Acts, to wit, prospectus disclosure system and ongoing disclosure system respectively.\textsuperscript{1248} The SEC responded to this proposal and initiated steps to introduce an integrated disclosure system in January 1980, which finally came into being in March 1982.\textsuperscript{1249} Through this system disclosure information under the Securities Acts has been standardised by setting forth all non-financial matters in Regulation S-K and financial statement requirements in Regulation S-X.\textsuperscript{1250} The SEC disclosure forms meant for domestic issuers (e.g., prospectus form S-1 and ongoing disclosure form F-10) ask, by cross-reference, for disclosure of substantially the same information as contained in these two regulations. In addition to the common items, of course, an initial offering disclosure form, unlike a continuous disclosure form, requires more information peculiar to such an offering, e.g., details of securities being offered.\textsuperscript{1251} In the following the contents of a US prospectus will be overviewed as per the requirements of Form S-1, the most common form for prospectus offering, which is used for all offerings for which no other form is prescribed.

7.2.3.1.2.1 Non-Financial Matters

The non-financial information required to be in a prospectus may be categorised and summarised as follows.

1. Securities, Price, Market, Underwriting and Distribution: This category includes disclosure of details of the securities being offered, plan of distribution, underwriting, proceeds to be received from the sale of securities, etc. briefly outlined below.


\textsuperscript{1250} See Bloomenthal, supra note 1247.
The description of securities must include their classes/kinds\(^\text{1252}\) (e.g., common shares, preferred stock\(^\text{1253}\)), selling price,\(^\text{1254}\) and the attaching rights, e.g., voting rights, dividends rights, liquidation rights etc\(^\text{1255}\). Where common equity is the subject of an offering, the prospectus must identify the principal US market(s) in which each of its class is being traded.\(^\text{1256}\) If there is no market, a statement must be added to that effect.\(^\text{1257}\) If the market is an exchange, it must provide the range of prices for securities.\(^\text{1258}\) It must also state the frequency and amount of any cash dividends declared on each class of its equity security for the two most recent financial years. If the registrant has not done so, or does not intend to do so, it must add a statement of this policy.\(^\text{1259}\) The prospectus must state the estimated net proceeds to be procured from the securities to be offered.\(^\text{1260}\)

Where a prospectus is underwritten, it must include information about the underwriter, underwriting compensation, underwriter’s right of representation on the board of directors, indemnification by the registrant of the underwriter against any liability arising under the Securities Act of 1933, etc.\(^\text{1261}\) If the offering is made otherwise than through underwriter, terms of any agreement, arrangement or understanding entered with them before the effective date of the registration statement.\(^\text{1262}\)

Information must be furnished as to the voting securities of the registrant owned beneficially by each person who is known to beneficially own five percent of

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\(^{1251}\) See \textit{ibid.}  
\(^{1253}\) See, for example, Prospectus, Lithia Motors, Inc., 25 February 2002, at p. 41 (hereafter Lithia Prospectus)  
\(^{1254}\) Reg. S-K, Item 501.  
\(^{1256}\) Reg. S-K, Item 201.  
\(^{1257}\) \textit{Ibid.}  
\(^{1258}\) Lithia Prospectus, \textit{supra} note 1253, at p. 12.  
\(^{1259}\) \textit{Ibid.}  
\(^{1261}\) Reg. S-K, Item 508.  
\(^{1262}\) Reg. S-K, Item 508.
any class of such securities.\textsuperscript{1263} Also required is the information as to the direct or indirect beneficial ownership of equity securities (other than directors’ qualifying shares) by the registrant’s directors and officers, as a group, without referring to their names.\textsuperscript{1264}

2. Use of Proceeds: The use of the proceeds of the securities must be disclosed. Accordingly a prospectus must state the principal purposes for which the net proceeds from the securities to be offered are planned to be used, with reference to the approximate amount to be expended for each of such purposes. If there is no specific plan for the proceeds, or major portion thereof, a statement must be added to that effect, with principal reasons for the offering.\textsuperscript{1265}

3. Risk Factors: A prospectus must disclose the factors that are likely to make the offering speculative or risky. There may be risks generally associated with any offering. The prospectus must explain how they affect the issuer or the securities of the issuer, which are subject of the offering.\textsuperscript{1266} For example, in a motor company’s prospectus discloses that as it is a vehicle company, its 'success depends in large part upon the overall demand for the particular lines of vehicles that each of [its] stores sells'.\textsuperscript{1267}

4. Information about the Registrant: This category includes information mainly about the issuer’s business,\textsuperscript{1268} property,\textsuperscript{1269} legal proceedings,\textsuperscript{1270} promoters and material contracts.\textsuperscript{1271} Of these business information is by far the most important matter that must be stated in a prospectus according to Item 101 of Regulation S-K. In the first

\begin{footnotesize}
\begin{itemize}
  \item[1263] Reg. S-K, Item 403.
  \item[1264] Ibid.
  \item[1265] Ibid.
  \item[1266] Reg. S-K, Item 504.
  \item[1267] Ibid.
  \item[1268] Form S-1, Item 11(a).
  \item[1269] Ibid., Item 11(b).
  \item[1270] Ibid., Item(c).
  \item[1271] Schedule A, para. 20.
  \item[1272] Ibid., para. 24.
\end{itemize}
\end{footnotesize}
place, the prospectus must give an account of the business done and intended to be
done by the registrant, and the general development (right from its incorporation) of the
business by it, its subsidiaries, and predecessors, if any, during which it may have
engaged in business. Second, it must disclose the amount of revenues from external
customers, profits or losses and total assets during the past three fiscal years, which are
attributable to each of registrant’s industry segment/franchises. If the company has
received no revenue during each of the past three fiscal years, a description of the
registrant’s plan of operation must be provided. Third, a description is required of the
principal products produced and services provided by the registrant. As well, required
is the description of the principal markets for, and the methods of distribution of, the
segment’s principal products and services. The amount or percentage of total revenues
contributed by any class of similar products and services must be added in the event of
their contribution of 10% or more (and in certain respect of 15%) of consolidated
revenue in any of the said three years. Relative to the company’s products other
information encompasses, among others, status of products/segment (e.g., whether
planning stage, any prototypes exist, etc.), availability of raw materials, competitive
condition in the business arena, and impacts of environmental law (e.g., how much
would be the expense to comply with the environmental law provisions that regulate
the discharge of materials into environment).

5. Management: A prospectus must contain (a) details (e.g., names, ages and past
business experience) of the directors, executive officers, and employees who make or
expected to make significant contribution to the business of the registrant,1273 (b)
disclosure of executive compensation.1274

1274 Ibid., Item 402.
6. Selected Consolidated Financial Information, and Management’s Discussion and Analysis: A federal prospectus must contain five years’ consolidated financial data for the registrant, which include total revenue, operating income, net income/loss, total assets, and long-term financial liabilities, etc. This will be followed by the management’s discussion and analysis of the financial condition, changes in financial condition, and results of operations. This will furnish information relative to liquidity, capital resources and results of operations, and also other optional information that the may be helpful in understanding the registrant’s financial condition. “Liquidity” refers to ‘the ability of an enterprise to generate adequate amounts of cash to meet the enterprise’s needs for cash’. Accordingly, a prospectus must identify any known trends or demands, commitments, events or uncertainties having the result in materially increasing or decreasing of the registrant’s liquidity. “Capital resources” disclosure requirement focuses on ‘the anticipated need for capital expenditures and the anticipated source of funds for such expenditures.’ Next, an MD & A must also, as aforesaid, describe the results of the registrant’s operations. First, it must describe significant events or transactions that have materially affected the amount of reported income from continuing operations, e.g., closing of unprofitable plants, improved/depressed market conditions, the depletion of inventories and impact thereof on profitability. Second, the MD & A must describe known trends or uncertainties having had or are likely to have, in the registrant’s view, material impact, favourable or unfavourable, on net sales, or revenues or income from continuing operations. Declining demand for and sales of the registrant’s products is an

1275 Ibid., Item 301. See, in this connection, Lithia prospectus, supra note 1253, at p. 14.
1277 Ibid., Item 303(a).
1278 Bloomenthal, supra note 1247, at p. 2-16.
1279 Reg. S-K, Item 303(a), para. (1).
1280 Ibid., Item 303(a), para. (2).
1281 Ibid., supra note 1247, at p. 2-16.
1282 Reg. S-K, Item 303(a), para. (3).
example of a known trend while as regards oil and gas glut, future oil price is an uncertainty both for oil and producers and service industry.\textsuperscript{1284} Third, there must be a narrative discussion of how the increase in net sales or revenues are attributable to the increase of prices, volume or amount of goods or services or introduction of new goods or services. Finally, the MD & A must discuss the impact of inflation and changing prices on the net sales, revenues and income of the registrant’s flowing from continuing operations.

Interim financial statements may also be included in addition to such full fiscal years’ information. In that case an MD & A must be added, which will address material changes to the items discussed above except the impact of inflation and changing prices on operations for interim periods.\textsuperscript{1285}

7. Other information: In addition to the information expressly required an issuer must include other material information to make the registration statement not misleading in light of the given circumstances.\textsuperscript{1286} This disclosure obligation lies on the issuer. At the same time the SEC can ask for further information to ensure full disclosure of material information.\textsuperscript{1287}

7.2.3.1.2.2 Financial Matters

(a) Financial Statements and Information: In order that an investor can ‘project the issuer’s future sales and net earnings’, the issuer is obliged to present financial data in

\textsuperscript{1283} Bloomenthal, \textit{supra} note 1247, at p. 2-15.
\textsuperscript{1284} \textit{Ibid.}, at pp. 2-15 and 2-16.
\textsuperscript{1285} Reg. S-K, Item 303(b).
\textsuperscript{1286} SA 1933, Rule 408.
\textsuperscript{1287} SA 1933, s. 7.
its prospectus. Regulation S-X requires an issuer to file the following financial statements:

1. audited balance sheets as of the end of each of the two most recent fiscal years;
2. audited statements of income (a.k.a. profit and loss statements) and cash flow for each of the three fiscal years preceding the date of most recent audited balance sheet being filed;
3. statements of changes in stockholders’ equity for the period for which balance sheet is filed; and
4. notes to financial statements filed.

While the statements of stockholder’s equity are prepared, retained earnings are also stated. The registrant is also required to add financial statements concerning acquisition or would-be acquisition of business. In respect of disposition of significant portion of business, which is not reflected in the financial statements, pro forma financial statements are to be furnished. The SEC may, however, dispense with any of the statements, when it is requested for by the registrant and when it does not hamper investors’ protection.

All the above financial statements must be prepared according to the US GAAP that are based on Statements of Financial Accounting Principles (SFAS) issued by the Financial Accounting Standards Boards (FASB). They must also be audited by qualified and independent auditors and the auditor’s reports must be

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1288 Schaumann, supra note 1214, at p. 63.
1289 Reg. S-X, Item 3-01.
1290 Ibid., Item 3-02.
1291 Ibid., Item 3-04.
1292 Ibid., Item 4-08.
1293 Ibid., Item 4-08.
1294 Lithia Prospectus, supra note 1253, p. F-5.
1295 Reg. S-X, Item 3-05.
1296 Ibid., Item 11-01(a)(4).
1297 Ibid., Item 3-13.
1298 Ibid., Item 4-01.
prepared in compliance with the US GAAS,\textsuperscript{1299} which are founded on Statements of Auditing Standards (SAS) set by the FASB.\textsuperscript{1300} To be “qualified” an auditor must be ‘duly registered and in good standing as such under the laws of his residence or principal office’.\textsuperscript{1301} His independence depends on his capability to exercise objective and impartial judgement on all issues covered by the accounting function.\textsuperscript{1302} The SEC considers all circumstances including relationship with the audit client\textsuperscript{1303} in assessing the auditor’s independence.\textsuperscript{1304} In this connection former Chief Justice Warren Burger is worth quoting:

By certifying the public reports that collectively depict a corporation’s financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation’s creditors and stockholders, as well as to the investing public. This “public watchdog” function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.\textsuperscript{1305}

\textbf{(b) Supplementary Financial Information:}\ According to Item 302 of Regulation S-K certain registrants who are engaged in interstate commerce or whose securities are listed on a national exchange need disclose net sales, gross profits, income before extraordinary items and cumulative effect of a change in accounting, per share data based on such income, and net income. These data shall cover each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included or are required to be included under Article 3 of Regulation S-X. If needed, differing data previously reported for the same period should be

\begin{itemize}
  \item \textsuperscript{1298} Schaumann, \textit{supra} note 1214, at p. 354.
  \item \textsuperscript{1299} Reg. S-X, Items 2-01 and 1-02(d) read together.
  \item \textsuperscript{1300} Schaumann, \textit{supra} note 1214, at p. 354.
  \item \textsuperscript{1301} Reg. S-X, Item 2-01(a).
  \item \textsuperscript{1302} \textit{Ibid.}, Item 2-01(b).
  \item \textsuperscript{1303} “Audit client” means ‘entity whose financial statement or other information is being audited, reviewed or attested and any affiliates of the audit client’. \textit{Ibid.}, Item 1-02(f)(6).
  \item \textsuperscript{1304} \textit{Ibid.}, Item 2-01(b).
\end{itemize}
reconciled. The registrant is also required to describe the effect of any disposals of segments of a business, extraordinary, unusual or infrequently occurring items recognised in said each quarter, and aggregate effect and nature of yearend or other adjustments material to the quarterly results.

(c) Forward-looking Information:

The SEC, by tradition, emphasised on the disclosure of risk oriented information of the past and was not prepared to permit forward-looking information in the registration statement until 1979 when it adopted the “safe harbour” rules. These rules allowed the issuers, on optional basis, to add forward-looking statements in a prospectus. Their main purpose is to provide the prospective investors an idea as to ‘whether the price of the security will go up or go down’. These statements refer to the following:

1. A statement of projection of the issuer’s revenues, incomes, earnings, per share, capital expenditures, dividends, capital structure or other financial items;
2. A statement of the plans and goals of its future operations;
3. A statement of its future economic performance as stated in the MD&A; and
4. Disclosed statements of the assumptions underlying or concerning any of the above statements.

The forward-looking statements must be prepared in ‘good faith’ with a ‘reasonable basis’. Though not mandatory, disclosure of assumptions underlying the statements

1306 Schaumann, supra note 1214, at p. 67. Also see Bloomenthal, supra note 1247, at p. 2-47.
1307 Schaumann, ibid., at p. 66.
1308 SA 1993, r. 175(c).
1309 Ibid., r. 175(a). See, in this connection, Wielgos v Commonwealth Edison Co., 892 F.2d 509 (7th Cir. 1989)
is often necessary to satisfy this test.\textsuperscript{1310} Thus, for example, where the disclosure of underlying assumptions is material to an understanding of a projection and hence to making investment decision, the registrant should provide assumptions along with the projection.\textsuperscript{1311} It is further required by the “bespeaks caution” doctrine developed by the US Courts\textsuperscript{1312} that the assumptions underlying the forward-looking statements be accompanied by cautionary statements that warn the readers of facts and circumstances with the effect of dimming the rosy picture of the company’s future presented in the projections. Both the projections and assumptions need to be updated with new developments making the previous statements obsolete as they lack reasonable basis.\textsuperscript{1313} The 1995 Private Securities Litigation Reform Act has given statutory effect to this doctrine.\textsuperscript{1314}

\textbf{7.2.3.1.2.3 GAAP Reconciliation}

When securities of general kinds (e.g. equity securities), as typified under section 3.1(c) discussed earlier\textsuperscript{1315}, (i.e., excluding investment grade securities, rights offerings, securities exchange bids and business combinations) are offered under the CMJDS, the prospectus shall include a reconciliation of the financial statements contained therein or incorporated by reference to Canadian GAAP.\textsuperscript{1316} The reconciliation may be provided in the notes to the financial statements or as a supplement included or incorporated by reference in the prospectus.\textsuperscript{1317} The reconciliation, as a separate item, shall explain and quantify any significant differences

\textsuperscript{1310} Schaumann, \textit{supra} note 1214, at p. 67
\textsuperscript{1311} \textit{See} e.g., \textit{Romani v Shearson Lehman Hutton}, 929 F.2d 875 (1\textsuperscript{st} Cir. 1991), \textit{Mayer v Mylod}, 988 F.2d 635 (6\textsuperscript{th} Cir. 1993), \textit{Rubinstein v Collins}, 20 F.3d 160 (5\textsuperscript{th} Cir. 1994), \textit{Saltzberg v TM Sterling/Austin Associates, Ltd.}, 45 F.3d 399 (11\textsuperscript{th} Cir. 1995).
\textsuperscript{1312} See, for example, \textit{Romani v Shearson Lehman Hutton}, 929 F.2d 875 (1\textsuperscript{st} Cir. 1991), \textit{Mayer v Mylod}, 988 F.2d 635 (6\textsuperscript{th} Cir. 1993), \textit{Rubinstein v Collins}, 20 F.3d 160 (5\textsuperscript{th} Cir. 1994), \textit{Saltzberg v TM Sterling/Austin Associates, Ltd.}, 45 F.3d 399 (11\textsuperscript{th} Cir. 1995).
\textsuperscript{1313} Schaumann, \textit{supra} note 1214, at p. 67.
\textsuperscript{1314} For a brief discussion on the Act, see \textit{ibid.}, at pp. 69-75.
\textsuperscript{1315} See text accompanied by notes 1231-1232, \textit{supra}.
\textsuperscript{1316} National Instrument 71-101, s. 4.6(1).
\textsuperscript{1317} \textit{Ibid.}
between the principles that have been applied in the financial statements and Canadian GAAP. Instead of reconciliation with Canadian GAAP, a US issuer may reconcile the financial statements to International Accounting Standards on permission from each applicable Canadian regulatory authority.

US federal law requires a prospectus to bear an auditor’s report prepared according to the US GAAS. National Instrument 71-101 does not require this to be reconciled. So, for the CMJDS purpose a US prospectus includes audited financial statements along with a report drawn up according to US GAAS.

7.2.3.1.2.4 Legends

The CMJDS requires a prospectus prepared according to the US federal securities law to set out legends, on the outside or inside front cover page or on a sticker on that page, that warn the readers about some matters of especial attention from investor protection viewpoint. These include, *inter alia*,

(i) that the prospectus being prepared according to US law may differ from the requirements of the law of Canadian province(s) where securities are being offered;

(ii) that financial statements have not been prepared in accordance with Canadian GAAP and as such not comparable to financial statements of Canadian issuers;

(iii) that all/certain of the directors and officers of the issuer and all/certain of the experts named in the prospectus are not residents of Canada and thus service of process may not be effected against these persons in Canada, although the issuer has

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1318 Ibid., s. 4.6(2).
1319 Companion Policy 71-101CP, s. 3.2(6).
1320 Ibid., s. 3.2(6). See, for example, *Lithia prospectus, supra* note 1253, at p. F-2.
1321 National Instrument 71-101, s. 4.6(2) and Companion Policy 71-101CP, s. 3.2(6).
appointed an agent of service of process in Canada, whose
details are stated in the prospectus;

(iv) that it may also not be possible to enforce against the issuer, its
directors, officers and experts named in the prospectus
judgements based on the civil liability provisions of the
applicable securities law of Canada; and

(v) that no securities commission or similar authority or the US has
in any way judged the merits of the securities being offered and
any representation to the contrary is an offence.1322

7.2.3.2 Regulatory Review

In order to offer securities under the CMJDS a US issuer is required to
select among from the Canadian provinces a “principal jurisdiction” to review the
offering.1323 If a jurisdiction so selected declines to act as a principal jurisdiction, the
issue needs to choose another one.1324 If the issuer is offering securities both in Canada
and the US, it must file the registration statement with the SEC and at the same time
with the principal jurisdiction.1325 It should also file preliminary and final prospectuses
with “non-principal” jurisdictions where securities are being offered.1326

When a CMDS offering is made both in Canada and the US, it is the
SEC that conducts review of the disclosure documents.1327 Be an offering made in
Canada and the US or only in Canada, the Canadian securities regulatory authorities
will monitor the materials filed ‘to check compliance with the specific disclosure and

1322 National Instrument 71-101, s. 4.3(1)(b).
1323 Ibid., s. 5.1, and Companion Policy 71-101CP, s. 3.2(11).
1324 National Instrument 71-101, s. 5.2. As of 2002 Canadian securities regulatory authorities of New
Brunswick, Prince Edward Island, Newfoundland, Yukon Territory and the Northwest Territories have
indicated their disagreement to act as a principal jurisdiction. Companion Policy 71-101, s. 3.2(11).
1325 National Instrument 71-101, ss. 6.1 and 6.2.
1326 Ibid., s. 6.3.
1327 Companion Policy 71-101CP, s. 3.2(11).
filing requirements’ of National Instrument 71-101. They will, however, review the substance of the disclosure documents in the “unusual case” which arises, through monitoring or otherwise, when they are led by reason to believe that ‘there may be a problem with a transaction or the related disclosure or other special circumstances exist’. Situations attracting merit jurisdiction on public interest and other specified grounds, as discussed earlier, available under Ontario securities law (and also other similar jurisdictions) may qualify as the “unusual case” in question. Apart from such circumstances a CMJDS offering is not subject to Canadian review jurisdiction in general. In this respect a CMJDS offering enjoys the “no review” status of a US MJDS offering.

In respect of the typical case of concurrent offering in Canada and the US in compliance with National Instrument 71-101, the principal jurisdiction in Canada will issue a receipt for a final prospectus when the SEC has declared the registration statement effective provided it (the principal jurisdiction regulator) finds no “unusual case” (i.e., ‘problem with the transaction or the related disclosure or other special circumstances’) involved in the offering. Following this each non-principal regulator issues a receipt subject to the same condition of absence of the “unusual case”. If the offering is made solely in Canada fulfilling the requirements of the said Instrument, the principal regulator and, to its heel, the other regulators issue receipts for the final prospectus subject to the condition that there is no “unusual case” involved in it.

The above discussion confirms that as under the US MJDS disclosure documents of a CMJDS offering are normally reviewed by the home jurisdiction, that

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1328 Ibid.
1329 Ibid.
1330 See text accompanied by notes 1090-1103, supra.
1331 Companion Policy 71-101, s. 3.2(12).
1332 Ibid.
1333 Ibid.
is, the SEC. In respect of unusual circumstances the Canadian regulatory authorities will exercise their merit review jurisdiction. In this context it would be helpful to look at the SEC review provisions in order to understand how far they are conform to or differ from Canadian (here the OSC) review provisions.

The Division of Corporation Finance of the SEC is responsible to process a registration statement (the principal component of which is the section 10 prospectus) when it is filed by an issuer in order to qualify for offering securities for public sale under section 5(c) of the Securities Act 1933. The Division staff passes the statement and gives effect to it normally after 20 days from the filing date, if it finds no deficiencies in the disclosures. In between the filing and the effective dates (called the “waiting period”) marketing of securities (but not sale) is allowed by oral offers, “tombstone ads” (short announcements), preliminary prospectuses, and summary prospectuses. If, however, any deficiencies with respect to the disclosures are found (e.g., omission of material information, or violation of accepted accounting principles), the staff will issue a “comment letter” to the issuer, in which they may ‘insist on or suggest changes, additions or deletions, or may request additional information as a prelude to further comments.’ In response to this letter the issuer prepares and files an amendment to the registration statement. This may be followed by further amendment(s) except the pricing amendment which, setting the

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1334 17 C.F.R. 200.30-1.
1335 SA 1933, s. 5(a). From this effective date sale of securities is allowed, but for their post-state delivery to be valid they must be accompanied or preceded by the final prospectus. SA 1933, s. 5(b)(2). See, in this connection, Fradinand S. Tinio, ‘As to what constitutes violation of s. 5(b)(2) of the SA 1933 requiring security to be accompanied or preceded by prospectus’, 28 ALR Fed. 811.
1336 SA 1933, s. 8(a).
1337 Schaumann, supra note 1214, at p. 29.
1338 Ibid., s. 10(b); SA rule 134.
1339 Ibid., s. 10(b); SA rule 430.
1340 Ibid., 10(b); SA rule 431.
1341 SA 1933, s. 8(b).
1342 Ratner and Hazen, supra note 1208, at p. 43.
price of the securities, is added later.\textsuperscript{1343} Since according to section 8(a) of the Securities Act 1933 the 20-day period runs afresh from the date of filing an amendment, the issuer generally submits a request along with the amendment(s) for acceleration of the effective date, which is generally granted subject to the staff’s satisfaction that there are no further comments.\textsuperscript{1344} Where the staff is of the view that the registration statement suffers from no deficiencies for which a comment letter could be issued, rather it involves ‘careless disregard of statutes and rules or a deliberate attempt to conceal or mislead’ or any other reason for which it ‘deems formal proceedings necessary in the public interest’, it may issue a stop-order preventing the registration statement from coming into effect.\textsuperscript{1345} Before the proceeding starts, the staff may advise the issuer to withdraw the registration statement provided this is consistent with the public interest and investor protection.\textsuperscript{1346}

\textbf{7.2.3.3 Continuous Disclosure}

A US issuer offering securities under the CMJDS in Canada becomes primarily subject to Canadian continuous reporting, insider reporting and proxy requirements.\textsuperscript{1347} Parts 14 to 17 of National Instrument 71-101 substitute US federal securities law requirements relating to current reports, annual reports, proxy statements, and insider trading for Canadian requirements concerning material change, annual reports, and information and proxy circulars, and insider trading discussed earlier. This substitution is subject to the fulfillment of the filing and/or dissemination requirements.

\begin{itemize}
\item \textsuperscript{1343} Previously pricing amendment was made prior to the effective date of the registration statement. Now omission of it is allowed under SA rule 430A provided it is added in the final prospectus filed pursuant to SA Rule 424.
\item \textsuperscript{1344} Bloomenthal, supra note 1247, at p. 4-3. Also see Schumann, supra note 1214, at p. 33.
\item \textsuperscript{1345} 17 C.F.R. 202.3. See, in this connection, Boraski v Division of Corp. Finance of US SEC, S.D.N.Y. 1971, 321 F. Supp. 1273. After a registration statement has become effective, the SEC can suspend its effectiveness on similar grounds under SA sec. 8(d) or SEA sec. 15(d). It warns thereby the investing public that Commission has found the statement unreliable. Oklahoma-Texas Trust v. Securities and Exchange Commission, CCA 10, 1939, 100F2d 888; Cooker v SEC, CCA 1, 1947, 161 F.2d 944.
\item \textsuperscript{1346} SA 1933, rule 477.
\item \textsuperscript{1347} Companion Policy 71-101CP, s. 3.6(1).
\end{itemize}
e.g., section 15.1 requires an issuer to file with applicable Canadian regulatory authorities the quarterly and annual reports that are filed with the SEC, and to send those to security holders.

Under Part 15 of NI 71-101 provincial requirements as to preparation of financial statements applying Canadian GAAP, audit reports according to Canadian GAAS, or reconciliation of the US financial statements to Canadian GAAP/GAAS, do not apply to issuers who file financial statements drawn up in compliance with the US law by operation of rules, blanket rulings or orders implementing the Instrument in those jurisdictions.

A US issuer would be deemed to have satisfied the requirements of Canadian securities legislation relating to beneficial shareholder communications if it complies with the requirements of Rule 14a-3 of the Securities Exchange Act 1934. But any Canadian clearing agency, or any Canadian intermediary whose last address, as appears in the issuer’s book, is in the local jurisdiction, is required to comply with (Canadian) NI 41 or any successor instrument to it.

As basically continuous disclosure documents prepared in compliance with the US federal securities law requirements constitute a substitute for the CMJDS requirements, it would be relevant to overview the US law in this regard in the following.

While an issuer offering securities for sale is under obligation to register those securities with the SEC under the 1933 Act, an issuer who has a class of securities listed on a national securities exchange for being traded is required to register

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1348 E.g., OSA, ss. 77 &78, and OSAR, s. 2(1).  
1349 E.g., OSA, ss. 77& 78, and OSAR, s. 2(2).  
1350 Companion Policy 71-101CP, s. 3.6. See, for example, (Ontario) Rule 71-801, Part 4.  
1351 Beneficial shareholders are those non-registered holders of securities who hold interests in securities through intermediary(ies). See NI 71-101, s. 18.1.  
1352 Ibid.  
1353 This Policy Statement is due to be replaced effective 1 July 2002 by National Instruments 54-101 and 54-102.
its securities with the SEC under section 12 of the 1934 Act. Both the issuers are required to file periodic reports with the SEC under section 15(d) and section 13 of the 1934 Act respectively, which are, by nature and content, are same.\textsuperscript{1355} Those are (a) annual report on Form 10-K, (b) a quarterly report on Form 10-Q, and (c) a current report on Form 8-K. As mentioned before, an integration between the 1933 Act and 1934 Act has been worked out principally through adoption of Regulation S-K that specifically sets out information to be contained in statements and reports to be filed under both Acts. In course of discussion of the contents of the said reports reference would be made to the provisions of this Regulation, where appropriate. In addition to those, discussion will be made on proxy statements and insider trading reports.

A. Annual Report

The annual report on Form 10-K is ‘recognized as the most effective means of communication between management and security holders. …[It] provides meaningful information regarding the business, management, operations and financial position of the issuer.’\textsuperscript{1356} The principal items covered by an annual report include financial statements, supplementary financial information, consolidated financial data, and management’s discussion and analysis of financial condition and results of operations. As both prospectus disclosure and continuous disclosure requirements have been integrated by Regulation S-K and Regulation S-X in order to avoid duplication of information,\textsuperscript{1357} the information ventilated by these items are the same as those disclosed by a prospectus, which have already been discussed elsewhere.\textsuperscript{1358}

B. Quarterly Report

\textsuperscript{1354} Companion Policy 71-101, s. 3.6(2).
\textsuperscript{1355} See Schaumann, \textit{supra} note 1214, at p. 198.
\textsuperscript{1356} See text accompanied by notes 1248-1250, \textit{supra}.
\textsuperscript{1357} See text accompanied by notes 1252-1287, \textit{supra}.
Substantially all reporting companies are required to file with the SEC and concerned exchanges a report on Form 10-Q within 45 days after the end of each of its first three fiscal quarters; no such report is required for the fourth quarter though.\textsuperscript{1359} The report includes basic financial statements, to wit, balance sheet, statement of income, and statements of changes in financial condition. They may be presented in a condensed form and without being audited.\textsuperscript{1360} The balance sheet is required to be as of the end of the most recent fiscal quarter and as of the end of previous year. Normally an interim balance sheet as of the comparable quarter of the previous year need not be included. It is provided only if necessary for understanding of the impact of seasonal fluctuations on the registrant’s financial condition. The statement of income is to be for the most recent fiscal quarter. For the purpose of comparative analysis between the preceding fiscal quarters of the present year and also between the corresponding quarters of the preceding fiscal years it is required that the statement of income cover the periods between the end of the preceding fiscal year and the end of the most recent fiscal quarter, and the corresponding periods of the preceding fiscal year. The income statement needs to show earnings and dividends per share. The calculation of earnings per share is to be presented as an exhibit according to Item 601(b)(11) of Regulation S-K.\textsuperscript{1361} Notes may be added to the financial statements so that the information provided does not become misleading.\textsuperscript{1362} Where, according to the registrant’s statement, the financial statements have been reviewed by an independent public accountant, a review report of the accountant must be filed with the interim statements.\textsuperscript{1363} In addition, if there has been any accounting changes, the registrant is under an obligation to state the date of any material accounting changes and the reasons therefor. A letter from the

\textsuperscript{1359} SEC Form 10-Q, General Instruction 1.
\textsuperscript{1360} Regulation S-X, Rule 10-01(a).
\textsuperscript{1361} Ibid., Rule 10-01(b)(2).
\textsuperscript{1362} Ibid., Rule 10-01(a)(5).
\textsuperscript{1363} Ibid., Rule 10-01(d).
registrant’s independent accountant is to be filed as an exhibit indicating if the change to an alternative principle is, in his judgement, preferable under the circumstances.\textsuperscript{1364}

In addition to the financial statements the quarterly report must include management’s discussion and analysis (MD&A) of financial condition and results of operations.\textsuperscript{1365} The MD&A shall discuss any material changes in financial condition from the end of the last fiscal year to the date of most recent interim balance sheet provided in the quarterly report.\textsuperscript{1366} It shall also discuss any material changes in results of operations between the most recent quarter and comparable quarter of the preceding year and any other year-to-date results with the results of the corresponding period of the prior year.\textsuperscript{1367}

Apart from the above, the quarterly report on Form 10-Q must also contain information concerning, among others, legal proceedings where they have been instituted during the quarter or where there have been material development with regard to them during the quarter;\textsuperscript{1368} material modifications in and restrictions (e.g., working capital restrictions and other limitations on the payment of dividends) on the rights of security holders of a class of registered securities;\textsuperscript{1369} material defaults in the payment of principal, interest, a sinking fund\textsuperscript{1370} or purchase fund instalment or any other material default not cured within 30 days, with respect to any indebtedness of the registrant or any of its significant subsidiaries;\textsuperscript{1371} and details of voting (e.g., date, type

\textsuperscript{1364} Ibid., Rule 10-01(b)(6).
\textsuperscript{1365} SEC Form 10-Q, Item 2.
\textsuperscript{1366} Regulation S-K, Item 303(b)(1).
\textsuperscript{1367} Ibid., Item 303(b)(2).
\textsuperscript{1368} SEC Form 10-Q, Part II Item 1.
\textsuperscript{1369} Ibid., Item 2.
\textsuperscript{1370} “This is an account created by transferring an amount from profit and loss account or appropriation account by debiting that account and crediting sinking fund account in order to provide for the redemption of a known liability or for the renewal of a wasting asset.” A.N. Saha, Mitra’s Legal & Commercial Dictionary, 5th ed (Calcutta and New Delhi, Eastern Law House, 1990), at p. 655.
\textsuperscript{1371} Form 10-Q, Item 3.
of meeting, election of directors, matters voted, votes cast, abstentions, etc) held during the quarter.\footnote{Ibid., Item 4.}

C. Current Report

A registrant is obligated to file current report on Form 8-K on occurrence of one or more of the following events:

1. A change in control of the registrant, which takes place through ownership of its shares by some person(s);\footnote{Form 8-K, Item 1.}
2. Acquisition or disposition of a significant amount of assets by the registrant otherwise than in the ordinary course of business;\footnote{Ibid., Item 2.}
3. Appointment of receiver, fiscal agent or similar agent for the registrant in bankruptcy proceeding;\footnote{Ibid., Item 3.}
4. Judicial or administrative order confirming the registrant’s plan of reorganisation, rearrangement or liquidation;\footnote{Ibid., Item 3.}
5. The resignation or dismissal of the certifying accountant;\footnote{Ibid., Item 4.}
6. The resignation of a director and furnishing of a letter by him to the registrant describing his disagreement on any matter relating to the registrant’s operations, policies or practices with a request to disclose it;\footnote{Ibid., Item 6.}
7. Any other matter considered by the registrant to be of material importance to the security holders.\footnote{Ibid., Item 5.}
The events referred to in 1-4 must be reported within 15 days of the events concerned, and events in 5-6 within five days. Other events (no. 7 above), being optional, may be submitted at any time, but preferably promptly after occurrence.

D. Proxy/Information Statement

Under the federal law proxy ‘is a power of attorney to vote for shares owned by someone else.’ A company registered under section 12 of the Securities Exchange Act 1934 can solicit proxies from its shareholders in compliance with the rules and regulations prescribed by the SEC to vote at meetings of the shareholders, or solicit consents or authorisations respecting any of the issuer’s securities if no meeting is not held. If it has not solicited proxies from the shareholders in connection with a meeting, it must furnish them with information ‘substantially equivalent’ to that which would be required if it has solicited proxies. Similar information is called for when a majority of its board of directors is replaced by the directors’ action otherwise than at the shareholders’ meeting, when there is a transfer of controlling stock transfer.

The SEC, under the above authority, has issued regulations prescribing the form of proxy and the information to be supplied to the shareholders. Under rule 14a-3, before every meeting of the securityholders, the registrant must furnish each of them with a proxy statement that contains information specified in the Securities Exchange Act 1934 Schedule 14. Along with this a proxy form must be added under rule 14a-4, on which the shareholders can approve or disapprove each matter to be presented in the meeting. In addition, there must be the registrant’s annual report when

1380 Ibid., General Instructions B(1).
1381 Ibid., supra note 1247, at p. 3-18.
1382 Ibid., supra note 1214, at p. 284.
1383 SEA 1934, s. 14(a).
1384 Ibid., s. 14(e).
1385 Ibid., s. 14(f).
directors are to be elected. The proxy statement or the information statement must contain, among others, the following information:

1. a statement identifying who is making the solicitation, the means (mail, etc.) being used, who bears the solicitation cost, the total expenditures to date and the total amount estimated to be spent in the proxy solicitation;

2. if directors are be elected at the shareholders’ meeting, names and ages of all directors of the registrant and all persons nominated or chosen to become directors, positions and offices (including directorship) with the registrant held by each of these persons, transactions with and indebtedness to the registrant or any of its subsidiaries;

3. details of about the registrant’s compensation of its executive officers, viz., the chief executive officer (CEO), the four most highly compensated officers but the CEO, and up to two persons for whom disclosure would have been provided but for the fact that they were not serving as the executive officers of the registrant at the end of the last completed fiscal year;

4. detailed information about specific matters for which proxy is sought, e.g., merger, acquisitions, liquidation or dissolution of the company;

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1386 SEC Rule 14a-3.
1387 Rule 14a-5(a) requires all information to be ‘clearly presented’ and logically organised. If the proxy statement is a false one, the persons whose votes solicited thereby will be protected. See H.L. Federman & Co v Greenberg, 405 F. Supp. 1332.
1388 SEA 1934 Schedule 14A.
1389 SEA 1934 Schedule 14A; Reg. S-K, Item 401.
1390 SEA 1934 Schedule 14A; Reg. S-K, Item 404(a).
1391 SEA 1934 Schedule 14A; Reg. S-K, Item 404 (c).
1392 SEA 1934 Schedule 14A; Reg. S-K, Item 402(a)(3).
1393 SEA1934 Schedule 14A.
5. disclosure of date, time and place of the meeting securityholders, number of shares outstanding and number of votes each class of securities is entitled to, record date for voting, change in control of the registrant, person(s) gaining such control, and amount and source of consideration used for the control.\textsuperscript{1394}

E. Insider Trading Report

Insider trading on material, nonpublic information (e.g., possible acquisitions by the issuer) is prohibited as a fraud in the United States under the Securities Exchange Act 1934 Rule 10b-5\textsuperscript{1395}. Although Rule 10b-5 does not specifically require disclosure of inside information by an insider in securities transactions, the law courts and the SEC have applied the rule to such transactions\textsuperscript{1396} inasmuch as ‘insider trading gave birth to [the rule]’\textsuperscript{1397}. Today the said rule extends to so many aspects of the securities regulation and has become ‘a judicial oak which has grown from little more than a legislative acorn’\textsuperscript{1398}. Insider trading law is as such a ‘prominent branch of [that] judicial oak’\textsuperscript{1399}.

Liability for insider trading under Rule 10b-5 arises when an insider purchases or sells a security of an issuer

(a) on the basis of material nonpublic information about that security or issuer,

\textsuperscript{1394} Ibid.
\textsuperscript{1395} SEA 1934 Rule 10b-5 makes it unlawful, in course of purchase or sale of any security, for any person to (a) employ any device, scheme or artifice to defraud, (b) make any untrue statement of a material fact, or omit to state a material fact, and (c) engage in any act, practice, or course of business that operates or would operate as a fraud or deceit on any person.
\textsuperscript{1396} Schauman, supra note 1214, at p. 229.
\textsuperscript{1397} Bloomenthal, supra note 943, at Ch. 13.01.
\textsuperscript{1398} Per Justice Rehnquist in Blue Chip Stamps v Manor Drug Stores, 421 US 723, 95 S.Ct. 1917, 1926 (1975), cited in ibid.
\textsuperscript{1399} Bloomenthal, ibid.
(b) in breach of a duty of trust or confidence that he or she owes the issuer or the shareholders of that issuer, or any source-person of the material nonpublic information.\textsuperscript{1400}

The first condition of liability, namely trading on the basis of material nonpublic information (in other words, undisclosed inside information) is fulfilled if the insider trades while in possession of this information regardless of whether he or she actually uses it.\textsuperscript{1401} Under \textit{Texas Gulf Sulphur}\textsuperscript{1402} even if a public announcement of an information is made by the registrant, an insider may not trade instantly on that. He needs to wait ‘until the news could reasonably have been expected to appear over the media of widest circulation.’ Second, insiders standing in trust and confidence with shareholders are duty bound to disclose inside information. This is additional to the issuer’s responsibility to disclose such information to shareholders and the public before trading in its securities starts. In \textit{Texas Gulf Sulphur} it was held that the issuer must make complete, accurate and timely disclosures. If the initial disclosures are incorrect or misleading there may arise a duty to correct or update them.\textsuperscript{1403}

In this context it should be mentioned that insiders in question include a director, officer, controlling shareholders, employee of the issuer.\textsuperscript{1404} Also included are accountants, lawyers, investment bankers and such other persons who have a confidential relationship with issuer and by virtue of it have access to inside information just for corporate purposes.\textsuperscript{1405} The liability extends further to tipees,

\begin{itemize}
\item \textsuperscript{1400} SEA 1934 rule 10b5-1.
\item \textsuperscript{1401} Schaumann, \textit{supra} note 1214, at 231.
\item \textsuperscript{1402} 401 F.2d 833 (2d Cir. 1968).
\item \textsuperscript{1403} See \textit{Wener v. The Quaker Oats Co.}, 129 F.3d 310 (3d Cir. 1997); \textit{Backman v Polaroid Corp.}, 910 F.2d 10 (1st Cir. 1990).
\item \textsuperscript{1404} \textit{SEC v Texas Gulf Sulphur Co.}, 312 F. Supp. 77 (S.D.N.Y. 1970), affirmed, 446 F.2d 1301 (2d Cir. 1971).
\item \textsuperscript{1405} \textit{Dirk v SEC}, 463 US 646 (1983).
\end{itemize}
meaning those who have been tipped inside information by insiders and who trade on the basis thereof, meaning those who have been tipped inside information by insiders and who trade on the basis thereof,\textsuperscript{1406} and to misappropriators\textsuperscript{1407}.

Apart from Rule 10b-5 Securities Exchange Act 1934 section 16 is also concerned with insider trading. While the former prohibits insider trading on material nonpublic information because it is a fraud, the latter prohibits such trading (buying or selling) within less than six months time and provides for disgorging of the profits (called “short-swing” profits) made thereby regardless of whether there was a fraud or not in the use of the information. Therefore, section 16(a)(1) of Securities Exchange Act 1934 requires directors and officers of any company, which has equity securities registered under section 12, to file reports of their holdings of such securities. The same reporting responsibility lies on beneficial holders of more than 10\% of any class of such securities. In this context beneficial holdings means ‘indirect holdings through entities such partnerships, trusts, and estates, and may also include securities owned by certain close relatives of the reporting person’.\textsuperscript{1408} The report must be filed within 10 days after one has become a director, officer or beneficial owner.\textsuperscript{1409} If there is a change in the beneficial ownership, a report thereon must also be filed.\textsuperscript{1410}

\subsection{7.2.3.4 Civil Liability}

US offerings in Canada under the CMJDS are subject to Canadian liability provisions.\textsuperscript{1411} Section 130 of the OSA provides for civil liability for prospectus misrepresentations in addition to common law actions like fraudulent misrepresentation. According to this provision a purchaser of a security offered by prospectus has a right of action for damages where the prospectus (or amendments

\textsuperscript{1406} See \textit{ibid.}; \textit{In re Cady, Roberts & Co.}, 40 SEC 907 (1961).
\textsuperscript{1409} SEA 1934, s. 16(a)(2) and (3).
\textsuperscript{1410} \textit{Ibid.}, s. 16(a)(2).
thereto) contains a misrepresentation (by way of statement or omission) provided the misrepresentation was there at the time of purchase. He need not prove that he actually relied on such misrepresentations. Nor will it hinder him that the defendant did not have any intention to defraud in making the misrepresentations. His right of action for damages is available against the following persons or companies:

(1) the issuer (when offering is a primary one);
(2) the selling securityholder (when the offering is a secondary one);
(3) each underwriter of the securities who is required to sign a certificate contained in the prospectus according to section 59 of the OSA;
(4) every director of the issuer at the time of filing of the prospectus or amendment thereto;
(5) every person or company (e.g., accountant, lawyer, engineer) lending consent in connection with reports, statements or opinions contained in the prospectus but only as regards the reports, statements or opinions particularly made by them;
(6) every person or company, namely the chief executive officer, chief financial officer, two directors on behalf of the board of directors other than those named in the foregoing, and a promoter of the issuer, who signed a certificate under OSA section 58 confirming the prospectus containing “full, true and plain disclosure of material facts” concerning the securities being offered thereby.

Against a damages action by a purchaser of security offered by prospectus the defendant can plead the following defences:

1411 Companion Policy 71-101CP, s. 2.4.
(1) The issuer and the selling securityholder have only one defence, namely that the purchaser knew of the prospectus misrepresentations at the time of purchase.¹⁴¹³ Their liability is strict liability. ‘No amount of care, good faith, or due diligence on the part of such defendants will otherwise protect them from liability.’¹⁴¹⁴

(2) Defendants other than the above may set defences against an allegation of misrepresentation occurring either in the nonexpertised portion or expertised portion (containing expert opinions or statements) of the prospectus. With respect to the former a defendant may be exonerated from the liability subject to the proof that

(i) the prospectus was filed without his or her or its knowledge or consent;¹⁴¹⁵

(ii) on becoming aware of any misrepresentation in the prospectus he or she or it withdrew the consent given earlier;¹⁴¹⁶

(iii) any statement that subsequently found to be false was an official statement and he or she or it had reasonable grounds to believe and did believe the statement to be true;¹⁴¹⁷

(iv) he or she or it conducted ‘such reasonable investigation as to provide reasonable grounds for a belief that there had been no misrepresentation’, or he or she or it actually believed that there had been no misrepresentation.¹⁴¹⁸

The last mentioned defence is known as the defence of “due diligence”. In this context the standard that is applied to ascertain what amounts to “reasonable investigations” or “reasonable grounds for belief” is ‘that required of a prudent person in the circumstances of the particular case’.¹⁴¹⁹

¹⁴¹³ OSA, s. 130(2).
¹⁴¹⁴ MacIntosh and Nicholls, supra note 1412, at p. 162.
¹⁴¹⁵ OSA, s. 130(3)(a).
¹⁴¹⁶ Ibid., s. 130(3)(b).
¹⁴¹⁷ Ibid., s. 130(3)(e).
¹⁴¹⁸ Ibid., s. 130(5).
Where the misrepresentation relates to the expertised portion of the prospectus, it is a defence for a non-expert defendant that he or she or it had no reasonable grounds to believe and did not believe that there had been a misrepresentation.\textsuperscript{1420} If the defendant is an expert and the impugned misrepresentation is attributable to inaccurate representation of his, her or its original (accurate) report, opinion or statement, it will be a defence that after reasonable investigation the defendant had reasonable grounds to (mistakenly) believe and did actually so believe that the prospectus or it amendment had contained fair representation of his, her or its report, opinion or statement.\textsuperscript{1421} Alternatively, he or she or it may, after becoming aware of the mistake, instantly apprise the OSC and issue a reasonable general notice that such an error has taken place.\textsuperscript{1422} Where the expert’s report, opinion or statement, albeit fairly duplicated in the prospectus, is the cause of inaccuracy, the expert can plead the “due diligence” defence\textsuperscript{1423} which is similar to that stated above\textsuperscript{1424}.

\textbf{7.2.3 Conclusion}

The foregoing discussion shows that under the MJDS a Canadian issuer may offer securities by prospectus prepared according to Canadian law and normally reviewed by the concerned Canadian securities authority. Similarly a US issuer may offer securities in Canada by prospectus drawn up by the US law and, in general, reviewed by the US federal securities authority, the SEC. In other words, MJDS prospectus is prepared and reviewed in compliance with the home country law of the issuer. The same is true of continuous disclosure documents. With respect to liability of the issuer and others, however, the host country law is applied.

\textsuperscript{1419} Ibid., s. 132.
\textsuperscript{1420} Ibid., s. 130(3)(c).
\textsuperscript{1421} Ibid., s. 130(3)(d)(i).
\textsuperscript{1422} Ibid., s. 130(3)(d)(ii).
\textsuperscript{1423} Ibid., s. 130(4).
\textsuperscript{1424} See text accompanied by notes 1418-1419, supra.
US federal securities law is founded on the disclosure philosophy while Canadian law (Ontario law in particular) is on the combination of the disclosure and merit review philosophies. Both require, as a basic rule, full, true and plain disclosure of material facts. Prospectus provisions call for same/similar categories of information, for example, information relating to securities, their underwriting and distribution, use of proceeds, risk factors, issuer and issuer’s business, management’s discussion and analysis of the financial condition, changes and results of operation. The information asked for disclosure under these broad categories is also similar. However, one item of information, namely purchaser’s right of prospectus delivery, withdrawal from purchase and rescission of the contract of sale, and damages in the event of misrepresentations in the prospectus, is not required to be disclosed in the US prospectus unlike Ontario. But similar rights are available under the US law.\textsuperscript{1425} Under both laws similar financial statements (balance sheet, income statement, retained earnings) are added to a prospectus, prepared according to respective GAAP and audited according to respective GAAS, must be reconciled with the host state’s GAAP and GAAS.

With regard to prospectus review the OSC is generally responsible to ensure that the prospectus contains full, true and plain disclosure. For the protection of public interest it may decline to lend approval to the prospectus. Besides there are some specific grounds on which it may exercise its discretion to refuse its consent. On the other hand, the SEC checks if a prospectus makes full disclosure in it as required by the 1933 Securities Act. It also may issue an order to prevent it from coming into effect in public interest. Thus to a great extent the both laws are similar. They differ only in that the SEC does not have any specific-ground discretion to refuse approval to a prospectus, which is a very limited and rarely exercised jurisdiction of the OSC. Of

\textsuperscript{1425} See SA, s. 10(b), s. 11.
course, within the MJDS framework both US and Canadian issuers are subject to this discretionary jurisdiction.

It has been said that Ontario continuous disclosure requirements were borrowed from the US. As such Ontario requirements of annual report, interim report, proxy/information circular, material change report and insider trading report have their counterparts in US federal law contents of which are more or less similar.

In respect of prospectus misrepresentations both laws contain very similar provisions concerning, in particular, who may be sued for misrepresentations, the remedy of damages for plaintiff and “due diligence” defences for defendants.

Since Canadian law and US federal law respectively form the basics of the USMJDS and the CMJDS, and they are similar or almost similar concerning prospectus disclosure, prospectus review, continuous disclosure and civil liability, it can be concluded that the US MJDS and CMJDS are similar ‘with some variation to accommodate differences in U.S. and Canadian procedural and institutional arrangements.’ In the forthcoming chapter prospectus disclosure law of the USMJDS (i.e., Canadian prospectus disclosure law) will be compared with the EC counterpart, which is the “core” of the present thesis.

PART IV
THE NORTH AMERICAN SECURITIES REGULATION AND THE EUROPEAN SECURITIES REGULATION: COMPARISONS

8.1 GENERAL


1427 For the reasons for choosing Canada, particularly Ontario, for comparison with the EC, see texts accompanied by notes 52-55 and 946-950, supra.
The EC is, as of today, a supranational political organisation of 15 (25 from May 2004) Member States. Of course it started its journey as an economic community in 1957. Economic integration was thought as the primary and catalytic goal in the hope that it would ultimately lead to political integration.\textsuperscript{1428} The architects of the EC sought to establish one market expanding throughout the Community where goods, person, services and capital (i.e. production and production related forces) could freely move beyond state boundary. To this end it was necessary to eliminate barriers to these four freedoms. Theoretically this was premised on Scitovsky’s view that the elimination of barriers could create a competitive integrated economic market in Europe.\textsuperscript{1429} In order to remove barriers the EC Commission devised a dual method: harmonisation and mutual recognition that occurs by legislation (mostly directives) and, in turn, by their incorporation in the national laws of the Member States. Anything that is not covered either by harmonisation or mutual recognition is governed by national laws of Member States. The process of legislation (directive making), and their implementation in the domestic jurisdiction of Member States are a convoluted and time consuming matter. This is so because of the roundabout method of the lawmaking and the political bickering between the Community and Member States or the Member States \textit{inter se}. This has not, however, hindered progress of the EC, rather integration has taken place through this process despite manifold national diversities (e.g., language, culture and law). The emergence of the EC-wide securities market regulated by directives is a glowing example of the success.\textsuperscript{1430} Based on disclosure theory these directives include mainly directives on listing particulars, accounting, public securities offerings and stock exchange listings.

\textsuperscript{1428} See text accompanying notes 82-119, \textit{supra}.
\textsuperscript{1429} See, for the theoretical discussion, chapter 2, \textit{supra}.
\textsuperscript{1430} For diversity in national securities regulation, see Karmel, \textit{supra} note 389.
Unlike the EC the MJDS is not a political nor fully-fledged economic alliance; it is merely a securities alliance of Canada and the United States created by an agreement. It was adopted as an initial step to further this regional cooperation beyond North America.\textsuperscript{1431} It aimed to remove obstacles to movement of capital/services across the border and as such is seemingly based on Scitovsky-like economic theory.\textsuperscript{1432} With a view to achieving this the US and Canada have followed the same method of harmonisation and mutual recognition as has been done by the EC. With close historical and philosophical links, both the States had been carrying very similar regimes particularly with respect to substantive disclosure requirements and prospectus review perspective.\textsuperscript{1433} In addition, Canada brought changes to its law notably concerning continuous disclosure, management’s discussion and analysis requirements in line with the US law.\textsuperscript{1434} To implement the MJDS Canada adopted the National Instrument 71-101 and the US various rules, forms and schedules. Under the system disclosure documents of one country are accepted in the other.

Thus so far as integration of securities markets is concerned the EC can be broadly said to conform to the MJDS in that both were created to establish obstacle-free regional markets premised on similar theoretical postulation. Founders of both devised harmonisation and mutual recognition/reciprocity as the methods of integration. Both the alliances have the same goal of expanding securities markets to greater areas, albeit as regards the market size the MJDS ‘pales’ compared to the EC, which is a large alliance of 15 (25 from May 2004) States\textsuperscript{1435}. Whether further expansion between them is possible depends on how far they are specifically similar.

\textsuperscript{1431} Supra note 49.
\textsuperscript{1432} See ch. 6.2, supra.
\textsuperscript{1433} Ch. 6.1, supra.
\textsuperscript{1434} Ibid.
\textsuperscript{1435} Warren, supra note 748, at p. 715.
This leads to comparison of the prospectus disclosure regimes of the two regions in the following.

**8.2 PROSPECTUS DISCLOSURE**

**8.2.1 Basic Disclosure Rules**

As discussed earlier, unless exempted from the prospectus requirement an issuer under both laws of the EC and Ontario must publish a prospectus for offering securities. Article 21(1) of the Admission and Information Directive (AID)\textsuperscript{1436}, which applies to maiden public offering of securities and also to securities listing, calls for \textit{the information} necessary for the investors and their investment advisors to make \textit{informed assessment} of the issuer’s affairs and the rights to the securities offered. In this context, it is relevant to look into the actual meaning and scope of \textit{the information}. This does not refer merely to the various types of items specified in the Directive because it is not feasible for the draftsmen to enumerate all information required of an issuer to disclose in prospectus. It is the responsibility of the issuer to disclose all information that encompasses the specified information plus any other information the issuer deems necessary for the investors’ assessment of the issuer. For this reason maybe, though the word “all” is missing in article 21(1) AID, its corresponding provision (article 5) of the proposed public offer prospectus Directive\textsuperscript{1437} (which would replace former after adoption) contains this before the words “the information”. So also Section 80 of the (UK) Financial Services and Market Act 2000, which implements the above provision of the AID, contains the word “all”.\textsuperscript{1438} However, does this information have any impact on the market? In light of the information, if an investor makes assessment of the issuer’s business etc. and finds it profitable to invest in the securities, he or she or it

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\textsuperscript{1436} Supra note 636.
\textsuperscript{1437} Supra note 857.
\textsuperscript{1438} This general obligation of disclosure, introduced in 1984, is ‘a new feature of English law’. Previously it was implied in the liability provisions for misleading prospectus. The new express obligation is, however, wider than the previously implied one. Oliver Warenham, ‘Contents of listing
may purchase some of them at a fixed price. If the assessment gives a reverse idea, investor may refrain from investing and consequently the securities’ price/value will decline. In this vein the information required of an EC prospectus having ‘substantial effect on the market price of the security’ amounts to ‘material information’\textsuperscript{1439}. Given this Warren put the prospectus disclosure requirement as thus- ‘The mandatory disclosure required by this directive [Listing Directive] is not limited to “filling out a form,” but instead extends to \emph{all material information} relating to the securities…’ \textsuperscript{1440}

Now, how should all material information be presented in a prospectus? An old authority says that an issuer must ‘state everything (material in full) with strict and scrupulous accuracy’ concerning the securities offered.\textsuperscript{1441} The International Organisation of Securities Commissions (IOSCO) reveals the modern practice as follows:

\begin{quote}
\ldots(M)ost countries rely on an overriding principle that, in connection with registration or listing of securities or a public offering of securities, a company should disclose all information that would be material to an investor’s investment decision and that is necessary for \emph{full and fair} disclosure.\textsuperscript{1442}
\end{quote}

From this it is understood that full and fair disclosure has become an international standard method of presentation of material information. The rationale behind may be that in absence of such disclosure investors may not correctly assess the issuer’s affairs and in turn may fail to make right investment decision. That will stultify the most important purpose of the securities legislation, namely the investor protection.\textsuperscript{1443} Thus

\footnotesize
\textsuperscript{1439} Pierce, \textit{supra} note 52.
\textsuperscript{1440} Warren, \textit{supra} note 694.
\textsuperscript{1441} New Brunswick & Canada Ry Co. v. Mugaridge (1860) 1 Dr & Sm. 363, at p. 381 (per Kindersley V.-C.).
\textsuperscript{1443} For example, see 9\textsuperscript{th} recital to the Preamble of the AID. The teleological approach of interpretation is based on following the principle:
full and fair disclosure of all material information should be considered as a postulate of the EC securities legislation in line with world securities law. In addition to this tacit requirement, of course, there is an express requirement provided under article 22(1) of the AID, as seen before, that disclosure be made easily analysable and comprehensible.\textsuperscript{1444} 

Now in view of the above discussion the basic disclosure requirement of EC prospectus can be restated that the prospectus shall contain full, fair and easily analysable and comprehensible disclosure of all material information for the investors’ informed decision making on investment in securities offered by the prospectus.

On the other hand, section 56 of the OSA enshrines the basic principle of disclosure that the prospectus must contain full, true and plain disclosure of all material facts that have actual or likely significant effect on the market price or value of securities offered in the sense that their ‘omission or misstatement would influence or change an investment decision with respect to the issuer’s securities’\textsuperscript{1445}. “Material facts” in question conforms to “material information” as defined in connection with the EC law above in that both have same market impact. Both laws call for “all” material information/facts. As already seen, as to the manner of presentation of such information/facts, the EC law requires, in line with international practice, full, fair and easily analysable and comprehensible disclosure vis-a-vis Ontario requirement of full, true and plain disclosure. Apart from the common component of full (meaning “complete”\textsuperscript{1446}) disclosure, do the basic rules of the two jurisdictions differ with respect

\begin{footnotes}
\item[1444] Text to note 702 supra.
\item[1445] Form 41-501F1, Instruction (4).
\end{footnotes}
to the rest? According to Kinney’s Law Dictionary, the word “fair” means ‘Just; equitable; equal; proper’. Black’s Law Dictionary defines it as ‘Having the qualities of impartiality and honesty; free from prejudice, favoritism, and self-interest. Just; equitable; even-handed; equal as between the conflicting interests.’ The word also means “reasonable”, e.g., “fair price”, “fair rent”. Since the present context relates to investor protection by information disclosure, it would be appropriate to use “fair” to mean “just”, or “proper” or “impartial and honest”, which is synonymous or almost synonymous with “true”. However, judicial interpretations show that the standard of “full and fair” disclosure and “full and true” disclosure are used in similar sense. Thus in New Sombrero Phosphate Co. v. Erlanger where a corporate prospectus disclosed that the issuer entered into a contract of property acquisition concealing the fact that the promoters were the vendors who charged double the purchase price. It falsely stated that the directors had approved the contract. The Court of Appeal held the promoters breached their duty of making full and fair disclosure. This was upheld by the House of Lords. A recent Australian case established that omission or untrue statement of facts material to investors’ decision making is a breach of the “full and fair” disclosure duty as it leaves the investors in ‘half-light’. Similar is the position in Canada. “Full and true” disclosure standard is applied to ensure that complete information free from falsity or ambiguity is supplied in prospectuses, otherwise it will create liability under the securities law. This rule applies to material changes as

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1447 Ibid., s.v. “fair”.
1449 Mitra’s Legal and Commercial Dictionary, supra 1370, at p. 302.
1450 [1877] L.R. 5 Ch.D. 73. Also see Lagunas Nitrate Company v. Lagunas, [1899] 2 Ch.D. 392 (Court of Appeal).
1452 Charles Rosedale and Natalie Moshinsky, Fraser v. NRMA Holdings Ltd (unreported) (Case Comment), (1995) 6(4) ICCLR C72-73.
well. The purpose behind is to ensure that the persons carrying on the business are honest and of good repute and that investors are protected from being defrauded. Finally the EC requirement of presentation of information in ‘easily analysable and comprehensible’ form has been copied from international practice. The purpose, as contained in the LPD and also later in the AID, is to enable the investors and investment advisers (to easily read and understand and thereby) to assess the issuer and its securities. In other words, the expression, ‘easily analysable and comprehensible’, purports to mean that the prospectus disclosures must be well readable and understandable by investors as well as professional advisers. Before the LPD was adopted, the ECOSOC recommended for deleting professional advisers as the object of the disclosure. For if disclosure is meant for them, that would not be useful to the investors inasmuch as they ‘can neither read nor understand the prospectus and can only base their decision to invest on the recommendation of financial consultant’. But if the disclosure is made readable and understandable by lay investors, that can be better understandable by sophisticated investors and professional advisers. In that case there is no need to delete professional advisers. Of course the proposed prospectus Directive provides for disclosure of information only to enable investors to make an informed assessment and has omitted “investment advisers”. Similar to the EC law Ontario requirement of “plain” disclosure means that the prospectus must be presented in a style so that it can be ‘read by investors generally and not only by security analysts

1455 Pezim v. B. C, supra note 1194.
1457 See Explanatory Memo. On the proposed prospectus Directive, supra note 857, comment on art. 5.
1458 AID, arts. 21(1) and 22(1) read together.
1459 [1974] OJ C11/24 and [1974] OJ C125/1, para. 3.1.2 However, disclosure cannot be as easily made as can be understood by the ‘school children’. Investors, especially lay investors, need professional people/institutions’ advice to understand the prospectus disclosure. But this does not negate the need of “plain disclosure” because sophisticated investors at least can understand the disclosure themselves and the lay ones can avail of the services provided by the financial professionals who will be able to comfortably understand the disclosure. Zahid and McGee, supra note 951, at pp 195-196.
1460 In a reverse way, “(i)if the disclosure is directed towards investment advisers it is unlikely to take a form which is accessible to ordinary investors.” Moloney, supra note 27, at p. 146.
1461 See art. 5(1).
and other trained persons.\textsuperscript{1462} Here readability means that the prospectus must be understandable. In other words, ‘the disclosure must understandable to readers and presented in an easy to read format’.\textsuperscript{1463} This is confirmed by the following instruction of the SEC that was the basis of Ontario provision:

The purpose of prospectus is to inform the investors. Hence, the information set forth in the prospectus should be presented in clear, concise, \textit{understandable} fashion. Avoid unnecessary and irrelevant details, repetition or the use of unnecessary technical language… .\textsuperscript{1464}

From the above discussion it can be concluded that the “full and fair” disclosure standard supposed to apply in the EC equates with the “full and true” standard of Canada. As well, the EC requirement of “easily analysable and comprehensible” disclosure conforms to the “plain” disclosure requirement of Canada. Thus as a whole EC basic disclosure requirement corresponds, in effect, to that of Canada despite their literal variation.

Secondly in order to fulfil the first general rule, namely the disclosure standard, Ontario law prescribes a particular form and specifies the information and financial statements to be contained in a prospectus. On the other hand to the same end the EC AID sets forth a particular layout\textsuperscript{1465} and, as minimal, various items of information and financial statements. The prospectus must comply include additional information prescribed by the Member States. Of course the proposed prospectus Directive prescribes a complete package of information that an EC prospectus must

\begin{footnotes}
\item[1462] \textit{Kimber Report, supra} note 1127, at para. 5.09.
\item[1463] Form 41-501F1, Instruction (5).
\item[1464] \textit{Kimber Report, supra} note 1127, at para. 5.09 (emphasis added). The SEC instruction for plain disclosure has been carried forward by the United States Securities and Exchange Committee, \textit{Disclosure to Investors: A Reappraisal of Administrative Policies under the 1933 and 34 Act} (1969) (popularly known as \textit{Wheat Report}). The report has been later echoed in \textit{Feit v. Leaseco Data Processing Equipment Corp.}, 332 F. Suup. 544 (ED NY 1971) at p. 565-566. See, for the plain language principles followed in Ontario, Companion Policy 41-501CP, sec. 1.2.
\item[1465] See Annex to AID, \textit{supra} note 636. Also see Annexes to the (repealed) LPD and the proposed prospectus Directive.
\end{footnotes}
uniformly embody. Thus respecting the second rule of prospectus’s compliance with securities legislation both regimes are also similar.

**8.2.2 Prospectus Contents**

**8.2.2.1 Non-Financial Matters**

It has been viewed before that prospectuses of the EC and Ontario contain some broad categories of information-items. For comparison purpose those may be rearranged as follows:

1. Securities being offered;
2. Issuer, its capital and activities;
3. Management;
4. Management discussion and analysis (MD&A);
5. Risk factors;
6. Responsibility declaration;
7. Purchaser’s statutory rights statement;
8. Miscellaneous.

In this sub-chapter prospectus information under both regimes, which has been overviewed before, will be compared. In this process some repetition of information will be unavoidably made. The UK practice will be mainly cited, where appropriate, as an example of the EC prospectus regulation vis-à-vis Ontario practice keeping the context of the MJDS in mind. The reason behind choosing the UK is, as mentioned earlier,¹⁴⁶⁶ that in Europe it is the country where the highest number of foreign companies are listed. In order to facilitate the comparison reference may be made to relevant international disclosure standards set by the International Organisation of Securities Commissions (IOSCO). Where the two laws significantly differ it would be

¹⁴⁶⁶ Text accompanied by note 56, supra.
useful to use the IOSCO’s standards as the yardstick to judge their comparative merits as such comparability of information is the purpose of those standards.\textsuperscript{1467}

**Category I: Securities**

**Price, Market and Underwriting commission:**

The cover page or first few pages of an EC prospectus must disclose, among other things, the number\textsuperscript{1468} and selling price\textsuperscript{1469} (per share and total) of the securities offered, the fact of application being made for a listing for new securities with a listing authority, e.g., the United Kingdom Listing Authority (UKLA), and name(s) of the stock exchange(s) (e.g. London Stock Exchange-LSE) where admission to official listing is or will be sought.\textsuperscript{1470} It must also present an indication or estimate of net proceeds after issue costs to be procured by the issuer, which include financial intermediaries’ commissions\textsuperscript{1471}. Underwriting commissions\textsuperscript{1472} come within the costs purpose of which is mainly to enable the investors assess the risks involved in investing in the issue offered. Investors can make the risk assessment from the formula: ‘the more difficult the issue is to sell, the larger will be percentage of the issue proceeds paid to the underwriter for his services’\textsuperscript{1473}. If, however, the issue is not underwritten,

\begin{itemize}
\item \textsuperscript{1467} IOSCO’s *International Disclosure Standards for Cross-Border Offerings, supra*, note 1442, Part I: Introduction: Background.
\item \textsuperscript{1468} AID, *supra* note 636, chs. 2.2.0, 2.4.1.
\item \textsuperscript{1469} Ibid., chs. 2.3.3., 2.4.0.
\item \textsuperscript{1470} Ibid., chs. 2.1 and 2.2.6. see *Prospectus, Oxford Technology 3-Venture Capital Trust Plc*, (Kent: 2002) (hereafter Oxford Prospectus), at p. 1.
\item \textsuperscript{1471} Ibid. ch. 2.3.9. See, for example, Oxford Prospectus, at p. 3.
\item \textsuperscript{1472} Underwriters charge commissions mainly because they incur costs in reselling securities, they invest huge amount of money in the securities, which they could invest elsewhere, and they, having reputation in the financial world, lend their approval to the merit of the securities of the issuer while reselling them. Julian R. Franks, John E. Broyles, and Willard T. Carleton, *Corporate Finance: Concepts and Applications*, (Boston: Kent Publishing Company, 1985), at p. 505.
\item \textsuperscript{1473} P.E. McQuillan, *Going Public in Canada*, (Toronto: The Canadian Institute of Chartered Accountants, 1971), at p. 118.
\end{itemize}
the prospectus must bear a statement to that effect\textsuperscript{1474}. The cover page of an Ontario prospectus must set out, among others, similar information on securities\textsuperscript{1475}.

**Description of Securities offered:**

The EC law requires nature and amount of the issue, number and type of shares offered\textsuperscript{1476} and summary of the rights, in general, attaching to the shares, and particularly the extent of voting rights\textsuperscript{1477}, entitlement to profits, and participation in the surplus on winding up\textsuperscript{1478}. It calls for information about pre-emptive rights\textsuperscript{1479} or restrictions on or withdrawal of such rights.\textsuperscript{1480} Ontario law requires almost the same information.\textsuperscript{1481} Unlike the EC law it requires a description of the provisions of modification of the rights attached to shares.\textsuperscript{1482} If any other class of securities creates any limitation or qualification or have higher/equal ranking over the shares being distributed, Ontario law asks for information about those other securities that will help the investors understand the rights attaching to the shares being distributed.\textsuperscript{1483} Another departure from the EC law emerges from the fact that in addition to the rights attaching to shares, the latter asks for other material “attributes and characteristics” of them which include

\textsuperscript{1474} AID, supra note 636, Annex A, Sch. A, ch. 2.3.7. See Oxford Prospectus, ibid., at p. 1.
\textsuperscript{1475} Form 41-501F1, Items 1.4, and 1.7 read together with Items 7.1, 7.2, 19.8 and 19.9 . See, for example, Rogers Prospectus, (Toronto: July 1997).
\textsuperscript{1476} AID, supra note 636, ch. 2.2.0. Also see Clifford Chance, Going Public in the UK- A Guide for US Corporations (NY: Clifford Chance, 1988), at p. 32.
\textsuperscript{1477} A company may issue more than one type of common stock, normally designated as Class A, Class B etc. Such designation allows it to vary one or more characteristics of shares, e.g. one class of shares may have full voting rights and others may less or no voting rights. See Haim Levy and Marshall Sarnat, Principles of Financial Management, (Englewood Cliffs, N.J.: Prentice Hall, 1988) at p. 287.
\textsuperscript{1478} AID, supra note 636, Annex A, Sch. A, ch. 2.2.2.
\textsuperscript{1479} “Pre-emptive rights” may be defined as the rights of the existing shareholders to purchase the securities offered so that they can maintain their pro rata ownership in the issuer company. See IOSCO, supra note 1442, at p.
\textsuperscript{1480} AID, supra note 636, chs. 2.3.0, 2.3.4.
\textsuperscript{1481} See Form 41-501F1, Items 1.3, 1.4 and 10.1.
\textsuperscript{1482} Ibid., Item 10.6.
\textsuperscript{1483} Ibid., Item 10.9.
(a) sinking or purchase funds provisions;\textsuperscript{1484}

(b) redemption\textsuperscript{1485}, retraction\textsuperscript{1486} (including the manner of choosing shares for redemption or retraction\textsuperscript{1487}), purchase for cancellation\textsuperscript{1488} or surrender\textsuperscript{1489} provisions;\textsuperscript{1490}

(c) provisions mandating or limiting the issuance of additional securities and any other material limitations\textsuperscript{1491}, and

(d) provisions requiring contribution of additional capital by shareholders.\textsuperscript{1492}

\textsuperscript{1484} Form 41-501F1, Item 10.1(g). For a company preferred share is normally a permanent source of funding having no fixed maturity. Preferred shareholders enjoy preference in the receipt of its dividends. On its winding up they get, on similar preference, a liquidated fund that usually amounts nearly to the amount of investment plus dividends in arrears. Typical preferred shares are redeemable at the option of the company and its articles of association provide for a sinking fund or a purchase fund provision for their retirement. The sinking fund provision states how the issuer will periodically pay for the retirement of the stock. Absent this provision the preferred stock is a “perpetuity”. Thus ‘(i)n effect, the sinking fund provision is tantamount to issuing redeemable preferred shares.’ As an alternative to the sinking fund provision, an Ontario prospectus may set out a provision stating how the issuer will purchase the preferred shares back, which is also called call provision. Levy and Sarnat, \textit{supra} note 1477, at p. 334.\textsuperscript{1486}

It refers to ‘company buy-back of own shares’ (that are cancelled on redemption) where it issues redeemable shares meaning ‘shares which the company is entitled to redeem at its option and irrespective of the wishes of the shareholder.’ Andrew McGee, \textit{Share Capital}, (London: Butterworths, 1999), at p. 115. Originally buying back securities by the issuer was held illegitimate in the nineteenth century in \textit{Trivor v. Whitworth}, (1887), 12 App. Cas. 409, [1886-90] All E.R. Rep. 46. The prohibition was subsequently replaced by statute. The rationale behind was to allow the issuer to buy the shares of a dissenting or dead shareholder, to facilitate employee stock plans, to eliminate fractional shares, to allow the acceptance of the shares in cancellation of an otherwise uncollectable debt owed by a shareholder to the corporation and to give the company more freedom to alter its financial structure. Brand Report (Ontario), cited in E.E. Palmer, D.D. Prentice, and B. Welling, \textit{Canadian Company law}, (Toronto: Butterworths, 1978), at p. 8-22.

\textsuperscript{1486} This is a right occasionally associated with preferred shares. This ‘permits the shareholder to tender the share to the company and the company has to buy it back at some price specified in advance.’ Gillen, \textit{Securities Regulation in Canada}, 2\textsuperscript{nd} ed. (Toronto: Carswell, 1998), at p. 11. In the event of market price fall, for example, such a shareholder can bring in his/her shares with prior notification to the issuer and sell them at the fixed price even though there is maturity date proper. In this way the retraction provision protects shareholders. Edmund M.A. Kwaw, \textit{The Law of Corporate Finance in Canada}, (Toronto and Vancouver: Butterworths, 1997), at p. 79.

\textsuperscript{1487} Form 41-501F1, Item 10.9(2).

\textsuperscript{1488} Unlike redemption that is done unilaterally by a corporation cancelling shares with the result of reducing the capital, purchase-for-cancellation takes place by agreement between the corporation and shareholders. The agreement governs the manner of share repurchase and the amount of payment the corporation will make for this which may be original issue price or the current redemption price. Kwaw, \textit{supra} note 1486, at pp. 78-79.

\textsuperscript{1489} Surrender of shares means ‘the voluntary giving up by the shareholders of his shares.’ Harry Rajak, \textit{Sourcebook of Company Law}, (Bristol: Jordan publishing, 1995), 648. Shares may be surrendered, where they are subject to forfeiture, to avoid the forfeiture formalities, or in exchange for new shares of same value with different rights. M S Oliver and E A Marshal, \textit{Company Law}, (London: Pithman Publishing, 1994), at p. 158.

\textsuperscript{1490} Form 41-501F1, Item 10.1(f).
Further Ontario law, contradistinguished from the EC law, asks for disclosure of information concerning ratings of securities (in the present context preferred shares) where rating(s) have been received from one or more approved rating organisations.¹⁴⁹³ Rating of securities (typically debt securities) is an estimate of their quality made by rating organisations since most of the investors cannot evaluate them.¹⁴⁹⁴ Preferred shares possess the features both of debt and equity. Because a preferred shareholder is entitled to a fixed amount of preferred dividend, this tends to render preferred share a bond. But failure to pay the dividend, unlike debt interest, is not a default of an obligation on part of the issuer. This features preferred share a common share.¹⁴⁹⁵ In view of the former feature preferred shares may be rated and as such Ontario requirement of rating disclosure applies to them and debt securities alike, especially when they are non-convertible because they ‘trade primarily on the basis of their yield and an assessment of creditworthiness by an independent rating organization.’¹⁴⁹⁷ Ontario law enjoins disclosure of principally the following rating information¹⁴⁹⁸:

(a) each security rating and the name of each approved rating organisation;

(b) description of the category in which the issuer’s securities have been rated;

(c) explanation of the features of the securities addressed in rating;

(d) any factors recognised by rating organisation(s) as making the securities unusually risky.

¹⁴⁹³ Form 41-501F1, Item 10.1(h).
¹⁴⁹⁴ Form 41-501F1, Item 10.1(i).
¹⁴⁹⁵ Ibid., Item 10.8.
¹⁴⁹⁶ See Levy and Sarnat, supra note 1477, at p. 319.
¹⁴⁹⁷ See ibid., at p. 333.
¹⁴⁹⁹ Companion policy NI 71-101CP, sec. 3.2(2).
Income Tax Benefits on Securities:

An EC prospectus must provide information on withholding of tax on income/dividends at source. If the issuer withholds the tax on dividends at source (meaning dividends are free of income tax), it must be disclosed to the investors.1499 This resembles the respective provision of IOSCO standards. Ontario law, in general terms, requires the prospectus to show the relevance of the income tax law to the purchasers of shares.1500 It is, however, the practice that prospectuses of both jurisdictions focus on the overall impact of income tax law on the investors and advise them to consult income tax advisers given doubts or particular circumstances.1501

Plan of Distribution:

It is a common requirement of the both regimes that the prospectus set out the plan of distribution of securities, that is, whether the securities are being offered through underwriters or by the issuer itself. If the issue is underwritten, in addition to the requirement of highlighting the underwriting commission in the cover page or one of the first few pages mentioned above, both laws further ask for details of the underwriters1502 because investor protection greatly depends on them. When the issuer itself offering the securities for sale/distribution without the intervention of an intermediary(ies) arranges underwriting, the underwrite(s) actively pass the soundness of the issue before entering into an (underwriting) agreement1503 with the issuer by

1498 Form 41-501F1, Item 10.8.
1499 AID, supra note 636, Annex A, Sch. A, ch. 2.2.3. See, for example, Oxford Prospectus, supra note 1470, at 7.
1500 Form 41-501F1, Item 28.2.
1501 See Oxford Prospectus, supra note 1470, at p. 37, and Rogers Prospectus, supra note 1475, at p. 58.
1502 An underwriter is defined as 'a person or company who, as principal, agrees to purchase securities with a view to distribution; or who, as agent, offers for sale or sells securities in connection with a distribution; or who has a direct or indirect participation in the distribution. Accordingly, an underwriter may be a principal or an agent.' : G.R.D. Goulet, Public Share Offerings and Stock Exchange Listings Canada (North York: CCH Canadian Limited, 1994), at p. 586.
1503 “An “underwriting agreement ” is ”an agreement pursuant to which an underwriter as principal agrees to purchase securities with a view to distribution, or as agent agrees to offer for sale and to sell securities in connection with a distribution.” : supra note 1502, at p. 586. An agreement by the
checking the truth in the information carried by the prospectus. Alternatively, where shares are offered by an intermediary(ies), they arrange underwriting and the underwriter(s) rely on the assessment of the issue by the intermediary(ies) who are responsible for the marketing and sponsoring of the issue. A good underwriter will, after such direct or indirect inquiry, underwrite an issue of a company ‘with a solid record of earnings, good management, and better than average growth prospects’. He does so because his success in the security world depends on ‘a reputation for making good investment recommendations’. Because of this role the underwriter is called ‘the gatekeeper of public interest’.

The AID provides for furnishing the “names, addresses and descriptions” of the underwriters. It does not define the scope of “descriptions” of the underwriters. This is followed by the requirement that if an issue is partially underwritten, that fact must be disclosed. Because issuers ‘almost invariably’ make arrangements for their securities to be (fully or partially or otherwise) underwritten and the latter provision requires disclosure of partial underwriting, the former provision of underwriters’ “descriptions” purport to require information of the underwriters’ “non-partial” underwriting of the issuer’s securities. Such “non-partial” underwriting information may, in line with international practice, include details about full underwriting commitment or “best efforts” underwriting arrangement by the underwriter of a firmly underwritten issue is know “underwriting agreement”, whereas a best efforts underwriter’s agreement as “agency agreement”. 

1505 Ibid., at p. 286.
1507 Ibid., at pp. 28-29.
1508 Supra note 1502, at p. 238.
1509 AID, Annex A, Sch.A, ch. 2.3.7.
1510 Ibid. An issuer’s securities may be partially underwritten, the rest being offered otherwise, e.g., through the selling efforts of brokers or dealers as provided for in the IOSCO’s Standards of Disclosure, supra note 1442, at Appendix 1A, ch. IX.B.6 (“Plan of Distribution”).
In respect of the former an underwriter commits, on fees, to purchase the issuer’s securities if they, in whole or in part, remain unsold. If all the securities are sold, the underwriter receives fees without any responsibility to take up any.\textsuperscript{1513} If, on the other hand, securities are offered on “best efforts” basis, the underwriters will be required ‘to take and to pay for only such securities as they may sell to the public.’\textsuperscript{1514}

From the foregoing it is established that the EC law provides, in effect, for the disclosure of full, partial and “best efforts” underwriting arrangement for the issuer’s securities. Similarly Ontario law calls for disclosure of the nature of the underwriters’ obligations to take up and pay for the securities, specifying the date by which they will do that.\textsuperscript{1515} If the issue is fully underwritten and the underwriters’ obligations are subject to conditions, the prospectus must contain a statement to that effect. This is called a “market out” clause, which, after stating the terms of the agreement (e.g., purchase price of securities by the underwriter on failure of the issue), declares that the underwriters may terminate their obligations if, acting reasonably, they conclude that given the state of the financial markets\textsuperscript{1516} it will not be profitable to market the securities.\textsuperscript{1517} From this clause the investors may be aware of the underwriters’ possible declining of their obligations. In that case they will feel safe from likely loss that might result out of their investment in the securities. From investor protection perspective this is an essential matter of disclosure that is not available under the EC law.

With the AID lacking any provision for over-allotment option in favour of the underwriter in order to stabilise the share price Ontario law provides for it where

\textsuperscript{1512} See the IOSCO’s Standards of Disclosure, supra note 1442, at Appendix 1A, ch. IX.B.9. (“Plan of Distribution”).

\textsuperscript{1513} Palmer Company Law, supra note 1511, at Ch. 5.131 (Westlaw visited on 9 Feb. 2003)

\textsuperscript{1514} IOSCO’s Standards of Disclosure, supra note 1442, Annex 1A, Ch. IX.B.9.

\textsuperscript{1515} Form 41-501F1, Item 19.1.

\textsuperscript{1516} As to whether markets in question means securities markets in general or markets in the particular issuer’s securities the Supreme Court of British Columbia leaned in favour of the latter. Retrive Resources Ltd. v. Canaccord Capital Corp., [1994] B.C.J. No1897 (S.C.).
the issue is fully underwritten\textsuperscript{1518}. This information is also provided in the cover page.\textsuperscript{1519} The UK law, however, contains provisions in this regard.\textsuperscript{1520} Similar requirement is provided for by the IOSCO Standards.\textsuperscript{1521} As to how the over-allotment option helps stabilisation of share price and hence attaches importance in share distribution the following is worth quoting:

If there is a healthy demand for the shares, the investment bank (underwriter) can essentially go short, by selling additional shares, and can cover this position either by purchasing back shares in the after-market in the event of share price falling below the issue price, or by exercising the option (called “green shoe” option\textsuperscript{1522}) to sell more shares (maximum 15\% of additional shares) at the issue price if demand continues to be strong and the share price rises above the issue price.\textsuperscript{1523}

As seen above, the descriptions of EC underwriters include disclosure of “best efforts” underwriting arrangements. Similarly Ontario law requires brief outline of “best efforts” underwriting arrangement.\textsuperscript{1524} The latter requires a statement of the minimum amount of funds necessary and the maximum amount possible to be raised by the sale of shares offered. Specifying normally a maximum period of 90 days for subscription Ontario prospectus must also state that the funds received during that period will be held by a depository that is a registrant, bank or trust company. If the minimum amount of funds is not raised, the funds will be returned to the subscribers.\textsuperscript{1525} There is no matching express provision in the EC law. As there is a scope of “best efforts” offerings under the AID, as a rule of practice it is presumed that the \textit{minimum amount} required to accomplish the purposes in the prospectus must be

\textsuperscript{1517} Form 41-501F1, Item 19.2.
\textsuperscript{1518} Ibid., Item 19.4.
\textsuperscript{1519} Ibid., Item 1.7(2).
\textsuperscript{1520} UK Listing Authority, \textit{Listing Rules}, Ch. 6 Part B para. 5(b).
\textsuperscript{1521} IOSCO’s \textit{Standards of Disclosure}, supra note 1442, Annex 1A, Ch. IX.B.5.
\textsuperscript{1522} Levy and Sarnat, \textit{supra} note1477, at p. 298.
\textsuperscript{1524} Form 41-501F1, Item 19.3.
\textsuperscript{1525} Ibid., Item 19.5.
specified… But how will the minimum amount of funds be maintained? There should be specific provisions in this regard. This is because this is an important provision from investor protection perspective. With respect to a fully underwritten issue the investors know that the underwriter will take the shares, if any, remaining unsold and their money will be invested in the issuer’s business. But when the issue is a “best efforts” one, they are unsure about what will happen to the shares unsold, if any. In the event of the issue being undersubscribed and the minimum required amount of funds not being raised, there should be some mechanism of paying back of their money because the purpose of the offering will not be fulfilled thereby. Ontario device of holding the subscription money by a depository to attain this purpose is appreciable. This can be called a safety tool in a “best efforts” offering which bears ‘generally more risk’ compared to a fully underwritten one.\(^{1527}\).

A similar provision of holding subscription money raised from the investors by a depository is contained in Ontario law where the issuer’s business is subject to receiving licenses, registrations and approvals necessary for the business operation. This money will be returned to the investors in case such licenses, registration or approvals are not received.\(^{1528}\) The EC law calls for information concerning how far the issuer’s business is dependent, if at all, on licenses, patents, or commercial/financial contracts, etc,\(^{1529}\) but it does not require holding of subscription money by a depository. If the issuer’s business is entirely dependent on these factors, it would be desirable for investor protection to keep the subscription money in a depository so that in the event of not obtaining them the investors can get their money back. This provision of the AID, particularly the commercial and financial contracts would be discussed further while considering material contracts for comparison.

\(^{1526}\) Goulet, supra note 1502, at p. 145 (emphasis added)
\(^{1527}\) McQuillan, supra note 1473, at p. 119.
\(^{1528}\) Form 41-501F1, Item 19.6.
Under Ontario Rule 41-501 an underwriter may decrease the price of the shares from the initial offering price disclosed in the prospectus and thereafter change the price not exceeding the initial offering price provided, among others, it (underwriter) has made a reasonable effort to sell all of the shares distributed under the prospectus at the initial offering price mentioned in the prospectus.\textsuperscript{1530} If the underwriter intends to exercise its privilege under this provision, it must be mentioned in the prospectus.\textsuperscript{1531} The EC law does not contain any provision akin to this, whereas this is an important provision given that the underwriter’s decreasing of price will create a discrimination among the investors, some purchasing at a higher price and some at a lower. At the very beginning of the offering the investors should be abreast of this possibility.

It has been revealed above that both regimes require statement of the share price. In addition to this common requirement Ontario law, unlike the EC law, enjoins the disclosure of the method of determining the distribution price, or the process of estimating where an estimate is provided instead of specific price.\textsuperscript{1532} For example, a most recent Ontario prospectus states that the price of common shares has been set after negotiation between the issuer and underwriters.\textsuperscript{1533} In this respect the offering price of a seasoned\textsuperscript{1534} company is determined by taking the share’s current market price as a guideline.\textsuperscript{1535} Normally the price is fixed a bit below the average

\begin{footnotesize}
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\item[1529] AID, supra note 636, Aneex A, Sch. A, Ch. 4.2.
\item[1530] Rule 41-501, sec. 11.1(3).
\item[1531] Form 41-501F1, Item 19.7.
\item[1532] Form 41-501F1, Item 19.10.
\item[1533] Prospectus, Real Resources Inc., (Toronto), March 7, 2003, at p. 11 (downloaded from http://www.sedar.com on 9 March 2003.)
\item[1534] A seasoned company is one whose shares are already traded on the market. See Levy and Sarnat, supra note 1477, at 298.
\item[1535] The market price of a security is ‘an average of views (of buyers and sellers) on the value of a security.’ Gillen, supra note 1486, at 53. The value of a security lies in the future expected returns vis-à-vis market risks inherent in the returns. Persons may differ in calculating the security value in this process. Those who are optimistic about its worth buy and those who are pessimistic sell and thus a market price is established. See, for details on how securities are valued, above, at pp. 47-52.
\end{itemize}
\end{footnotesize}
price, since a degree of underpricing is usually considered necessary to induce the market to absorb the new issue. On the other hand, an unseasoned offering price is set is substantially below their true market value. In Ontario often pricing is not done until the final prospectus is prepared lest any change in the ongoing market affects the price or value of the shares that are subject of the prospectus. In the UK, similar to Ontario, shares are also underpriced for IPOs, this pricing method is not published though. This is done usually, in practice, at the last moment when the decision to proceed with the floatation is finalised, called the “impact day” which is almost ten days prior to the start of share trading. This time is needed to advertise the issue, to print and distribute the prospectus, and to receive back the share application forms from investors. This is not the case in Ontario where preliminary prospectuses are already available to the investors from securities dealers during the “waiting period” (time between the submission of the preliminary prospectus and approval to the final prospectus) and hence trading can start immediately after the approval of the final prospectus.

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1536 Thus underpricing is ‘an indirect cost of issuing equity finance’ in addition to the direct costs including legal fees, accounting costs, and underwriting commissions. T.J. Jenkinson, Initial Public Offerings in the UK, USA and Japan, (London: Centre for Economic Policy Research, 1990), “Non-Technical Summary”. (emphasis original)

1537 Levy and Sarnet, supra note 1477, at p. 298. (emphasis is original) See, for example, Prospectus, Real Resources Inc., supra note 1533, cover page. On the last trading day (before the offering was announced) the closing price of common shares on the TSX (Toronto Stock Exchange) was Can $5.07, but the offering price was set at Can $4.95. For theoretical study of why initial public offerings (IPOs) are “systematically” underpriced, see Jenkinson, supra note 1536, at pp. 15-22. Alternative to underpricing, share price used to be fixed by tender from the prospective investors, as was in the UK. See Jenkinson, above, at p. 7.

1538 A company’s first public offer. Levy and Sarnat, Ibid.

1539 Ibid.

1540 Gillen, supra note 1502, at p. 129. For similar American practice, see Jenkinson, supra note 1536, at 7.

1541 Ibid., at p. 1.

1542 David Keeling, Corporate Finance: Public Companies and the City, (Bristol: Jordan Publishing, 2001), at p. 117.

1543 Jenkinson, supra note 1536, at p. 3.

1544 Ibid., at p. 6.

1545 “Securities Dealer” means a person or company that trades in securities as a principal or agent. OSA, s. 1(1) “Dealer”. Dealers are distinguished from brokers who buy or sell securities as agent only.
Use of Proceeds

Both laws are similar with regard to the requirement of disclosure of the purposes for which the sale proceeds of the securities will be used by the issuer in addition to mere indication or estimate of them. The EC law barely asks for the “intended application of such proceeds” without any elaboration. On the other hand, Ontario law lays down detailed provisions in this regard. It requires description of each of the principal purposes with roughly required amounts, for which the net proceeds will be applied. It will not ordinarily suffice to say that the proceeds will be spent “for general corporate purposes”. If any other funds, in a material amount, are to be used simultaneously with the sale proceeds, the amount of those other funds must be disclosed. Where an amount exceeding ten percent of the net proceeds is designed to acquire assets, Ontario prospectus must describe the particulars of such assets, their purchase price and the vendors (if they are insiders, associates or affiliates of the issuer). If any part of the consideration for the purchase consists of the issuer’s securities, it must furnish information including the brief particulars of the class, number/amount and voting rights (if any) attached to those securities. Where the sale proceeds will be used to meet indebtedness incurred within two preceding years, the prospectus must also clarify the use of the debt money plus details of the creditor that is an insider, associate or affiliate of the issuer. If the issuer does have any unallocated funds that it will keep in a trust or escrowed account, or invest or add to its

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1546 AID, supra 636, Annex A, Sch. A, Ch. 2.3.9.
1547 Form 41-501F1, Item 7.3.
1548 Ibid., Item 7, Instruction 1.
1549 Ibid., Item 7.5.
1550 Ibid., Item 7.6. See, in this regard, Prospectus, Real Resource Inc, supra note 1533, at p. 11.
1551 Ibid.
1552 Ibid., Item 7.7.
working capital\textsuperscript{1553}, this fact must be disclosed together with the details of the general and supervisory arrangements of the said account, or investment of unallocated funds and the investment policy to be observed.\textsuperscript{1554} If there are any provisions or arrangements made for holding any part of the net proceeds in trust or escrow until some conditions (e.g., the Board of Directors’ resolution for asset acquisition) are fulfilled, the particulars of those provisions or arrangements must be described.\textsuperscript{1555} This is probably to assure the investors that their money will not be wasted, rather will be saved until an opportunity for proper use ensues.

The discussion of the provisions of both laws concerning corporate use of proceeds shows that broadly they are same in effect, i.e. they require the intended application of the sale proceeds of securities. It is the responsibility of the issuer to bring to light details of how it will utilise the money. Thus, for example, a UK prospectus states that the funds will be principally invested in “gilt-edged” stock\textsuperscript{1556}. Later the funds will be ‘drawn down as required to make investments.’\textsuperscript{1557} After this it proceeds with description of the prospective investments and the investment policies to be followed\textsuperscript{1558} according to relevant provisions\textsuperscript{1559}. But this does not substitute providing in detail for the application of the funds as in Ontario. Ontario law has dual ends to serve: it educates the issuers about what they are required to disclose on the one hand, and protects the investors against non-disclosure of a material fact in this regard on the other, which the issuers are bound to make public. For example, if an issuer intends to purchase a property owned by the Managing Director, the express

\textsuperscript{1554} Form 41-501F1, Item 7.4.
\textsuperscript{1555} Ibid., Item 7.1.
\textsuperscript{1556} “Gilt-edged” stocks, commonly known as “gilts”, are issued by the Bank of England, the British Government’s Bank, at a fixed rate of interest to raise capital from the public, when the government income is not enough to meet the expenditures. See Keeling, supra note 1540, at p. 60.
\textsuperscript{1557} Oxford Prospectus, supra note 1470, at p. 10.
\textsuperscript{1558} See, ibid., at pp. 10-12.
\textsuperscript{1559} AID, supra note 636, Annex A, Sch. A, Ch. 4.7.
requirement of making the investing public known of who is the owner of the property and how the purchase price has been determined is instructive for the issuer. On the other hand, the investors should know of this fact because the Managing Director by virtue of his/her position might have unjustly influenced the Board of Directors to decide to purchase the property above the market price. Thus broad provisions tend to suffer from limitations unlike the detailed ones. Accordingly Ontario provisions of application of proceeds seem to have more merits than those of the EC.

**Prior Sales of Shares, and Escrowed Shares**

In the present category of information, namely information concerning securities being offered, the above captioned two items required by Ontario law do not have their counterparts in the EC law. Where shares of the same class as being distributed have been sold within 12 months before date of the prospectus or are to be sold by the issuer or selling securityholder, Ontario prospectus must state their prices and number sold or are to be sold at each price.\(^{1560}\) Also it must state the ranges of price and volume traded of the same class of shares that have been traded on a Canadian or foreign stock exchange or market on which greatest volume of trading takes place in general.\(^ {1561}\) This item of information enables the investors to compare the offer price with that of the previous offering. They may assess the underlying value of the securities by tallying the prospective returns against the risks involved in the investment in them,\(^ {1562}\) or by analysing the pattern of prices or volume of trading,\(^ {1563}\) and then conclude if the shares have been over- or under-priced vis-à-vis the previous pricing.

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1560 Form 41-501F1, Item 13.1.
1561 Ibid., Item 13.2.
1562 Gillen, supra note 1486, at p. 51.
An Ontario prospectus is required to disclose the number of shares of each class held in escrow (meaning deposited on trust with a depository) and the percentage that number forms of the whole class.\footnote{1564} It must also furnish the name of the depository specifying a date of and conditions for release of those shares from escrow.\footnote{1565} Now, who must escrow shares? OSC Policy 5.9 requires related securityholders holding the beneficial ownership of shares (meaning interests in shares held through intermediaries)\footnote{1566} to escrow their shares with a depository.\footnote{1567} Here a related securityholder means a promoter of the issuer, or a director or officer of the issuer holding more than 5\% of the beneficial ownership of shares, or any person or company (may be called principal/control shareholder) holding more than 10\% of the beneficial ownership of shares.\footnote{1568} In order to escrow shares an agreement is entered into among the depository (sometimes called escrow agent), the issuing company and the shareholder(s) whose shares are subject to escrow.\footnote{1569}

Escrow shareholders are entitled to voting rights and dividends in relation to the escrowed shares.\footnote{1570} Of this the investors will be apprised if the item in question is disclosed. Another benefit lies in the fact that the escrowed shareholders cannot release such shares whenever they want. They can unlock only in particular circumstances enumerated under Section VII of the aforementioned OSC Policy with the OSC’s consent.\footnote{1571} For example, where the escrowed shares constitute not exceeding 30\% of the issued and outstanding shares immediately after distribution under prospectus, 10\% of them can be released immediately after nine months from the

\footnote{1563} Ibid., at pp. 51-52.  
\footnote{1564} Form 41-501F1, Item 14.1.  
\footnote{1565} Ibid., Item 14.2.  
\footnote{1566} NI 71-101, s. 18.1. Voting shares held by a person or company as a trustee for the benefit of the children of a settlor of the trust may be an example of such ownership of shares.  
\footnote{1567} OSC Policy 5.9, s. III.A. See, for instance, Tele-Talk Inc., (1988) 11 OSCB 3124.  
\footnote{1568} Ibid., s. II(k).  
\footnote{1569} For a specimen escrow agreement, see Davies, Ward & Beck, Canadian Securities Law Precedents, Part 3, Sec. 2, Subsec. 3.2.3, on http://www.uk.westlaw.com visited on 20 March 2003.  
\footnote{1570} Ibid., para. 5.1.
date of final receipt, and 30% immediately after every first, second and third anniversary of the initial release. If the escrowed shareholders were not required at all to release or were allowed to release their shares at their wish without the OSC’s consent, they could take advantage of their position in the issuing corporation and make some unjust profits unlike the investing public. For example, a promoter or director could access to inside information and could sell unloading their shares at their suitable time. Thus ‘(t)he escrow arrangement is designed to ensure that a promoter…shares risk with the public from whom capital is raised.’

It is worth mentioning that escrow, for the present purpose, includes, in addition to the above, securities subject to a pooling agreement which is a ‘common voting agreement’ among a group of shareholders (e.g., small shareholders) in order to wield control on the issuer’s administration. Of course this does not necessarily mean that the shareholders thereby agree to resell the shares in a concert. Though EC law is devoid of escrow provisions, it requires indication of persons having control, individual or joint, over the issuer. Joint control in question means ‘control exercised by more than one company or by more than one person having concluded an agreement which may lead to their adopting a common policy in respect of the issuer’. This agreement meant for controlling the issuer seems to be a pooling agreement.

**Category II: Issuer, its Capital and Activities**

1572 OSC Policy 5.9, sec. VII(B).
1573 Victor P. Alboini, *Commentary to Securities Act*, Sec. 15.10.2[e], on http://uk.westlaw.com visited on 17 March 03.
1574 Form 41-501F1, Instruction to Item 14.
1576 Williams Hicks, *ibid*. (footnotes omitted).
1577 AID, *supra* note 636, Annex I, Sch. A, Ch. 3.2.6.
**Issuer and its subsidiaries:**

Both laws call for issuer’s name, address(es) of the head office, registered office, and, after stating its legal form (incorporated or unincorporated), the legislation under which it was established/continued. Following this, where the issuer belongs to a group of companies, the EC law requires description of the group and the issuer’s position in that group. It does not specify what matters should be described. In this way the word “description” seems to be an open-ended one and may include statements of whether the issuer is the parent company or a subsidiary, number of companies forming the group, number and value of its share holdings in the group, and the relationships within the group, e.g. issuer’s voting strength, control on the corporate administration, etc. Similarly Ontario prospectus must describe the interrelationships among the issuer and subsidiaries. In particular it is required to state each subsidiary’s place of incorporation or continuation, issuer’s voting strength accruing from the voting securities beneficially owned or otherwise showing in percentage of votes attaching to the subsidiary’s all voting securities, and percentage of each class of restricted shares (e.g., escrowed shares) which are beneficially held by the issuer or otherwise. Where securities are issued in connection with an acquisition, amalgamation, merger, reorganisation or arrangement, the prospectus must describe the intercorporate relationships both at the pre and post completion of the proposed transaction. It may be noted that disclosure of the intercorporate relationships may not be required when a subsidiary’s total assets, and sales and operating revenues, constitute not more than 10% or those of subsidiaries in aggregate do not constitute not

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1578 Ibid.
1579 Form 410501F1, Item 4.1, and AID, Annex I, Sch. A., Ch. 3, paras. 3.1.0 and 3.1.2.
1580 AID, supra note 636, Annex I, Sch. A, Ch. 3.2.8.
1581 Ibid., Ch. 3.2.9.
1582 Form 40-501F1, Item 4.2(1).
1583 Ibid.
1584 Ibid., Item 4.2(2).
exceeding 20%, of the issuer’s consolidated assets, and consolidated sales and operating revenues at most recent financial year.\textsuperscript{1585}

**Capital of the Issuer**

As seen earlier, both laws of the EC and Ontario require number and type of securities being offered. In addition to this, the EC Directive (AID) provides for furnishing information on the amount of issued capital\textsuperscript{1586}, number and classes of shares that compose this capital, amount of unpaid capital\textsuperscript{1587} with nominal value of the shares,\textsuperscript{1588} the amount of nominal capital\textsuperscript{1589}, any undertaking to increase the capital,\textsuperscript{1590} and conditions contained in the memorandum and articles of association governing the changes in the capital and in the respective rights of different classes of shares, where such conditions are more rigorous than is required by law.\textsuperscript{1591} There are no counter provisions in Ontario law. It only calls for description of any material change in and effect of that change on the share or loan capital of the issuer since the most recently completed financial year.\textsuperscript{1592}

**Description of the Business**

An EC prospectus must provide a description of the issuer’s principal activities including the main kinds of products sold and/or services rendered.\textsuperscript{1593} It must indicate any significant new products/activities.\textsuperscript{1594} An Ontario prospectus is required to describe general development of the issuer’s business for the three most recently

\begin{itemize}
\item\textsuperscript{1585} *Ibid.*, Instruction to Item 4.
\item\textsuperscript{1586} Issued capital means share capital allotted to the members of a company. Oliver and Marshall, *supra* note 1489, at p. 114.
\item\textsuperscript{1587} Unpaid capital refers to part of the issued capital that has not yet been paid by the members. *Ibid.*
\item\textsuperscript{1588} AID, *supra* note 636, Annex I, Sch. A, Ch. 3.2.0.
\item\textsuperscript{1589} This is the maximum amount of capital which a company is not allowed to exceed in issuing shares. Oliver and Marshall, *supra* note 1489, at p. 114.
\item\textsuperscript{1590} AID, *supra* note 636, Ch. 3.2.1.
\item\textsuperscript{1591} *Ibid.*, Ch. 3.2.4.
\item\textsuperscript{1592} Form 41-501F1, Item 11.
\end{itemize}
completed financial years and any subsequent period covering the principal products or services.\textsuperscript{1595} If there is any change in view in the current financial year (which may include new products/services), a discussion must be made on that.\textsuperscript{1596} If the products or services are not fully developed, the Ontario prospectus must disclose the stage of their development and research carried out in this regard, where appropriate.\textsuperscript{1597} The EC law also contains similar provisions.\textsuperscript{1598} In addition to the general description of products/services, both laws warrant disclosure of the income from them. The AID calls for the ‘(b)reakdown of net turnover (income after tax) during the past three financial years by categories of activity (sales of products/renderings of services) and into geographical markets…. ’\textsuperscript{1599} This matches international disclosure requirement provided for by the IOSCO.\textsuperscript{1600} While for the purpose of disclosure the AID does not specify any minimum income accruing from the products/services, Ontario Form fixes it to 15\% of total consolidated revenues for each of the two most recently completed financial years for each category of principal products or services\textsuperscript{1601}. The kind of information in question subject to disclosure under both laws is, however, similar in effect, namely income form the products/services.

The AID provides for summary description of operations during the last three years which have changed the issued capital or the number and classes of shares that compose the capital. It does not detail the ambit of this provision.\textsuperscript{1602} Theoretically business operations include four things: financing, staffing, production and

\textsuperscript{1593} AID, supra note 636, Annex I, Sch. A, Ch. 4.1.0.
\textsuperscript{1594} Ibid.
\textsuperscript{1595} Form 40-501F1, Item 5.1.
\textsuperscript{1596} Ibid.
\textsuperscript{1597} Ibid., Item 6.1, para. (1)(c).
\textsuperscript{1598} Ibid., Annex I, Sch. A, Ch. 4.3. In this connection, see IQE plc Prospectus,(Cardiff, 2001), at pp. 43-44.
\textsuperscript{1599} AID, supra 636, Annex I, Sch. A, Ch. 4.1.1.
\textsuperscript{1600} See IOSCO’s Disclosure Standards, supra note 1442, at p. 61.
\textsuperscript{1602} AID, supra note 636, Annex I, Sch. A, Ch. 3.2.5.
These are called for in Ontario prospectus not merely as a historical description, but for providing a picture of the present and future operations. For example, Ontario prospectus must include, among others, the following:

(i) actual or proposed method of production of products or providing services;

(ii) number of employees as at the end of the financial year or as an average over that year whichever is more relevant;\(^\text{1604}\)

(iii) the requirement of specialised skill and knowledge and extent of its availability to the issuer;

(iv) sources, pricing and obtainability of raw materials,

(v) the financial and operational effects of the requirements of environmental protection on the issuer’s earnings, expenses\(^\text{1605}\) and competitive condition in the present and future financial years.\(^\text{1606}\)

Though the AID does not provide for incorporation of all the foregoing information concerning operations, EC prospectus, in practice, contains such information.\(^\text{1607}\) In line with its Ontario counterpart\(^\text{1608}\) it carries an assessment of the competitive position of the issuer’s product markets\(^\text{1609}\).

The AID asks for the location and size of the issuer’s principal establishment(s) (one accounting for more than 10% of the turnover or production) and summary information about its real estates.\(^\text{1610}\) Ontario law lacks provision for


\(^{1604}\) See, for the EC counterpart provision, AID, supra note 636, Annex I, Sch. A, Ch. 4.6.

\(^{1605}\) Expenses in this context include both the costs of complying and non-complying with environmental regulations. Levine v NL Industries, Inc. [1991, CA2 NY] 926 F2d 199.

\(^{1606}\) Form 40-501F1, Item 6.1, para. (1)4.

\(^{1607}\) See IQE Prospectus, supra note 1598, at pp. 43-45.

\(^{1608}\) Form 40-501F1, Item 6.1, para. (1)5.

\(^{1609}\) See IQE prospectus, supra note 1598, at pp. 45-46.

\(^{1610}\) AID, supra note Annex I, Sch. A, Ch. 4.1.2.
disclosure of information about the principal establishments. It does not call for, in
general, information concerning real estate as such. It solicits disclosure of significant
acquisitions or dispositions, complete or proposed, which will include, inter alia, nature
and date of, consideration for, and effect of such acquisitions or dispositions on the
operating and financial position of the issuer.\textsuperscript{1611} Absent any similar provisions in the
EC law it is required of an Ontario issuer to disclose the following:

(a) any trend, commitment, event or uncertainty presently known or
reasonably expected to have a material effect on the issuer’s
business, financial condition or results of operations;\textsuperscript{1612}

(b) nature and results of any bankruptcy, receivership or any other
similar proceedings instituted against or voluntarily brought by the
issuer within the three most recently completed financial year or
current financial year;\textsuperscript{1613}

(c) nature and results of any material reorganisation of the issuer or any
of its subsidiaries within same time frame as mentioned in paragraph
(b) above.\textsuperscript{1614}

In addition to the general description of business both the laws provide
for disclosure of information relevant to particular business activities. The AID thus
lays down provisions for ‘mining, extraction of hydrocarbons, quarrying and similar
activities.’\textsuperscript{1615} The Ontario Form draws upon specific provisions for mineral
projects\textsuperscript{1616}, and oil and gas operations.\textsuperscript{1617} Mining activities are common. The EC law
lacks provisions for oil and gas operations. The provisions for “similar activities” may,
however, cover such operations. In this way the particular activities requiring specific

\textsuperscript{1611} Form 40-501F1, Item 5.2.
\textsuperscript{1612} Ibid., Item 5.3.
\textsuperscript{1613} Ibid., Item 6.1, para. (2).
\textsuperscript{1614} Ibid., Item 6.1, para. (3).
\textsuperscript{1615} AID, supra note 636, Annex I, Sch. A, Ch. 4.1.3.
\textsuperscript{1616} Form 40-501F1, Item 6.3.
disclosures under both laws seem to be similar. The EC law asks for ‘description of deposits, estimate of economically exploitable reserves and expected period of working.’\(^{1618}\) It does not define the terms “description of deposits”. It may include, as required in Ontario\(^{1619}\), property description of the mineral(s)/oil and gas, its location, historical background, nature and extent of exploration of the deposits, quantity and quality of mineral resources, etc. Ontario law provides for furnishing to what extent the estimate of mineral resources and mineral reserves may be affected by certain factors like metallurgical, environmental and legal factors.\(^{1620}\) In other words, it asks for the estimate of the exploitable resources and reserves, which comes out after deduction of the portion likely to be so affected\(^{1621}\). Thus Ontario law requirement conforms to that of the EC law. The only divergence is that while the EC law provides the disclosure requirement in a capsule form Ontario law lays down that in a detailed form.

**Principal Shareholders**

The EC Directive (AID) asks for merely indication of shareholders holding, directly or indirectly, a proportion of the issuer’s capital, which Member States may fix at not exceeding 20%.\(^ {1622}\) In the UK this limit is 3%.\(^{1623}\) On the other hand, Ontario Form requires far-detailed information in this regard, although it does define what percentage of holding would render a shareholder a principal shareholder. Previously, however, Item 26 of the repealed Form 12 fixed this limit to 10% of any class of securities. However, Item 15 calls for, among others, the following:

\[^{1618}\] AID, *supra* note 636, Annex I, Sch. A, Ch. 4.1.3.
\[^{1619}\] See Form 40-501F1, Item 6.3, paras. 1,3, 5, and 10, and Item 6.4, paras. 1,2,3 and 8.
\[^{1621}\] See also *ibid.*, Item 6.4, paras. 5 and 6.
\[^{1622}\] AID, *supra* note 636, Annex I, Sch. A, Ch. 3.2.7.
\[^{1623}\] (UK) Listing Particulars, Ch. 6, para. 6.C.16.
(a) names, (addresses) and holdings of securities by principal shareholders and each selling securityholder, if any securities are being distributed for the account of a securityholder;

(b) if any principal shareholder or selling securityholder is an associate\textsuperscript{1624} or affiliate\textsuperscript{1625} of another person or company, material facts of the relationship including any basis for influence over the issuer (the purpose behind being to unveil the identity of any person or company that controls the principal shareholder\textsuperscript{1626});

(c) if securities are being distributed in connection with an acquisition, amalgamation, merger, reorganisation or arrangement, holdings of each principal shareholder and selling securityholder that will exist after giving effect to the transaction;

(d) if 10\% of any class of voting securities is held or is to be held subject to any voting trust or other similar agreement, number/amount of the securities so held or to be held and the duration of the agreement along with the details of the voting trustees and their rights & powers under the agreement.

**Legal Proceedings**

The EC Directive (AID) requires an issuer to furnish information in a prospectus on any legal or arbitration proceedings and its actual or likely significant effect on its financial position.\textsuperscript{1627} Requisite “information” on proceeding in question,

\textsuperscript{1624} E.g., a relative, spouse of a person, or a partner of a person or company. OSA, s. 1(1).

\textsuperscript{1625} E.g., a company which is a subsidiary of some other company or both are controlled by same person or company. Goulet, \textit{supra} note 1502, at p. 563.

\textsuperscript{1626} It has, therefore, been observed by the OSC that ‘generally a receipt should not be issued for a prospectus if the issuer is unable to identify the individual, if any, who controls a principal security holder of that issuer.’ Interpretation Note 2- 1983 O.S.C.B. 4536 cited in \textit{Tricor Holdings Co. Ltd.}, [October 1988] 11 O.S.C.B. 4059 at p. 4088.

\textsuperscript{1627} AID, \textit{supra} note 636, Annex I, Sch. A, Ch. 4.4.
though not defined, may include its parties, subject matter, date of institution and forum\textsuperscript{1628}. Ontario Form enjoins description of ‘any legal proceedings material to the issuer’ to which it is a party or its property is the subject matter. It does not define what does the “description” would include. As with the EC counterpart it may include details of the parties, subject matter, etc. and also the likely results of the proceedings and their effects on the issuer’s financial position. In addition, Ontario prospectus must include details about proceedings in contemplation. It may be noted that no information on legal proceedings need be provided in Ontario if the claim for damages does not exceed 10\% of the issuer’s current assets and its subsidiaries on a consolidated basis.\textsuperscript{1629} Although the EC requirement is not qualified by the amount of claim for damages unlike the Ontario counterpart, it may be said to be similar to the latter in that it seems to call for similar kind of information concerning legal proceedings. Of course Ontario law, distinguished from the EC law, does not require information on arbitration proceedings.

**Material Contract**

Ontario Form defines a “material contract” as ‘a contract that can reasonably be regarded material to a proposed investor in the securities being distributed.’\textsuperscript{1630} It should be such as has not been made in the ordinary course of business.\textsuperscript{1631} An underwriting agreement may be an example of this type of contract. It is further provided that such a contract must not be more than two years old preceding from the date of the prospectus.\textsuperscript{1632} The prospectus must set out the complete list of all

\textsuperscript{1628} The name of the court deciding a case was held, however, not material and disclosure of necessary information except the forum did not give rise to the issuer’s liability in the US. *Freer v Mayer*, [1992, SD NY] 796 Supp 89.

\textsuperscript{1629} Form 41-501F1, Instruction to Item 22. For judicial interpretation on similar US provision, see *Wilson v Great American Industries, Inc.* [1987, ND NY] 661 F Supp 1555.

\textsuperscript{1630} *Ibid.*, Item 27, Instruction (1).

\textsuperscript{1631} *Ibid.*, Item 27.1.

\textsuperscript{1632} *Ibid.*
material contracts and provide particulars of each of such contracts, which include its
date, parties, consideration and general nature.\textsuperscript{1633} The prospectus must also state a
reasonable time and place for inspection of the contracts during the distribution of
securities being offered.\textsuperscript{1634} The prospectus must be accompanied by a copy of the co-
tenancy, unitholders’ or limited partnership agreement, if applicable.\textsuperscript{1635}

There is no item of “material contract” in the EC Directive (AID). The
UK Listing Rules, however, provide for this. Similar to Ontario requirement para.
6.C.20 of Chapter 6 obliges an issuer to disclose a summary of the principal contents
including the date of, parties to, consideration for, and terms and conditions of each
material contract made within two years immediately before publication of the
prospectus. This provision applies also to any other contract containing any obligation
or entitlement that is material to the issuer as at the date of the prospectus.\textsuperscript{1636} It is also
ordained that material contracts be displayed for inspection,\textsuperscript{1637} which is identical to
Ontario requirement. A material contract in question is subject to disclosure because it
is “significant” to the company’ and, therefore, material to investors’ informed decision
making for investment.\textsuperscript{1638}

**Category III: Management**

**Directors and Executive Officers, Executive Compensation and Indebtedness**

The EC Directive (AID) primarily requires details of the names,
addresses and functions of the members of the administrative, management or
supervisory bodies in the issuer company and principal activities accomplished by them

\textsuperscript{1633} Ibid., Instructions (2) and (3).
\textsuperscript{1634} Ibid., Item 27.1.
\textsuperscript{1635} Ibid., Item 27.2.
\textsuperscript{1636} Listing Particulars, supra note 1623, Ch. 6, para. 6.C.20(b)
\textsuperscript{1637} Ibid., Ch. 6, para. 6.C.7(c).
\textsuperscript{1638} Oliver Warenham, ‘Contents of listing particulars’, in Maurice Button, ed., supra note 1438, pp. 99-
134, at p. 110.
outside that company. The members of the bodies in question typically include directors and executive officers. The same particulars are required of partners of unlimited liability in respect of a limited partnership with a share capital, and founders of the issuer provided it has been set up for fewer than five years. On the other hand, Ontario Form calls for the names and addresses of directors and executive officers of the issuer and their respective positions and offices held. This is similar to the said particulars required of the members of the administrative, management and supervisory bodies of an EC issuer. While the EC Directive (AID) asks for details of those members’ activities outside the issuer, Ontario Form requires those provided the outside activities are their principal occupation. An EC prospectus must disclose the total number of shares held (on record or beneficially) by the members of the said bodies. On the other hand, an Ontario prospectus is required to provide the number and percentage of voting shares of the issuer or its subsidiaries, only which are beneficially owned or over which control/direction is exercised by the directors and executive officers as a group. Thus both the EC Directive (AID) and Ontario Form mandate very similar kind of information.

Again, both laws require information on options granted respecting the issuer’s shares. The EC Directive (AID) requires information on options granted to the members of the administrative, management or supervisory bodies. It does not detail what sorts of information should be provided in this connection. Ontario Form, on the other hand, contains provision for supplying information on options to purchase

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1639 AID, supra note 636, Annex I, Sch. A, Ch. 6.1.
1640 See, for example, the implementation of this provision of the AID in the UK, Listing Particulars, supra note 1623, Ch. 6. Para. 6.F.1.
1641 AID, supra note 636, Annex I, Sch. A, Ch. 6.1.
1642 Form 41-501F1, Item 16.1, para. (1).
1643 Ibid., para. (5).
1644 AID, supra note 636, Annex I, Sch. A, Ch. 6, para. 6.2.1.
1645 Form 41-501F1, Item 16.1, para. (3).
1646 Option is a contract that gives ‘the holder of the option the right to buy or sell a specified quantity of specific security within a specific period of time at a stated price.’ Gillen, supra note 1486, at p. 13.
shares by past and present directors and executive officers of the issuer and its
subsidiaries, all other past and present employees of the issuer and its subsidiaries, all
consultants of the issuer and any other person including the underwriter.\textsuperscript{1648} Contrasted
with the EC provision, it clearly states that the prospectus must describe the designation
and number, price (or the formula for its future determination), and, if reasonably
ascertainable, market value both on the date of grant and specified (purchase) date, of
the shares under option, and consideration for the grant.\textsuperscript{1649}

The AID provides for presentation of what remuneration was paid or
benefits in kind granted to all members of the administrative, management or
supervisory bodies during last financial year.\textsuperscript{1650} Likewise Ontario law also asks for a
Statement of Executive Compensation which must be prepared according to Form
40.\textsuperscript{1651} The Statement must include the following:

(a) annual compensation (salary, bonus, etc.) and long-term
compensation (e.g., stocks under option which resembles benefits in
kind as under the AID\textsuperscript{1652}) awarded to the chief executive officer
(CEO) and other “Named Executive Officers”\textsuperscript{1653} for each of the
three recently completed financial years;\textsuperscript{1654} and

(b) compensation paid to directors for the most recently completed
financial year.\textsuperscript{1655}

\textsuperscript{1647} AID, supra note 636, Annex I, Sch. A, Ch. 6, para. 6.2.1.
\textsuperscript{1648} Form 41-501F1, Item 12.
\textsuperscript{1649} Ibid., Instruction.
\textsuperscript{1650} AID, supra note 636, Annex I, Sch. A, Ch. 6, para. 6.2.0.
\textsuperscript{1651} Form 41-501F1, Item 17.
\textsuperscript{1652} On this subject see United States v. Wallach, [1988, SD NY] 733 F Supp 769.
\textsuperscript{1653} According to Item I.3 of Form 40, other “Named Executive Officers” refer to-
(a) four most highly compensated executive officers of the issuer, other than the CEO, who were
serving as executive officers at the end of most recently completed financial year, provided such an
officer’s total salary and bonus exceeds $100,000;
(b) those executive officers for whom disclosure under paragraph (a) would have been required but for
the fact that they were not serving as officers of the issuer at the end of the most recently completed
financial year.
\textsuperscript{1654} Form 40, Item II.
\textsuperscript{1655} Ibid., Item XI.
However, the following matters concerning directors and executive officers required by Ontario law do not have their match in the EC law:

(a) the requirement of disclosure of any cease trade order or bankruptcy or insolvency proceedings against a director or executive officer or a controlling shareholder while he or she is or has been a director or executive officer of any other issuer within last 10 years before the date of the prospectus;\textsuperscript{1656}

(b) the requirement of description of the penalties or sanctions and the terms of and circumstances giving rise to the settlement agreement where a director or executive officer or a controlling shareholder has been subject to any penalties or sanctions imposed that would be relevant for investors in making investment decision;\textsuperscript{1657}

(c) information on personal bankruptcy of a director or executive officer or a controlling shareholder of the issuer within 10 years before the date of the prospectus;\textsuperscript{1658}

(d) disclosure of particulars of material conflicts of interests, present or potential, between the issuer or any of its subsidiaries and a director or executive officer of the issuer or any of its subsidiaries;\textsuperscript{1659}

(e) for a junior issuer information for each member of management\textsuperscript{1660} including name, age, position, responsibilities and educational background, principal occupations or employment during the five years prior to the date of the prospectus.

\textsuperscript{1656} Form 41-501F1, Item 16, subitem 16.2.
\textsuperscript{1657} Ibid., subitem 16.3.
\textsuperscript{1658} Ibid., subitem 16.4.
\textsuperscript{1659} Ibid., subitem 16.5.
\textsuperscript{1660} In this context “management” means ‘all directors, officers, employees and contractors whose experience is critical to the issuer, its subsidiaries and proposed subsidiaries in providing the issuer with a reasonable opportunity to achieve its stated business objectives.’ Ibid., subitem 16.6, instruction (1).
years preceding the date of the prospectus, and his/her experience in
the issuer’s industry.\textsuperscript{1661}

In addition to the foregoing, both laws contain provisions for divulging
indebtedness of issuer’s members of administration or management. An EC prospectus
must provide the total of all unpaid loans the issuer has granted to the members of
administration, management or supervision.\textsuperscript{1662} It must also describe any guarantees
given by the issuer for their benefit.\textsuperscript{1663} Likewise an Ontario prospectus shall reveal the
directors’ and executive officers’ indebtedness (other than routine indebtedness\textsuperscript{1664}) to
the issuer, or to any other entity. In the case of the latter it must describe any guarantee,
support agreement\textsuperscript{1665} or letter of credit or other similar arrangement or undertaking
given by the issuer or any of its subsidiaries.\textsuperscript{1666} While the AID requires merely the
total of loans and guarantee against them, the Ontario Form calls for additional details
including name and position of the borrower, the largest aggregate amount of
indebtedness that remained unpaid at any time during the previous completed financial
year, security provided for the loan to the issuer, its subsidiaries or any other entity,
material terms of the indebtedness and any adjustment or amendment made thereto.\textsuperscript{1667}

\textbf{Interest of Management and Others in Material Transactions}

The AID enjoins revealing of the nature and extent of interests of the
members of the administrative, management or supervisory bodies in the issuer’s
unusual transactions (e.g., purchases outside the normal activity) during the last and

\begin{itemize}
\item \textsuperscript{1661} \textit{Ibid.}, subitem 16.6.
\item \textsuperscript{1662} \textit{AID, supra} note 636, Annex I, Sch. A, Ch. 6, para. 6.2.3.
\item \textsuperscript{1663} \textit{Ibid.}
\item \textsuperscript{1664} A loan is a routine indebtedness if, for example, it is made by the issuer to a full-time employee
    secured against the borrower’s residence the amount being not more than the annual aggregate salary of
    borrower from the issuer and its subsidiaries. Form 41-501F1, Item 18, instruction (1).
\item \textsuperscript{1665} “Support agreement” includes ‘an agreement to provide assistance in the maintenance or servicing of
    any indebtedness and an agreement to provide compensation for the purpose of maintaining or servicing
    any indebtedness of the borrower.’ \textit{Ibid.}, instruction (2).
\item \textsuperscript{1666} \textit{Ibid.}, Item 18, subitem 18.1, para. (1).
\end{itemize}
present financial years. On the other hand, the Ontario Form provides for information about the material interests of the directors, executive officers, principal shareholders and their associates or affiliates in transaction(s) effected within last three years or proposed transaction(s) that have materially affected or will materially affect the issuer or its subsidiary(ies).\(^ {1668}\) Thus AID provision departs from Ontario’s in two respects. First, the former calls for interests (material or non-material) of the members of the administrative, management or supervisory bodies, but the latter for material interests only, e.g., especial benefits received by them in any transaction provided information about it is significant to the investors\(^ {1669}\). The scope of the former’s requirement seems to be broader. Second, the former invites the relevant information about unusual transactions while the latter for material transactions. Both the terms “unusual transactions” and “material transactions” remain undefined. But both laws have given examples of transactions covered by these terms, namely buying or selling of assets,\(^ {1670}\) which take place outside the ordinary course of business unless buying and selling is the business of the issuer. Such transactions being of mammoth size are likely to have significant effects on the issuers. And, therefore, the transactions envisaged by the both laws seem to be of similar nature.

**Category IV: Management’s Discussion and Analysis (MD&A)**

Item 8(1) of Form 41-501F1 requires the following consolidated financial data derived from the financial statements contained in the prospectus for each of the three financial years preceding the date of prospectus and any period following the most recent financial year end. The following data must be presented in a

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\(^ {1667}\) Ibid., subitem 18.1, paras. (2),(3), and (4) read together.  
\(^ {1668}\) Form 41-501F1, Item 23.  
\(^ {1669}\) Ibid., see instructions (1) and (4).  
\(^ {1670}\) See AID, *supra* note 636, Annex I, Sch. A, Ch. 6, para. 6.2.2., and Form 41-501F1, Item 23, para. (3).
summary form: (a) net sales or total revenue; (b) income from continuing operations; (c) net income or loss; (d) total assets; (e) long-term financial liabilities in total; (f) declared cash dividends; and (g) other financial information deemed necessary for better understanding of and revealing other trends in the financial condition and results of operations. In addition to the annual information, Item 8(2) calls for periodic disclosure of the information enumerated in (a), (b)&(c) for the last two financial years. Item 8(3) requires disclosure of the issuer’s dividend policy, any change thereto, and any restriction preventing distribution of dividends.

Item 8(5) asks for the Management’s Discussion and Analysis (MD&A) for annual financial statements for the issuer included in the prospectus prepared in compliance with the requirements of Form 44-101F2. The management needs to discuss the dynamics of business and analyse the financial statements. Through the MD&A investors can ‘better assess the issuer’s performance, position and future prospects.’ Form 44-101F2 provides in detail for what matters are to be included in the MD&A. In general it requires, among others, the following in the MD&A:

(a) An analysis of the issuer’s financial condition, cash flows and results of operations in the most recent financial years comparing them with those of previously completed financial year including information necessary for facilitating the analysis and comparison, e.g., internal and external factors affecting the issuer, reasons of change or absence of change in its financial condition and results of operations, the consequence of discontinued operations and important changes in the business direction. For instance, one prospectus, after stating an increase in the interest income in 2002 against 2001, says

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1671 Form 44-101F2, Instruction (1).
1672 Ibid.
1673 Form 44-101F2, Item 1, para. (1).
that the increase resulted from the issuer’s investments in instruments earning a higher rate of return.\textsuperscript{1674}

(b) Disclosure of information on the risks and uncertainties the issuer is encountering so that the issuer’s financial condition and changes therein and results of operations can be comprehended;\textsuperscript{1675}

(c) Description of any changes or prospective changes in the issuer’s accounting policies and the effects thereof;\textsuperscript{1676}

(d) Unless already included in the financial statements, discussion, \textit{inter alia}, of the use of financial instruments by issuer, risks attached with them, and issuer’s policies to tackle the risks.\textsuperscript{1677}

In addition to the general requirements Items 3 and 4 of the above Form has laid down detailed provisions with respect to the issuer’s liquidity, capital resources\textsuperscript{1678} and results of operations. Those can be briefly mentioned in the following:

(a) The MD&A must discuss the issuer’s ability to raise sufficient cash or cash equivalent whenever necessary. The balance sheet conditions or income or cash flow items that are, in the belief of the issuer, the indicators of its liquidity must also be described.

(b) After identifying the known trends or expected fluctuations in its liquidity if it is shown that the issuer is deficient in liquidity, it must indicate what actions have been or will be taken to remedy that deficiency.


\textsuperscript{1675} \textit{Ibid.}, para. (3).

\textsuperscript{1676} \textit{Ibid.}, para. (5).

\textsuperscript{1677} \textit{Ibid.}, para., (6).

\textsuperscript{1678} “Capital resources” in this context means ‘indebtedness, share capital and any other financial arrangement, whether or not it is reflected on the balance sheet of an issuer, that can be reasonably considered to provide financial resources to the issuer’. Form 44-101F2, instruction (3).
(c) Requirements concerning working capital must be generally discussed. For example, one prospectus discloses that its working capital falls short in 2002 compared to 2001 due to acquisitions, which would be topped up with the funds to be raised by the sale of securities being offered.\textsuperscript{1679}

(d) If there are any legal or practical restrictions in transferring funds from the subsidiaries to the issuer, those need to be disclosed with special reference to their effect on the issuer’s ability to meet its obligations.

(e) If the issuer is in default to pay dividends or interest or principal amounts of loans, this must be disclosed in detail.

(f) As of the most recently completed financial year the MD&A must describe and quantify the commitments for capital expenditures indicating their general purposes and anticipated sources of funds to meet them. It must also quantify the expenditures that are, though not committed, necessary to meet the issuer’s plans discussed under the MD&A or elsewhere in the Annual Information Form (AIF) which is prepared for quarterly information in compliance with Form 44-101F1

(g) Any known trends in the issuer’s capital resources, and sources of financing under arrangement but not yet utilised must also be discussed.

(h) The MD&A is required to describe any unusual events or transactions and significant economic changes liable for material effect on the issuer’s income or loss from continuing operations together with the extent of the effect. Any other significant components of revenue or expense that are necessary to understand the results of operations must also be disclosed.

(i) Any known trends or uncertainties (e.g., changes in the costs of labour or materials in future) that have had or will likely to have favourable or unfavourable effect on

\textsuperscript{1679} Tempus Prospectus, supra note 1674, at p. 55.
net sales or revenues or income or loss received from continued operations need to be discussed.

(j) A discussion must be made on how far changes in selling prices, changes in the volume or quantity of goods or services being sold or introduction of new products or services have led to any changes in net sales or revenues.

(k) It is required to show how inflation and specific price changes impact on the issuer’s net sales and revenues and income or loss from continuing operations.

(l) Where the issuer’s business is a developing one, the results of operations need to be analysed and material expenditures discussed.

Unless an exemption is granted by the concerned Competent Authority(ies) of a Member State (e.g., the UKLA), an EC prospectus must, as required by Chapter 7 of Annex I of the AID, contain general information on the issuer’s business trends since the financial year end to which the last published annual accounts relate. In particular, this must include most recent trends in production, sales, stocks, costs and selling prices, and the state of the order book. Also must be included information on the issuer’s prospects for the current financial year at least. This item looks like the MD&A of Ontario in that it calls for general as well as particular information about the issuer’s business trends since the end of the financial year to which the last published accounts relate. Information on the “business trends” implies comparative information about the issuer’s business between the last and currently published accounts dates. In other words, the present EC item solicits comparative information for the last two financial years. Unlike Ontario, of course, it does not need consolidated financial data along with it. In practice, such data are provided,1680 but not always.1681 The data are not immediately followed by any management discussion, however. The prospectus advises to read the data in conjunction with detailed financial

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1680 See IQE Prospectus, supra note 1598, at p. 28.
information extracted from financial statements accompanied by notes thereto. Of course, comparative information may be traced scattered in a prospectus.\textsuperscript{1682}

Thus though substantially the present item of information under both laws deals with similar subject matter, Ontario Form lays down detailed requirements of disclosure in this regard unlike the AID. Accordingly in practice the required discussion and analysis is made in an Ontario prospectus, while that is not the case with the latter in the true sense in spite of its great significance of providing investors an opportunity to ‘look at the issuer through the eyes of management’.\textsuperscript{1683}

\textbf{Category V: Risk Factors}

In order that the investors can clearly understand the risks involved in and the speculative nature of the investment enterprise Item 20 of the Ontario Form mandates their disclosure in the order of their seriousness in the eyes of the issuer. Among those factors are included cash flow and liquidity problems, if any, general risks involved in the issuer’s business, risks concerning health and environment, regulatory constraints, management experience, dependence on the key personnel, etc. that ‘would be most likely to influence the investor’s decision to purchase the securities’. Such factors are to be mentioned in the Summary and then described under a separate head.\textsuperscript{1684}

In contrast to Ontario, the EC law does not lay down any particular requirement for risk factors disclosure. This does not mean that an EC prospectus need not have to disclose risk factors at all. Even though those factors are not organised at one place, they may be scattered throughout the prospectus in the information imparted under some other heads, on the basis of which the investors have to make their own risk

\textsuperscript{1681} See Oxford Prospectus, \textit{supra} note 1470.
\textsuperscript{1682} See IQE Prospectus, \textit{supra} note 1598, at p. 44 where it provides comparative figures of the issuer’s research and development costs for 2000, 1999 and 1998.
For example, it is a matter of risk that the issuer is dependent on patents, licences or financial contracts that are fundamentally important from the issuer’s business or profits perspective, which are subject to disclosure at some other place already mentioned earlier. Similar information is also furnished under Ontario law. As well as Ontario law provides for unveiling the risk factors separately earmarked so that even the lay investors, who “actually” read them, can learn about the risky nature of the investment, albeit practically the assessment is done by professional investors or investment advisers taking the whole disclosure in view. From this practical assessment perspective scattering risk factors in an EC prospectus ‘seems more realistic’. But there is no denial that were the factors required to be assembled under one head in addition to haphazard disclosure elsewhere, that would have helped the investors learn about the risks involved in their intended investment. The IOSCO standards require an independent item of “Risk Factors” for disclosure in a corporate prospectus, which is ‘intended to be a summary of more detailed discussion contained elsewhere in the document (prospectus).’ This confirms the international practice in this regard. As such by not categorising “risk factors” as an independent item the AID falls short of this international standard. However, despite its omission in the AID, the UK Listing Particulars embody provisions for a prospectus to disclose the risk factors not mentioned elsewhere. Similar provisions have been inserted in the proposed Prospectus Directive as well.

1683 (Ontario) Form 44-101F2, instruction (1).
1684 Ibid., Item 20 read together with Item 3, subitem 3.1.
1685 Lorenz, supra note 147, at p. 816.
1686 AID, supra note 636, Sch. A, Ch. 4.2. See Lorenz, ibid., at p. 817.
1687 Form 44-101F2, Item 19.6.
1688 Lorenz, supra note 147, at p. 817.
1689 Ibid.
1690 IOSCO’s Disclosure Standards, supra note 1442, pt. III, sec. D.
1691 UK Listing Particulars, Ch. 6, para. 6.G.1(b). In this connection see, IQE Prospectus, supra note 1598, at pp. 66-74.
Category VI: Responsibility Declaration

The AID requires a responsibility declaration for the information contained in the prospectus.\(^{1693}\) It is assumed that the issuer’s directors make the declaration.\(^{1694}\) Accepting the responsibility for the prospectus information they declare that the information is ‘in accordance with the facts and does not omit anything likely to affect the import of such information’.\(^{1695}\) This provision, as implemented in the UK\(^{1696}\), renders, in the event of omissions or wrong information, the directors liable plus the issuer, those who have accepted the responsibility for the information and also those who have authorised the contents of the prospectus or any part of it. An expert may be an example of one of those who have “accepted” the responsibility or who have authorised the contents.\(^{1697}\) No liability will, however, arise if such a person merely gives advice in a professional capacity.\(^{1698}\) In addition to the declaration the prospectus must state that the annual accounts of the issuer have been audited. If audit reports on annual accounts have been refused or qualified by official auditors, the prospectus must reproduce such refusal or qualifications with reasons given therefor along with details of the official auditors. If any other information provided in the prospectus has been so audited, it needs to be indicated.\(^{1699}\)

Similar to the above director declaration the veracity of an Ontario prospectus information is, under Item 33, certified by the Chief Executive Officer, Chief Financial Officer and other than them two directors on behalf of the issuer,\(^{1700}\)

\(^{1692}\) PD, supra note 857, Annex I, IV.D.
\(^{1693}\) AID, supra note 636, Annex I, Sch. A, Ch. 1, para. 1.2.
\(^{1694}\) Wareham, supra note 1438, at p. 106.
\(^{1695}\) IQE Prospectus, supra note 1598, at p. 118, read together with AID, supra note 636, Annex I, Sch. A, Ch. 1, para. 1.2.
\(^{1696}\) FSMA through the FSMA (Official Listing of Securities) Regulations 2001 (SI 2001/2956), reg. 6(1). This retained the Financial Services Act 1986 provisions as contained in sec.s 152(1) and 168(1).
\(^{1698}\) Wareham, supra note 1438, at p. 107.
\(^{1699}\) AID, supra note 636, Annex I, Sch. A, Ch. 1, para. 1.3.
\(^{1700}\) OSA, s. 58(1). See, for specimen, Real Resources Prospectus, supra note 1533, at p. C-1.
and also by the underwriters. The OSA requires a certificate by the auditors who have audited the financial statements confirming that the ‘financial statements present fairly, in all material respects, the financial position of the Company’. 

It may be added in this connection that an Ontario prospectus must unveil the interests of the auditor and other experts (e.g., lawyer, engineer, etc.), which include direct or indirect interests in the issuer’s property, beneficial ownership of the issuer’s securities, and likely appointment/election of their director, officer or employee as the issuer’s director, officer or employee. The AID, on the other hand, does not provide for this. The UK Listing Rules, of course, call for their details, but not interests.

**Category VII: Purchasers’ Statutory Rights Statement**

An Ontario prospectus must bear a statement of the purchasers’ rights, namely rights to prospectus delivery and withdrawal from purchase, and rights to damages against civil liability. Under the rights provision, a dealer must send the latest prospectus or an amendment thereto to the purchaser either before entering into the agreement of purchase and sale or by the end of the second day after entering into such agreement (excluding the weekends and holidays). The purchaser gets an opportunity to review the disclosure made in the prospectus and to decide whether to withdraw from the purchase. He or she or it may make withdrawal

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1701 OSA, s. 59(1). Also see, Real Resources Prospectus, *ibid.*, at p. C-2.
1703 Form 41–501, Item 28.3.
1704 (UK) Listing Rules, Ch. 6, para. 6.A.8.
1705 OSA, s. 60.
1707 OSA, s. 130.
1708 For the definition of “dealer”, see *supra* note 1545.
1709 As to how securities are offered and sold to the public, see text accompanied by notes 1542-1545, *supra*.
1710 OSA, s. 71(1).

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by simply notifying the dealer in writing.\textsuperscript{1711} Secondly, the purchaser has a right of action for damages or a right of rescission of the purchase instead, if the dealer fails to perform the said duty of prospectus delivery.\textsuperscript{1712} Required by Item 31 of the Ontario Form a prospectus states these rights and then advises the investors to ‘refer to any applicable provisions of the securities legislation…for the particulars of these rights or consult with a legal advisor’.\textsuperscript{1713}

As said earlier, the AID is the minimum prospectus disclosure standards set by the EC. It does not touch the domestic securities offering procedure, which may differ from Member State to Member State. The Member States may, while implementing the AID, add more provisions as necessary for prospectus disclosure, and may also adopt its own procedure of offering. As such there is no scope of purchasers’ rights statement under the AID. Thus the AID falls apart from the Ontario Form in this respect. Domestic procedures of the EC Member States do not match with Ontario’s either. For instance, the UK selling/purchasing mechanism of the primary market differs from that of North America (and, therefore, Ontario). Mentioned earlier elsewhere\textsuperscript{1714}, in the UK a prospectus, after approval by the Competent Authority (UKLA), is published in newspapers and securities are allotted to the applicant-public by the issuer/underwriter. As such there is no need of dealer/broker in this process and therefore, no statement of purchasers’ rights against them. Of course investors have remedies of damages, rescission of contract and criminal action against the issuer, its directors and others.\textsuperscript{1715} Other Member States like France, Germany and Italy have similar offering procedure, no dealer/broker involvement is there.\textsuperscript{1716}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{1711} Ibid. 71(2).
\item \textsuperscript{1712} Ibid., s. 133.
\item \textsuperscript{1713} Prospectus, Real Resources Inc., supra note 1533, at p. 15.
\item \textsuperscript{1714} See text accompanied by notes 1542-1544, supra.
\item \textsuperscript{1715} For details on the liability for false or misleading disclosure, see Keeling., supra note 1540, at pp. 139-142.
\end{itemize}
\end{footnotesize}
Category VIII: Miscellaneous Category

Ontario Item 29 mandates disclosure of other material facts than those categorised as different items. This is ‘the catch-all provision, to ensure that no information is omitted merely because it cannot be categorized’.\footnote{1717} The AID does not contain any similar provision. One may argue that the general requirement of “full and fair” disclosure obligates an issuer to impart all material information, specified or not, necessary for the investor in making the investment decision and, therefore, “other material facts”, as a separate category, may be a superfluous requirement. It may be looked at from another angle of view as well. The category of item in question, together with the general requirement, may serve as a double-handed tong to bind the issuer to fully comply with the disclosure obligation. There will be no excuse for an issuer to omit, intentionally or naively, any material fact on the ground that it has not been categorised as a material fact. Here lies the merit of the present category of item. An example of such an item may be the non-compliance with environmental law requirements. If a company or its management is held liable with heavy penalties for flouting environmental obligations (e.g., by air pollution, spills, etc.), this must tarnish the reputation of the company’s business. This harms the shareholders in that the damages are paid out of the corporate earning which, in turn, affects the amount of their dividends and secondly disrepute mars the business resulting in less earnings than before. Furthermore, this adversely impacts on the secondary market and consequently value of the securities is likely to decline. Thus environmental non-compliance has an effect on the price of securities and, therefore, should be subject to disclosure as a material fact.\footnote{1718} As indicated before,\footnote{1719} Ontario law provides for this disclosure.

\footnote{1716}{See Steinberg, \textit{supra} note 1442, at pp. 10-17.}
\footnote{1717}{Johnston and Rockwell, \textit{supra} note 895, at p. 76.}
\footnote{1718}{Michael Deturbide, ‘Corporate protector or environment al safeguard? The emerging role of the environmental audit’, 5 J.Env.L.&Pract. 1, at p. 10 n. 29. Some other authors wrote: Material facts are ‘broader than just balance sheet considerations and will clearly encompass environmental factors’.
which is probably grounded on this premise. Though the EC has not itemised this matter for mandatory disclosure,^\textsuperscript{1720} an addition of “the miscellaneous category” to the AID may facilitate the disclosure of this and other similar matters in the prospectus.

8.2.2.2 Financial Matters

8.2.2.2.1 Historical and Theoretical Background

‘Double-entry bookkeeping^\textsuperscript{1721}, listed companies, accountancy professions and published financial statements are all European inventions.’^\textsuperscript{1722} Other regions of the world (e.g., North America) seem to have borrowed the phenomenon of accounting from Europe and have patterned it according to their own legal, financial and taxation systems. This has resulted in divergent accounting systems all over the world. Different scholars have attempted to classify them on different bases without universal acceptance. Professor Nobes has offered a classification on the basis of origination of accounting systems (similar to biological classification) keeping in mind harmonisation as the objective of such classification: such ‘classification should show which countries might be easiest to harmonize and which the most difficult’.^\textsuperscript{1723} To quote him further:

A country’s accounting practices are bound up with where they came from; and those countries whose

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^\textsuperscript{1719} See text accompanied by notes 1605-1606, supra.

^\textsuperscript{1720} Of course the UK prospectus discloses environmental relevance of the issuer’s business and the state of its compliance with the environmental regulations. Prospectus, IQE, supra note 1598, at p. 51.

^\textsuperscript{1721} Bookkeeping is a part of accounting concerned with recording ‘in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character’. By double-entry bookkeeping ‘each transaction is recorded by a double (double-sided) entry, the amount on one side being equal to the amount on the other side.’ If, for example, £100 is entered on the “debit” side (left side), an entry (e.g., liabilities) or combination of entries (e.g., liabilities and equity) of the same amount must be entered on the credit side (right side). Irving Kellogg, How to Use Financial Statements: A handbook for Lawyers, (New York, St. Louis, San Francisco, London, Sydney, Toronto, Mexico and Panama: McGraw-Hill Book Company, 1969), at pp. 44 and 45. (omitting the original source of reference).

^\textsuperscript{1722} Nobes, supra note 421, at p. 1. (emphasis added)

accounting has similar origins usually have similar practices. Similarly, those countries similar practices tend to have similar background factors like laws and ownership structures.\footnote{Ibid.}

He included the Netherlands, UK, Ireland, Australia, New Zealand, US and Canada in one family (micro-based) and Italy, France, Belgium, Spain, Germany, Japan and Sweden in another family (macro-uniform). The former consists of three species: Netherlands (business, economics theory based), UK, Ireland, New Zealand and Australia (UK influence based) and, US and Canada (US influence based). The latter family also falls into three species: Italy, France, Belgium and Spain (tax based), Germany and Japan (law-based) and Sweden (government economics based).

As Professor Nobes’ classification shows, there is a stark divide within Europe: common law Europe (the UK and Ireland) and continental Europe (except the Netherlands with some affinities with the UK). In the former, where law is codified to a limited extent and is developed by judicial interpretation to address situation-specific, accounting profession (e.g. in the UK the Accounting Standards Committee-ASC, presently Accounting Standards Board -ASB) formulates standards to solve accounting issues. In continental Europe commercial law, on the other hand, defines the detailed rules of accounting and financial reporting and the governments control the accounting profession. e.g., in Germany and France, the Commercial Code embodies the accounting rules that are supplemented by company law. This made harmonisation in Europe very difficult, but not impossible. The accounting directives (i.e., 4\textsuperscript{th} and 7\textsuperscript{th} Company Law Directives) brought changes to the attitude, law and practices in the Member States. Until 1981, when the UK implemented the Annual Accounting Directive through Companies Act, there were limited accounting provisions in the Companies Act. Principal legal requirement was that accounts were required only to
show a “true and fair view” (TFV), which has been explained before. Now the Companies Act contains detailed accounting provisions compared to before bringing other Member States’ (mainly Germany) practices in it while keeping ‘much of the British accounting traditions’. At the same time common law accounting has impacted on its continental counterpart on a larger scale by exporting thereto the TFV philosophy, general principles of accounting and so on. Thus the EC has become a “neo-accounting” system with mixed traits and components of both common law and continental accountings.

Now, in order to facilitate the forthcoming comparisons between the EC and Canadian accountings, it would be relevant to trace the historical and theoretical links with its counterpart: ‘a perspective of the evolutionary development of the ideas behind known accounting actions can make current accounting more understandable and accounting criticisms more intelligibly debatable.’

It is already known that Canadian company law takes it roots from English law. The English Joint Stock Companies Act of 1844 laid down provisions for mandatory audit and preparation of balance sheet for annual meeting. The English Joint Stock Companies Act of 1856 replaced those provisions, but provided a set of “model articles”, Table B, applicable ‘in the event of an incorporating company did not register its own particular articles.’ The model article provisions for financial statements that were ‘remarkably modern…served as guides in corporate reporting practices in England, Canada and the United States’ in spite of their non-binding effect.

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1725 Nobes, supra note 421, at p. 3.
1726 Texts accompanied by noted 489-507, supra.
1727 Nobes, supra note 1723, at p. 90.
1729 Text accompanied by notes 964-975, supra.
1730 Murphy, supra note 1728, at p. 53.
1731 Ibid.
influence of these provisions on Canadian legislation may be traced, for example, in the Ontario Companies Act of 1907 which was directly copied to legislate, at the federal level, the Companies Act of 1917.\textsuperscript{1732} The 1907 Act provides that the directors shall lay before the company a balance sheet and statement of income and expenditure setting out the classes of assets and liabilities to be contained in the balance sheet, which, when compared, seem to have been clearly based on the financial statements provisions of the model articles enshrined in Table B of the English Act of 1856.\textsuperscript{1733} After 1917 and until 1953 the notable legislation made in the concerned area are the federal Companies Act, 1934 and the Companies Act, 1935, which provided for detailed information in the financial statements to cater to the public clamour for such disclosure following 1929’s share market crash and 1930s’ recessions.\textsuperscript{1734} This was a superiority gained over the contemporary English legislation (the Companies Act of 1928) that, similar to its predecessors, contained very minimum requirements.\textsuperscript{1735} In 1953 the Ontario Companies Act of 1907 was revised with modern disclosure provisions that were ‘virtual copy’ of the recommendations of the Institute of Chartered Accountants of Ontario (ICAO).\textsuperscript{1736} The ICAO relied totally on the Institute of Chartered Accountants of Canada (CICA)’s first bulletin on the recommended disclosure standards of 1946.\textsuperscript{1737} This episode evidences influences of the Chartered Accountants Institutes on 1953 Act, which continued in almost all subsequent legislation concerning financial statement disclosure.\textsuperscript{1738} The Institutes were, in turn, influenced by American counterparts ‘as they carefully screened American thought and practices before making their own


\textsuperscript{1733} See, for the text of the 1907 Act and Table B of the 1856 Act, Murphy, \textit{supra} note \textit{ibid.}, at p. 439 and Murphy, \textit{supra} note 1728, at pp. 53-54.

\textsuperscript{1734} Murphy, \textit{supra} note 1732, at p. 441.

\textsuperscript{1735} \textit{Ibid.}, at p. 442.

\textsuperscript{1736} \textit{Ibid.}, at p. 444.

\textsuperscript{1737} \textit{Ibid.}

\textsuperscript{1738} Murphy, \textit{supra} note 1728, at p. 137.
recommendations”. The reasons behind the American influence on Canadian accounting have been articulated by Prof. Murphy elsewhere as follows:

...through the importance, proximity and articulateness of the American accounting profession, edicts of the Securities and Exchange Commission (SEC), the American parent-Canadian subsidiary relationships of many corporations, and the close ties amongst international public accounting firms.

However, the English and American influences could not dominate on Canada, rather it has its unique approach to accounting. Principal uniqueness lies in its according legislative status to the CICA. Since the beginning of the twentieth century the legislative authorities entrusted the accounting Institutes with the task of laying out the framework of financial statement disclosure. In the mid-1960s the public was demanding for narrowing down the scope of acceptable accounting practices and also for vaster disclosure, which led to ‘the formal delegation of the determination of standards and disclosure requirements to the Institute (CICA).’ And the CICA Handbook recommendations were given mandatory standards status in the 1970s by the federal and provincial legislative and administrative authorities. As such the CICA Handbook received legislative position and its recommendations formed part of the law of the land.

The overhead position of the CICA contrasts with its English and American counterpart bodies. In England the Companies Acts conventionally contained the minimum legal requirements for the preparation of financial statements. And the Accounting Institute’s (Institute of Chartered Accountants of England and Wales, ASB

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1739 Murphy, supra note 1732, at p. 445.
1740 Ibid.
1741 Murphy, supra note 1732, at p. 448.
1742 Ibid.
1743 Ibid.
1744 Murphy, supra note 1740, at 525.
in particular) recommendations acted as guides thereto. With the implementation of the accounting directives, as said above, the Companies Act now contains the formats of accounts and detailed rules of accounting to be followed in preparing financial statements, which has constrained the freedom of the standard setters and accounts preparers. Nevertheless, traditional status of the recommendations has improved with the *Argyll* case of 1981: ‘they are becoming firm rules backed by sanctions’. Of course, in fact, *Argyll* having been decided by a Magistrates court does not have binding force; it is likely to be followed in similar cases, however.

Further, in 1989 statutory recognition has been given to the existence of accounting standards inserting section 256 in the Companies Act, 1989 and paragraph 36A in Schedule 4. In this way, over time the value of accounting standards has undoubtedly enhanced, but jurisprudentially they do not constitute the law of the land because they have not been statutorily declared to have mandatory effect. But there is no doubt that ‘they will have a very persuasive effect in the courts’ interpretation as to whether or not a company’s accounts present a true and fair view as the standard-setters can override the details of law in order to erect high the TFV requirement. For example, even though the Annual Accounting Directive and Companies Act allow Last-in-

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1746 Murphy, *supra* note 1732, at p. 447 and 448.
1748 This is an unreported criminal case in which the main matter of decision was whether accounts impugned gave a “true and fair view”, even though they were prepared in contravention of two provisions of the Companies Act of 1948 and a statement of standard accounting practice (SSAP 14). The auditor’s report certified the accounts to have been true and fair in spite of breaching of the Companies Act provision and an accounting standard on the ground that necessary information was disclosed in notes rendering the accounting not misleading. The Magistrates Court, that tried the case, held that the accounts were not true and fair and so breached the Companies Act (and the accounting standard). See R. K. Ashton, ‘The Argyll Foods case: a legal analysis’, in R. H. Parker, P.W. Wolnizer and C.W. Nobes (eds.) *Readings in True and Fair* (New York and London: Garland Publishing, 1996), 319-332, pp. 173-182, and John Birds, ‘The first “true and fair view” prosecution’, 2(6) Co. Law.(1981) 275. (The Company Lawyer)
1751 Davis, Paterson and Wilson, *supra* note 1747, at p. 9.
1753 Companies Act 1985, Sch. 4, para. 27(2)(b).
first-out (LIFO) formula for the assessment of valuation, Appendix to SSAP 9 rejects suggests that it should not be used because it will not impart a true and fair view.\textsuperscript{1754} Companies having US subsidiaries commonly use LIFO for tax reasons notwithstanding.\textsuperscript{1755}

In the US the Council of the American Institute of Certified Public Accountants (AICPA) has designated the Financial Accounting Standards Board (FASB) to set up accounting principles.\textsuperscript{1756} The principles, standards and practices of the FASB have substantial authoritative support subject to the control by The Securities and Exchange Commission (SEC).\textsuperscript{1757} The SEC closely monitors the regular functioning of the FASB and even goes to the extent of overruling the FASB’s pronouncements that it is not satisfied with.\textsuperscript{1758} This indicates that the actual authority concerning accounting standard-setting lies in the SEC instead of the FASB.\textsuperscript{1759}

The historical and theoretical ties and contrasts between the two regions impact on the fundamental tenets and requirements, and particular rules/standards used in the preparation of financial statements. As such a blend of divergence and conformity between the financial accountings of the two regions would surface in the forthcoming discussion.

8.2.2.2.2 Basic Philosophy: True and Fair View versus Fair Presentation:

\textsuperscript{1757} Ibid.
\textsuperscript{1758} See Nobes and Parker, \textit{ibid.}, at pp. 12-13.
\textsuperscript{1759} See Murphy, \textit{supra} note 1732, at p. 448.
The “true and fair view” (TFV) is the pivot of the EC accounting directives, which, it is iterated, demands that financial statements show distortion-free actual financial standing of a company. To do that the statements should be made primarily in conformity with the Directives provisions. There are two exceptional situations in which the only-compliance with the Directives provisions may be avoided. First, in the event of the application of the Directives provisions being insufficient to give a TFV additional information must be provided.\textsuperscript{1760} Again, if the application of any provision of the Directives fails to impart a TFV and an extra information cannot cure this shortcoming, that provision must be avoided setting notes explaining the reasons of such departure and a statement of its effects on the assets, liabilities, financial position and profit or loss.\textsuperscript{1761} The ultimate purpose of thus honouring the TFV philosophy all the time is to protect the investors by providing them with reliable information so that they can make informed investment decision. To that end, it does not matter how the financial statements are made, be in compliance with the Directives provisions or by deviation from them. Of course, compliance with the provisions is preferred.

In support of the above legal position of TFV requirement an English case may be considered keeping the present context of comparison in mind. The English case law is chosen because the UK, the mother of the TFV philosophy, has incorporated the accounting directives provisions \textit{in toto} in the Companies Act, 1985. This has, as said before\textsuperscript{1762}, elevated the status of the profession-made accounting standards in that the Companies Act provisions may be ignored and standards may be applied in the preparation of financial statements in order to project a TFV.\textsuperscript{1763} Among

\textsuperscript{1760} Annual Accounting Directive, art. 2(4), and Consolidated Accounting Directive, art. 16(4).
\textsuperscript{1761} Annual Accounting Directive, art. 2(5), and Consolidated Accounting Directive, art. 16(5).
\textsuperscript{1762} Text accompanied by note 1747, \textit{supra}.
\textsuperscript{1763} See the text accompanied by note 1754, \textit{supra}.
the other Member States Germany’s position is extreme compared to the UK’s. Germany requires strict application of law in the preparation of financial statements. If needed, it allows adding extra information to fill the gap of the law. It does not, however, permit departure from law to prepare statements otherwise. Other Members’ (e.g. Ireland, the Netherlands, Denmark) practices are similar or almost similar to the UK’s. However, in Caparo Industries plc v. Dickman auditor’s responsibility with regard to financial statements was in issue. In dealing with that issue the Court of Appeal examined the nature of limited liability companies, position of the shareholders in such entities, their need of financial statements and the role of both the management and auditors in satisfying that need. It stated that in a limited liability company the overall management is delegated to the directors, though real power of control vests in the shareholders. For effective power control and financial decision-making they need ‘independent and reliable information on financial standing of the company’. To cater to this need the management is primarily responsible to prepare financial statements and the auditors are secondarily duty-bound to attest that those statements give a “true and fair view” of the company’s financial position. In other words, auditors certify that the company accounts are reliable for the shareholders’ decision-making. Thus the essence coming out of this case is that the company accounts must be reliable. How can the accounts be reliable? This is answered by the Companies Act, which, copying from the accounting directives, provides for drawing

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1764 Nobes, supra note 1754, at p. 327.
1765 Ibid., at p. 329.
1768 Ibid., at p. 804.
1769 Ibid., at pp. 804-805.
1770 Ibid., at 804.
1771 Ibid.
up of accounts by application of the provisions contained in it or by way of departure from them.

On the other hand, Section 1400.03 of the CICA Handbook recommends that ‘(f)inancial statements should present fairly in accordance with Canadian generally accepted accounting principles the financial position, results of operations and cash flows of an entity’. This means, it continues, that they (financial statements) should ‘represent faithfully the substance of transactions and other events…’. According to Cambridge Advanced Learner’s Dictionary one of the meanings of “faithfully”, relevant to the present context, is “exactly.” 1772 In light of this meaning it may be said that by its “present fairly” requirement under Section 1400.03 the Handbook requires exact presentation of financial information in an entity’s financial statements. Whether the requirement of “fair presentation” or “exact presentation” envisages the same thing as the TFV requirement does may be determined by looking at the general sections of the CICA Handbook. The Handbook defines GAAP as comprising ‘broad principles and conventions of general application’ and also ‘rules, and procedures that determine accepted accounting practices at a particular time’. 1773 The principles of general application are typified in the Handbook as “primary sources” of GAAP that include, among others, (i) Recommendations made by the Accounting Standards Board (AcSB) as contained in the Handbook (Sections), (ii) Accounting Guidelines including Appendices and AcSB Notices. 1774 Where these primary sources fail to suit any particular situations not visualised by the primary source-makers, the Handbook allows entities to consult “other” sources in choosing the appropriate policies and disclosures. 1775 Such policies and disclosures, required to be determined by professional (accountant or auditor) judgment, must be consistent with the primary

1773 CICA Handbook, sec. 1100.02(b).
1774 Ibid., sec. 1100.02(c).
Also they must be material (i.e., significant to financial decision making) and meet qualitative characteristics of financial statements (e.g. understandability, relevance, and reliability, etc.) discussed beforehand. Accounting pronouncements by US Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) are an example of such “other” sources. From this it is understood that the primary sources are the Canadian GAAP in the strict sense and therefore, receive, as noticed above, the law-of-the-land status. (Henceforward “GAAP” will be used in this strict sense, and GAAP and CICA Handbook will be interchangeably used). GAAP can be avoided when they fail to impart an exact view of an entity’s financial position in a given situation because, lacking the “exact presentation” financial statements would not be reliable for their users (investors and creditors) in making their ‘resource allocation decisions’.

This will justify adopting “other” sources of accounting standards. Thus from the user protection perspective “fair presentation” or “exact presentation” connotes reliable information that permits departure from the GAAP and resorting to “other” sources of accounting standards. Reliability of information is the goal and legal compliance (i.e., GAAP compliance) to get to that goal is a means, not the means. If the goal is frustrated, legal compliance will be no good defence. Thus in Kripps v. Touche Ross & Co. the financial statements were in fact misleading but certified by auditors to be “fair” on the ground that they were made according to the GAAP. The British

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1775 Ibid., sec. 1100.06.
1776 Ibid., sec. 1100.04.
1777 Ibid., sec. 1000.17-1000.23.
1778 Text accompanied by notes 508-521, supra.
1780 Text accompanied by note 1746, supra.
1781 CICA Handbook, sec. 1000.12.
1782 CICA Handbook, sec. 5400.16, as cited in Kripps case, infra note 1783, in part states that To permit all auditors to judge in a consistent manner whether financial statements “present fairly”, there must be standard against which those judgments can be made; generally accepted accounting principles provide such a standard. (emphasis added).
Columbia Court of Appeal turned down the auditors’ ground of defence and held that they (auditors) cannot ‘hide behind’ the GAAP\textsuperscript{1784} (to use them as a shield against their liability) because they are responsible to pass the ‘fairness’ of the statements and not merely their conformity with the GAAP\textsuperscript{1785}. The Court further reasoned in effect that the GAAP being set by a professional body (CICA) for its members (accountants and auditors) compliance therewith cannot save the members committing wrong to the rest of the community.\textsuperscript{1786} This means that where the accounts are misleading, the plea that they were made in compliance with the GAAP (which is law for Canadian accounting and auditing professions) will not stand because that will vitiate the whole policy of the parliamentary legislation in company and securities area, namely the investor protection. Earlier a Commission Report likewise maintained, as regards the auditor’s responsibility to ensure fair presentation, that the auditor should not ‘just see that individual accounting standards are complied with by the client but also to “stand back” and assess whether the financial statements as a whole yield a fair impression of the state of affairs’.\textsuperscript{1787}

Contextually the basic philosophy of the US GAAP, the prototype for Canadian GAAP, may be cross-referenced to here. In the US the accounting principles and rules are more codified in detail than in Canada.\textsuperscript{1788} There financial statements are required to “present fairly” the financial position of the company and the results of its operation in conformity with the GAAP.\textsuperscript{1789} This means GAAP compliance is \textit{the} test

\textsuperscript{1784} Ibid., at p. 440 (para. 66).
\textsuperscript{1785} Ibid., at p. 439 (para. 64).
\textsuperscript{1786} Ibid., at pp. 441-442 (para. 73).
\textsuperscript{1787} Report of the Commission to Study the Public’s Expectations of Audits, (Toronto: The Canadian Institute of Chartered Accountants, June 1988).
\textsuperscript{1789} Auditor’s Standard Report prescribed by SAS 58 effective on and from 1 January 1989 produced in Robert S. Kay and D. Gerald Searfoss, Handbook of Accounting and Auditing, 2\textsuperscript{nd} edn. (Boston and New York: Gorham and Lamont, 1989), at p. 5-6.
of “fair presentation”, whereas in Canada GAAP compliance is a test of fairness. Similar to Canada, there are “rare” exceptions where application of the GAAP can be established as resulting in misleading financial statements. In such cases departure is disclosed in notes with reasons therefor. Since there is still a possibility of misleading results in spite of GAAP compliance, it was held in US v. Simon that conformity with GAAP ‘may be very persuasive but not necessarily conclusive’ evidence that financial statements are not misleading. The Enron and other scandals of the recent past have reaffirmed that it is the auditor’s responsibility to ensure that the financial statements are not merely complied with GAAP, rather they were not “enronned” and, therefore, not misleading for investor decision-making.

1791 Supra note 1782.
1792 Meek, supra note 1790, at p. 60.
1793 Ibid.
1794 425 F. 2d 796.
1795 Ibid., at pp. 805-806.
1796 Enron was one of the top leading companies listed on the New York Stock Exchange (NSE). Driven by temptation and greed to make money by cheating the capital market in early 2001 they engaged in derivative-based contracts that involved commodities dealt in by them on behalf of others. This exposed the company to a great risk and uncertainty. To avoid its adverse impact on the stock price they hid this matter, rather continued to falsely disclose positive reported earnings in financial statements which were too difficult to understand. In addition, the company incurred huge financial loss resulting from the collapse of some of their “special-purpose entities” (SPEs) created purposely to channel goodly amounts off the published balance sheet in order to show its better credit standing. It did not, however, treat the EPEs as their subsidiaries by narrowly interpreting the GAAP. As such, the SPEs’ assets and liabilities were not brought into the consolidated financial statements. Notwithstanding this falsification the auditing firm, Andersen, knowingly certified those statements. Enron could not fool the stock market. Their sins of falsification were unearthed at the cost of their doom by the end of December 2001 when their trading was shut down by the NSE. Paul B.W. Miller and Paul R. Bahnsen, Quality Financial Reporting (New York, Chicago, etc.: McGraw-Hill, 2002), at pp. 304-309. After Enron, series of corporate scandals were unveiled, e.g., Worldcom, Global Crossing, Adelphia Communications. See Robyn Rebollo, ‘Tracking resources for the Sarbanes-Oxley Act of 2002’, 22(3) LIA 1, at p. 1. These wrongdoings were responded by the Congress with more stringent law, namely the Sarbanes-Oxley Act of 2002, Pub. L. No. 107204, 116 Stat. 745, effective from 30 July 2002. Most important change wrought by the Act is the creation of the Public Company Accounting Oversight Board responsible for overseeing the corporate accounting and auditing process. Among others are the sledgehammer rules of financial disclosure, independence of auditors and enforcement. See, for details on the Act, Brian Kim, ‘Sarbanes-Oxley Act’, 40(1) (Winter 2003) HJL 139. Professor Ronen has criticised the Act as an inadequate measure against corporate accounting crime and has proposed, among others, a “market-based” solution, namely Financial Statements Insurance (FSI). According to this proposed mechanism of instead of appointing and paying auditors, companies would purchase financial statements insurance that provides for coverage to investors against losses suffered as a result of misrepresentation in financial reports. Joshua Ronen, ‘The post-Enron reform: financial statement insurance, and GAAP revisited’, 8(1) (Autumn 2002) SJLBF 39-68.
1797 Following the Enron scandal of 2001 the company name, “Enron”, has turned to a verb meaning “hype and spin”. Miller and Bahnsen, ibid., at p. 313.
From the comparison of the TFV and “fair presentation” philosophies of the EC, and Canada that copies from the US, respectively, it may be concluded that reliable financial information is the common demand of both laws to enable the investors, among other users of financial statements, to make informed investment decision. In pursuit of this goal both laws, while emphasising for the application of the legal provisions in the preparation of financial statements, allow departure therefrom, where necessary. Since the directives set out the minimum requirements, compared to Canada there is, however, a wider scope of exercising subjective judgement in general in the EC. Depending on how much the concerned national laws are codified, this scope of subjectivity varies. For example, as already seen, in the UK the Companies Act provides for minimum requirements on exhaustion of which (or overriding which) the accounting standards will apply. On the other hand, in Germany the laws in this regard are, as in Canada and the US, mostly codified, and as such subjectivity is restricted. Originally referring to the TFV the following words of Professor Flint seem to represent each of the concepts ‘as a safety valve remedying the deficiencies of prescription and ensuring that departures from the recognized regulations and practices should only be permissible when they do fairly reflect what has happened to the company.’

8.2.2.2.3 As Regards General Principles and Basic Qualities

As previously discussed, the accounting directives provide for preparation of corporate accounts applying some basic principles, namely the principles of going concern, consistency, prudence, accrual, historical cost and so on. In Canadian

1798 See text accompanied by note 1749-1754, supra.
1799 See text accompanied by note 1765, supra.
1801 Text accompanied by notes 508-525, supra.
accounting these principles are also followed. In addition, the financial statements, in both jurisdictions, must conform to a set of qualities. The CICA Handbook makes it incumbent that the information contained in financial statements (material items in the same sense of material facts defined earlier) must be understandable, relevant, reliable and comparable. The purpose behind is to render the information useful to the users (investors, members, contributors, creditors and others) in making their resource allocation decisions and/or assessing management stewardship. Thus the first quality of financial information presented in the financial statements is that they must be understandable by the users who are presumed to have a ‘reasonable understanding of business and economic activities and accounting, together with a willingness to study the information with reasonable diligence.’ Second quality is that information must be relevant to the decision making by the users. It is so when the information can help the user ‘evaluate the financial impact of past, present or future transactions and events, or confirm, or correct, previous, present or future evaluations.’ Penultimately, the information must be reliable in the sense that they do not conflict with the transactions and events actually underlying them in the view of knowledgeable and independent observers and that they are free from bias (meaning consistent overstatement or understatement of information). The last quality of the financial statements must be their comparability with the financial statements of some other entities or with those prepared at some other points of time. By this the users can discern out the similarities and dissimilarities between two sets of financial statements. Consistency between them suffers because of change in the accounting

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1802 See, for the discussion of the principles, Langhout, supra note 510, at pp. 4-10.
1803 Text accompanied by note 1445, supra.
1804 CICA Handbook, sec. 1000.17
1805 Ibid., sec. 1000.18.
1806 Ibid., sec. 1000.15.
1807 Ibid., sec. 1000.19.
1808 Ibid., sec. 1000.20.
1809 Ibid., sec. 1000.21.
policies. Therefore, if there is a need of change in the policies, the effects of such change should also be disclosed.\textsuperscript{1811} With respect to EC financial statements the same qualities are also required ‘for making economic decisions and assessing the stewardship of management’, as it has been confirmed by the European Financial Reporting Advisory Group (EFRAG) while making recommendation for adopting the IAS by the EC as its accounting standards in view of the fact that the IAS do not conflict with the TFV philosophy and that they meet the said qualities of financial statements.\textsuperscript{1812}

\textbf{8.2.2.2.4 Financial Statements, Their Contents and Formats in General}

Financial statements that are ‘the formal summarized presentations of financial information contained in the accounting records of a business’\textsuperscript{1813} disclose the amounts of the issuer’s sales, expenses, profits, presently available finance and sources thereof, and thus enable the investors to learn about the issuer’s past and present financial conditions.\textsuperscript{1814} They are of similar kinds all over the world\textsuperscript{1815}, particularly in the two regions in question. From the overview of the accounting directives it is known that the chief financial statements in the EC are balance sheet, profit and loss account (in Canada also called income statement, or statements of earnings\textsuperscript{1816}), and notes thereto, which together constitute annual accounts and also consolidated accounts. A

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{1810} Ibid., sec. 1000.22.
\item\textsuperscript{1811} Ibid., sec. 1000.22 and 1000.23.
\item\textsuperscript{1812} ‘FESE supports EFRAG’s endorsement of all existing IAS and SIC interpretations’, Brussels 27 June 2002, visited at http://www.fese.be/initiatives/european_representation/2002/efrag_submission.htm on 5 July 2002 (hardcopy on file), and also the EFRAG letter of 19 June 2002 to John Mogg, Director General, Internal Market-Director General on the said matter on the same website visited on the same date. Also see Barry J. Epstein and Abbas Ali Mirza, \textit{IAS: Interpretation and Application of International Accounting Standards}, (New Jersey: John Wiley & Sons, Inc., 2003), at p. 15.
\item\textsuperscript{1813} Kwaw, supra note 1486, at pp. 47-48.
\item\textsuperscript{1814} Roger Oldcorn, \textit{Company Accounts}, 3\textsuperscript{rd} ed (Houndmills, Basingstoke, Hampshire and London: Macmillan Business, 1996), at p. 3.
\item\textsuperscript{1815} Ibid.
\item\textsuperscript{1816} Langhout, supra note 510, at p. 53.
\end{enumerate}
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The cash flow statement is also published. They, duly audited, constitute an important component of the annual report required to be presented to company’s general meeting. Ontario requires the same documents (notes inclusive). In addition, it calls for retained earnings statement that does not have any counterpart as an independent statement in the EC, but this is disclosed as an offshoot of the profit and loss statement. For this reason it is not being considered for comparison. As in the EC, Ontario financial statements (both annual and consolidated) are audited and presented to the shareholders’ general meetings. Of the comparable financial statements is number one is the balance sheet, which is a ‘static record of the financial structure of the (issuer’s) business’. It does not show any profitability of the issuer, which is the function of profit and loss account. In both jurisdictions (including the US) the balance sheet presents three broad categories of things: assets, liabilities and the difference between them called shareholders’ equity. Of course, some terms used for the items included in these categories differ. For example, a British balance sheet uses, in line with the accounting directives, “stocks”, “debtors” “creditors” and “retained earnings” respectively for North American “inventories”, “accounts receivable”, “accounts payable” and “retained profits”. The income statement (profit and loss account) shows the issuer’s financial performance under three broad heads, namely revenue, expenses, and net income/profit. In this respect both Canada (and US) and the EC stand on the same line, though some accounting terms differ as it is with the

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1817 See IQE prospectus, supra note 1598, at p. 78.
1821 See ch. 7.2.1.2.4.2, supra.
1822 Kwaw, supra note 1486, at 49.
1823 Ibid., at p. 48.
1824 E.g., Annual Accounting Directive, art.s 9 and 10.
1825 See Oldcorn, supra note 1814, at pp. 143 and 144, and Kwaw, supra note 1486, at p. 49.
1826 Kwaw, ibid., at p. 52.
balance, e.g., EC “turnover” is synonymous with North American “revenue”.\textsuperscript{1827} The cash flow statement shows ‘all of the cash that flowed into and out of the firm during a period of time’ from operating, financing and investing activities.\textsuperscript{1828} As with the other two statements the contents of the cash flow statements (in the UK also called funds flow statements) are, in broad layout, namely inflows/outflows operating, financing and investing activities,\textsuperscript{1829} albeit the EC accounting directives do not provide for it. There are some terminological differences, of course, e.g., for inflow/outflow from investing activities Ontario sometimes uses “income-producing properties”\textsuperscript{1830} for the EC’s (the UK’s) “tangible fixed assets”\textsuperscript{1831}. In most of the cases the terminological differences are immaterial, but sometimes confusions may erupt.\textsuperscript{1832} For example, as shown above, Canadian “inventory” stands for British “stock” which is also used for share in Canada, e.g., “stock dividend”\textsuperscript{1833}. So, it would be confusing to a Canadian user of financial statements if it is stated that “First-in-first-out” (FIFO) (an inventory valuation method) has been used for the valuation of “stock”. Again, “amortization”, defined later,\textsuperscript{1834} is used in Canada with respect to both tangible and intangible assets, whereas in the UK its counterpart, “depreciation”, is used for tangibles and “amortization” for intangibles.\textsuperscript{1835} Probably Eliot reflected on the confusion proneness of words when he says:

\begin{quote}
‘Words strain, 
Crack and sometimes break…’\textsuperscript{1836}
\end{quote}

\begin{flushleft}
\textsuperscript{1827} See IQE Prospectus, supra note 1598, at p. 75 and Rogers Prospectus, supra note 1475, p. A-4, and Lithia Prospectus, supra note 1253, at p.F-4.
\textsuperscript{1828} Bodie and Merton, supra note 1553, at p. 67.
\textsuperscript{1831} IQE Prospectus, supra note 1598, at p. 101.
\textsuperscript{1832} For terminological differences between the US and the UK financial statements and the likely resulting confusions, see Nobes, supra note 52, at pp. 31-33.
\textsuperscript{1833} When dividends are paid in the form of additional shares to the shareholders/stockholders instead of cash, this is called “stock dividend”. Gillen, supra note 1486, at p. 9.
\textsuperscript{1834} See text accompanied by notes 1894-1897, infra.
\textsuperscript{1835} Davies, Paterson, and Wilson, supra note 1747, at p. 747.
\textsuperscript{1836} Four Quarters, Burnt Norton, V by T.S. Eliot cited in Nobes, supra note 52, at p. 31.
\end{flushleft}
In order to present the above mentioned three broad categories of balance sheet information, namely assets, liabilities and shareholders’ equity, Articles 9 and 10 of the Annual Accounting Directive prescribe two alternative formats, horizontal (also called account form) and vertical formats (also called report form). They equally apply to consolidated balance sheet under the Consolidated Accounting Directive.\textsuperscript{1837} Canada has the same formats.\textsuperscript{1838} The horizontal format is the traditional two-sided statement that presents assets on one side, typically left-handed side, and liabilities and shareholders’ equity on the other side (right-handed side).\textsuperscript{1839} The vertical format presents the same information vertically but in a bit different order,\textsuperscript{1840} e.g., “current assets” is followed by “current liabilities” showing next the difference between them (working capital). Compared to the former (horizontal format) it displays ‘more clearly the working capital position of the business and the equality of the amount of net assets’ (i.e., total assets-total liabilities=shareholders’ equity).\textsuperscript{1841} Despite format similarity Canadian balance sheet differs from the EC’s in that very often it presents current assets at the top.\textsuperscript{1842} With regard to income statement Articles 23-26 of the Annual Accounting Directive prescribes four alternative formats that also apply to consolidated income statement under Article 17 of the Consolidated Accounting Directive. Their application depends on the type of business carried on by particular companies. For example, Format in Article 25 or 26 would apply to a company that sells products as the captions include items like “cost of sales” and “distribution costs”.\textsuperscript{1843} And Format in Articles 23 or 24 would be appropriate for a manufacturing company as it is required to present expenses for “raw materials and consumes” and

\textsuperscript{1837} See Bough, supra note 499, at pp. 22-23.  
\textsuperscript{1838} Langhout, supra note 510, at p. 65.  
\textsuperscript{1839} Ibid.  
\textsuperscript{1840} Bough, supra note 499, at p. 23.  
\textsuperscript{1841} Langhout, supra note 510, at p. 65.  
\textsuperscript{1842} See ibid., at pp. 65-66. For exceptional practice, see Alexis Nihon Prospectus, supra note 1830, at p. F-18.  
\textsuperscript{1843} See Bough, supra note 499, at p. 23.
“staff costs”.  In Canada there is no prescribed format for income statement, but how information would be presented in a particular statement depends, as in the EC, on the nature or type of business.

8.2.2.2.5 Accounting Rules/Standards Applicable to Financial Statements in General

While similar financial statements are required in both jurisdictions, the accounting rules, guides or principles of accounting (generally called standards of accounting) according to which they are prepared are not the same. An Ontario balance sheet, and an income statement (profit and loss account) are prepared and presented according to Canadian GAAP. In Europe they are done basically according to the accounting directives that have been implemented in national laws of the Member States at the minimum level given the divergent national legal, accounting and tax system. Those directives being 20 years old and significant changes having taken place in the financial reporting system and developments in the standard-setting, the Community has planned to revise them, but not to eliminate them because they are still valuable accounting law. Of such changes and developments worth mentioning is the widespread use of derivative financial instruments like futures, options and swaps in the international financial markets, and leading accounting standard-setters’ leaning towards the “fair value” model from the “historical cost” model for the valuation of

1844 Ibid.
1847 “Towards a real standardisation of European companies’ financial statements: the adoption of IAS as a means of overcoming the differences in national laws”, http://www.leaseeurope.org/speaches-pdf/Micossi.pdf visited on the 4th November 2003 (hard copy on file), at p. 1. Because of the harmonisation national accounting rules/practices are compatible to some extent and thereby their variances are narrowed down. And this is what harmonisation tends to mean.
1848 Epstein and Mirza, supra note 1812, at p. 16.
such instruments.\textsuperscript{1849} In order to modernise the EC accounting directives the Commission published a Communication,\textsuperscript{1850} which proposed that all listed companies draw up their consolidated accounts in accordance with one single set of accounting standards, namely the International Accounting Standards (IAS), presently called International Financial Reporting Standards (IFRS), latest by 2005. This led to the adoption of a Regulation\textsuperscript{1851} (known as IAS Regulation) requiring application of the international accounting standards to consolidated accounts of companies having securities admitted to trading on a regulated market of any Member State (hereafter listed companies) from 1 January 2005 forth\textsuperscript{1852}. International accounting standards in question mean the sum total of IAS, IFRS, related interpretations, subsequent amendments to those IAS, IFRS and related interpretations, and future IAS, IFRS and related interpretations,\textsuperscript{1853} (hereinafter altogether referred to as IAS). However, the application of IAS to annual accounts of any listed company, or to consolidated or annual accounts of any unlisted company are, of course, left optional for the Member States\textsuperscript{1854} (e.g., the UK decides to apply IAS to such accounts as well\textsuperscript{1855}). To this end, the accounting directives are being updated. The first measure was the fair value directive of September 2001\textsuperscript{1856} that amended the accounting directives and accounting directive for banks,\textsuperscript{1857} and thereby introduced “fair value” method for valuation of derivative financial instruments so that the internationally recognised accounting standards and these directives become consistent\textsuperscript{1858}. To the heel of this directive, on 28

\textsuperscript{1849} The Commission’s Proposal for a Fair Value Directive, OJ C311E/1, p. 1, Preamble, at recitals (6) and (7).
\textsuperscript{1851} Regulation 1606/2002, OJ L243/1.
\textsuperscript{1852} Ibid., art. 4.
\textsuperscript{1853} Ibid., art. 2.
\textsuperscript{1854} Ibid., art. 5.
\textsuperscript{1855} Peter Holgate, ‘The FSAP and international accounting standards’, (speech) at Financial Services Action Plan Conference, supra note 876.
\textsuperscript{1857} Articles 1, 2 and 3 of the Fair Value Directive, ibid., have made amendments to the fourth, seventh (company) accounting directives and the accounting directive for banks, 86/635/EEC, respectively.
\textsuperscript{1858} Fair Value Directive, ibid., preamble, recital (9).
May 2002 the Commission proposed a directive\textsuperscript{1859} to amend the accounting directives aimed at bringing convergence between them (accounting directives) and the IAS so that the EC financial statements ‘can be used globally, for cross-border transactions or listing anywhere in the world’\textsuperscript{1860}. In future more legislative attempts may be made on the same line. In this process it is worth noting that the EC is not going to adopt the IAS intact proposed by the International Accounting Standards Board (IASB) (previously International Accounting Standards Committee- IASC), a non-government organisation outside the EC. Rather it will adopt them (ISA) subject to endorsement by the Commission assisted by the newly created Accounting Regulatory Committee and an accounting technical committee after satisfaction that they (IAS) conform to the basic requirement of TFV of the accounting directives.\textsuperscript{1861} However, the updating process has not largely transformed the original accounting directives. Still they form the core of the EC accounting law as they stand today.

On the other hand, it should be mentioned, the (Canadian) AcSB has entered into liaison arrangements with the IASB alongside its close working with the (US) FASB and other national standard setting bodies. The purpose is to ‘agree on much needed improvements to existing Canadian standards and the development of new standards, rather than adopting IASB Standards’.\textsuperscript{1862} In other words, instead of adopting Canada is converging its GAAP with IAS. An example of this effort is that presently the AcSB is carrying on a project to use IAS 39, “Financial Instruments:

\textsuperscript{1859} OJ C227E/336, 24.9.2002,
\textsuperscript{1860} IAS Regulation, supra note 1851, preamble, recital (5).
\textsuperscript{1861} Ibid., recitals (9) and (10). Also see ‘Towards a real standardisation of European companies’ financial statements: the adoption of IAS as a means of overcoming the differences in national laws’, supra note 1847, at p. 4.
\textsuperscript{1862} Clarence Byrd, Ida Chen and Joshua Smith, Financial Reporting in Canada, 27\textsuperscript{th} ed, at ch. 7, “Reference to Accounting Principles Used”, \url{http://www.knotia.ca} visited on 16 June 03 (hard copy on file).
Recognition and Measurement” as the base for future Canadian standards’. The CICA’s firm commitment to convergence appears from its own words:

International activities have become increasingly important to the AcSB’s mission. In the absence of clearly demonstrated, unique Canadian circumstances, it is unlikely that the AcSB will adopt a new accounting standard in Canada that differs from those of our international colleagues. Consequently, the activities of international groups such as the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) significantly affect Canadian standard setting.\(^{1864}\)

However, accounting standards/rules of either jurisdiction have not yet been fully converged with the IAS. Therefore, the existing rules/standards of the two regions, as they stand today, are being compared in the forthcoming sub-chapters.

Before going to the comparison a mention needs to be made about cash flow statement. The accounting directives do not provide for this document. The proposed changes in the EC include empowering the Member States to require cash flow statements to be prepared according to IAS7.\(^{1865}\) Earlier the IOSCO endorsed that its members should:

\[
\text{take all necessary steps to accept cash flow statement prepared in accordance with IAS 7 as an alternative to statements prepared in accordance with domestic standards in connection with cross-border offerings and continuous reporting by foreign issuers.}\]

This endorsement has already been implemented by the following Member States:

Austria, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, and Switzerland.\(^{1867}\) The UK that is following its own standards respecting cash flow statements may apply the same in near future as its

\(^{1863}\) Ibid.
\(^{1864}\) Ibid., citing http://www.cica.ca., under “Standards - International Activities”.
\(^{1865}\) Epstein and Mirza, supra note 1812, at p. 16.
GAAP is ‘metamorphosing to IAS anyway’\(^\text{1868}\). Canada and the US, among other states, have also implemented the IOSCO endorsement in their home jurisdictions.\(^\text{1869}\)

Thus the two regions (the EC and Canada), by implementing or metamorphosing to IAS7, are closer with regard to cash flow statement. But they differ with respect to standards applicable to two principal financial statements, namely balance sheet and, profit and loss accounts. These two are the main statements because ‘(a) review and investigation of the financial affairs of the company generally commences with the historic balance sheets and income statements of the enterprise…(since they) provide an understanding of the financial position and financial results of the company over time.’\(^\text{1870}\) Therefore, the accounting directives and Canadian GAAP respecting these two financial statements are compared in the following.

### 8.2.2.2.6 Specific Rules/Standards Concerning Annual Accounts

#### I. Assets: Conception, Valuation, Depreciation and Impairment, etc.

**1. Definition and Classification of Assets:**

As stated earlier, a balance sheet consists of three basic sections: Assets, Liabilities and Owner’s Equity. CICA Handbook defines assets as ‘economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained.’\(^\text{1871}\) On the other hand, there is no definition of assets in the accounting directives. The UK ASB defines it as ‘rights or other access to future economic benefits controlled by an entity as a result of past transactions or

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\(^{1868}\) Holgate, *supra* note 1855.


\(^{1871}\) CICA Handbook, sec. 1000.29.
events’. The two definitions differ in that while CICA Handbook treats the resources (e.g., real property) themselves as assets the ASB treats the rights or other access to future economic benefits from the resources. For example, if an enterprise X has a piece of land and it is used to produce rubber, the ASB will call the right to use the land for economic benefit (production of rubber) as asset. This approach tends to ‘alter the natural meaning of the word “asset” (which does indeed refer to the item (of property) itself)’ and not the right to use it. As such the ASB definition has been criticised as a ‘meaningless’ one.

However, despite lacking any definition the Annual Accounting Directive classifies assets into fixed and current. The CICA Handbook makes the similar classification, albeit such classification ‘may not be appropriate in the financial statements of certain types of enterprises such as financial institutions or companies in the development stage.’ The Directive and the Handbook, however, differ with respect to the manner the segregation between them is made. According to the former the categorisation of assets as fixed or current depends on the “purpose” intended to serve. If assets are ‘intended for use on a continuing basis’, they shall be itemised as fixed assets. From this rule it can be deduced that current assets are those assets that are not so intended. The CICA Handbook, on the other hand, makes the segregation in terms of current assets that “include” ‘those assets ordinarily realizable within one year from the date of the balance sheet or within the normal operating cycle, where that is longer than a year’. Here the word “realizable” refers to convertible into cash or

1873 Davis, Paterson and Wilson, ibid., at p. 115.
1874 Ibid., at p. 131.
1875 Annual Accounting Directive, arts. 9(C) and 9(D), and 10(C) and 10(D).
1876 CICA Handbook, sec. 1510.09.
1877 Annual Accounting Directive, art. 15(1).
1878 Annual Accounting Directive, art. 15(2). This provision applies to the Consolidated Accounting Directive under art. 17(1).
1879 CICA Handbook, sec. 1510.01.
receivables (through sale) or services (through use).\textsuperscript{1880} And the phrase “operating cycle” means the ‘elapsed time between the purchase of inventory items (raw materials or merchandise) and their conversion into cash’ (through sale of the finished products made from the raw materials),\textsuperscript{1883} and a normal operating cycles spans beyond a year.\textsuperscript{1882} Thus current assets, according to the Handbook\textsuperscript{1883}, include assets convertible into cash, receivables or services in one year and inventory in more than one year from the balance sheet date. Also added to these are temporary investments and prepaid expenses.\textsuperscript{1884} By contrast, convertibility into cash within a particular timeframe is irrelevant for the EC assets to become current assets. All that is required is, as seen upfront, that they are intended not to be used on a continuing basis opposed to fixed assets. In other words, they are subject to disposal. For example, in 1998 the accounts of Wolseley plc, a UK company, transferred real property awaiting disposal, from fixed assets, to current assets.\textsuperscript{1885} But Davies, Paterson and Wilson differ with Wolseley’s interpretation and held that assets awaiting disposal should be included in fixed assets.\textsuperscript{1886} They reasoned their position as follows:

The (Companies) Act says that fixed assets must be intended for use on a continuing basis, but this not\textsuperscript{1887} normally interpreted to mean that individual items should be transferred out of fixed assets when a decision to dispose of them has been made; the definition refers more to the nature of the item and its original function when it was acquired.

If this usual interpretation is accepted and real property subject to disposal is included in fixed assets, that will differ from Canadian practice which places such a property in the category of current assets. For example, similar to Wolseley, Rogers, a Canadian

\begin{footnotesize}
\textsuperscript{1880} Kohler, supra note 480, at p. 354.
\textsuperscript{1881} Ibid., at p. 290.
\textsuperscript{1882} Ibid.
\textsuperscript{1883} CICA Handbook, sec. 1510.02.
\textsuperscript{1884} Ibid. Also see Kohler, supra note 480, at p. 133.
\textsuperscript{1885} Davies, Paterson, and Wilson, supra note 1747, at p. 727.
\textsuperscript{1886} Ibid., at pp. 727-728.
\textsuperscript{1887} Ibid. at p. 727. (emphasis is added)
\end{footnotesize}
company, segregated assets-for-sale (in the prospective fiscal year) from the fixed
assets. In that case the same asset that appears in fixed assets of an EC balance sheet
will be shown in current assets of a Canadian balance sheet. Inversely, if the usual
interpretation is disregarded as was done by Wolseley, there still remains divergence
between the two laws. The Annual Accounting Directive does not prescribe any time
limit within which a real property for sale should be sold, whereas in Canada the period
is one fiscal year. Therefore, an EC real property subject to sale may remain
categorised as current assets for an indefinite time. In Canada that possibility is
restricted by one fiscal year time limit. If a real property is convertible in one fiscal
year, it will be shown as a current asset. The Annual Accounting Directive tends to
allow presenting such a property as a current asset from date of decision for its disposal
regardless of the possibility of actual disposal. For this reason probably Davies and
other advocated for its inclusion in the fixed assets in view of its nature and function as
a property. As such both interpretations of the Directive provision are problematic.
Whichever interpretation is taken, the separate totals of current assets and fixed assets
of the two balance sheets (which is the usual practice in both regions) will look
different.

2. Tangible fixed assets:

Recognition and Valuation:

Literally meant assets that can be seen and touched, in Canada tangible
fixed assets (property, plant and equipment) refer to those assets that, having been
acquired with the intention of being used on a continuous basis, are in use and not

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1889 See IQE Prospectus, supra note 1598, at p. 77 for EC practice, and Byrd, Chen and Smith, supra
note 1862, ch. 10 “Current Assets and Current Liabilities” (companies’ survey results).
intended for sale in the ordinary course of the business.\textsuperscript{1890} From the Annual Accounting Directive definition of fixed assets given above, tangible fixed assets may be ascribed to those assets that having physical existence are intended to be used on a continuing basis in the operation of the business. The CICA Handbook recommends that such assets should be recorded at historical cost, i.e., purchase price or production cost.\textsuperscript{1891} The Annual Accounting Directive lays down the same valuation rule in Article 32 in general and in Article 35(1)(a) in particular.\textsuperscript{1892} In both jurisdictions the historical cost method is used in most of the situations for the valuation of fixed assets.\textsuperscript{1893} In this context it may be noted that “cost” not being ‘straightforward’, in respect of a fixed asset, ‘should include not only the invoice price of the asset but also all costs involved in getting the asset into a location and condition where it can be productive.’\textsuperscript{1894} Thus for plant and machinery, for example, cost includes ‘delivery charges, sales taxes and installation charges,’ and for land and buildings, ‘legal fees, architect’s fees, clearing the land and so on, as well as the builder’s and the cost of the land.’\textsuperscript{1895}

\textbf{Amortisation/Depreciation:}

Where tangible fixed assets are valued at cost the CICA Handbook recommends, for each major category of them, that the cost and the accumulated amortisation\textsuperscript{1896} of such assets (except land) be disclosed.\textsuperscript{1897} In this context

\begin{footnotesize}
\begin{enumerate}[\textsuperscript{1890}]
\item CICA Handbook, sec. 3061.04.
\item CICA Handbook, sec. 3061.16.
\item In connection with Annual Accounting Directive see (English) Companies Act 1985, sch. 4, paras. 17 and 22.
\item Alexander and Nobes, \textit{Ibid.}
\item Ibid.
\item In the EC (and in particular in the UK) depreciation is used in connection with tangible assets while amortisation for intangible assets. Davies, Paterson and Wilson, \textit{supra} note 1747, at p. 747.
\item CICA Handbook, sec. 3061.54.
\end{enumerate}
\end{footnotesize}
“amortisation” refers to the generic term for European “depreciation”\textsuperscript{1898}, which (UK) SSAP 12 defines as ‘the measure of the wearing out, consumption or other reduction in the useful economic life\textsuperscript{1899} of a fixed asset whether arising from use, effluxion of time or obsolescence\textsuperscript{1900} through technological or market change’\textsuperscript{1901}. In light of this definition “accumulated amortisation” refers to ‘the figure that represents the total value of annual depreciation of assets, such as plant and equipment, that is deducted from the original value of such assets.’\textsuperscript{1902} Similarly, the Annual Accounting Directive mandates fixed assets to be systematically depreciated over their useful economic lives.\textsuperscript{1903} Accordingly, as in Canada, the cost, and accumulated depreciation are ventilated in the company accounts.\textsuperscript{1904} In addition to the cost and accumulated depreciation, depreciation methods and rate are also disclosed in both jurisdictions.\textsuperscript{1905} Of all the methods the straight-line method is the most popular in both jurisdiction,\textsuperscript{1906} by which a particular amount is fixed for payment per annum to ultimately amortise/depreciate the book value of a fixed asset by the end of its expected useful life (the period over which the company expects to reap benefits from that asset). Ideally

\textsuperscript{1898} Kohler, supra note 480, at p. 26. In deciding the accounting case of Von Baumbach v. Sargent Land Co the US Supreme Court has recognised depreciation as a “common knowledge” and thereby has established it as a legal concept. 242 U.S. 503, at p. 524 (1917). See Hills, supra note 1846, at p. 91.
\textsuperscript{1899} “Useful economic life” means ‘the period over which the present owner will derive economic benefits from its use.’ SSAP 12 cited in Blake, supra note 1755, at p. 94.
\textsuperscript{1900} “Obsolescence” has been described in a more detailed extent by the US Supreme Court as follows: Obsolescence may arise from changes in the art, shifting of business centres, loss of trade, inadequacy, supersession, prohibitory laws and other things which, apart from physical deterioration, operate to cause plant elements or the plant as a whole to suffer diminution in value. United States Cartridge Co. v. United States, 284 U.S. 511, at p. 516 (1932).
\textsuperscript{1901} Ibid.
\textsuperscript{1902} Kwaw, supra note 1486, at p. 51.
\textsuperscript{1903} Annual Accounting Directive, art. 35(b). For the definition of “useful economic life”, see note 1899, supra.
\textsuperscript{1904} See IQE Prospectus, supra note 1598, at pp. 79 and 87, and Homes and Sugden, supra note 1496, at pp. 34 and 35.
\textsuperscript{1905} Byrd, Chen and Smith, supra note 1862, at ch. 25, “Disclosure of Amortization Methods and Rates”; and IQE Prospectus, supra note 1598, at p. 79.
\textsuperscript{1906} Ibid. Also see FEE, supra note 1893, at p. 103.
this method may be applied to those fixed assets whose service will consistently continue for whole span of its useful life, e.g., a lease of a building for 20 years.\textsuperscript{1907}

\textit{Revaluation:}

Though historical cost method is predominantly used in both regional accounting, whether it reflects the actual value of the assets and thereby gives a TFV of the company is questionable because it shows the value at some back date, which may have increased/decreased at the date of the balance sheet.\textsuperscript{1908} This is particularly so when inflation reigns an economy,\textsuperscript{1909} which means ‘a general increase in prices that causes a fall in the purchasing power of money.’\textsuperscript{1910} Germany experienced inflation in the 1920s, the UK and France in the 1970s. In order to address this problem the Annual Accounting Directive, while based itself mainly on strict historical cost, held out options of revaluation methods for some Member States.\textsuperscript{1911} These options are available under Article 33 at current cost, which are mainly based on

- (a) net current replacement cost (gross current replacement cost less cumulative depreciation), or
- (b) net realisable value (‘expected sale receipts less costs involved in a sale’), or
- (c) economic value (‘discounted net present value of the expected net cash flows from the particular assets’).\textsuperscript{1912}

In addition to “current cost” valuation that is done at the balance sheet date the (English) Companies Act provides for “market value” basis that implies a value at the

\textsuperscript{1907} Holmes and Šugden, \textit{supra} note 1496, at p. 35.
\textsuperscript{1908} McGee, \textit{supra} note 489, at pp. 882-883.
\textsuperscript{1909} As to what different problems may arise from the application of historical cost in time of inflation, see Blake and Amat, \textit{supra} note 485, at p. 83.
\textsuperscript{1910} Alexander and Nobes, \textit{supra} note 1890, at p. 215.
\textsuperscript{1911} \textit{Ibid.}, at p. 123. For the impact of price changes on accounting, see \textit{ibid.}, at pp. 218-219.
\textsuperscript{1912} Alexander and Nobes, \textit{supra} note 1893, at p. 122.
asset’s last valuation date. Other Member States (except Germany and Switzerland) also permit revaluation of tangible fixed assets. Old data evidence practice of revaluation in the Member States to a limited extent, but with stable economy today this practice seems to be somewhat obsolete as in the UK. In Canada, on the other hand, revaluation is rarely used. Thus in both jurisdictions predominance of the historical cost method is common with respect to tangible fixed assets and revaluation constitutes an exception. The main rationale behind is that the former is easy and is based on objective estimates while the latter is founded on subjective estimates and is not, therefore, very much reliable.

**Impairment Test:**

Apart from amortisation, CICA Handbook subjects fixed tangibles to an impairment test. According to this, when owing to events or circumstantial changes (e.g., significant decrease in market price) the carrying value (historical cost or revalued amount) of an asset (or asset group) seems not to be recoverable, the company should make an estimate of the future cash flows expected to result from its use and eventual disposition (recoverable amount) and compare them with the carrying amount. If the latter (carrying amount) exceeds the former (recoverable amount), an impairment loss (difference between the carrying amount and the fair value) should be recognised.

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1913 Companies Act 1985, Sch. C, para. 31(2).
1914 Axel Haller, ‘Comparative analysis of major accounting issues’ in Walton, Haller and Raffournier, supra note 1766, 324-335 at p. 329.
1915 See FEE, supra note 1893, at pp. 97-98.
1916 Davies, Paterson and Wilson, supra note 1747, at pp. 812-813.
1917 Byrd, Chen and Smith, supra note 1862, at ch. 25, “Basis of Valuation”.
1919 CICA Handbook, sec. 3063.10.
1920 Ibid., sec. 3063.09.
1921 Ibid., sec. 3063.05.
value\textsuperscript{1922} should be recognised in the income statement.\textsuperscript{1923} The financial statements should disclose the following in the period in which an impairment loss is recognised:

(a) a description of the impaired tangibles;

(b) facts and circumstances leading to the impairment;

(c) unless itemised independently on the income statement, the amount of the impairment loss and the heading in the income statement that contains that loss;

(d) the method(s) applied for determining the fair value of the impaired tangibles.\textsuperscript{1924}

On the other hand, the Annual Accounting Directive does not contain any provisions respecting impairment test. Some Member States, however, provide for this matter.\textsuperscript{1925} Particularly speaking, in the UK FRS 11 recommends for writedown\textsuperscript{1926} of impairment loss to the profit and loss account where, similar to CICA Handbook position, the recoverable amount of fixed tangibles falls below their carrying value in a given circumstance(s).

3. Goodwill and Other Intangible Assets (e.g., patents, licences, brands, trademarks, etc.):

\textit{Definition:}

CICA Handbook defines “goodwill” as ‘the excess of the cost of an acquired enterprise over the net of the amounts assigned to assets acquired and the liabilities assumed.’\textsuperscript{1927} In other words, it refers to the difference between the purchase price of an enterprise and the assigned value of its net assets. The assigned value in

\textsuperscript{1922} “Fair value” is used in the same sense of “Fair market value” defined at note 1926, infra.

\textsuperscript{1923} \textit{Ibid.}, sec. 3063.04.

\textsuperscript{1924} \textit{Ibid.}, sec. 3063.24.

\textsuperscript{1925} See Haller, \textit{supra} note 1914, at p. 329.

\textsuperscript{1926} Writedown is a transfer of ‘a portion of a portion of the balance of an asset account to an expense account or to profit and loss.’ Kohler, \textit{supra} note 480, at p. 452

\textsuperscript{1927} CICA Handbook, sec. 3062.05(b).
question is technically called fair market value\textsuperscript{1928} synonymously used for fair value\textsuperscript{1929} that ‘would be agreed upon in an arm’s length transaction (transaction based on freedom of negotiating parties\textsuperscript{1930}) between knowledgeable, willing parties who are under no compulsion to act.’\textsuperscript{1931} This is an advantage gained by an established business of repute over time (going concern), which a start-up business is devoid of in the beginning.\textsuperscript{1932} The factors generating this advantage include ‘the general public patronage and encouragement, which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation of skill or affluence…”\textsuperscript{1933} etc. On the other hand, the Annual Accounting Directive does not define goodwill. The (UK) SSAP 22 (revised in 1989) defines it as ‘the difference between the value of a business as a whole and the aggregate of the fair values of its separable net assets’ (i.e., assets ‘identified and sold (or discharged) separately without necessarily disposing of the business as a whole’).\textsuperscript{1934} The two definitions, if compared, look alike in substance as they commonly ascribe “goodwill” to the difference between the fair value of net asset (owners’ equity) and the purchase price of the business as a whole.

Recognition and Impairment of Goodwill in Canada:

The CICA Handbook recommends for presentation of goodwill in the balance sheet\textsuperscript{1935} at the amount initially recognised (e.g., purchase cost) less any

\textsuperscript{1929} Rosen, Vessette and Muccilli, \textit{supra} note 1870, at p. 248.
\textsuperscript{1930} See Kohler, \textit{supra} note 480, at p. 33.
\textsuperscript{1931} CICA Handbook, sec. 3062.05(a).
\textsuperscript{1932} \textit{C.M. Allred Estate v. M.N.R.}, \textit{supra} note 1928.
\textsuperscript{1934} Blake, \textit{supra} note 1755, at p. 197.
\textsuperscript{1935} CICA Handbook, sec. 3062.48.
writedown for impairment. Prior to 1 January 2002 goodwill of limited useful life needed to be amortised. On and from that date, instead of amortisation, goodwill is subject to a minimum annual impairment test. Intervening tests may take place if the events or circumstances so demand. The test is conducted at the reporting unit level. This means that ‘(f)or the purpose of testing goodwill for impairment all goodwill acquired in a business combination should be assigned to one or more reporting units as of the date of acquisition.’ A reporting unit may either be an operating segment or a component of the segment one level below. The test entails a comparison between the fair value of the reporting unit and its carrying amount (e.g., purchase price), including goodwill. When the fair value of a reporting unit exceeds its carrying amount, there is no impairment of its goodwill. But when its carrying amount exceeds the fair value, its goodwill is impaired. To measure the loss (if any) resulting from the impairment the fair value of the reporting unit’s goodwill (the excess of the fair value of the reporting unit over the fair value of its net assets including previously unrecognised intangible assets) should be compared with its carrying amount. If the carrying amount of the goodwill exceeds the fair value, the

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1936 Ibid., sec. 1581. For the definition of “writedown”, see supra note 1926.  
1939 Ibid., sec. 3062.23.  
1941 An operating segment is defined as a component of an enterprise that engaging in business activities may earn revenues therefrom, whose operating activities are reviewed by the enterprise’s chief operating decision maker and for which discrete financial information is available. A component that, though not earning initially may amount to an operating segment, e.g., a start-up operations that are yet to earn. CICA Handbook, sec. 1701.10. ‘An operating segment is deemed to be a reporting unit when all of its components are similar, when none of its components is a reporting unit, or when it is comprised of a single component.’ CICA Handbook, sec. 3062.05(d).  
1942 A component of an operating segment is treated as a ‘reporting unit when the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of the component.’ When two or more components share similar economic characteristics, they are aggregated and considered a single reporting unit. CICA Handbook, 3062.05(d).  
1944 Ibid., sec. 3062.27(a).  
1945 See CICA et al, supra note 1940, at p. 13.  
1946 CICA Handbook, sec. 3062.27(b).
excess is the impairment loss.\textsuperscript{1947} The amount of loss is subtracted from the initially recognised amount (book value) of goodwill presented in the balance sheet and written down to the income statement as a separate line item.\textsuperscript{1948} For each goodwill impairment loss, the financial statements should include the period in which the impairment loss is recognised, description of the facts and circumstances liable for the impairment, and the amount of the impairment loss.\textsuperscript{1949} If the impairment loss is an estimate, the fact and reasons therefor should be disclosed. The nature and amount of any adjustments made to the initial estimate should also be spelled out.\textsuperscript{1950}

\textit{Recognition, Amortisation and Impairment of Other Intangibles in Canada:}

With respect to intangible assets other than goodwill (excluding financial assets\textsuperscript{1951}) the CICA Handbook recommends that they should be aggregated and presented as a separate line item in a the balance sheet.\textsuperscript{1952} Each of these assets should be initially recognised and measured at cost.\textsuperscript{1953} None of them is written down or written off\textsuperscript{1954} in the acquisition period unless it becomes impaired during that period.\textsuperscript{1955} An intangible asset recognised in the balance sheet should be amortised over its useful life,\textsuperscript{1956} unless the life is determined to be indefinite in which case its impairment should be tested.\textsuperscript{1957} When amortised, the amortisation method should be disclosed, which ‘will reflect the pattern in which the economic benefits of the

\textsuperscript{1947} \textit{Ibid.}
\textsuperscript{1948} \textit{Ibid., sec. 3062.22, 3062.48 and 3062.49.}
\textsuperscript{1949} \textit{Ibid., sec. 3062.53(a) and (b).}
\textsuperscript{1950} \textit{Ibid., sec. 3062.53(c).}
\textsuperscript{1951} \textit{Ibid., sec. 3062.05(c).}
\textsuperscript{1952} \textit{Ibid., sec. 3062.50.}
\textsuperscript{1953} \textit{Ibid., sec. 3062.06. [Jan. 2002]}
\textsuperscript{1954} This means to ‘transfer the balance of account previously regarded as an asset to an expense account or to profit or loss.’ Kohler, \textit{supra} note 480, at p. 452.
\textsuperscript{1955} CICA Handbook, sec. 3062.06. [Jan. 2002]
\textsuperscript{1956} “Useful life” refers to ‘the period over which an asset is expected to contribute directly or indirectly to future cash flows of an enterprise.’ CICA Handbook, sec. 3062.05(e). This definition is similar to that of the UK given above, note 1899.
\textsuperscript{1957} CICA Handbook, sec. 3062.10. [Jan. 2002]
intangible assets are consumed or otherwise used up.\footnote{1958} In the event of the pattern being indeterminable, a straight-line method is used.\footnote{1959} Annually a review of the amortisation method and estimate of the useful life should be made.\footnote{1960} An intangible asset subject to amortisation should be tested for impairment and an impairment loss will be recognised if its carrying amount is not recoverable and exceeds its fair value.\footnote{1961} Unlike goodwill the impairment losses need not be disclosed separately in the income statement; rather the income statement caption where they are placed should be disclosed.\footnote{1962} The loss should not be reversed if the fair value subsequently goes up.\footnote{1963} Again, the impairment test applies to intangibles having indefinite useful lives once a year or more frequently if events or changes dictate so.\footnote{1964} When the carrying amounts exceed the fair value, the excess should be recognised as the impairment loss.\footnote{1965} When impairment loss is recognised, the following should also be contained in the financial statements: the period in which the loss is recognised, a description of the impaired intangibles and the facts and circumstances posing the impairment, the amount of impairment loss, and the caption of the income statement carrying the said loss.\footnote{1966}

\textit{Recognition, Amortisation/Depreciation and Impairment of Goodwill and other Intangibles in Europe:}

\footnote{1958}Ibid., sec. 3062.14.\footnote{1959} Ibid.\footnote{1960} Ibid., sec. 3062.11. [Jan. 2002]\footnote{1961} Ibid., sec. 3063.04 [April 2003] and sec. 3063.5 read together with sec. 3062.18. Impairment test of intangibles differs from that of goodwill in that goodwill impairment is tested at the reporting unit level while as regards intangibles the test is done at the individual asset level. This means that the fair value of the intangible asset should be compared with its carrying amount.\footnote{1962} Byrd, Chen and Smith, supra note 1862, ch. 26, “Current Developments”.\footnote{1963} CICA Handbook, sec. 3063.06. [April 2003]\footnote{1964} Ibid., sec. 3062.19. [Jan. 2002]\footnote{1965} Ibid.\footnote{1966} Ibid., sec. 3062.54(b).
The Annual Accounting Directive provides for disclosure of goodwill acquired for valuable consideration.\textsuperscript{1967} It then calls for amortisation of goodwill over a period of five years\textsuperscript{1968} or over an extended period to be prescribed by the Member States, which must not exceed the usual economic life of the asset.\textsuperscript{1969} The directive requires disclosure of intangibles other than goodwill but does not lay down any provisions concerning their amortisation or impairment. Certain Member States have provisions respecting such matters.\textsuperscript{1970} In the UK, in particular, the Companies Act and concerned accounting standards cover both goodwill and other intangibles. The Companies Act requires disclosure of goodwill and other intangibles in the balance sheet\textsuperscript{1971} at historical cost\textsuperscript{1972} or at current cost, if alternative accounting rules are applied to them (except goodwill)\textsuperscript{1973}. It then mandates their amortisation systematically over their useful economic lives\textsuperscript{1974} (if any) down to its residual value,\textsuperscript{1975} where applicable,\textsuperscript{1976} charging the amount amortised, as an operating charge\textsuperscript{1977}, to the profit and loss account.\textsuperscript{1978} The amortisation charge is thus based on their carrying value, which may either be historical cost\textsuperscript{1979} or revalued amount\textsuperscript{1980}. The straight-line method is recommended to be the preferable method of amortisation.\textsuperscript{1981}

\textsuperscript{1967} Annual Accounting Directive, art.s 9 and 10.  
\textsuperscript{1968} Ibid., art. 34(1)(a).  
\textsuperscript{1969} Annual Accounting Directive, art. 37(2).  
\textsuperscript{1970} See Haller, \textit{supra} note 1911, at pp. 327-328.  
\textsuperscript{1972} Ibid., sch. 4, para. 17.  
\textsuperscript{1973} Ibid., para. 31(1).  
\textsuperscript{1974} For the definition of “useful economic life” in UK, see \textit{supra} note 1899.  
\textsuperscript{1975} Residual value means net realisable value at the end of its useful life, which is measured on the basis of the prices available on the acquisition or revaluation date. Davies, Paterson and Wilson, \textit{supra} note 1747, at p. 748.  
\textsuperscript{1976} According to Financial Reporting Standard (FRS) 10 (para. 28), in the amortisation of goodwill no residual value is attributable to it. To other intangibles, however, such an attribution may be possible where the residual value can be ‘measured reliably’, namely when (a) a legal or contractual right is receivable at the end of the use period of an intangible asset, or (b) a readily ascertainable market value is available for the residual asset. FRS 10, paras. 28 and 29, cited in Davies, Paterson and Wilson, \textit{supra} note 1747, at p. 773.  
\textsuperscript{1977} Davies, Paterson and Wilson, \textit{ibid.}, at pp. 767-768.  
\textsuperscript{1978} Companies Act 1985, para. 18.  
\textsuperscript{1979} Ibid., para. 21(2).  
\textsuperscript{1980} Ibid., para. 32.  
\textsuperscript{1981} FRS 10, \textit{supra} note 1976, para. 30 cited in Davies, Paterson and Wilson, \textit{supra} note 1747, at p. 773.
The Companies Act does not admit of an indefinite life for goodwill\textsuperscript{1982} and so no impairment review. This is convergent with ISA 22. Financial Reporting Standard (FRS) 10, on the other hand, takes a dual approach both to goodwill and other intangibles allowing amortisation and impairment review depending on the useful lifespan of a particular asset. In practice, the predominantly accepted view is that goodwill does not have a useful life exceeding 20 years and, therefore, should be subjected to amortisation only, not to impairment test that is considered to be ‘very onerous’ with respect to goodwill.\textsuperscript{1983} However, there are still circumstances where indefinite useful life can be ascribed to goodwill and other intangibles, which necessitates impairment review instead of amortisation in order to give way to the true and fair override.\textsuperscript{1984} This justifies the application of FRS 10. For example, according to this standard, goodwill and intangibles may be presumed to have lives exceeding 20 years and, therefore, impairment review would be justified when they may be shown to be durable for indefinite time and capable of continued measurement.\textsuperscript{1985} Durability depends on the nature of the business, usual life length of the products to which goodwill is attached, and so on.\textsuperscript{1986} And they will be said to be capable of continued measurement when the measurement is justifiable in terms of cost involved in it, for example, where the goodwill of an acquired business is distinct and can be readily measured.\textsuperscript{1987} Thus when goodwill or any intangible is identified as having infinite lifespan and its recoverable amount declines below the carrying value, the difference, as in Canada, is written down to the profit and loss account as per FRS 11.\textsuperscript{1988}

\textit{Sum-up:}

\textsuperscript{1982} Companies Act 1985, para. 21. See Davies, Paterson and Wilson, \textit{ibid.}, at p. 747.
\textsuperscript{1983} Davies, Paterson and Wilson, \textit{ibid.}, at p. 769.
\textsuperscript{1984} \textit{Ibid.}, at p. 770.
\textsuperscript{1985} FRS 10, para. 19 cited in Davies, Paterson and Wilson, \textit{supra} note 1747.
\textsuperscript{1986} \textit{Ibid.}, para. 20, \textit{ibid.},
\textsuperscript{1987} \textit{Ibid.}, para. 23, \textit{ibid.}, at pp. 771-772.
\textsuperscript{1988} For example of practical application by particular companies, Davies, Paterson and Wilson, \textit{ibid.}, at p. 786.
From the foregoing it is gleaned that CICA Handbook does not permit amortisation of goodwill regardless of the length of life. It recommends for amortisation of other intangibles having limited lifespan and impairment review of both goodwill and intangibles that can span for indefinite time. The Annual Accounting Directive, on the other hand, provides for amortisation of goodwill remaining silent about other intangibles’ amortisation or impairment review. The UK, among some particular Member States that provide for in this regard, allows (a) amortisation of goodwill or any intangible asset having a lifespan of 20 years, and (b) impairment review when such an asset is considered to have an infinite life.

4. Research and Development: 1989

CICA Handbook defines research and development follows:

**Research** is planned investigation undertaken with the hope of gaining new scientific or technical knowledge and understanding. 1990 (e.g., For example, laboratory research for the discovery of new knowledge.)

**Development** is the translation of research findings or other knowledge into a plan or design for new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use. 1992 (e.g., design, construction and testing of pre-production prototypes and models.)

The Annual Accounting Directive, on the other hand, does not define research or development. Of course, the UK SSAP 13 defines them in the similar terms as under

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1989 Annual Accounting Directive includes research and development in fixed intangible assets. See arts. 9 and 10. In practice, fixed tangible assets, such as laboratory buildings and equipment, used to facilitate research and development may be capitalised and written off over their useful lives through profit and loss account as is done under SSAP 13. See *ibid.*, at p. 905. This justifies labelling this item independently of others, which is also done in Canada. See CICA, *Significant Differences in GAAP*, supra note 1940, at pp. 93-96. Therefore, in this present work research and development has been segregated from other assets and treated independently.

1993 *Ibid.*, sec. 3440.05.
the Handbook. However, the Directive and the Handbook differ in that the former allows capitalisation and amortisation of research and development expenses for maximum five years while the latter restricts the allowance to development costs only provided it can be satisfied that

(a) the product or process is clearly defined and the costs attributable to product or process can be identified;
(b) the product or process is technically feasible;
(c) there is an indication of the management’s intention to produce and market, or use, the product or process;
(d) there is clear indication of a future market for the product or process, or if it is to be internally used instead of sale, it is useful to the enterprise;
(e) there exist or expected to be available, adequate resources to complete the project.

If, however, these criteria are not fulfilled, the development costs should be charged to as an expense to the income for the period in which they were incurred. It may be noted here that the UK accounting respecting research and development is similar to that of Canada mentioned above.

5. Current Assets: Inventories

A balance sheet in both jurisdictions discloses inventories and their valuation. Inventories include, in general, goods that have been acquired or

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1994 SSAP 13, para. 21. Davies, Paterson, Wilson, supra note 1747, at p. 901
1995 Annual Accounting Directive, art.s 34(1)(a) and 37(1).
1997 Ibid., sec. 3450.19.
1998 See Companies Act 1985, sch. 4, para. 3(2); SSAP 13, paras. 16 and 19, Davies, Peterson and Wilson, supra note 1747, at pp. 902-903.
1999 See Byrd, Chen and Smith supra note 1862, Sec. 3030, Ch. 21 (visited on 19 Sept. 03.) and IQE Prospectus, supra note 1598, at pp. 77 and 87.
manufactured and are awaiting resale or sale respectively.\textsuperscript{2000} In fact, they also cover unbilled work of a service company or things used in delivering services (e.g., parts and supplies stored for use in aircraft carrier).\textsuperscript{2001} The CICA Handbook recommends for disclosure of valuation basis without specifying any,\textsuperscript{2002} but in practice the lower of cost and market is mostly used (73\% of companies in 2001).\textsuperscript{2003} The Annual Accounting Directive provides for valuation at the lower of cost and market\textsuperscript{2004}, which is used all over Europe.\textsuperscript{2005} Here “cost” refers to the direct or indirect expenditures incurred in bringing the goods or services to their present condition and location.\textsuperscript{2006} And “market” includes replacement cost or net realisable cost, defined elsewhere\textsuperscript{2007}, in respect of stocks that have decreased in utility compared to their costs because of outdatedness, physical decay, and so on.\textsuperscript{2008} In addition to the cost basis, the methods applied for determining the cost and market are to be disclosed, though neither the Handbook nor the Directive mandates any particular method.\textsuperscript{2009} In practice, the First-in, first-out (FIFO), the Last-in, first-out (LIFO) and Weighted-Average Cost (WAC) are the mainly used methods in Canada. FIFO is based on the assumption that in the process of the sale or production of stocks (especially the perishable ones) the oldest are sold or applied first\textsuperscript{2010} the most recently owned or produced ones being left.\textsuperscript{2011} Opposite is the basis of LIFO, viz., that the goods acquired or produced most recently are disposed of first, for example a stock-store is emptied from the top.\textsuperscript{2012} WAC, unlike FIFO and LIFO, ignores the sequence of the physical flow of inventories and

\textsuperscript{2000} Byrd, Chen and Smith, \textit{ibid.}, and Mike, Peterson and Wilson, \textit{supra} note 1747, at p. 960.
\textsuperscript{2001} \textit{Ibid.}
\textsuperscript{2002} CICA Handbook, sec. 3030.10.
\textsuperscript{2003} Byrd, Chen and Smith \textit{supra} note 1862, at ch. 21, “Basis of Valuation”.
\textsuperscript{2004} Annual Accounting Directive, art. 39.1(a) and (b).
\textsuperscript{2005} See Nobes, \textit{supra} note 421, at p. 74, and Haller, \textit{supra} note1914, at p. 331.
\textsuperscript{2006} Davies, Paterson and Wilson, \textit{supra} note 1747, at p. 962, and Jan R. Williams, 2002 \textit{Miller GAAP Guide}, (New York: Aspen Law and Business, 2002), at. p. 27.03.
\textsuperscript{2007} See text accompanied by note 1912, \textit{supra}.
\textsuperscript{2008} Williams, \textit{supra} note 2006, at pp. 27.03-27.04.
\textsuperscript{2009} CICA Handbook, sec. 3030.09-11, and Annual Accounting Directive, art. 40(1).
\textsuperscript{2010} Davies, Paterson and Wilson, \textit{supra} note 1747, at p. 964-965.
\textsuperscript{2011} Williams, \textit{supra} note 2006, at p.27.06.
allocates an equal cost both to the inventories used and inventories left over by ‘the
computation of an average unit cost by dividing the total cost of units by the number of
units’. Of these three FIFO and WAC are used very often in Canada, the LIFO
being the least. Similarly, FIFO and WAC are popular in practice in Europe. LIFO is not, however, allowed in some countries (e.g., Denmark, Finland and Sweden). In some countries it is allowed but not used, so to say, e.g., the UK.

II. Liabilities:

CICA Handbook defines liabilities as ‘obligations of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future.’ The accounting directives do not provide any definitions of liabilities as they do not with regard to assets. The UK, however, defines liabilities as ‘obligations of an entity to transfer economic benefits as a result of past transactions or events’. Shorter though, this definition gives the same idea as the Handbook definition does. Like assets the CICA Handbook classifies liabilities as current and non-current for the purpose of balance sheet. Section 1510.03 terms current liabilities as ‘amounts payable within one year from the date of balance or within the normal operating cycle, where this is longer than a year’ (corresponding to the cycle used for current assets defined above). The EC Directives in question do not specifically segregate liability as current and non-current, but they require amounts under the “creditors” head due and payable within one year to be separately shown from those due and payable after one year from

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2012 Davies, Paterson and Wilson, supra note 1747, at p. 966.
2013 Ibid., at p. 965.
2014 Byrd, Chen and Smith supra note 1862, at ch. 21, “Methods of Cost Determination”.
2015 See Haller, supra note 1914, at p. 331.
2016 Ibid., at p. 331.
2017 See ibid., at p. 331, and Davies, Peterson and Wilson, supra note 1747, at p. 966.
2018 CICA Handbook, sec. 1000.32.
the date of the balance sheet. By way of example, long-term debt obligation (which is typically owed to credit institutions) payable in one year from the date of the balance sheet is segregated from the same obligation payable after one year both under the Handbook and the directives. Segregation of obligations payable within and after one year is thus common in both laws. As the former type of obligations is styled as “current liabilities” under the Handbook, so can be done with regard to the liabilities under the directives. Liabilities payable after one year under both laws can obviously categorised as “fixed or non-current liabilities”. Hence the classification of liabilities under both laws may be said to be the same.

Apart from the above the two jurisdictions differ/concur as follows:

(1) The CICA Handbook calls for separate totals of current and long-term liabilities to be presented on the balance sheet; as aforesaid the Directives require similar presentation.

(2) As both the Handbook and Directives mandate producing amounts payable at two different periods of time (viz., in one year and after one year) any part of long-term debt obligation that is repayable within one year is placed under the current liability side of the balance sheet.

(3) For long-term obligations of bonds, debentures and similar securities, the Handbook requires the disclosure of interest rate, maturity date, amount unpaid, sinking fund, redemption and conversion provisions. The Directives provide for disclosure of

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2020 Annual Accounting Directive, art. 9 Liability C. Creditors and art., 10 F and I.
2021 CICA Handbook, sec. 1510.04; Annual Accounting Directive, art. 9 Liabilities .C.2 and art. 10.1.2.
2022 CICA Handbook, sec. 1510.07.
2023 Supra note 2020.
2024 CICA Handbook, sec. 3210.04. For EC practice see IQE prospectus, supra note 1598, at p. 88.
2025 CICA Handbook, sec. 3210.02.
information concerning debentures which ‘include debenture stock, bonds and other securities of a company.’ Unlike the Handbook they do not detail what information should be disclosed in this regard. The (UK) Companies Act 1985, however, provides that where such securities have been issued during the financial year, their classes, and for each class the amount issued and the consideration received by the company be stated.

(4) In respect of long-term debts the total amount of payments required in each of the forthcoming five years to meet sinking fund or retire provisions need to be disclosed in Ontario. There is no corresponding provision in the Directives.

(5) The CICA Handbook mandates showing debentures that are redeemed but not cancelled yet as a deduction from the relative liability. There is no counter provision in the Directives or in the Companies Act 1985. Of course previously companies Act required details of such debentures, which have been repealed in 1996.

(6) An Ontario balance sheet should state separately if any of the liabilities are secured indicating their secured status. Similar disclosure as a note is incumbent on EC companies

III. Income Computation

It is the purpose of an income statement to show the readers how much net income (profits or loss) the enterprise has made during the period to which it

2026 Bough, supra note 499, at p. 74.
2027 Companies Act 1985, sch. 4 para. 41(1).
2028 CICA Handbook, sec. 3210.03.
2029 Ibid., sec. 3210.05.
2030 See Companies Act 1985, sch. 4, note to para. 41.
2031 CICA Handbook, sec. 3210.07.
relates. This is done by matching the costs against revenues by applying typically the accrual method defined before elsewhere. By that method, which is overwhelmingly used and hence has become a legal requirements especially for large enterprises, revenues are recorded when earned and costs are recorded when liability is incurred. In order to determine the net income the revenues and costs, recorded by this method, are matched (i.e., costs are allocated to revenues). In that process from gross revenue (all revenue received from ordinary business transactions or service activities) cost of goods sold/services provided, and other costs essentially related to the goods sold/services performed (e.g., trade discounts, allowances on the goods sold/services provided and refunds on returned goods, etc.) are deducted to arrive at gross income. From gross income are deducted the cost of selling, general and administrative cost and other operating expenses and thereby is determined the net income. The general and administrative expenses and other costs include taxation, pension plan, and interest expenses. Of them taxation is the only item on which Europe (particularly the UK, Ireland and Netherlands) and North America sharply differ.

**Income Tax**

Before going into the crux of the tax issue the general aspects of difference likely to arise between countries of the world and, therefore, between and within the two regions in question may be highlighted. The taxation system on which countries of the world normally differ is similar in Canada and some of the European countries like the UK, Ireland and the Netherlands. They have imputation system while, it can be contextually mentioned, the US has a classical system. In the classical system

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2033 See for the concepts of matching, and accruals, text accompanied by note 521, supra.
2035 Hills, supra note 1846, at pp. 182-184.
2036 Ibid., at p. 218.
dividends are not deducted from the taxable income. Again, the recipients of the dividends are taxed afterwards.\textsuperscript{2038} As a results, this creates an ‘economic double taxation’.\textsuperscript{2039} This defect is cured in the imputation system by charging to the recipients of dividends part of the tax that the enterprise paid for its income out of which the dividends were distributed.\textsuperscript{2040} This system-based distinction does not harm financial reporting.\textsuperscript{2041} Rather it is the second difference, namely impact of tax regulations on accounting calculations, that matters. In some countries (e.g., the US, Canada, the UK and the Netherlands) tax rules have little influence on accounting rules. There the accounting requirement of “fair presentation” generally overrides the taxation rules.\textsuperscript{2042} As a result, ‘many adjustments to accounting profit are necessary in order to arrive the tax base: taxable income.’\textsuperscript{2043} On the other hand, in countries (e.g., France and Germany (and also Japan)) where taxation rules have dominance on the accounting, the taxable income closely agree to the accounting profit.\textsuperscript{2044} In the former case significant differences arise between the accounting income and taxable income, which is unlike in the latter. Countries having big differences between accounting income and taxable income experience matching problem, particularly respecting deferred tax that arises because of the gap of timing between the accounting income and taxable income. To calculate deferred tax both Canada and the US used to treat it as a cost and included in the income statement. But the USA sifted from this to the Future Income Tax Asset/Liability (FITAL) approach (also may be called balance sheet approach) in 1992 by adopting the Statement of Financial Accounting Standards No. 109 (SFAS 109).\textsuperscript{2045} Canada followed the pursuit of the US and the AcSB incorporate a new Section 3465

\textsuperscript{2037} Ibid., at pp. 226, 231 and 240.
\textsuperscript{2038} Alexander and Nobes, supra note 1893, at p. 199.
\textsuperscript{2039} Ibid.
\textsuperscript{2040} Ibid., at p. 200.
\textsuperscript{2041} Ibid., 71.
\textsuperscript{2042} Ibid., 195.
\textsuperscript{2043} Ibid.
\textsuperscript{2044} Ibid.
(replacing Section 3470) into the CICA Handbook in 1997. Now they treat deferred tax as an asset/liability and compute it as a temporary difference to be explained later. The IASB has, to the heel of North America, has changed its stance and introduced IAS 12 effective from 1 January 1998. On the other hand, although the Annual Accounting Directive requires deferred tax disclosure, it does not provide for accounting method in this regard. Member States with significant differences between accounting income and tax income (e.g., the UK) are sticking to the traditional approach of treating deferred tax as a cost and so as an income statement item because it arises from timing difference explained later.

Now aforementioned two antagonistic approaches may be detailed here.

At the outset, “deferred tax” should be defined. In the words of Alexander and Nobes,

> It (deferred tax) is amounts of tax which, because of the accruals convention, accountants think relate to the current or previous accounting periods but which the tax system does not yet consider to be taxable. That is, deferred tax is caused by accounting for reversible timing differences between when expenses and revenues are included in the accounting calculations as opposed to when they are included in the tax calculations.

As can be understood from this definition, deferred tax is charged on items of income or expenditure presented on the income statement in the accounting period, but taxable in a different period. For example, depreciation that is a legally recognised cost is, as seen earlier, measured in accounting. Tax law also allows depreciation (technically called “capital allowance”), which stands higher than the accounting depreciation because usually a higher tax depreciation rate is given in order to

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2046 See Byrd, *Chen and Smith*, supra note 1862, at ch. 38, “Background”.
encourage business investment. In that case the difference between the accounting depreciation and tax depreciation, called “timing difference”, is taxable. The tax so levied is called “deferred tax”. Over time the timing differences will diminish and at some point of time will reverse. For the initial years (until reversal) the deferred tax is added to the payable tax and during the reversal time it is deducted therefrom.

However, an example may be given about how timing difference is calculated and therefrom how deferred tax is determined. Say, the historical cost of an item of plant and machinery is £1,00,000, which is to be depreciated over 10 years. The depreciation charge is £10,000 per annum and the capital allowance rate is 25% per annum on a reducing balance basis. The tax rate is 25%. Now, the deferred tax for the first year may be calculated as follows:

Capital allowance = 25% of £100,000 = £25,000
Accounting depreciation = £10,000
Timing difference = capital allowance–accounting depreciation
= £25,000 - £10,000 = £15,000
Tax rate = 25%

Therefore, deferred tax = Timing difference x tax rate
= (£25,000-£10,000) x 25%
= £15,000 x 25%
= £3750.

This is the European (income statement) approach toward deferred tax. Canada (and the US, and IASB), as mentioned above, deals with this as a balance sheet matter and treats it as an asset or liability (FITAL approach). According to Section 3465 of the CICA Handbook, a deferred tax is charged on “the differences between the carrying amounts (net book value after depreciation) of assets and liabilities in the accounting records, and their corresponding tax basis (tax written down value gained after capital allowance) as defined in the tax legislation.” These differences are called

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2051 *Mississippi River Fuel Corp. v. FPC*, 163 F.2d 433, at p. 448 (D.C. Cir. 1947)
2052 Among others, see text accompanied by notes 1896-1907, *supra*.
2053 Davies, Paterson and Wilson, *supra* note 1747, at p. 1377.
2054 *Byrd, Chen and Smith, supra* note 1862, at ch. 38, “Alternative Methods”.
“temporary difference”. Thus whereas under income statement approach the deferred tax is charged on the “timing difference”, under the balance sheet approach it is charged on the “temporary difference”. Taking the above example, the deferred tax on the temporary difference for the first year may be computed as follows:

Carrying amount = £100,000 - £10,000 = £90,000  
tax basis = £100,000 - £25,000 = £75,000  
Temporary differences = carrying amount – tax basis = £90,000 - £75,000 = £15,000  
tax rate = 25%  

Therefore, deferred tax = temporary tax x tax rate  
= £15,000 x 25%  
= £3750.

From the above computation of deferred tax under both the income statement, and balance sheet perspectives it appears that the results of calculation are same. This happens in many cases. But this should not delude one that they are, in effect, similar. There exist some real and significant differences between the two, which tend to lead to diverging results of tax computation. Davies, Paterson and Wilson have dealt with this issue while comparing the concerned UK standards with the IASB and the US pronouncements on FITAL. Two particular aspects, namely the scope of “temporary difference”, and the concept of “tax base” under the FITAL approach may be mentioned here in brief. First, in calculating timing differences permanent differences are not included. “Permanent differences” are those items of income that not taxable, or those items of expense that are deductible against taxes. For example, depreciation of an asset of £2,00,000 not subject to tax allowance is a permanent difference and is not included in the income statement. On the other hand, the balance sheet approach treats all items in balance sheet, except the shareholders’ equity, either as assets or liabilities. And, therefore, the strict calculation of temporary differences will attract

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2055 Davies, Paterson and Wilson, supra note 1747, at p. 1456.  
2056 See ibid., at pp. 1456-1472.  
2057 Ibid., at p. 1375.  
2058 Ibid., at p. 1457.
the asset in question and accordingly deferred tax will be charged on its carrying amount, whereas tax base is zero. The determination of the tax base in such a given case is another problematic aspect of the balance sheet approach. As stated above, deferred tax is computed under this approach by multiplying the tax rate on the temporary difference that is the difference between the carrying amount of an asset or liability, and tax base. How would temporary differences be calculated whether the tax base is zero as in the present case? Applying the calculation formula the temporary difference would be the carrying amount of the asset (£2,00,000) minus zero (0), which amounts to £2,00,000. Tax rate will be applied on this amount, which will give an “absurd result”. This absurdity is a result of ‘the fact that the temporary difference approach focuses on settlement of assets and liabilities, whereas in the real world tax is levied on gains and losses.’

8.2.2.2.2.7 Specific Rules/Standards Concerning Consolidated Accounts

Introductory:

Where a group of companies are related together, one (called parent company) having control on others (called subsidiaries) (by owning majority of shares in subsidiaries, for example), the preparation of an annual account for the parent would be misleading since its assets, revenues and expenses are linked to the subsidiaries. Consolidation of accounts of the group was devised to address this problem first in the United States in the 19th century. It shows the accounts of the

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2059 Ibid., at p. 1459.
2060 Ibid., at p. 1460.
2061 For the definition of “control” in this context, see the text accompanied by notes 2076, supra.
2062 Nobes, supra note 52, at p. 49.
2063 Ibid., at p. 50.
parent company and its subsidiaries ‘as though they were one entity.’\textsuperscript{2064} The Consolidated Accounting Directive and CICA Handbook Sections 1590 and 1600 contain the accounting rules of consolidation in the EC and Canada respectively. The former, it may be noted, is ‘very close to UK practice in its main provisions.’\textsuperscript{2065}

\textit{Consolidation Criteria:}

The EC Consolidated Accounting Directive has enumerated a number of situations where a parent-subsidiary relationship exists and, therefore, preparing consolidated accounts becomes incumbent on a parent company. Subject to exemptions\textsuperscript{2066} those situations may be set out as follows:

1. where the parent has majority of share voting rights in a subsidiary;\textsuperscript{2067} or

2. where the parent has a shareholding and a right to remove a majority of the members of the administrative, management or supervisory body of the subsidiary;\textsuperscript{2068} or

3. where the parent has a dominant influence over the subsidiary according to control agreement or company constitution, even though it does not have any shareholding;\textsuperscript{2069} or

4. where the parent has a shareholding and

\hspace{1em} (a) a majority of the members of the administrative, management or supervisory bodies have been appointed solely as a result of its voting rights, or

\hspace{1em} (b) it controls by agreement the majority voting rights.\textsuperscript{2070}

\textsuperscript{2064} Blake and Amat, \textit{supra} note 485, at p. 69.
\textsuperscript{2065} Nobes, \textit{supra} note 421, at pp. 51 and 52.
\textsuperscript{2066} See Consolidated Accounting Directive, arts. 5-11 and 13-15.
\textsuperscript{2067} Consolidated Accounting Directive, art. 1(1)(a).
\textsuperscript{2068} Ibid., art. 1(1)(b).
\textsuperscript{2069} Ibid., art. 1(1)(c).
In addition, Member States may require consolidation where the parent has participating interest\(^{2071}\) in a subsidiary\(^{2072}\) and where companies are managed on a unified basis pursuant to a contract or corporate constitution, or are managed by the same persons.\(^{2073}\)

Similar to the Consolidated Accounting Directive, the CICA Handbook recommends for consolidation when there exists a parent-subsidiary relationship. It says, ‘(a)n enterprise (a parent) should consolidate all of its subsidiaries.’\(^{2074}\) ‘The consolidation’, it continues, ‘commences at the date the parent acquires control (on a subsidiary) and continues as long as control continues.’\(^{2075}\) Here “control” means ‘the continuing power to determine its (the subsidiary’s) strategic, operating, investing and financing policies without the co-operation of others.’\(^{2076}\) Now, how can the power to determine the policies in question be exercised? The board of directors of the subsidiary (as it is usual in any enterprise) determine such policies. If the parent has the majority share voting power in that the subsidiary, it can elect the majority of the directors and thereby control the policy making.\(^{2077}\) Thus normally the control of the parent results from the level of its equity interest in the subsidiary. It may be gained by other means as well\(^{2078}\), for example, through a statute or agreement, or through the ownership of financial instruments (e.g., rights, options, warrants, convertible debt, etc), which, after conversion, would give the owner the majority of the voting rights.\(^{2079}\)

\(^{2070}\) Ibid., art. 1(1)(d).
\(^{2071}\) See, for the definition of participating interest, Annual Accounting Directive, art. 17.
\(^{2072}\) Consolidated Accounting Directive, art. 1(2).
\(^{2073}\) Ibid., art. 12.
\(^{2075}\) Ibid., sec. 1590.19. (emphasis added)
\(^{2076}\) Ibid., sec. 1590.03(b).
\(^{2077}\) Ibid., sec.s 1590.07 and 1590.08.
\(^{2078}\) Ibid., sec. 1590.06.
\(^{2079}\) Ibid., sec. 1590.12.
Such control situations have their counterparts in the EC Consolidated Accounting Directive, which have been set out above.

Thus under both the Directive and the Handbook the basic criterion for consolidation is the “control” by the parent over its subsidiary(ies), although the Directive has defined in more detail the control situations requiring consolidation than the Handbook. The control, it may be added, provides the parent with “the right and ability to obtain future economic benefits from the resources (of the subsidiary)” and exposes it to “the related risk”. Similar to this as laid down in the Handbook, “right and risk” also flow out from the “control” situations enumerated in the Directive mentioned above.

Preparation of Consolidated Accounts:

The EC consolidated accounts that consist of consolidated balance sheet, the consolidated profit-and-loss account and notes on the accounts shall be prepared clearly and in compliance with the Consolidated Accounting Directive. The Directive requires that the consolidated accounts give a true and fair view (TFV) of the assets, liabilities, financial position and profit or loss of the group included in it. The TFV is the overriding principle and applies in the same sense as it applies under the Annual Accounting Directive discussed above. The formats of annual accounts under the Annual Accounting Directive are the formats for consolidated accounts “without prejudice to the provisions of this (Seventh) Directive and taking account of the essential adjustments resulting from the particular characteristics of consolidated accounts as compared with annual accounts.” Further, valuation rules of the Annual

\[\text{References:}\]

\[2080\] Ibid., sec. 1590.03(a).
\[2081\] Consolidated Accounting Directive, art. 16(1) and (2).
\[2082\] Ibid.
\[2083\] See ibid., art. 16(4), (5) and (6), in conjunction with the text accompanied by notes 489-507 and 1760-1771, supra.
\[2084\] Ibid., art. 17(1).
Accounting Directive, discussed earlier\(^{2085}\), are applicable to consolidated accounts.\(^{2086}\) Thus, in brief, the Annual Accounting Directive provisions relating to TFV, formatting, and valuation apply to consolidated accounting. Of course there are some requirements particularly meant for consolidated accounting, for example, the principles of consolidation discussed later.

Similar to the EC provisions, the CICA Handbook provides that 

‘(c)onsolidated financial statements should adhere to the disclosure and presentation requirements for all financial statements.’\(^{2087}\) The financial disclosure requires valuation of assets and liabilities, determination of loss/profit, which have been discussed above. And the core of the presentation requirement is the requirement to fairly present the financial statements, which has also been discussed. In other words, provisions concerning annual accounts zeroed in earlier\(^{2088}\) are applicable to consolidated statements as far as the presentation and disclosure requirements (valuation rules inclusive) are concerned. Aside from this, there are some particular requirements that, as is the case with the EC counterpart, are peculiar to consolidated statements.\(^{2089}\) Worth mentioning are the principles of consolidation. Both the Directive and the Handbook provide principally that in the preparation of consolidated accounts the following be eliminated:

(a) debts and claims between group undertakings in the consolidation;

(b) income and expenditure relating to transactions between them; and

(c) profits and losses resulting from transactions between them.\(^{2090}\)

\(^{2085}\) See text accompanied by notes 1891-1912.

\(^{2086}\) Ibid., art. 29(1).

\(^{2087}\) CICA Handbook, sec. 1600.65.

\(^{2088}\) Texts accompanied by notes 1772-1782 and 1891-1912, supra.

\(^{2089}\) Ibid.

PART V

SUMMARY AND CONCLUSION: THE ROAD TOWARDS INTEGRATION

1. General

Today the European Union is a mammoth supranational political organisation of 15 (soon going to be 25) Member States. Compared to before it is getting more federation-like with the prospective adoption of the European Union Constitution Treaty. Securities regulation is one of the economic areas in which integration has taken place. In this area integration is brought about by the Community legislation (typically by directives) that harmonise the Member States’ laws at a minimum level and also provide for mutual recognition of legal requirements/conditions among them. This is based on Scitovsky’s economic integration theory that advocates for elimination of hindrances to creating a competitive regional market. On the other hand, the MJDS is a US-Canada securities alliance, not any supranational body. This conforms broadly to the EC securities regulation in that it has effected integration by the methods of harmonisation and mutual recognition. It has done so by introducing similar sets of rules in both jurisdictions. Of course, Canada, on most parts, has brought changes to its laws to match them with the US’s. There is no supranational law-making process unlike the EC. Theoretically this arrangement also seems to be premised on Scitovsky’s concept of economic integration.

2. Securities Regulation: Broad Aspects

The laws of securities regulation of the two regions, founded basically on the disclosure philosophy, provide, in common, for “full, true and plain” disclosure of material information in the corporate disclosure documents so that the investor can
make informed investment decision. Canadian law slightly departs from the EC law in this respect. The former authorises the securities regulatory authority to review the merits of securities offered by prospectus in public interest and also on some specified grounds. This is a very limited area of interference by the authority, their usual and main function being the reviewing of the prospectus disclosures. Except this, both jurisdictions are broadly similar.

3. Prospectus Disclosure: Nonfinancial Matters

Both laws have similarities as well as dissimilarities with respect to particular items of disclosure, which may be recapitulated in the following:

(1) While both laws require disclosure of the rights attaching to securities, Canadian law asks for “other” attributes and characteristics of them, including sinking/purchase funds provisions, redemption, retraction, surrender provisions, etc. Again, unlike the EC Directive (AID) Canadian law calls for information relating to rating of securities (e.g., preferred shares). The additional information so asked for is useful for better investment decision making.

(2) It is a common requirement of both laws that details of underwriters be furnished in a prospectus. A Canadian provision concerning firm commitment underwriting outshines the EC provision in that the former requires a “market out” clause and an “over-allotment” option while the latter does not. The “market clause” is an alerting message for the investors that the underwriter may leave the market if there is a “bearish” trend in the financial market. Further an “over-allotment” option can help the underwriter stabilise the share
price in the event of its going above the issue price because of short supply.

Apropos “best efforts” offering it is a Canadian requirement that the minimum amount of money to be raised thereby be disclosed and the sale proceeds be deposited in a trust account until that amount is raised. The AID lacks such a provision, whereas this is a safeguard for the investor as in the case of undersubscription they will be paid back their money from that trust account.

(3) The disclosure of information about the application of sale proceeds is essential under both laws. Unlike its EC counterpart Canadian law asks for more details about whether any other funds will be applied along with the sale proceeds or whether the sale proceeds will be used to repay loans, or whether any unallocated funds will be kept in an escrow account, etc.

(4) Dissimilar to Canada, the AID does not provide for furnishing any information about prior sales of the issuer’s securities or about any escrowed shares. Investors can compare prior sale price with the present price and thereby can make a comparative assessment of the value of securities. The escrowed share provision is an embargo on the issuer’s administrative officers holding any beneficial ownership of shares so that they cannot sell and make unjust profits by exploiting their official position.

(5) As above Canadian law also contains more extensive and pervasive provisions than the EC Directive with respect to issuer’s business, principal shareholders, and management. For example, the EC Directive does not specifically call for the business trend, impact of
bankruptcy or receivership proceedings and effect of the material reorganisation of the issuer or its subsidiaries, etc.

(6) It is a Canadian requirement that an item, Management’s Discussion and Analysis (MD&A), be provided in a prospectus, whereas there is no exactly similar EC requirement. The AID asks for an MD&A-like information of a very limited scope, which is not always carried by a prospectus in practice. This item enables the potential investor to receive an overall picture of the issuer from the management perspective. Therefore, Canadian provision, compared to the EC’s, can be said to be more investor-protection oriented.

(7) Though it is an international standard that “risk factors” involved in an investment be ventilated at one place of a prospectus, the EC Directive falls short of this. Canada complies with this standard. The advantage of this is that investors can read all the risk factors at one location instead of searching for them scattered elsewhere in the prospectus.

(8) In addition to the specified items Canadian law enjoins for other material facts, which is missing from the AID. This is a “catch-all” provision and would bind the issuer to disclose matters in its knowledge, even though they are not specified by law.

The above summary in conjunction with the detailed comparison of the nonfinancial disclosure requirements confirms that Canadian requirements are more comprehensive and pervasive than the EC counterparts. The specific divergences should not, however, obviate the fact that both laws, with identical philosophical basis, lay down the same basic rule of “full, true and plain” disclosure of material facts. This
fundamental requirement covers the whole range of disclosures, be specified or not. If a material fact is not disclosed, in either jurisdiction it will not be a sustainable defence that it is not specified by the law. Issuers must open the whole basket of facts to investors through a prospectus. Therefore, specific-item based differences should not hinder integration between them. Of course, there is no denial that specifically defining of particular items in detail would help the issuers prepare a prospectus. The more detailed the specific items are the better it would be for issuers. This would in turn protect the investor by providing them detailed information. Therefore, the EC may, it is suggested, insert more detailed provisions in the AID in line with Canadian law. This would facilitate integration of the two regional markets (the EC and the MJDS). For the same purpose the proposed “passport” prospectus directive should be drafted in such a way so that its disclosure requirements may match with Canadian ones.

In this connection a few words may be said about Canadian merit review system. As mentioned earlier, Canadian regulatory authority has the power, to a limited extent, to pass the merit of securities offered by an MJDS prospectus irrespective of the issuer’s country of origin (Canada or the US). This is good for the investors and also for a healthy securities market because in that case no securities bearing “abnormal” business risk (e.g., securities offered by an issuer with discredited management) would be able to enter the market. On the same ground a prospectus offering under the transatlantic integration, proposed later, may be brought under the said review jurisdiction. Alternatively, the EC can provide for similar requirement of merit review by the national securities regulatory authorities. In that case, an EC prospectus with proposed similar disclosures subject to merit review would assume a “passport” status in North America and vice versa.

Historically Canadian accounting has close links both to English and American accountings. It maintains its own uniqueness, however, in that the CICA has received over time a legislative status and its recommendations form a part of the law of the land. On the other hand, in the EC the accounting directives contain detailed provisions, which are implemented in the domestic jurisdictions of the Member States, e.g., in the UK by the Companies Act 1985. Accounting standards recommended by the professional bodies (e.g., the ASB in England) constitute guides for accountants. As such, traditionally they do not have the status of law, albeit they have persuasive force on judicial interpretation.

Whatever may be the status of accounting standards, in both jurisdictions financial statements are prepared to present reliable information for their users. To this end both laws allow departure from legal rules (Canadian GAAP and the EC directives) and application of accounting standards determined by professionals (accountants/auditors) on a case-by-case basis. And both jurisdictions require presentation of financial statements with common basic qualities of understandability, relevance, comparability and the like applying a common set of general principles, e.g., going concern, accrual and historical cost. Besides, common formats are followed to draw up such statements, although some accounting terms used therein are not same (e.g., stocks v. inventories).

Notwithstanding the aforementioned basic similarities the accounting laws and standards of Canada and the EC do not fully match with each other. This can be reproduced in the following capsule summary:

(1) The accounting directives do not define “asset”. Canadian GAAP and the UK GAAP define it in two conflicting senses. The former defines it as economic resources (e.g., real property) while the latter as
the rights to economic benefits flowing from them. Again, they differ with respect to the classification of assets. The Annual Accounting Directive defines “fixed assets” as those that are intended to be used on a continuous basis and “current assets” as those that not so intended. CICA Handbook, on the other hand, tends to define the former as those that are not convertible into cash, receivables or services in one year, and the latter as those that are so convertible. As a result, a particular property subject to sale may be presented under “current assets” in the EC and under “fixed assets” in Canada.

(2) With respect to tangible assets both the Handbook and the Annual Accounting Directive provide for disclosure of cost, accumulated depreciation and amortisation method. Historical cost and straight-line are the typically used common methods of cost and depreciation measurement. The Handbook subjects fixed assets to an impairment test while the Directive does not provide for it. Of course the UK, among other Member States, requires this.

(3) The EC Directive requires amortisation of goodwill, but the Handbook does not. The latter provides for impairment review of both goodwill, and other intangibles of indefinite lifespan. The EC Directive is silent about other intangibles, though the UK, among other Member States, allows amortisation of any intangibles (goodwill inclusive) of 20 years of life, and impairment review of those of indefinite life.

(4) The EC Directive allows capitalisation and amortisation of research and development expenses but the Handbook limits this to development costs only.
(5) As regards inventories both regimes are similar to the effect that the usual valuation basis is the lower of cost and market, popular method for determining this basis being the FIFO and WAC.

(6) The Directive and Handbook provisions concerning definition and classification of liabilities are similar. Particular rules of presentation of liabilities on the balance sheet are, on most parts, similar too.

(7) Canada and the EC take two antagonistic approaches to income tax (deferred tax) computation. The former treats it as a balance sheet item, but the latter as a profit and loss item. Although both approaches eventually produce the same results in general, divergences may arise in particular cases. For example, the balance sheet approach tends to attract non-taxable matters (“permanent differences”) as an asset for tax calculation, whereas they are excluded from calculation according to profit and loss statement approach.

(8) The accounting philosophy, general principles, formats and specific rules mentioned above are also applicable to consolidated accounts. The Consolidated Accounts Directive and the CICA Handbook require consolidation in similar situations by application of similar principles.

In light of the above summary it may be concluded that in addition to the philosophical and general principles based similarities the EC and Canadian accounting conform with respect to, among others, cost and depreciation methods of tangible assets, valuation basis of inventories and the method applied to determine that basis, definition and classification of liabilities and particular rules of their presentation, the principles of consolidation, etc. But formidable divergences arise in the matters of fixed assets, their definition and classification, amortisation and impairment of
goodwill and other intangibles, and computation of deferred tax. These differences will give conflicting accounting results as evidenced from above discussion. The immediate possible solution to this problem is reconciliation of the financial statements prepared according to the GAAP of one jurisdiction to the GAAP of the other.\footnote{See Company Reporting Limited, \textit{SEC Filing by Non-US Companies, supra} note 1077, at p. 6.} Of course, the EC’s convergence with the IAS will ease the problem. For example, as said earlier,\footnote{Text accompanied by note 2047, \textit{supra.}} the IASB adopted IAS 12, in line with the US and Canadian GAAPs, recommending for applying the balance sheet approach to deferred tax calculation. If the EC converges with this standard, its present gap with Canada (and also with the US) will narrow down.

Like the EC, it may be repeated, Canada is converging its GAAP with the IAS.\footnote{Text accompanied by notes 1862-1864.} It is also converging with the US GAAP. Again, the IASB are carrying a project that ‘will seek convergence on topics where a high-quality solution is available from existing international and national standards.’\footnote{\url{http://www.cica.ca}, under “Standards- International Activities,” visited on 12 April 2004.} In particular, their plan is ‘to eliminate differences between IAS and the US GAAP.’\footnote{\textit{Ibid.}} From this it is understood that that Canada, the US and the EC are converging with the IAS. In that case it is very unlikely that there will remain any significant differences among them. Differences may still remain in the areas of “unique” regional/national circumstances. Therefore, except those circumstances the converging GAAPs of the EC, the US and Canada will look very similar, as if harmonised. A former Canadian Finance Minister reflects on the benefits of such accounting harmonisation as follows:

\begin{quote}
The greatest benefit that would flow from harmonization would be the comparability of international financial information. Such comparability would eliminate the current misunderstandings about the reliability of ‘foreign’ financial statements and would remove one of
\end{quote}
the most important impediments to the flow of international investment…

Therefore, when the convergence project will be complete in both jurisdictions, there should not be any impasse to their integration. Financial statements of one jurisdiction could be accepted in the other save the “unique” circumstances. Accounting practice of one jurisdiction in such especial areas may be mutually recognised in the other, or may be reconciled to the other’s GAAP.

Now it is clear that the integration of the MJDS and the EC securities regime is possible by forming one transatlantic regime. This may be called the “Transatlantic Disclosure System” (TDS). In order to materialise this possibility into a reality, some suggestions may be reiterated. First, since the EC AID provisions respecting some nonfinancial items are inferior to those of Canadian law in extent, quality and effect, the former should be harmonised to the latter. Second, because the merit review jurisdiction of the Canadian regulatory authority is beneficial both for the investor and the market, the merit of securities offered under the proposed TDS should be reviewed by the Canadian regulatory authority. Alternatively, the EC may provide for such power to be exercised by the Member States’ regulatory authorities. Third, as the ongoing convergence of national/regional GAAPs with the IAS is likely to result in a harmonised international GAAP, the convergence project should be completed as soon as possible. Until its completion financial statements of one jurisdiction may be reconciled to the other. The TDS thus proposed to be created may expand to other regions of the world and form one world market in securities in the days to come.

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