

**PROSPECTUS DISCLOSURE AND THE ROLE OF THE  
SECURITIES COMMISSIONS IN ONTARIO AND  
BANGLADESH: A COMPARATIVE STUDY**

by

Md. Anowar Zahid

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## **DEDICATION**

To:

my parents,  
parents-in-law, and  
teachers.

## TABLE OF CONTENTS

	Page
<b>Abstract .....</b>	<b>vii</b>
<b>List of Abbreviations and Acronyms .....</b>	<b>viii</b>
<b>Acknowledgments .....</b>	<b>x</b>
<b>1 PRELUDE.....</b>	<b>1</b>
<b>2 PROSPECTUS DISCLOSURE AND THE ROLE OF THE OSC AND THE SEC-COMPARISONS.....</b>	<b>12</b>
<b>2.1 Contextualizing Prospectus Disclosure and the Role of the Securities Commissions.....</b>	<b>12</b>
2.1.1. Introduction.....	12
2.1.2. Ontario .....	12
2.1.3. Bangladesh.....	32
2.1.4 Conclusion.....	36
<b>2.2 Prospectus Disclosure and the Role of the OSC and the SEC: Theoretical Bases.....</b>	<b>39</b>
2.2.1 Introduction.....	39
2.2.2 Central Message of the Theories.....	40
2.2.3 History and Rationale for the Adoption of the theories in Ontario and Bangladesh.....	42
2.2.3.1. Ontario.....	43
2.2.3.2 Bangladesh.....	59
2.2.4 Conclusion.....	62

<b>2.3</b>	<b>Prospectus Disclosure and the Role of the OSC and SEC- Comparison of the Laws.....</b>	<b>63</b>
2.3.1	Introduction.....	63
2.3.2	Prospectus Disclosure.....	63
	2.3.2.1. Basic Rules of Disclosure.....	63
	2.3.2.2. Contents of Prospectus.....	68
	2.3.2.2.1 Non-financial Matters.....	69
	2.3.2.2.2 Financial Matters.....	90
	2.3.2.2.3 Certificates.....	100
	2.3.2.2.4 Statement of Purchaser’s rights..	101
2.3.3	Role of Securities Commissions.....	103
2.3.4	Summary.....	122
<b>3</b>	<b>CRITICAL EVALUATION OF THE COMPARISONS.....</b>	<b>125</b>
<b>4</b>	<b>EPILOGUE.....</b>	<b>146</b>
4.1	Conclusion.....	146
4.2	Recommendations.....	148
	<b>BIBLIOGRAPHY .....</b>	<b>153</b>

## ABSTRACT

In early 1998 Bangladesh adopted on recommendation by the Asian Development Bank (ADB) the disclosure review system in respect of prospectus registration replacing the merit review system. According to the new system, a company offering shares to the public for sale must make “full and fair” disclosure of all material information. The Securities and Exchange Commission (SEC), in giving consent to the issuance of shares, is required to ensure that the requisite information has been disclosed in the issuer’s prospectus. It does not have any power to look into the merit of an offering. Whether this system would benefit investors as well as the national economic development of Bangladesh is evaluated in the present thesis by comparing Ontario law with Bangladesh law.

The fundamental difference between Ontario law and Bangladesh law is that the former is based on the combination of the disclosure theory and the “blue sky” (merit review) theory while the latter is based on the disclosure theory alone. Accordingly, the Ontario Securities Commission (OSC) exercises twofold powers: it reviews the disclosures contained in a prospectus and also determines the merit of the offering. In other words, it ensures that “full, true and plain” disclosures are made in a prospectus, and at the same time it examines the offering to see whether any element jeopardizing the public interest is present in the offering. If it determines that any factor exists which suggests that it should be precluded in the public interest, it will refuse to receipt a prospectus.

This thesis argues that the characteristic feature of a security transaction is that it involves risks a range of risks for investors including fraud risks which result from misstatement or understatement of material facts. Prospectus disclosures eliminate many of the risks arising from lack of information, and offer various investment opportunities to people who, depending on their differing risk bearing capabilities, make investment decisions in light of such disclosures. Thus the disclosure regime has the effect of creating an environment of investment competition in the securities industry. As a result, resources are mobilized into the productive sectors, which eventually brings economic development of a country. From this perspective the disclosure approach recently adopted by Bangladesh seems to be encouraging. But the success of this system depends largely on the assurance that the risks offered by prospectuses are “normal” business risks of profit and loss, and that “abnormal” business risks are precluded. Since the SEC does not have any preclusion jurisdiction, it is argued that it cannot protect the investors against abnormal business risks. If investors suffer any losses resulting from such risks, they may lose confidence in the securities industry of Bangladesh. Thus, a compromise between the two approaches of disclosure and merit review, as in Ontario, has been suggested for Bangladesh both from investor protection and economic development perspectives.

## LIST OF ABBREVIATIONS AND ACRONYMS

A.C.- Appeal Cases  
AD-Appellate Division  
ADB- Asian Development Bank  
Alta L. Rev.- Alberta Law Review  
Alta. C.A.- Alberta Court of Appeal  
Admin.L.R.- Administrative Law Review  
B.C.C.A.- British Columbia Court of Appeal  
B.C.L.- Bangladesh Law Cases  
B.C.Prov. Ct.- British Columbia Provincial Court  
B.C.R.- British Columbia Reports  
Bus. Law.- Business Lawyer  
CA- Companies Act  
Cal. L.Rev.- California Law Review  
Can. Bar Rev.- Canadian Bar Review  
Can. L.T.- Canadian Law Times  
Can. Pub. Adm.-Canadian Public Administration  
C.C.C.-Canadian Criminal Ca  
CCI- Controller of Capital Issues  
Ch.- Chancery Division  
CICA- Canadian Institute of Chartered Accountants  
CMDP- Capital Market Development Program  
Co. & Sec. Law Journal- Company and Securities Law Journal  
Corp. Fin.-Corporate Finance  
CSE- Chittagong Stock Exchange  
CY- Calendar Year  
D.L.R.-Dominion Law Reports  
D.L.R.- Dhaka Law Report  
DSE- Dhaka Stock Exchange  
F.- Federal Reporter  
F.Supp.- Federal Supplement  
FY- Financial Year  
GAAP- Generally Accepted Accounting Principles  
GAAS- Generally Accepted Accounting Standards  
GDP- Gross Domestic Product  
GNP- Gross National Product  
Harv. L.Rev.- Harvard Law Review  
IAS- International Accounting Standards  
IASC- International Accounting Standards Committee  
ICAB- Institute of Chartered Accountants of Bangladesh  
IPO- Initial Public Offering

ISA- International Standards of Auditing  
J.E.L.P.- Journal of Environmental Law and Practice  
O.A.C.-Ontario Appeal Cases  
Ont. C.A.- Ontario Court of Appeal  
Ont. Gen. Div.-Ontario General Division  
Osgoode Hall L.J.-Osgoode Hall Law Journal  
O.R.- Ontario Reports  
OSA- Ontario Securities Act  
OSAR- Ontario Securities Act Regulation  
OSC- Ontario Securities Commission  
O.S.C.B.- Ontario Securities Commission Bulletin  
O.W.N.- Ontario Weekly Notes  
PIR- Public Issue Rules  
S.Ct.-Supreme Court Reporter  
S.Cal. L.Rev.-Southern California Law Review  
Sask. L.Rev.- Saskatchewan Law Review  
SEC- Securities and Exchange Commission  
SECA- Securities and Exchange Commission Act  
SEO- Securities and Exchange Ordinance  
SER- Securities and Exchange Rules  
TSE- Toronto Securities Exchange  
Tex. Int. L.F.- Texas International Law Forum  
Tex. L.Rev.- Texas Law Review  
U.S.- United States Reports  
U.T. Fac.L.Rev.-University of Toronto Faculty of Law Review  
U.T.L.J.-University of Toronto Law Journal  
U.W.O.L.Rev.- University of Western Ontario Law Review  
Virg. U.L.Rev.- Virginia University Law Review  
W. Res. L.Rev.- Western Reserve Law Review  
W.W.R.-Western Weekly Reports  
Wash. L.Rev.- Washington Law Review

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## 1 PRELUDE

The People's Republic of Bangladesh, born on 16 December 1971, is a developing country with the Gross Domestic Product (GDP) of US \$ 33 billion and annual per capita GDP of US \$ 265.<sup>1</sup> It has a heavy foreign loan and a deficit budget. For the last four financial years (FYs) its GDP growth has been within the range of 4% to 6%<sup>2</sup>; in FY 1996/97 it was 5.9%<sup>3</sup> and in the FY 1997/98 it was 5.6%.<sup>4</sup> For the FY 1998/99 it was forecast to be 6.2%.<sup>5</sup> It has a very low saving and a poor investment rate. In the FY 1997/98 its gross domestic savings and investment were merely 7.9% and 16.3% of the GDP respectively.<sup>6</sup> In the same period Bangladesh had an inflation rate of 6.3%<sup>7</sup>, a budget deficit of 5.4%<sup>8</sup> of the GDP and a foreign debt of US \$ 14,813.0 million or 43.7% of the GDP<sup>9</sup>.

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<sup>1</sup> Dhaka Stock Exchange (DSE), *Bangladesh: Introduction to the Dhaka Stock Exchange*, (Dhaka: DSE, 1998) at 1.

<sup>2</sup> See Asian Development Bank (ADB), *Asian Development Outlook-1998* (Hong Kong: Oxford University Press, 1998) at 117, and *infra* notes 3 and 4.

<sup>3</sup> Bangladesh Bank, *Barshik Report (Annual Report), 1997-98*, (Dhaka: Bangladesh Bank, Feb.1999) at 2. .

<sup>4</sup> *Ibid.*

<sup>5</sup> *Supra* note 2.

<sup>6</sup> *Supra* note 3 at 14.

<sup>7</sup> *Supra* note 3 at 4.

<sup>8</sup> *Supra* note 3 at 3.

<sup>9</sup> *Supra* note 3 at 7.

To add to its fiscal difficulties, Bangladesh has a small capital market. In the calendar year (CY) of 1992 there was a market capitalization of barely US \$314 billion, and in CY 1996 it increased to US \$4.6 billion.<sup>10</sup> Following a scam<sup>11</sup> in 1996 the market experienced a decline of capitalization. As of June 1997 market capitalization fell to US \$2.5 billion.<sup>12</sup> At the end of March 1998 it further declined to nearly US \$2.3

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<sup>10</sup> See ADB, *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grants to the People's Republic of Bangladesh for the Capital Market Development program*, (ADB: Manila, 1997) at 58 (hereinafter *ADB Report*).

<sup>11</sup> In 1996 an artificial profitable (secondary) share market was created by the manipulation of share prices by some dishonest insiders of companies and at the same time the bank interest rate decreased. This led many investors to withdraw money from the banks and to invest it in the share market. But when the manipulation was detected, a meteoric fall of share prices took place in the market. Overnight many investors lost everything. A World Bank report highlights this episode as below:

The lack of transparency and accountability combined with a frail regulatory framework and indigent infrastructure paved the way for market manipulations during July-November 1996. During this period, share prices multiplied nearly four times; market capitalization jumped from a tiny fraction to around 20 percent of GDP, increasing almost three-fold; the price-earning ratio soared to 80; and law and order situation was created when 20 to 30 thousand unemployed students, *mastans* (hoodlums) and others gathered every day outside the Dhaka and Chittagong stock exchanges (DSE and CSE) to trade shares, hoping that they would get rich overnight. For some the fantasy indeed became a reality, but for most of the half a million retail investors, who assumed a position in the market with cash taken out of their savings and fixed deposits, real asset sales and borrowings, it turned into a nightmare. Since mid-November 1996, share prices moved mostly in one direction- down - and the price index has now dipped below the bourses' starting point in mid-1996. *Bangladesh Annual Economic Update 1997* (South Asian Region, the World Bank: October 1997) at 25.

<sup>12</sup> *Supra* note 10.

billion (approx. Tk. 111 billion).<sup>13</sup> The ratio of market capitalization to GDP in 1992 was merely a 1.3% and rose to 12.9% in 1996.<sup>14</sup> As of March 1998 that ratio fell to about 7% of the GDP and about 8% of the GNP compared to 16% and 37% of GNP in Pakistan and India respectively, the two neighboring securities markets of Bangladesh.<sup>15</sup> In the primary market, initial public offerings (IPOs)<sup>16</sup> raised about US \$2.7million in 1992.<sup>17</sup> This amount increased to about US \$44.5 million in 1996,<sup>18</sup> followed by a fall to about US \$17 million (Tk. 800 million) in 1997.<sup>19</sup> In 1996 24 IPOs of US \$54.94 million worth were issued.<sup>20</sup> In the following year only 12 IPOs of US \$12.55 million were offered.<sup>21</sup> Thus in these two calendar years, on average, only 18 IPOs of about US \$33.75 million were issued, whereas to meet the investment need of the country 100 IPOs of nearly US \$276 million ( approx. Tk. 13000 billion) are required.<sup>22</sup> In the secondary market , on the other

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<sup>13</sup> See “Secondary Market Affairs” *SEC Quarterly Review* 4:3 (Jan.-March 1998) at 8. Taka (Tk.) is the currency of Bangladesh. As of February 1998 US \$ 1= 46.30 taka., *supra* note 3 at 122..

<sup>14</sup> *Supra* note 10 at 6.

<sup>15</sup> “Current Issues in Bangladesh Capital Market” *Portfolio* 1:6 (April 1998) 7 at 7.

<sup>16</sup> “Initial Public Offering” is the process pursuant to which the first offer and distribution of securities of an issuer to the public, either through an underwriter or occasionally directly by the issuer, is made by way of a prospectus... An IPO may consist of or include a secondary distribution of securities held by an existing .shareholder.”: G. R. D. Goulet, *Public Share Offerings and Stock Exchange Listings in Canada*, (North York, Ontario: CCH Canadian Limited, 1994) at 569

<sup>17</sup> *Supra* note 10 at 6.

<sup>18</sup> *Supra* note 10 at 6.

<sup>19</sup> See F. E. Cookson, and M. E. Hauque, “Bangladesh Capital Market: Current Issues and Options” *Portfolio* 1:8 (June 1998) 11at 12.

<sup>20</sup> *Supra* note 1 at 11.

<sup>21</sup> *Supra* note 1 at 11.

<sup>22</sup> *Supra* note 19 at 11.

hand, the annual turnover of securities in 1992 at the stock exchanges<sup>23</sup> was about US \$1 million, which rose to over US \$700 million in 1996.<sup>24</sup> Up to March 1998 it stood at about US \$0.805 million ( Tk. 37.84 million).<sup>25</sup> The number of listed companies is increasing every year. In 1992 there were 145 companies listed on the Dhaka Stock Exchanges (DSE).<sup>26</sup> This number increased to 183 in 1995 when the Chittagong Stock Exchange (CSE) was established.<sup>27</sup> As of March 1998 both the bourses had 203 companies on the lists in total.<sup>28</sup> The number of listed securities is also increasing ; it was 153 in 1992<sup>29</sup> and rose to 223 in 1998.<sup>30</sup>

All the statistics given above make it clear that Bangladesh is a poor economy with a very low contribution from the securities industry to the GDP. In view of this scenario the Asian Development Bank (hereinafter ADB), with the ultimate aim of eradication of poverty and improvement of living conditions, has underscored the need for reform, on the highest priority basis, in the Bangladesh financial sector (banking sector and capital market) because “(w)ithout efficient financial markets the mobilization of additional resources for development will slow down”<sup>31</sup>. Similarly, the Government of

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<sup>23</sup> Bangladesh has two stock Exchanges, viz. the Dhaka Stock Exchange Ltd. and the Chittagong Stock Exchange Ltd.

<sup>24</sup> *Supra* note 10.

<sup>25</sup> *Supra* note 13 at 2.

<sup>26</sup> *Supra* note 10.

<sup>27</sup> *Supra* note 10.

<sup>28</sup> *Supra* note 13 at 2.

<sup>29</sup> *Supra* note 10.

<sup>30</sup> *Supra* note 13 at 2.

<sup>31</sup> *Supra* note 2 at 118. Stiglitz considers the financial markets of a country the brain of its economic system and says that “if they fail, not only will the sector’s profits be lower

Bangladesh considers “the development of the domestic capital market to be critical to its overall resource mobilization effort vital for the future growth and development of the country’s economy”<sup>32</sup>. Accordingly, the Government recognizes the need to introduce capital market reforms<sup>33</sup> and, following the 1996 security market scam, adopted a reform program called the Capital Market Development Program (CMDP) with the broad objective “to develop a fair, transparent, and efficient market”<sup>34</sup>. To this end Bangladesh received a financial loan and technical assistance grants from the ADB on the recommendation of an ADB report (hereafter *ADB Report*).<sup>35</sup>

The *ADB Report* put forward its recommendation after reviewing the state of Bangladesh capital market and the concerned institutions. One of its findings was that in the area of IPO approval the Securities and Exchange Commission (hereafter SEC), the securities market watchdog of Bangladesh, was applying a system based on merit

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than would otherwise have been, but the performance of the entire economic system may be impaired.”: J.E. Stiglitz, “The Role of the State in Financial Markets,” *Proceedings of the World Bank Annual Conference on Development Economics 1993*, (World Bank: Washington, D.C., 1994) at 23, cited in A. Hossain and S. Rashid, “Financial Sector Reform”, in M.G. Quibria, ed. *The Bangladesh Economy in Transition*, (Delhi: Oxford University Press, 1997) 221 at 221. In particular, the importance of the securities markets in the national economy of a country lies in the fact that they “channel individual institutional savings to private industry and thereby contribute to the growth of capital investment”. *S. Rep. No. 91-1218*, at 2, quoted in T. W. Joo, “Who Watches the Watchers? The Securities Investor Protection Act, Investor Confidence, and the Subsidization of Failure”, (1999) 72 S. Cal. L. Rev. 1071 at 1081.

<sup>32</sup> *Supra* note 10 at 48.

<sup>33</sup> *Supra* note 10 at 2.

<sup>34</sup> F. Narayan, “The Capital Market Development Project” *Portfolio*, *supra* note 15 at 14.

<sup>35</sup> *Ibid.* For the title of the report, note 10 *supra*.

regulation instead of full disclosure of information through prospectus.<sup>36</sup> This caused considerable delay in getting approval to IPOs from the SEC<sup>37</sup>, which ranged from 6-12 months.<sup>38</sup> It also revealed that in 95% of cases its assessment of issuers' projections contained in prospectuses turned out to be wrong.<sup>39</sup> Sometimes the concerned officials intentionally delay in approving the prospectus with an intention of being (illegally) "satisfied".<sup>40</sup> At the end of the year it lends approval to prospectuses en masse. As a result, the market gets flooded by Initial Public Offerings (IPOs). Because of so many IPOs coming together in the market at a time the issues are less subscribed and the issuer fails to implement its commitments as forecast because of a shortage of funds. This, in turn, affects the investors who get less or no dividends.<sup>41</sup> According to media reports during the last few years only 5% of companies have disbursed dividends as forecast in their prospectuses.<sup>42</sup> Thus, on the whole, the investors and the public lost their confidence in the market, which deteriorated when the 1996 share scam took place.

In consideration of the aforementioned finding of the *ADB Report* the SEC decided to give up the "merit review" policy and to adopt the "full disclosure" policy.<sup>43</sup> In

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<sup>36</sup> *Supra* note 10 at 13. For discussion of the concepts of "disclosure" and "merit regulation", *infra* notes 179-189 and accompanying texts.

<sup>37</sup> *Supra* note 10 at 13.

<sup>38</sup> "SEC-er behishebi karmokando" ("Irresponsible Activities of the SEC") *Share Bazar*, (a Bengali national magazine), 4:8 (16 July 1998)3 at 4.

<sup>39</sup> *Ibid.* at 5.

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*

<sup>42</sup> *Supra* note 38 at 5.

<sup>43</sup> K.U. Ahmad, "Informational efficiency in the Stock Market", *The Daily Star* (a national daily) (27 July 1998) at 4.

early 1998 it started asking issuers to provide full disclosure of information in prospectuses and advised the investing public to make their investment decisions in light of such disclosure.<sup>44</sup> It formally adopted the disclosure review system in January 1999 by making the *Public Issue Rules, 1998*.<sup>45</sup> (hereinafter *PIR*).

Under the new legal arrangement the investors in Bangladesh have been given the whole responsibility of making investment decisions in light of the disclosed information by the issuers in prospectuses. The SEC no longer shares the responsibility, it merely ensures full and fair disclosure of material information.<sup>46</sup> But this disclosure system poses different kinds of problems. For example, it is difficult for the investors, particularly the lay investors, to assess the merit of a security which is ever speculative in nature.<sup>47</sup> In making investment decisions they need to purchase services of the market intermediaries like investment advisors. Such institutions are, however, newly developed in Bangladesh and as such their services are hardly reliable.<sup>48</sup> In addition, the accuracy of information disclosed in prospectuses is questionable.<sup>49</sup> Legal remedy against any questionable disclosure or misstatement in prospectuses is far beyond the reach of the

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<sup>44</sup> See T.I. Khalili, M.A.Kashem and M.S. Rahman, "Restoring Lost Confidence" *Star Magazine* (a supplementary of the *Daily Star* ), (3 April 1998) 4 at 6.

<sup>45</sup> No. SEC/Sec. 7/P/R-98/140, *Bangladesh Gazette* (supplementary), (25 Jan. 1999)121.

<sup>46</sup> For discussion of the concept of full and fair disclosure of material information, *infra* notes 291-198.

<sup>47</sup> *Supra* note 38 at 35. For the nature of a security, *infra* notes 76-118 and the accompanying texts.

<sup>48</sup> *Supra* note 38 at 35.

<sup>49</sup> *Supra* note 38 at 35. Also see M. Rahman, Letter to the Editor, *The Holiday* (a national weekly) (26 June 1998) at 2.

investors because it involves costs and time.<sup>50</sup> The only remedy availed of is the administrative action by the SEC, namely imposition of fines on the responsible companies.<sup>51</sup> But this does not help the investors. If a company is penalized for misstatement, the fines will be received by the government, not by the investors. Due to all these factors the investors have lost their attraction for investment in securities<sup>52</sup> This aspect of the problem connected with the disclosure regime in Bangladesh necessitates the present endeavor.

This thesis will examine the above problems with a view to making recommendations as to how they can be addressed. It will do so by a comparative analysis of a well developed regime, namely Ontario. The reason behind choosing Ontario for comparison is that it is the biggest securities market in Canada, and its law and policy with respect to securities regulation are basically followed in other provinces. Its economy depends on these markets “to play a pivotal role in the capital formation and wealth creation process...(generating) significant jobs in the financial services sector”<sup>53</sup>. Given this role the OSC wants them (the markets) to be “efficient, open and fair”<sup>54</sup> so that

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<sup>50</sup> For a general view of the problems in civil litigation, see R. Rahman, *Civil Litigation in Bangladesh*, (Dhaka: Nuruzzaman Choudhury, 1986).

<sup>51</sup> See “Regulatory Matters- Penalty Imposed” *SEC Quarterly Review* (Oct.-Dec. 1994) 19.

<sup>52</sup> *Financial Express* (a national daily) (18 July 1998) at 1; *The Bangladesh Observer* (a national daily) (5 July 1998) at 1.

<sup>53</sup> Ontario Securities Commission (OSC), *A Changing Commission for a Changing Market- 1997 OSC Annual Report* (hereinafter *1997 Annual Report*), (Ontario: OSC, 1997) at 7.

<sup>54</sup> *Ibid.*

- (a) “capital can be raised and securities traded quickly and without unnecessary costs or impediments”;
- (b) “current, complete and comparable public information about issuers and market activity are available”; and
- (c) “customers interests come first and investors are protected from market abuses”.<sup>55</sup>

As a measure of investor protection Ontario securities law requires the full, true and plain disclosure of information relevant to investor decisions.<sup>56</sup> It prescribes forms detailing the matters to be contained in the prospectuses of different types of companies. Each of the forms sets out so many matters that if it is truly complied with, there may be little undisclosed. Non-disclosure or partial disclosure or false disclosure is remediable by an investor suit for damages which is easy and less time consuming. As a result, in most of the cases information provided by companies is found to be full and true, though not always in plain terms.<sup>57</sup> Besides, the OSC has a discretionary jurisdiction, though not often used, to refuse a prospectus in public interest and on some other specific grounds, which serves as an investor protection shield. Thus the Ontario investors enjoy the benefits of both disclosure and, to some extent, merit review. As a result, in Ontario there is an increasing demand for IPOs.<sup>58</sup> It indicates that the investors

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<sup>55</sup> *Ibid.*

<sup>56</sup> *Ontario Securities Act(OA)*, R.S.O. 1990, c. S.5, s. 56.

<sup>57</sup> D. L. Johnston and K.D. Rockwell, *Canadian Securities Regulation*, (Toronto: Butterworths, 1998) at 81.

<sup>58</sup> *Supra* note 53 at 11.

have confidence in the securities markets which, in turn, contributes to the formation of capital and the economic progress of the province.

The present work is an attempt to find out, through comparison, what types of information are subject to prospectus disclosure and what role the respective securities commissions of Ontario and Bangladesh play in this regard. In other words, it will be considered whether disclosure required by the laws of Ontario and Bangladesh is enough to guarantee the investor protection or whether further interventions by the securities commissions are needed to ensure investor confidence. After discerning the similarities and disparities between the Ontario and Bangladesh laws, prescriptions to the problem prevalent in the latter would be suggested to import from the former, where appropriate. The proposed comparison is justified given the facts

- (a) that the matters to be compared (disclosure and the roles of the OSC and SEC) have a common function under both the systems, namely to provide information to the investing public concerning an investment enterprise and thereby to ensure its protection<sup>59</sup>;
- (b) that both Ontario and Bangladesh belong to the same legal and economic family, namely common law system and market economy system.

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<sup>59</sup> This functional affinity is the core of comparative research. To quote Bogdan, “The compared legal rules and institutes must be comparable to each other *functionally*: they must be intended to deal with the same problem.” : M. Bogdan, *Comparative Law*, (Sweden: Norway: Law and Taxation Publishers, 1994) at 60.

The whole work is divided into four Sections .Section 1 constitutes the present part of the thesis. Section 2 makes comparisons between the disclosure regimes of Ontario and Bangladesh. This Section has three sub-divisions: Sub-section 2.1 gives an introductory idea to the central theme of the thesis. It explains the circumstances necessitating prospectus registration both in Ontario and Bangladesh. The purpose is to see if the prospectus registration renders similar functions under both the jurisdictions. Sub-section 2.2 looks into the theoretical foundations of prospectus regulation with a view to revealing how Ontario and Bangladesh conform or differ in this regard. Sub-section 2.3, which constitutes the centrepiece of the Section, is designed to discern the actual similarities and disparities between the concerned laws. Section 3 provides a critical evaluation of the comparisons of the concerned laws and the underlying theories. Section 4, the closing part, contains the conclusion of the thesis and sets forth some recommendations for reforms of laws, where necessary.

## **2 PROSPECTUS DISCLOSURE AND THE ROLE OF THE OSC AND THE SEC- COMPARISONS**

### **2.1 CONTEXTUALIZING PROSPECTUS DISCLOSURE AND THE ROLE OF THE SECURITIES COMMISSIONS**

#### **2.1.1 INTRODUCTION**

The central focus of the thesis is the role of the securities commissions of Ontario and Bangladesh with respect to disclosure through prospectus. It deals with the extent to which information should be disclosed to the investors and whether the commissions should review the merits of the securities offered by the prospectuses. Discussion of matters like these in the forthcoming parts of the thesis presupposes, as a preliminary, an inquiry into the meaning and purpose of a prospectus, the nature of transactions requiring a prospectus, and the involvement of the respective securities commissions of Ontario and Bangladesh in this respect. The following discussion is being directed to that end.

#### **2.1.2 ONTARIO**

The *OSA* does not contain a definition of “prospectus”.<sup>60</sup> A prospectus is generally understood as a document that contains detailed information<sup>61</sup> concerning the issuer,<sup>62</sup> its business, management and security<sup>63</sup> being distributed<sup>64</sup>, etc. so that the potential investor(s) can make an informed decision on investment in security. It is “the principal ticket to freely tradable securities”<sup>65</sup>. It is the “principal” ticket because

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<sup>60</sup> However, a dictionary of Canadian law defines it as “[a]ny prospectus, notice, circular or advertisement of any kind whatsoever, ... whether in writing or otherwise offering to the public for purchase or subscription any shares or debentures of any company”. Daphne A. Dukelow and Betsy Nuse, *The Dictionary of Canadian Law*, 2d ed. (Carswell: Scarborough, 1995) s.v. “prospectus”. This definition is almost the reproduction of s. 30 of the English *Companies Act, 1900*, 63 & 64 Vict. c.48, and s. 95 of the (Ontario) *Companies Act, 1907*, S.O. 1907 c. 34. It may, however, be said to be an obsolete definition in view of the modern securities law of Ontario. First, under the modern securities law of Ontario prospectus is not meant to be anything like advertisement, notice, etc., which rather, if made in furtherance of the sale of securities, will be called “trading” in securities. See the texts accompanying notes *infra* notes 119-134. Second, today prospectus is not meant to distribute securities to the *Public*. Because the word, “public” triggered interpretive problems, the legislature deleted it from the statute with reference to prospectus requirement in 1981. For details, see *infra* note 73. Third, according to the modern law a prospectus is required to distribute *securities*. But the given definition only covers a narrow area of securities, namely shares and debentures. Thus an infinite variety of securities are left outside its fold.

<sup>61</sup> Information required by the *OSA* will be discussed in Sub-Section 2.3, below.

<sup>62</sup> “Issuer” means a person or company who has outstanding, issues or proposes to issue, a security. : *OSA*, R.S.O. c.S.5, s. 1(1) “issuer”.

<sup>63</sup> For the meaning and definition of “security”, see the text accompanying *infra* notes 76-118.

<sup>64</sup> For the meaning of “distribution”, see texts accompanying *infra* notes 135-146.

<sup>65</sup> Dillon, “The Prospectus Exemptions, Process and Presentation”, *Basic Securities*, (Toronto: Law Society of Upper Canada, April 1988)1 at 1 excerpted in H.L. O’Brien, *Securities Regulation Cases and Materials*, vol. 1, (Halifax: Faculty of Law, Dalhousie University, Fall 1995) at 623 (Course materials prepared for law students of Dalhousie University).

normally a person or company can carry on a distribution<sup>66</sup> in securities only by having a prospectus approved by the OSC.<sup>67</sup> There are exceptions to this provision. First, exemptions from the prospectus requirement are available under the *OSA*<sup>68</sup> or *Regulation* or the OSC Rules.<sup>69</sup> Second, they may be granted by the OSC at its discretion where statutory exemptions are not applicable.<sup>70</sup> Thus though prospectus is the general requirement for issuing securities, there are exceptional situations in which this requirement does not apply. This arrangement, called the “closed system”, was introduced in Ontario on 15 March 1981.<sup>71</sup> Prior to that date distributions of securities *to the public*

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<sup>66</sup> For the meaning and definition of “distribution” in securities, see the text accompanying *infra*.notes 135-147.

<sup>67</sup> *OSA*, R.S.O. 1990 c.S.5, s. 53(1).

<sup>68</sup> *OSA*, R.S.O. 1990 c.S5, ss. 72-73.

<sup>69</sup> *Ontario Securities Act Regulation (OSAR)*, R.R.O. 1990, Regulation 1015, s. 14; *OSA*, R.S.O. 1990 c.S.5 as am., 143. For the rule-making power of the SEC, see *infra* note 603.

<sup>70</sup> *Ibid.* s. 74(1). The discretion enjoyed by the OSC with respect to prospectus registration impacts on the Ontario securities industry. The following comment is quite appropriate in this respect:

the Act (*OSA*) is devised in such a way to make the securities industry in Ontario beholden day in and day out to the Commission (OSC). They are either there trying to find that they fit within the requirements of the registration provisions or that the prospectus meets the requirements of the regulations and the forms which are required by the commission, or they are there seeking to expand and enlarge upon one of the areas of the exemptions so that they can see whether they escape the net of the Securities Commission, or they are there begging the Securities Commission to exercise the extremely wide discretionary powers vested in the commission. *Legislature of Ontario Debates- Official Report (Hansard)*, 31 (6 April 1978) at 1291 (Mr. Renwick).

<sup>71</sup> For details see H.G. Emerson, “Business Finance under the “Closed System” of the Ontario Securities Act: Statutory Scheme and Pitfalls”, in Law Society of Upper Canada,

were only possible by filing a prospectus with the OSC unless exemption provisions did apply.<sup>72</sup> In other words, *non-public* distributions were kept out of the scope of prospectus regulation. However, it was not clear who was the “public” that needed protection, which created “a minefield of interpretive difficulties”<sup>73</sup>. To replace such difficulties with “simplicity and certainty”<sup>74</sup> the present system was set up.

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*Special Lectures -Corporate Law in the 80s*, (Don Mills: Rechar De Boo Publishers, 1982) 29 at 35-45.

<sup>72</sup> OSA, S.O. 1978 c. 47, s. 51. Before this act (effective from June 1978) prospectus was required where there was a primary distribution of securities to the public.: OSA, R.S.O. 1970 c. 426, s. 35. Because the word “public” was debatable, *Merger Report* recommended for its removal from the OSA.: *Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements*, (Ontario: Department of Financial and Commercial Affairs, Province of Ontario, Feb. 1970) (*Merger Report*), at para. 3.20. See for the interpretive debates, *infra* note 73.

<sup>73</sup> Johnston and Rockwell, *Securities Regulation in Canada*, *supra* note 57, at 70. For example, in several cases “public” was interpreted differently. *Nash v. Lynde*, [1929] A.C. 158 (H.L.) is the leading English case in which the word was considered in reference to securities legislation. There it was maintained that a document as a prospectus should be “shown to *any person as a member of the public* and as an invitation to that person to take some of the shares referred to” therein. (Per Lord Hailsham L.C., at 164). Viscount Sumner said, ““The public”,...is of course a general word. No particular numbers are prescribed. Anything from *two to infinity* may serve: perhaps *even one*, if he is intended to be first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be *open to any one* who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not.” (at 169) (emphasis added). Further, in effect he said that “friends, even if they are business friends” do not constitute the public and, therefore, a single private communication among them is not a prospectus. (at 168). Thus close friends and business associates were excluded from the definition of “public”. This is known as “friends and business associates” test. In *R. v. Empire Dock Ltd.* (1940), 55 B.C.R. 34 (C. C.), one of the earliest Canadian cases, it was observed by Lennox Co. J. that “the meaning of the words ‘the public’ cannot be tied down to a specific quantity”. (at 37). The US Supreme Court enunciated a test called “need to know” test in its decision in the *SEC v. Ralston Purina Co.* (1953), 346 U.S. 119, 73 S.Ct. 981. In that case the defendant company sold its securities of worth \$

Under the closed system, if the exemption-bypasses are not open, no person or company can trade in a security without a prospectus provided such trade is a

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2,000,000 to its own employees under a stock investment plan. Some of the employees held positions in the company and the others were more junior employees, e.g., foreman entrusted with the duty of supervision at the lowest level. The Court held it would be superfluous if a prospectus information were provided to the first categories of employees because they did know of them by virtue of their position in the company. Rather the other employees devoid of the positional advantage had a “need to know” of them. The Court said, “The design of the statute (*The Securities Act, 1933*) is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions. ... An offering to those who are shown to be able to fend for themselves is transaction ‘not involving any public offering’”. (at 124-125, footnote omitted). It also said that “the statute would seem to apply to a “public offering” whether to a few or many.” (at 125, footnote omitted). Thus the Court means that whoever has or have a “need to know”, irrespective of the number, must be supplied with a prospectus while securities are offered for sale. In *R. v. Piepgrass* (1959), 29 W.W.R. 218, 23 D.L.R. (2d) 220, 125 C.C.C. 364, 31 C.R. 213 (Alta. C.A.) the Alberta Court of Appeal said, “It is clear from cases and from the authorities cited that it is impossible to define with any degree of precision what is meant by the term “offer for sale to the public”” (Per Macdonald J. A., 23 D.L.R. at 228). Of course, it applied the “friends and business associates” test and held the accused liable because the persons (five in number) to whom they sold shares “were not in any sense friends or associates of the accused, or persons having common bonds of interest or association.” (23 D.L.R. at 228). In *R. v. McKillop*, [1972] 1 O.R. 164, 4 C.C.C. (2d) 390 (Prov. Ct.) a small group of persons were termed as public. An offer of sale of shares to them was held to be an offering to the public. Both *Ralston Purina* and *Piepgrass* were referred to in this case. The court laid down that

In my opinion the sales made by the accused to the various named individuals were not of a strictly private nature. In other words, shares were not only available to those particular people to the exclusion of all others. While it is true that the individuals who purchased the shares constituted a small number in proportion to all residents of this community, nevertheless, they were not a favoured few, so far as possessing knowledge of the availability of the shares was concerned. (1 O.R at 168 and 4 C.C.C. at 394, per Greco, Prov. Ct. J.).

<sup>74</sup> *Merger Report, supra* note 72.

distribution of such security.<sup>75</sup> The definitions of “security”, “trade” and “distribution” are the key to understanding the nature of securities transactions as well as the significance of the need of a “prospectus”.

### Security:

The *OSA* enumerates a list of 16 instruments to be included within the ambit of “security”.<sup>76</sup> That list is not however, exhaustive.<sup>77</sup> Its fold is so expansive that it may entail “anything that acts like a security, even if not specified in the definition”<sup>78</sup>. It

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<sup>75</sup> *OSA*, R.R.O. 1990., c.S.5, s. 53(1).

<sup>76</sup> *Ibid.*, s. 1(1) “security”.

<sup>77</sup> Section 1(1) in defining “security” uses the word “include” instead of “mean” and thus the definition is inclusive in nature. However, as to whether the definition is exhaustive or not there is a debate between Alboini and, Johnston and Rockwell while commenting on the decision in *Re George Albino*, [Feb. 1991] 14 O.S.C.B. 365. In this case a question arose whether “the phantom stock plan” (a long term incentive plan) was a security or not. One commissioner held in the affirmative, one in the negative and third one declined to decide the issue. On the basis of this decision V. P. Alboini says that “the definition (of security) has been treated as if it were exhaustive”: V. P. Alboini, *Securities Law and Practice*, 2d ed., (Toronto: Carswell, 1984), vol. I, at 0-29. His interpretation seems to be grounded on that it was a 2:1 majority decision. But Johnston and Rockwell differ with Alboini in that his interpretation was “incorrect” as “[o]nly one commissioner used the reasoning” (that the phantom stock plan was not security): Johnston and Rockwell, *supra* note 57 at 25 n. 15. In fact, declining to decide an issue, in law, should not, it is submitted, be interpreted to have amounted to a negative decision. As such the decision in the present case cannot be said to be a 2:1 decision. Thus Johnston and Rockwell’s argument may be said to be correct.

<sup>78</sup> Johnston and Rockwell, *supra* note 57 at 125. In this connection Iacobucci is worth quoting, “If the definition is not sufficiently wide to catch what are thought to be securities, then obviously the objectives of the statute will not be attained”. : F. Iacobucci, “The Definition of Security for Purposes of a Securities Act”, *Proposals for a Securities Market Law for Canada*, (Ottawa: Ministry of Supply and Services, 1979) at 230, excerpted in H. L. O’Brien, ed. *Securities Regulation Cases and Materials*, (Halifax, Faculty of Law, Dalhousie University, Fall 1995) at 404. This purposive approach to

is so broadly interpreted because the *Securities Act* is a remedial legislation.<sup>79</sup> The Supreme Court of Canada made this point clear when it said that “(s)uch remedial legislation must be construed broadly, and must be read in the context of the economic realities to which it is addressed”<sup>80</sup>. The court had in mind the basic policy objective of the securities legislation, namely the protection of the investing public.<sup>81</sup> Thus in *George Albino* it was reiterated that “[i]f the particular set of legal rights and obligations under review was found to be a security, the investing public would be protected through full, true and plain disclosure of all material facts in a prospectus”<sup>82</sup>.

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interpreting the meaning of “security” has been taken by courts of US and Canada in various cases.: see *infra* note 101-113 and the accompanying texts.

<sup>79</sup> Remedial legislation is “(a) statute having for its object either to redress some existing grievance, or to introduce some regulation or proceeding conducive to public good”. Benjamin W. Pope, *Legal Definitions*, (Chicago: Callaghan and Company, 1920) s.v. “remedial legislation”. As to how a remedial statute should be construed Maxwell lays down that “remedial statutes...are to be construed liberally and beneficially, so as to promote as completely as possible the suppression of the mischief intended to be remedied, and to give life and strength to the remedy”. : P.B. Maxwell, *The Interpretation of Statutes*, (Colorado: Fred B. Rothman & Co., 1991) at 203.

<sup>80</sup> *Pacific Coast Coin Exchange v. OSC* (1977), [1978] 2 S.C.R. 112 at 127; 80 D.L.R. (3d) 529 at 538. What is meant by “economic reality” in the present context? It has been defined by the Supreme Court of Hawaii in *State Commission of Securities v. Hawaii Market Center*, 485 P. 2d. 105 (Hawaii Sup. Ct. 1971) at 109 as the “subjection of the investor’s money to the risks of an enterprise over which he exercises no managerial control”. This formula was borrowed from R.J. Coffey, “The Economic Realities of a “Security”: Is There a More Meaningful Formula?”, (1967) 18 W. Res. Law Rev. 367.

<sup>81</sup> See *PacificCoast*, 2 S.C.R 112, at 126; 80 D.L.R. (3d) 529, at 538. For this point see also *Hawaii, ibid.*

<sup>82</sup> *Re George Albino, supra* note 77 at 427.

However, Gillen groups the aforesaid 16 branches into three, to wit, common securities, less common securities and non-exclusive securities.<sup>83</sup> Within the “common” category are included, first, different kinds of shares, and bonds, debentures and other evidence of indebtedness.<sup>84</sup> The expression “other evidence of indebtedness” covers all forms of debt instruments, e.g., loan commitment letters sold for a substantial consideration.<sup>85</sup> Second, it (the common category of securities) covers documents which are evidence of option, subscription or other interest in a security.<sup>86</sup> “An option is a contractual right to purchase or sell a security at a specific exercise price”<sup>87</sup>, e.g., warrants and rights. “Subscription” refers to forms which one can sign up in order to buy securities. The term “other interest” is of very wide scope.<sup>88</sup> Third, the “common” securities also include those which are “commonly known” as securities.<sup>89</sup> There is no well accepted definition of “commonly known” securities. The US Supreme Court laid down a test of determination of such securities, namely the “character the instrument is given in commerce by the terms of the offer, the plan of distribution, and economic inducements held out to the prospect”<sup>90</sup>. For example, a basic pyramid scheme was held

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<sup>83</sup> M.R. Gillen, *Securities Regulation in Canada*, 2d. ed., (Scarborough: Carswell, 1998) at 107.

<sup>84</sup> OSA, R.S.O.1990, c. S.5, s. 1(1) “security” (e).

<sup>85</sup> *U. S. v. Austin*, 462 F. 2d 724 (10<sup>th</sup> Cir.), cert. denied, 409 U. S. 1048 (1972).

<sup>86</sup> OSA, R.S.O. 1990, c. S.5

<sup>87</sup> Alboini, *Securities Law and Practice*, *supra* note 77 at 0-38.

<sup>88</sup> *R. v. Hansen* (1973), 12 C.C.C. (2d) 368 (B. C. Prov. Ct.).

<sup>89</sup> OSA, R.S.O. 1990 c. S.5, s. 1(1) “security” (a).

<sup>90</sup> *SEC v. C.M. Joiner Leasing Corporation*, 320 U.S. 344 (1943) at 352-53, 64 S.Ct. 120 at 124.

to be a security of such kind.<sup>91</sup> The “less common category” includes “items all of which would normally involve an initial payment, which will be used to produce some future returns”<sup>92</sup>, e.g., a certificate of interest in oil, natural gas or mining lease,<sup>93</sup> an income or annuity contract not issued by an insurer<sup>94</sup> and a document evidencing an interest in a scholarship or educational plan or trust.<sup>95</sup> The last category, namely the non-exclusive category, includes the following:

- (i) “a document evidencing title to, or an interest in, the capital, assets, property, profits, earnings or royalties of a person”<sup>96</sup>;
- (ii) “a profit sharing agreement or certificate”<sup>97</sup>;
- (iii) “an investment contract other than investment contract within ”the meaning of the *Investment Contracts Act*<sup>98</sup>.

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<sup>91</sup> *SEC v. Glenn W. Turner Enterprises*, 348 F. Supp. 766 (D. Ore. 1972.).

“A pyramid scheme is a scam. One person (the top of the pyramid) starts it. That person convinces others to give him or her money in exchange for some kind of product or service. Those purchasers are the second level of the pyramid. They recover their money and make a profit by selling the same good or service to more people. The base of the pyramid expands as more people buy into the scheme. Higher levels receive a percentage of sales on lower levels. Eventually, the pyramid collapses, as there is nobody left to invest. When that happens, the people at the bottom of the pyramid lose all of their investment. The person at the top often chooses this time to flee the country with his or her proceeds.” : Johnston and Rockwell, *supra* note 57 at 27.

<sup>92</sup> Gillen, *supra* note 83 at 108.

<sup>93</sup> OSA, R.S.O. 1990 c. S.5, s. 1(1) “security” (j). In *Emery English*, [Jan. 1966] O.S.C.B. 27, the OSC held a sale of a fractional interests in certain oil leases as trading in securities.

<sup>94</sup> *Ibid.*, s. 1(1) “security” (m).

<sup>95</sup> *Ibid.*, s. 1(1) “security” (o).

<sup>96</sup> *Ibid.*, s. 1(1) “security” (b).

<sup>97</sup> *Ibid.*, s. 1(1) “security” (i).

<sup>98</sup> *Ibid.*, s. 1(1) “security” (n).

All of these sub-categories are “sufficiently broad and vague enough to capture all that needs to be regulated” under the *Ontario Securities Act*.<sup>99</sup> Thus documents evidencing “interests in property” may relate to numerous transactions of daily life.<sup>100</sup> They have been judicially interpreted to concern transactions with the purpose of investment only inasmuch as the basic policy objective of the act is to protect the *investing* public.<sup>101</sup> A profit sharing agreement is recognized as being included within the branch of “investment contract”<sup>102</sup> which also remains undefined in the *OSA*. Judicial interpretations of the term have, however, been made in USA and Canada. In *SEC v. C.M. Joiner Leasing Co*<sup>103</sup> the defendant offered leases and assignments that conveyed interest in property. The Court interpreted the transaction as “investment contact” looking into the *nature* of the instrument concerned. It said that “(i)n applying the acts of this general purpose, the courts have not been guided by the nature of the assets back of a particular document or offering. The test rather is what character the instrument is given in commerce by the

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<sup>99</sup> Gillen, *supra* note 83 at 110.

<sup>100</sup> *Supra* note 83 at 110.

<sup>101</sup> *OSC v. Brigadoon Scotch Distributors (Can.) Ltd.*, [1970] 3 O.R. 714, 14 D.L.R. (3d) 38 (Ont. H.C.). In this case warehouse receipts for scotch whisky traded through a broker was held to be a security because the purpose of the purchase was not consumption, rather investment. Earlier, in *R. v. Dalley*, [1957] O.W.N. (C.A.) 123 an agreement evidencing the sale of a fractional interest in the rights of prospecting petroleum and natural gas in a land was held by the Ontario Court of Appeal as a security. It said, “The agreement was designed ... to serve the same purpose as corporate shares would have served..., namely as evidence of title”. (per LeBel J.A.) at 125.

<sup>102</sup> The OSC declined to admit “profit sharing agreement” beyond “investment contract” in *Raymond Lee*, [June 1978] *OSCB* 119 at 125, saying that “Literal application of this clause ... (to designate such agreement a separate branch of security) would expand the application of the Act (*OSA*) into realms limited by the imagination of counsel”.

term of the offer, the plan of distribution, and the economic inducements held out to the prospect".<sup>104</sup> In this respect it (the court) was guided by the broad policy of the *Securities Act, 1933*. It said, "Courts will construe the details of an act in conformity with its dominating general purpose, will read text in light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy".<sup>105</sup> This broad purposive approach has been adopted by courts to interpreting the meaning of "security" in general and "investing contract" in particular. In *SEC v. W.J. Howey Co.*<sup>106</sup> the U.S. Supreme Court had to decide only the question whether a scheme that involved no actual participation of the investor was an investment contract. It set forth a test called *common enterprise* test to determine "whether the scheme involves (1) an investment of money in (2) a common enterprise (3) with profits to come (4) solely from the efforts of others".<sup>107</sup> Subsequently, this test had been applied in a lot of cases in US both at the state and federal levels. One author establishes by research that the *Howey* test is "incomplete or misleading" in that (1) it defies the risk of loss of the initial contribution made by the purchaser; (2) the phrase "common enterprise" is ambiguous (e.g. an organization where there must be more than one investor, whereas the risk of loss may exist even if there is a single investor); and (3) compared to the risk of loss of original investment much emphasis is

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<sup>103</sup> 320 U.S. 344 (1943), 64 S.Ct. 120.

<sup>104</sup> *Ibid.* at 352-353.

<sup>105</sup> *Ibid.* at 350-351.

<sup>106</sup> 328 U.S. 293 (1946).

put on the inducement of future profits whereas the risk is “the single most important economic characteristic which distinguishes a security from the universe of other transactions”.<sup>108</sup> Then the author presents his own formula extending the meaning of “economic realities” of a security.<sup>109</sup> Later, in *State of Hawaii v. Hawaii Market Center*<sup>110</sup> one of the basic questions was whether the minimal participation of the investors in an enterprise would mean that they did not expect profits “solely” from the efforts of others or promoters. The Supreme Court of Hawaii found a problem with the word “solely” used in the common enterprise test established in the *Howey* quoted above. It termed the *Howey* test as “mechanical” to protect the investors and interpreted the word “solely” from broader statutory policy perspective so that investors even with minimal participation in the management of the enterprise be protected. Then it laid down a test for determining the nature of security transaction, which is known as *risk capital* test in line with the definition of “security” proposed by Professor Coffey.<sup>111</sup> That test reads as follows:

An investment contract is created whenever:

- (1) An offeree furnishes initial value to an offeror, and
- (2) a portion of this initial value is subjected to the risks of the enterprise, and
- (3) the furnishing of the initial value is induced by the offeror’s promises or representations which give rise to a reasonable understanding that a

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<sup>107</sup> *Ibid.* at 301.

<sup>108</sup> R.J. Coffey, “Economic Realities of a “Security” : Is There a More Meaningful Formula?”, *supra* note 80 at 374-375.

<sup>109</sup> For Coffey’s definition of “security”, *infra* note 118.

<sup>110</sup> *Hawaii*, *supra* note 80.

<sup>111</sup> *Infra* note 118.

- valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and
- (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.<sup>112</sup>

In *Pacific Coast*<sup>113</sup> the Supreme Court of Canada applied both *Howey and Hawaii* tests in determining whether a particular transaction was an investment contract. It emphasized upholding the policy objective of the *OSA* (i.e. investor protection) in interpreting securities transactions even beyond those tests, if necessary. To quote De Grandpre J.:

It is clearly legislative policy to replace the harshness of *caveat emptor* in security related transactions and courts should seek to attain that goal even if tests carefully formulated in prior cases prove ineffective and must continually be broadened in scope. It is the policy and not the subsequently formulated judicial test that is decisive.<sup>114</sup>

The following definition qualifies the tests discussed above.<sup>115</sup>

An investment contract is a contract whereby a person, having been led to expect profits, undertakes to participate in the *risk* of a *venture* by a contribution of capital or loan, without having the required knowledge to carry on the venture or without obtaining the right to participate *directly* in decisions concerning the carrying on of the venture.<sup>116</sup>

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<sup>112</sup> *Hawaii*, *supra* note 80 at 109.

<sup>113</sup> *Pacific Gold Coast*, *supra* note 80.

<sup>114</sup> 2 S.C.R. 112 at 132.

<sup>115</sup> See Johnston and Rockwell, *supra* note 57, at 30.

<sup>116</sup> *Quebec Securities Act (QSA)*, Q.S. 1982 c. 48, s.1 “an investment contract”(emphasis added).

As appears from this definition, investment in the risk of an enterprise in the management of which the investor does not have any actual control is the chief feature of an investment contract.<sup>117</sup> This is also true of any security transaction in general.<sup>118</sup>

**Trade:**

Like “security”, “trade” is defined inclusively under the *OSA*. In the first place it includes “any sale or disposition of a security for valuable consideration”,

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<sup>117</sup> This basic feature is defined as “economic reality” of a security transaction. For the definition and interpretation of the concept, *supra* notes 80.

<sup>118</sup> See *supra* notes 80 and 90-108 and the accompanying text. Coffey, *supra* note 80 at 377 defines “security” based on the “economic reality” concept as below:

A “security” is:

- (1) A transaction (except an isolated transaction not involving an offering to the public) in which
- (2) a person (“buyer”) furnishes value (“initial value”) to another (“seller”); and
- (3) a portion of initial value is subjected to the risks of an enterprise, it being sufficient if-
  - (a) part of initial value is furnished for a proprietary interest in, or debt-holder claim against, the enterprise, or
  - (b) any property received by the buyer is committed to use by the enterprise, even though the buyer retains specific ownership of such property, or
  - (c) part of initial value is furnished for property whose present value is determined by taking into account the anticipated but unrealized success of the enterprise, even though the buyer has no legal relationship with the enterprise; and
- (4) at the time of the transaction, the buyer is not familiar with the operations of the enterprise or does not receive the right to participate in the management of the enterprise; and
- (5) the furnishing of initial value is induced by the seller’s promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above initial value, will accrue to the buyer as a result of the operation of the enterprise.

whatever may be the modes of payment (i.e., marginal, installment or otherwise).<sup>119</sup> The purchase of a security cannot be said to be a trade within this definition, “at least with respect to distributions of securities”<sup>120</sup> because the object of securities regulation is to regulate the sellers and protect the buyers.<sup>121</sup> “(A)ny sale or disposition” in question refers to both primary and secondary market transactions (of sale or disposition).<sup>122</sup> Secondly, the term, “trade” includes transactions on behalf of others. Within this category are two types of transactions, namely (1) “participation as a floor trader in any transaction in a security upon the floor of any stock exchange”<sup>123</sup> and (2) “any receipt by a registrant of an order to buy or sell a security”<sup>124</sup>. The former refers to a floor transaction on an exchange by an agent of a broker and the latter to a registered dealer’s receipt of an order to buy or sell from a client. The definition of the latter kind of trade confirms that a purchase or an order to purchase a security is not a trade but receipt of an order for purchase is.<sup>125</sup> Penultimately, “trade” includes “transfer, pledge or encumbrancing of securities (by control persons) ... for the purpose of giving collateral for a debt made in good faith”.<sup>126</sup> The last branch of the definition encompasses “any act, advertisement, solicitation,

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<sup>119</sup> *OSA, R.S.O. 1990 c. S.5, s. 1(1) “trade” (a).*

<sup>120</sup> Gillen, *supra* note 83 at 122.

<sup>121</sup> W.W. Cameron, “Regulation and Distribution of Securities in Ontario” (1954) 10 *U.T.L.J.* 199 at 199.

<sup>122</sup> Gillen, *supra* note 83 at 122.

<sup>123</sup> *OSA, R.S.O. 1990 c.S5, s. 1(1) “trade” (b).*

<sup>124</sup> *Ibid.* s. 1(1) “trade” (c) Here “registrant” means a person or company registered or required to be registered” under the *OSA.*: *OSA, ibid.*, s. 1(1), “registrant”.

<sup>125</sup> Alboini, *supra* note 77 at 0-69.

conduct or negotiation directly or indirectly in furtherance of "any of the above mentioned branches of trades."<sup>127</sup> The orbit of this branch is difficult to draw. For its application the basic requirement is that there be some act in furtherance of a trade or, in other words, before the completion of a trade.<sup>128</sup> An offer to sell,<sup>129</sup> providing a list of names of prospective purchasers of a security,<sup>130</sup> advertisements published before and after incorporation of a company with the effect of soliciting the public,<sup>131</sup> etc. are examples of trading within the meaning of this branch. But if an act takes place "after" the completion of a trade, that will not be attracted by the definition.<sup>132</sup>

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<sup>126</sup> *OSA*, R.S.O. 1990 c.S5, s. 1(1) "trade" (d). A person holding more than 20% of the voting securities of the issuer seems to be a control person under section 1(1) "distribution" (c) of the *OSA*.

<sup>127</sup> *OSA*, R.S.O. c.S5, s. 1(1) "trade" (e). As to why this branch has been brought within the definition of "trade" Gillen writes,

The pre-sale process may involve a variety of pre-sale activities before the customer actually buys. The sales pitch may involve various pressure tactics and possibly subtle misrepresentations. There is a risk that the buyer may rely on these pre-sale representations or be influenced by pre-sale pressure tactics. To prevent the potential loss in confidence in the market from such activities, securities acts regulate these activities as well. Gillen, *supra* note 83 at 123.

<sup>128</sup> *Ibid.*

<sup>129</sup> Alboini, *supra* note 77 at 0-67.

<sup>130</sup> *OSC v. Luccis & Co.*, June 1962 O.S.C.B. 1.

<sup>131</sup> *R. v. Golden Shambrock Mines Ltd.*, [1965] O.R. 692, [1965] 3 C.C.C. 72 (Ont.C.A.). The ads were published by a private company. On that ground it was argued that it was not a trade within the meaning of the *OSA*. The court did not accept this because they constituted "a representation intended to induce the person solicited to purchase". Thus "solicitation" to purchase was an act in furtherance of trade (sale).

<sup>132</sup> *Re Ontario Securities Commission and C.A.P. Ltd.*, (1972) 1 O.R. 205 (H.C.). *Cf. R. Sussman*, [March 1993] 16 O.S.C.B. 1209.

It should be noted that all the branches of trade have one common ingredient, to wit, consideration, both actual (e.g., sale) and contemplated (e.g., an offer to sale).<sup>133</sup> Transactions involving such considerations as envisaged by the *OSA* are too many to mention. The Legislature, with the purpose of protecting the investing public in mind, has “chosen to define it (trade) broadly in order to encompass almost *every conceivable* transaction in securities”,<sup>134</sup> in the same vein as it has done with respect to the term of “security” itself.

**Distribution:**

A trade in securities, as defined above, (e.g., sale, disposition, or offered for sale or disposition) will be called a distribution in any of the following circumstances and will give rise to the need of a prospectus:

1. A trade in securities will amount to a distribution if they have not been previously issued.<sup>135</sup> In other words, a person or company issuing securities from treasury will be said to distribute securities and will, therefore, be required to file a prospectus with

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<sup>133</sup> Absent consideration a gift is not a trade.: *Huntingford, W. Thomas and Anchor Machine & Manufacturing Ltd.* (1990), 13 O.S.C.B. 3478.

<sup>134</sup> *R. v. Sussman, supra* note 132 at 20-21. (emphasis added).

<sup>135</sup> *OSA*, R.S.O. 1990 c.S5, s. 1(1) “distribution” (a). In *Durham Securities Corporation Ltd.* there was a distribution of securities in British Columbia. Within two days from the date of completion of the sale a registrant in Ontario purchased a considerable number of those securities mostly from the original purchasers and then resold them to Ontario residents. The OSC disregarded the difference of two days between the original distribution in British Columbia and the resale in Ontario and considered them happening “concurrently”. On this basis it did not view the shares to have been previously issued.

- the OSC for its acceptance. This is the most common type of distribution necessitating a prospectus.<sup>136</sup>
2. If securities, previously issued, have been redeemed or purchased back by or returned to the issuer as gifts and the issuer trades in them ( e.g., resells or offers for resale), it will be a distribution requiring a prospectus<sup>137</sup>. The prospectus is so required because in such cases the issuer “may well have access to information that is not available to the public.”<sup>138</sup>
  3. Where a control person of an issuer releases securities from his or her or its holdings and trades in them, that will amount to a distribution and a prospectus will be required.<sup>139</sup> A “control person” is a person or company or combination of persons or companies who, by holding sufficient number of any securities of the issuer, can materially affect the control of the issuer.<sup>140</sup> A holding of more than 20% of the outstanding voting securities of the issuer is, in absence of evidence to the contrary, deemed to give a person or company the said (“control person”) position.<sup>141</sup> In such a

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Therefore, the sale by the Ontario registrant was held illegal as he did not file a prospectus with the OSC. [Dec. 1990] 13 O.S.C.B. 5109.

<sup>136</sup> Gillen, *supra* note 83 at 124.

<sup>137</sup> OSA, R.S.O. 1990 c. S.5, s. 1(1) “distribution” (b).

<sup>138</sup> Gillen, *supra* note 83 at 125.

<sup>139</sup> OSA, R.S.O. 1990 c. S.5, s. 1(1) “distribution” (c). In *Company X, Re* (1995), 18 O. S. C. B. 797, the Controlling Shareholder, holding 80% of shares, sought exemption from prospectus requirement for sale of rights. The OSC dismissed the application, because the sale constituted a distribution and required filing and delivery of prospectus.

<sup>140</sup> See Johnston and Rockwell, *supra* note 57 at 69..

<sup>141</sup> OSA, R.S.O. 1990 c. S.5, s. 1(1) “distribution” (c). “Voting security” is a non-debt security attaching voting right under all circumstances or under particular circumstances that exist. OSA, R.S.O. 1990 c. S.5, s. 1(1) “voting security”.

case a person to be a control person need not to have actual control. It will suffice if it can be established that his or her position is such that he or she should materially affect control.<sup>142</sup> Thus in *Re Deer Horn Mines Ltd.*, the 14.6% security holder argued that it did not have control, the OSC held it sufficient to materially affect control of the issuer.<sup>143</sup> A prospectus is required of a control person distributing securities with a view to compelling him to disclose information susceptible to the price of securities, which he may have known by virtue of his position in the issuer's company. Otherwise, he might have concealed such information and made unfair profits.<sup>144</sup>

4. As said earlier, exemptions from the prospectus requirement are specified in the *OSA* or *Regulation*<sup>145</sup>, or are granted by the OSC applying its discretionary powers.<sup>146</sup> The rationale for such exemption provisions may be that the purchaser is such a person who does not need the prospectus information for his or her protection. If that purchaser resells his securities, the subsequent purchaser may, however, require such protection. In that case the subsequent sale will be a "distribution" necessitating a prospectus.<sup>147</sup>

Thus, as shown above, the *OSA* defines "security" and "trade" in an inclusive fashion. Also the judiciary, in interpreting them, takes a very broad approach in

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<sup>142</sup> *Merger Report*, *supra* note 72 at 4.02.

<sup>143</sup> [Jan. 1968] O.S.C.B.12.

<sup>144</sup> See Gillen, *supra* note 83 at 126.

<sup>145</sup> *OSAR*, 1990 Reg. 1015, s.14; *OSC Rules*, Rule 46-501.

<sup>146</sup> *OSA*, R.S.O. 1990 c. S.5, s. 74(1). For the rationale of such exemptions, see Gillen, *supra* note 83 at 127.

<sup>147</sup> *OSA*, R.S.O. 1990 c. S.5, s. 1(1) "distribution" and s. 72(4), (5) and (6).

pursuance of the legislative policy of protecting the investing public in consideration of the economic reality of security transactions, namely risk in the investment in an enterprise in which the investor exercises no effective managerial control. In so doing the courts seem to be “oversolicitous” to bring even “doubtful” schemes within the fold of “security”, which the legislature has left undefined.<sup>148</sup> As a result, perhaps there will be found no instance where a person has been refused a remedy because the transaction in question is not a security within the statutory definition.<sup>149</sup> Similarly, “trade” is interpreted broadly.<sup>150</sup> “Distribution” has, however, been defined exclusively to mean any one of the four kinds of issuing of securities as mentioned above.<sup>151</sup> 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, it will be incumbent on the issuer to meet the prospectus requirement. In other words, if there is a distribution of a security, “(t)here can be no question but ...the filing of a prospectus”<sup>152</sup> because “its acceptance by the Commission (OSC) is fundamental to the protection of the investing public”<sup>153</sup>.

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<sup>148</sup> Laskin C.J. in *Pacific Coast Coin Exchange*, *supra* note 80 at 117.

<sup>149</sup> See W.V.R. Smith, “Securities Regulation in Ontario”(1968) 4 *Texas Int’l. L.F.* 454 at 461.

<sup>150</sup> See the text accompanying *supra* note 134.

<sup>151</sup> See the text accompanying *supra* notes 135-146.

<sup>152</sup> Per Henry J. in *Jones v. F.H. Deacon Hodgson Inc.*, [1986] 9 O.S.C.B. 5579 (H.C.), at 5590. In this case the plaintiff purchased some shares from the defendant investment dealer who offered shares for sale as part of a distribution of securities, but no prospectus was filed with the OSC prior to such distribution as required by section 53(1) of the *OSA*. Subsequently the purchaser sought a declaration from the court to the effect that absent prospectus the contract of purchase and sale of securities was void. On that basis he claimed back the money he paid to the defendant as purchase price. Henry J. held the transaction null and void in view of s. 53(1) which clearly prohibits distribution of

### 2.1.3 BANGLADESH

In Bangladesh the *Public Issue Rule (PIR)* defines “prospectus” as “any document prepared for the purpose of communicating to the *general public* a company’s *plan* to offer for sale its *securities*”<sup>154</sup>. According to *The Companies Act, 1994 (CA)*, the issuance of an application form for shares or debentures of a company must be accompanied by a prospectus unless such form is issued (a) in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares or debentures, or (b) in relation to shares or debentures which are *not* offered to the public.<sup>155</sup> Reading this provision together with the prospectus definition it may be simply

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securities without filing a prospectus the purpose being the protection of the investing public. The statutory purpose was the core of his consideration. In his own words, “While the court should be reluctant to interfere with contracts freely made, in this case the overriding consideration is the need to support the fundamental purpose of the statute as a matter of public policy to protect the integrity of the regulatory scheme of the Act;...” (at 5601). A contrast is found in a British Columbia case based on similar facts in which the Court of Appeal declined to hold the non-compliance with the prospectus filing provision of the *British Columbia Securities Act*, S.B.C., 1967, c.45, s. 37, void *ab initio* because that would allow the companies that issued shares without filing prospectus “to escape their obligations to perform their agreements (of sale)”. *Ames v. Investor-Plan Ltd.* (1973), [1973] 5 W.W.R. 451, 35 D.L.R. (3d) 613 (B.C.C.A), at 618. This decision was criticized by a commentator who concluded that “In a case of non-compliance such as *Ames* there is every reason to hold that the purpose of the legislation and protection of the public require that such contracts be declared prohibited and illegal and therefore *voidable* (but not void as in *Jones*) at the option of the purchaser.” (footnote omitted and emphasis added). Stanley M. Beck, “Securities Regulation- Failure to File Prospectus- Validity of Contract- Exclusiveness of Statutory Remedy” comment (1974) 52 Can. Bar Rev. 589 at 598.

<sup>153</sup> *Jones, ibid.* (per Henry J.).

<sup>154</sup> *PIR*, r. 2(d). (emphasis added).

<sup>155</sup> *The Companies Act, 1994* (Act No. 18 of 1994) (hereinafter *CA 1994*), s. 135(3).

put that when a company offers securities to the general public for sale, it must publish a prospectus.<sup>156</sup> From this general requirement the Securities and Exchange Commission (SEC) may, however, grant exemptions.<sup>157</sup> Thus, absent exemptions, an offering of securities to the public for sale requires filing a prospectus with the SEC. The meanings of “securities”, “offer for sale” and “the public” are essential to understand the context of prospectus requirement in Bangladesh.

### **Securities:**

*The Securities and Exchange Ordinance(SEO), 1969* defines “securities” to mean any of the following instruments.

- (a) government securities<sup>158</sup> meaning promissory notes (including treasury bills), stock-certificates, bearer bonds and all other securities issued by the Government except a currency-note<sup>159</sup>;
- (b) instruments which create a charge or lien on the assets of a company.<sup>160</sup>
- (c) instruments acknowledging loan to or indebtedness of a company, e.g., debentures, debenture stock.<sup>161</sup>

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<sup>156</sup> See D. Keenan, *Smith and Keenan’s Company Law*, (London: Pitman Publishing, 1987) at 111.

<sup>157</sup> *Securities and Exchange Ordinance, 1969*, Ordinance No. XVII of 1969, (hereinafter *SEO*), s. 2D(1).

<sup>158</sup> *SEO, 1969*, s. 2(l)(i).

<sup>159</sup> *The Securities Act, 1920* (Act No. X of 1920), s. 2(a).

<sup>160</sup> *SEO*, s. 2(l)(ii).

- (d) Any stock, transferable shares, script, note and bond.<sup>162</sup>
- (e) Investment contract.<sup>163</sup>
- (f) Pre-organization certificate or subscription.<sup>164</sup>
- (g) Any interest or instrument commonly known as “security”.<sup>165</sup>
- (h) Any certificate of deposit for, certificate of interest or participation in, temporary or interim certificate for, receipt for, or any warrant or right to subscribe to or purchase, any of the above.<sup>166</sup>

The types of securities have, as discussed earlier, their counterparts in Ontario law, albeit the latter provides a longer list of securities. However, the most striking point of difference in this respect between the laws of Ontario and Bangladesh is that the former defines securities inclusively while the latter exclusively, i.e., in defining “securities” the *OSA* uses the word “include” but the *SEO* uses “mean”. Therefore, while interpreting “securities”, the Canadian courts (particularly Ontario’s) take a broader view and sometimes define securities beyond the branches named in the *OSA*. In so doing they take into consideration the statutory objective of “investor protection” and the “economic reality” of securities transactions.<sup>167</sup> Like Ontario the securities legislation of Bangladesh

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<sup>161</sup> *Ibid.*, s. 2(a) (iii).

<sup>162</sup> *Ibid.*

<sup>163</sup> *Ibid.*

<sup>164</sup> *Ibid.*

<sup>165</sup> *Ibid.*

<sup>166</sup> *Ibid.*

<sup>167</sup> *Supra* note 80.

has a broad objective of providing protection to the investing public.<sup>168</sup> Needless to say, in both the jurisdictions the nature or the “economic reality” of securities transactions should also be same because the said reality is universally associated with every security transaction. Therefore, it may be argued that in Bangladesh “securities” should be defined and interpreted inclusively alike in Ontario. In other words, the *SEO* should use the word “include” instead of “mean” to define “securities and an amendment to that effect is desirable so that no transactions qualifying the “economic reality” test can be carried on without a prospectus and the investing public can be protected thereby.

### **Offer for Sale:**

In Bangladesh a prospectus is required for the sale of securities of a company.<sup>169</sup> Unlike Ontario, Bangladesh law is silent with regard to the need of a prospectus for the resale of securities, e.g., for resale of securities after buyback by an issuer, resale by a control person.<sup>170</sup> In other words, “offer for sale” of securities in the present context means only an offering of a company’s treasury securities for public sale. Any other disposition of securities (e.g., pledge by a control person as in Ontario) does not require the publication of a prospectus.

### **The Public**

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<sup>168</sup> See the preambles to the *SEO* and the *Securities and Exchange Commission Act, 1993* (hereinafter *SECA*).

<sup>169</sup> *Supra* note 156.

There is no definition in the securities law nor is there any judicial interpretation available in Bangladesh on who constitutes “the public” to the context of securities law. In Canada, as seen earlier, the term “the public” created interpretive difficulties and, therefore, was eliminated from the *OSA* with respect to securities registration.<sup>171</sup> The same is true in Bangladesh.

#### 2.1.4 CONCLUSION

It appears from the foregoing discussion that unlike the Ontario counterpart Bangladesh law defines “securities” very narrowly. It calls for a prospectus when there is a sale of treasury securities, which is the most common form of “distribution” of securities in Ontario. But Bangladesh law falls apart from Ontario law in that the latter requires a prospectus also for secondary offerings (e.g., resale by a control person). Nevertheless, the fundamental points of similarity between the two laws in this respect are that prospectuses perform the same function of making disclosure information to the buyers of securities with the purpose of protecting their interests, and that, unless exemptions are available, prospectuses must have to be filed with the respective securities commissions, namely the OSC and the SEC. It may be noted in this connection that neither of the securities laws of Ontario and Bangladesh does define “disclosure”. *Black’s Law Dictionary* defines it in terms of the securities law as “the revealing of certain financial and other information believed relevant to investors considering buying

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<sup>170</sup> The texts accompanying notes 136-148 *supra*.

securities in some venture”.<sup>172</sup> The basic principle in this regard is that a prospectus must disclose whatever information is required by the law under which it is issued. This was underlined in the English case of *Roussell v. Burnham*.<sup>173</sup> In this suit the defendant company issued a prospectus on 14 Nov. 1906 offering 70,000 shares to the public for subscription. Among others, it mentioned 1000 shares as the minimum subscription upon which the allotment of shares might be made. It also contained a description of the material contracts, which included the names of the parties thereto and their dates, character and effect. On 26 November of the same year a French translation of that prospectus was published, in an abridged form, in a French newspaper, *Le Journal*. In the latter there was missing the statements of, *inter alia*, the amount of the minimum subscription, the names of the parties to and dates of some of the material contracts. It, however, contained a statement which ran, in translated form, as thus- “The company is in a position at once to allot 1000 shares according to the provisions of its articles, but 15,000 shares have already been subscribed”. The plaintiff, a Frenchman, filled out the application form printed in the *Le Journal* seeking an allotment of 700 ordinary shares. He was allotted those shares for which he paid in part. Subsequently, a call for the unpaid money was made, but he declined repudiating the allotment and demanding back the money he paid. The company turned down his request, which gave rise to a litigation. The plaintiff chiefly relied on the ground that the *Le Journal* contained no information about

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<sup>171</sup> *Supra* note 73..

<sup>172</sup> *Black's Law Dictionary*, 6th ed., s.v. “disclosure”.

<sup>173</sup> (1909) 1.Ch. 127 at 131 (per Parker J.).

the minimum subscription upon which directors might proceed to allot shares under s. 4 of the *Companies Act, 1900*. He also pleaded that the prospectus in question should be the one on which he actually relied; that the defendant had published another prospectus which fulfilled the statutory requirements was immaterial. The defendant based its defense on that it thought the plaintiff, when applied, relied on the real prospectus instead of the advertisement in the French newspaper. The Court, however, upheld the plea of the plaintiff. Parker J. interpreted the above quoted statement (“The company is in a position at once to allot 1000 shares...”) as to suggest that the minimum subscription on which the directors could go to allotment 1000 shares, but he doubted if such an implied statement amounted to name the minimum subscription. He underlined the importance of naming the minimum. He observed that

But even if there is such an implication as is suggested, I do not think it would be a sufficient compliance with the Act. The provision is inserted for the protection of applicants for shares, that they know the extent of the risk which they run having regard to the old practice of going to allotment where no sufficient capital has been provided for working expenses. .... it appears to me that the statement which the Legislature contemplated was an express statement, and not one which can be implied or inferred from other statements in the prospectus.<sup>174</sup>

In other words, Parker J. underscored that whatever information is asked by the law must be disclosed by an issuer in its requisite form or fashion. In *R. v. Garvin*<sup>175</sup>, a newspaper ad, instead of providing full information required by the *Companies Act, 1907*<sup>176</sup>, stated

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<sup>174</sup> *Ibid.* at 132-133.

<sup>175</sup> 18 O.L.R. 49.

<sup>176</sup> S.O. 1907, c. 43.

the name of a mining company, the nature of the mining claims owned by it (the company), the names of the directors, etc. directing the public that “For full particulars apply to J.W. Garvin & Co.... or to any well known Toronto brokers”. This was held to be a prospectus within the meaning of s. 95 of the Act. But since it did not contain all requisite information, the court held it be a violation of the Act. Merdith CJ. maintained that “it (prospectus) shall contain the information which the Act (*Ontario Companies Act, 1907*) requires to be inserted in a prospectus”.<sup>177</sup>

The next Sub-Sections will examine the extent of disclosure and the role of the securities commissions in each jurisdiction.

## **2.2 PROSPECTUS DISCLOSURE AND THE ROLE OF THE OSC AND THE SEC: THEORETICAL BASES**

### **2.2.1 INTRODUCTION**

Since prospectus regulation in Ontario and Bangladesh is the centrepiece of the present work, it is necessary to look into the theoretical assumptions underlying the laws of the respective jurisdictions. It will help to understand on what rationales are based the respective laws of Ontario and Bangladesh. The loopholes and shortcomings of laws originate from the defects of the underlying theories and, therefore, any reform to the laws needs re-thinking of those theories. Thus before going into the comparative study of the

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<sup>177</sup> *Supra* note 175 at 55.

legal provisions concerning prospectus regulation it is necessary to inquire into their theoretical rationales. To quote Eagleton, where the “taken-for-granted activities begin to falter, log-jam, come unstuck, run into trouble,...theory proves necessary”<sup>178</sup>.

The theories underlying the laws of Ontario and Bangladesh are presented below in brief followed by the history of their adoption in the respective jurisdictions.

### 2.2.2 CENTRAL MESSAGE OF THE THEORIES

In Canada (and, therefore, in Ontario) securities regulation in general and prospectus regulation in particular are based on the fusion of two theoretical flows, namely the disclosure theory and blue sky theory.<sup>179</sup> Bangladesh corporate and securities law is underpinned by the disclosure theory. The United Kingdom (UK) and the United States of America (USA) are the birth places of the disclosure and blue sky theories respectively.<sup>180</sup>

The disclosure theory posits that the sale of securities by a corporation be allowed without governmental or administrative interference provided full disclosure of information concerning the securities is made to the prospective investors. The first and foremost end served by this theory is to provide information to the investors and thereby to make them independent in making their investment decision in light of the information

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<sup>178</sup> Terry Eagleton, *The Significance of Theory*, (Oxford, UK: Cambridge, Mass. USA: Basil Blackwell, 1990) at 26.

<sup>179</sup> Goulet, *supra* note 16 at 79.

<sup>180</sup> J.P. Williamson, *The Securities Regulation in Canada*, (Toronto: University of Toronto Press, 1960) at 4 and 11.

disclosed by the issuer. The government or government agent entrusted with the responsibility of overseeing the securities markets, namely the securities commission, is required to ensure that such disclosure is made. It does not, in a paternalistic manner, determine the merit of the offerings and thereby not decide for the investors as to whether investment should be made or not.<sup>181</sup> Thus while the United States of America (USA) at the federal level opted for this theory as the basis of the *Securities Act of 1933*<sup>182</sup>, the then President Franklin D. Roosevelt emphasized that “(t)here is ... an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.”<sup>183</sup> The ultimate purpose is to “to protect the public with least possible interference to honest business”.<sup>184</sup> “The purpose of the whole (disclosure system) is to provide an equality of opportunity for all investors in the market place, to sellers as well as buyers.”<sup>185</sup> As such, through disclosure of information an open and transparent market would be established where the potential

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<sup>181</sup> Gorder, with respect to disclosure review, writes, “[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.”: G. Gorder, “Compromise Merit Review- A Proposal for Both Sides of the Debate”, (1984) 60 Wash. L. Rev. 141 at 143 note 14.

<sup>182</sup> 15 U.S.C. 77a (1995).

<sup>183</sup> 77 *Cong. Rec.* (March 29, 1933), at 955 (Message from President Franklin D. Roosevelt).

<sup>184</sup> *Ibid.*

<sup>185</sup> *Merger Report, supra* note 72 at para. 2.01.

investors, in order to own a security, would compete with each other to reach an “equilibrium price”. This “equilibrium price”, also called “accurate price”<sup>186</sup>, “should reflect as nearly as possible the security’s ‘intrinsic value’”.<sup>187</sup> In other words, if a security’s price reflects its fundamental value, it will be called an accurately priced security. Such a security, in turn, ensures “that (investment) capital is properly allocated, and this is good for society in general”<sup>188</sup>.

The blue sky theory, on the other hand, postulates that the merit of securities be assessed by the securities commission or concerned government body applying its discretion before the securities are offered to the public for sale. On its judgment of merit it should refuse permission for sale if it considers it (the sale) against 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”<sup>189</sup>. The purpose of blue sky legislation is, like that of disclosure law, to protect the investors, but in a “paternalistic” manner.

### **2.2.3 HISTORY AND RATIONALE FOR THE ADOPTION OF THE THEORIES IN ONTARIO AND BANGLADESH**

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<sup>186</sup> See R. A. Robertson, “In Search of the Perfect Mutual Fund Prospectus”, (1999) 54 Bus. Law. 461 at 468-69.

<sup>187</sup> A. R. Rodier, “Prospectus Disclosure Under the Proposed Securities Act in Ontario: Problem in a Changing Environment”, (1985) 23 U.W.O.L.Rev.21 at 23.

<sup>188</sup> Robertson, *supra* note 186 at 468.

### 2.2.3.1 Ontario

The concept of corporate disclosure dates back to the 19<sup>th</sup> century English history of company law following the repeal of the *Bubble Act, 1720*<sup>190</sup> in 1825<sup>191</sup> which

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<sup>189</sup> Iacobucci, *supra* note 78 at 229.

<sup>190</sup> 6 Geo. 1, c. 18, cited in L. C. B. Gower, *Principles of Modern Company Law*, 5th ed. (London: Sweet & Maxwell, 1992), at xlvii.

<sup>191</sup> Securities regulation in the sense of provisions concerning the licensing of brokers was first introduced in 1285 by the a statute of Edward I. By the end of 17<sup>th</sup> century share trading and stock-broking were common in London. In 1697 the legislature passed “An act to restrain the number and ill practice of brokers and stock-jobbers.” : 8 & 9 Wm. 3 (1697) c. 32, quoted in L. Loss, *Fundamentals of Securities Regulation* , (Boston and Toronto: Little, Brown and Company, 1983) at 1. During first and second centuries of the 18<sup>th</sup> century mushroomed the number of companies. Of them the most influential was the South Sea Company which was granted monopoly by the British Government to trade with South America and the Pacific Islands. The company flotations boom is popularly called the “south sea bubble”. Fraudulent stock promotion by such companies (including the South Sea Companies) were rampant. In order to check this “gambling mania” the Parliament, instigated by the South Sea Company, passed the *Bubble Act* in 1720. Gower, *ibid.* at 25. It declared mischievous undertakings void and illegal (s. 18), and imposed penalties on brokers dealing in securities of illegal companies (s. 21). see, Gower, *ibid.* at 26. However, the passage of the *Bubble Act* left an adverse impact on the business of South Sea Company alongside the business of other speculative enterprises, though the real purpose of this statute was “not to tone down a speculative boom in shares of other joint stock companies but to reduce their competition with South Sea Company for public funds”. Goulet, *supra* note 16 at 83. The public lost confidence in the stock market, which caused a meteoric fall of the share prices of the South Sea Company. The Company could not recover from this position and ultimately it along with its contemporaries burst out like bubbles in the sea. A poem reflects on the fate of the South Sea Company and its contemporaries, and their effect on the then society as follows:

“The Bubbles now are banished from the Light,  
And hide their heads in Realms of Endless Night.  
Life vanishes away like to a Dream  
And what is now become of the South Sea Schemes.”

A Gideonette ,*The Art of Stockjobbing*,(London: 1746, G.L.P.C., XVIII-46-3, quoted in Armand Budington, *The English Business Company after the Bubble Act 1720-1800*, (New York: The Commonwealth Fund, 1938) at 24.

was the “first attempt at a Company Act”<sup>192</sup> in England. In fact, the *Joint Stock Companies Act of 1844*<sup>193</sup> was first to provide for the “modern prospectus requirement”<sup>194</sup> and thereby to introduce a mechanism of disclosure as a “safeguard against fraud”<sup>195</sup>. Through this legislation “(m)odern securities regulation began in England”<sup>196</sup>. 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.<sup>197</sup> In the following year the *Directors’ Liability Act*<sup>198</sup>, 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 (which was subsequently introduced in the USA as blue sky Law discussed below) and ultimately rejected it after a Commission report that said:

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<sup>192</sup> Gower, *supra* note 190 at 26.

<sup>193</sup> 7 & 8 Vict. C. 110 & 111, cited in Gower, *supra* note 190.

<sup>194</sup> Loss, *supra* note 191 at 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 Gower, *supra* note 190 at 39.

<sup>195</sup> Gower, *supra* note 190 at 39.

<sup>196</sup> Williamson, *supra* note 180 at 4.

<sup>197</sup> *Derry v. Peek* (1889), 14 A.C. 337 (H.L.).

Your Committee may observe that they have dismissed from their consideration every suggestion for a public enquiry by the registrar or other official authority, into the soundness, good faith, and prospects of undertaking at this or any other stage of a company's formation. To make any such investigation into the position of every new company complete or effectual would demand a very numerous staff of trained officers, and lead to great delay and expense, while an incomplete or perfunctory investigation would be worse than none. It 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.<sup>199</sup>

The *Companies Act of 1900*<sup>200</sup> followed, which contained greater disclosure requirements. This Act, after amendment in 1907, was replaced by the *Companies (Consolidation) Act of 1908*<sup>201</sup> further widening the scope of disclosure. To quote Mulvey:

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.<sup>202</sup>

“The English experience through 1908 laid the basis for Canadian legislation”<sup>203</sup> Securities regulation in Canada started in the guise of corporate legislation in late 1870s.<sup>204</sup> Particularly, Ontario introduced securities regulation in 1891 by adopting

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<sup>198</sup> 53 & 54 Vict. C. 60, cited in Gower, *supra* note 190, at xlviii.

<sup>199</sup> One clause of the Report Cd. 7779, 1895, quoted in T. Mulvey, “Blue Sky Law”, (1916) 36 Can. L. T. 37 at 45.

<sup>200</sup> 63 & 64 Vict. C. 48, cited in Gower, *supra* note 190 at xlviii.

<sup>201</sup> 8 Edw. 7, C. 69, cited in Gower, *supra* note 190 at xlviii.

<sup>202</sup> *Ibid.*

<sup>203</sup> *Supra* note 180 at 8.

<sup>204</sup> Goulet, *supra* note 16 at 84.

the English *Directors' Liability Act of 1890*<sup>205</sup>. In 1897 it required the delivery of financial statements to the shareholders.<sup>206</sup> In 1907 *Ontario Companies Act*<sup>207</sup>, based on the English *Companies Act of 1900*<sup>208</sup>, was passed. It provided for wider scope of prospectus disclosure compared to the English act.<sup>209</sup> In 1912 the Ontario act introduced, among others, a provision of public offerings by underwriters.<sup>210</sup> After 1912, the “blue sky” legislation discussed below was added to the disclosure legislation of Canada in general and Ontario in particular.

Blue sky law<sup>211</sup> was first introduced in the state of Kansas of United States in 1911.<sup>212</sup> In *Hall v. Geiger-Jones Co.*<sup>213</sup> it was stated that the aim of the law was to

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<sup>205</sup> *Ibid.* at 85.

<sup>206</sup> *Ibid.*

<sup>207</sup> S.O. 1907 c. 43.

<sup>208</sup> *Supra* note 201.

<sup>209</sup> Goulet, *supra* note 16 at 85..

<sup>210</sup> *Ibid.*

<sup>211</sup> It is not certain 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. A Canadian author, for example, in an attempt to define blue sky law wrote:

The State of Kansas, most wonderfully prolific and rich in farming products, has a large population of agriculturists not versed in ordinary business methods. This State was the hunting ground of promoters of fraudulent enterprises; in fact their fraud became so barefaced that it was stated that they would sell building lots in the blue sky in simple. Metonymically they became known as blue sky merchants, and legislation intended to prevent their frauds was called Blue Sky Law. *supra* note 199 at 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,

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

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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 360 n. 59. The authors vetted some other materials, but failed to find the exact time and place of the origin of the term. At last they reached the conclusion, though “highly speculative”, that

the phrase could not have been newly minted in 1910 without some explanation appearing in the historical record. Since the term evidently came out of Kansas, it seems most likely that it had long been in use there to describe some other type of fraudulent conduct outside the securities area, most likely fraudulent land promotions during pioneer days, and was simply borrowed for the context of securities fraud laws. (at 360)

<sup>212</sup> 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 5 and 7. The Kansas statute came into force after the Populist Party had won election in 1910. In that election J.N. Dolley, a retired grocer and a bank director, gave support to and worked hard for the said party. In recognition to his contribution Dolley was appointed Bank Commissioner by the newly elected government. With the knowledge that many “unsophisticated” investors had lost much money in dealings in fraudulent securities he initially established a department in his office to carry out investigation into publicly offered securities. People intending to invest in a particular security were advised 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. To gain better result Dolley felt that his department should have the power to register securities and securities salesmen and that power should be backed by a statute. Then followed the Kansas act effective from 15 March 1911, which was known as “An Act to provide for the Regulation and Supervision of Investment Companies and providing penalties for the violation thereof”. T. Mulvey, *Canadian Company Law*, (Montreal: John Lovell & Son Ltd., 1913) at 733.

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<sup>214</sup> and save the people from losing money in fraudulent or “blue sky” concerns.<sup>215</sup> A company, if registered, was obliged to submit semi-annual reports and to maintain various records with the Commissioner who could cancel the registration for “sufficient” cause.<sup>216</sup> Thus the Commissioner “fathered the paternalistic approach to state security regulation”<sup>217</sup>.

Later on, the concept of “blue sky law” became popular and entered other jurisdictions of 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

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<sup>213</sup> 37 S.Ct. 217 (1916) at 221-222.

<sup>214</sup> “ But, if said bank commissioner finds that such articles of incorporation or association, charter, constitution and by-laws, plan of business or proposed contract, contain any provision that is unfair, unjust, inequitable or oppressive to any class of contributors, or if he decides from his examination of its affairs that said investment company is not solvent and does *not* intend to do a *fair and honest business*, and in his judgment does *not* promise a *fair return* on the stocks, bonds or other securities by it offered for sale, then he shall notify such investment company in writing of his findings, and it shall be unlawful for such company to do any further business in this state... .”: *Kan. L. 1911*, c. 133, s.5, quoted in Loss and Cowett, *supra* note 212 at 8 n. 24.(emphasis added)

<sup>215</sup> J.N. Dolley revealed that “I estimate that it (Kansas Blue Sky Law) has saved the people of this state at least six million dollars since its enactment”. : The report of the State Banking Commissioner, published Sept. 1, 1912, quoted in *supra* note 172 at 38. But “(t)here were no statistics or other evidence in the office of the Bank Commissioner in May, 1913, upon which such a statement could be founded”. Mulvey, *supra* note 199 at 39.

<sup>216</sup> *Supra* note 180 at 12.

<sup>217</sup> Loss and Cowett, *supra* note 212 at 9.

passage of the *Sale of Shares Act of 1912*<sup>218</sup> which was “an exhibition of paternalism”<sup>219</sup> 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*<sup>220</sup>. 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.<sup>221</sup>

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”<sup>222</sup> within and without, Ontario passed the *Securities Act of 1945*<sup>223</sup> which was, in fact, the first modern security statute for Canada.<sup>224</sup> It followed the *Urquhart Report*<sup>225</sup> prepared in 1944. The striking feature of

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<sup>218</sup> S.M. 1912, c. 75.

<sup>219</sup> Mulvey, *supra* note 212 at 734.

<sup>220</sup> S.O. 1928, c. 24.

<sup>221</sup> Goulet, *supra* note 16 at 88.

<sup>222</sup> Williamson, *supra* note 180 at 30.

<sup>223</sup> S.O. 1945, c. 22.

<sup>224</sup> *Supra* note 222.

<sup>225</sup> *Report of the Royal Ontario Mining Commission, 1944 (Urquhart Report)* In early 1940s the Ontario government paid special attention to mining industry given its prominent role in the economy and formed this commission headed by N.C. Urquhart, a director of Noranda Mines, to study problems it was facing . It found out, *inter alia* , that lack of government encouragement and failure of the prevailing securities act to prevent frauds were the main causes of decline of the mining industry in Ontario. Its main recommendation was to repeal the existing securities legislation and enact a new act with provisions relating to, among others, full, true and plain disclosure of information to the investing public and curbing down the powers of the Securities Commission. The Ontario Legislature, however, accepted its disclosure motif only, and rejected the proposal about circumscribing the OSC. M. G. Condon, *Making Disclosure: Ideas and Interests in Ontario Securities Regulation*, (Toronto: University of Toronto Press, 1998) at 17-24.

the act is that it adopted full, true and plain disclosure provision<sup>226</sup> on the one hand, and entrusted the Ontario Securities Commission (OSC) with a *discretion* to enforce that provision, on the other.<sup>227</sup> The discretion provision, in addition to disclosure, allowed the

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<sup>226</sup> *OSA, 1945, c.22, s. 49(1)* lays down the disclosure provision as follows-

No broker or salesman shall trade in any security either on his own account or on behalf of a person or company where such trade would be in the course of a primary distribution to the public of the security until,

- (a) a clear and concise statement in the form prescribed by the regulations dated and signed by every person who is, at the time of the filing, a director or promoter of the person or company issuing the security or an underwriter or optionee of the security, containing a *full, true and plain* disclosure of all material facts including details of all options and any other information that may be prescribed by the regulations, has been filed with the Commission and a written receipt therefor received from the registrar; (emphasis added). .....

(b)

<sup>227</sup> *Ibid.*, s. 52 provides for the discretionary power of the OSC as follows:

The Commission may in its *discretion* accept for filing any statement or correcting statement, balance sheet, profit and loss statement or report submitted for filing under section 49 and direct the registrar to issue a receipt therefor unless it appears to the Commission that,-

- (a) the statement or any balance sheet, profit and loss statement or report which is required to accompany the statement,
  - (i) fails to comply in any substantial respect with any of the requirements of section 49;
  - (ii) contains any statement, promise or forecast which is misleading, false or deceptive; or
  - (iii) has the effect of concealing material facts;
- (b) an unconscionable consideration has been paid or given or is intended to be paid or given,

OSC “to enter the realm of *substantive* regulation of issues of securities”<sup>228</sup>. Thus for the first time, through this enactment, a compromise between the disclosure and blue sky theories was worked out by the Ontario Legislature. This rendered the act “more than a

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- (i) for promotional purposes; or
- (ii) for the acquisition of property; or
- (c) the proceeds from the sale of the securities which are to be paid into the treasury of the company, together with other resources of the company, are insufficient to accomplish the objects indicated in the statement; or
- (d) such escrow or pooling agreement as the Commission deems necessary or advisable with respect to securities issued for a consideration other than cash has not been entered into.

This discretion provision has been retained in the subsequent amendments of the act with some additional situations of exceptions. A literal interpretation of the section may lead to the conclusion that if the exceptional situations existed, the OSC would not have any discretion, rather it must refuse to accept the prospectus: see Baillie, “The Protection of the Investor in Ontario”, (1965) 8 Can. Pub. Adm. 172 at 220. This interpretation has some inherent problems with regard to the exercise of the discretion by the OSC director. Baillie, while interpreting the discretion provision contained in s 44 of the *OSA*, R.S.O. 1950, c.351 said, “ since many of the circumstances are matters of opinion rather than determinable fact, it makes jurisdiction dependent upon his own state of mind, although he is the person exercising the jurisdiction; and it places upon him the responsibility for deciding new criteria, other than the circumstances spelled out in the section, upon the basis of which to exercise his discretion.” Baillie, (1965) 8 Can. Pub. Adm. 172 at 220. Then he refers to the OSC’s perception that “it has a discretion only as to the existence of the circumstances” specified in the section. (at 220). However, the purpose of such discretion is to “insure from the outset that the public offering is being made on a fair and equitable basis”. : O.E. Lennox, “Securities Legislation and Administration”, in Law Society of Upper Canada, *Special Lectures- Company Law*, (Toronto: Richard De Boo Limited, 1950) 81 t 85.

<sup>228</sup> Baillie, *ibid.*, at 175.

full disclosure statute”<sup>229</sup>. Recently an author has reflected on this development as

follows:

Disclosure of corporate information to shareholders had been a feature of company legislation prior to 1945. The significance of the Securities Act of that year lay in the fact that power to enforce the provision of information to prospective investors in the course of a primary distribution of securities was granted to an administrative agency. The 1945 act was the first piece of securities legislation in Canada to adopt as a guiding principle the requirement that those wishing to make an initial distribution of securities to the public provide ‘full, true and plain disclosure’ of all material facts relating to the issue. The OSC then had to embark on the task of forging its authority and identity in this new realm of administrative activity, involving control over issuers of securities as well as market intermediaries.<sup>230</sup>

The aforementioned new theoretical standing of Ontario, which may be coined as the “Amphibianism”, has been carried forward to underpin the subsequent legislative changes till today. After 1945, the most remarkable reform to the *OSA* occurred in 1966 at the backdrop of securities scandals<sup>231</sup> of 1960s as they were worthy of “commanding substantial public attention”<sup>232</sup>. Before the amendment, several Commissions were formed to study different problems having bearing, direct or indirect,

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<sup>229</sup> *Ibid.* at 232.

<sup>230</sup> Condon, *supra* note 225, at 41.

<sup>231</sup> Two events taking place in early sixties may be referred to. The first concerned the insider trading of Canadian Oil Company’s shares before its takeover by Shell Oil in 1962 in absence of any law governing insider trading. Second, there was a decline in the price of shares of Windfall Oils and Mines Ltd. in July, 1964. The price fell from \$5.60 to 80 cents in one day whereas it rose from 65 cents only at the beginning of that month “amid rumours of an important mineral find in the area near Timmins, Ontario, ... which proved false.” Both the events “underlined the principle that a free and efficient marketplace could operate only in an atmosphere of full public disclosure”. Toronto Stock Exchange (TSE), *Toward an Ideal Market* (Toronto: TSE, 1983) at 15-16.

on the securities market. Those Commissions in their reports<sup>233</sup>, despite the differences of their investigation areas, emphasized commonly on more disclosure provisions in the *OSA*, though they linked it (disclosure) to different regulatory objectives.<sup>234</sup> Thus disclosure was suggested as “a testament to its versatility as a regulatory strategy”<sup>235</sup>. While underlining the importance of disclosure as a means of attaining the various regulatory objectives, all but the *Kimber Report* refused to concede a role to the OSC anything more than a facilitative one.<sup>236</sup> The *Kimber Report* advocated for broader discretionary powers of the OSC. For example, it suggested that the OSC be granted powers to refuse acceptance of a prospectus for filing by a company if it (the company)

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<sup>232</sup> Condon, *supra* note 225 at 55.

<sup>233</sup> *Report of the Royal Commission on Banking and Finance (Porter Report)*, (Ottawa: Queen’s Printer, 1964), *Report of the Attorney General’s Committee on Securities Legislation in Ontario (Kimber Report)*, (Toronto: Queen’s Printer, 1965), *Report of the Royal Commission to Investigate Trading in the Shares of Windfall Oils and Mines Limited (Kelley Report)*, (Toronto: Queen’s Printer, 1965), and *Report of the Royal Commission Appointed to Inquire into the Failure of Atlantic Acceptance Corp. (Hughes Commission)*, (Toronto: Queen’s Printer, 1969). Porter Commission’s main concern was to review the functioning of the financial system of Canada. Securities market was a component of the broad subject of inquiry. In its study the Commission focused on the development of the secondary securities markets with emphasis on the public confidence so that stock ownership increase. Kimber Committee was entrusted with a study to review the “the provision and working of securities legislation in Ontario” in general and to look into the problems of takeover bids, insider trading, degree of disclosure, etc. in particular. The Kelley Commission was constituted to find out what caused the fall of share price of the Windfall Oils and Mines Ltd. in 1964, and whether there was any breach of the law. The Hughes Commission embarked on an inquiry into the activities and bankruptcy of the Atlantic Acceptance corporation.

<sup>234</sup> The *Porter Report* connected it with increased ownership of shares and investor protection, *Kimber* with public confidence and market efficiency, *Kelley* with public protection and *Hughes* with public confidence and stability. Condon, *supra* note 225 at 62-63.

<sup>235</sup> Condon, *supra* note 225 at 63.

fails (a) to provide insider trading reports,<sup>237</sup> (b) to comply with the requirements of annual and interim reporting<sup>238</sup> and (c) to comply with proxy provisions.<sup>239</sup>

The rationale of the *Kimber Report's* proposal for broader powers of the OSC may be sought in its argument for its (OSC's) independent status as an administrative agency instead, under the erstwhile arrangement, of its subordination as a branch of the Department of the Attorney General.<sup>240</sup> It argued that such relationship might be justified during the early years of the securities legislation when its (securities legislation) main purpose was the prevention of frauds.<sup>241</sup> It observed that "(t)he *administration* of securities legislation should not be directed primarily to criminal and quasi-criminal law enforcement but rather to the enhancement of the position of the

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<sup>236</sup> *Ibid.* at 63.

<sup>237</sup> *Kimber Report, supra* note 233 para. 2.31(e).

<sup>238</sup> *Ibid.* ara. 4.07(f).

<sup>239</sup> *Ibid.* para. 6.27(f).

<sup>240</sup> The OSC, established in 1937, was a component of several government bodies like the Legislature and the Department of the Attorney General. It was converted into a branch of the latter alone by securities act amendments of 1962-63. Such subordinate status of the OSC accompanied different hazards in its smooth functioning. For instance, it could not appoint experienced people from the security industry because the rules of the parent department concerning recruitment and salary did not permit so. Secondly, people had to face hassles in discharging their official responsibilities. Investigation procedure is worth mentioning. When a concerned OSC personnel wanted to make investigation, he or she had to have an order from the Attorney General in that respect. On completion of the investigation the decision of framing charges depended on the Director of Public Prosecutions. The OSC's recommendations in this regard were not heeded to always. : See Baillie, *supra* note 227, at 211-12 and n. 152. However, in 1966 the OSC was set up as an independent government agency following the recommendation of the *Kimber Report*. It is now a corporation without share capital. It, as an agent of Her Majesty the Queen in right of Ontario, is entitled to exercise its powers. It is an administrative tribunal. It has been given more autonomy with self-finance in June 1997. : See *OSA*, ss. 3(1), 3(12), 141(1), and *OSC 1997-Annual Report, supra* note 53 at 2.

securities industry in the economic life of the province”<sup>242</sup>. Simply stated, the *Kimber Report* envisaged that the OSC have a broader role primarily meant for the improvement of the securities industry. To that end it seemed to have suggested for the said discretionary powers as the administrative mechanism of the OSC. Condon maintains this view in interpreting the *Kimber Report*:

Since these discretionary powers could operate as controls over the activities of corporations or industry members, it may be assumed that Kimber, in rejecting the use of ‘criminal and quasi-criminal law enforcement,’ saw discretionary sanctioning powers as *more* effective tools to achieve ‘the enhancement of the position of the securities industry in the economic life of the province.’<sup>243</sup>

Ultimately, in spite of the antipathy of the other reports for discretionary powers side by side with disclosure, the *Kimber Report’s* recommendations blending the two (disclosure and discretion) were accepted by the legislature and the *Securities Act of 1966*<sup>244</sup> was passed.<sup>245</sup> Thus “Amphibianism”, introduced in 1945, and reinforced and

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<sup>241</sup> *Kimber Report, supra* note 233 para. 8.03.

<sup>242</sup> *Ibid.* (emphasis added).

<sup>243</sup> Condon, *supra* note 225 at 74-75. (emphasis added).

<sup>244</sup> OSA, S.O. 1966, c.142.

<sup>245</sup> The OSA of 1966 has thus been commented to be “the faithful conversion of the (Kimber) report’s recommendations” H.S. Bray, “Recent Developments in Securities Administration in Ontario: The Securities Act, 1966” in J.S. Ziegel, ed., *Studies in Canadian Company Law*, vol. I (Toronto: Butterworths, 1967) 415, at 418. Following the 1966 *Ontario Securities Act* amendments have been effected to the securities legislation in other provinces. Hence, the *Kimber Report* is said to form the foundation of the modern securities regulation in Canada, “even though it did not provide any greater degree of permanence or of uniformity than the earlier instance of Ontario’s leadership in 1930”. : P. Anisman, “The Regulation of Securities Market”, in R. Cumming, ed., *Harmonization of Business Law in Canada*, (Toronto: University of Toronto Press, 1986) at 78 (footnotes omitted).

confirmed in 1966, was retained as the theoretical base of modern securities law of Ontario and also of other provinces of Canada.<sup>246</sup> As to why the legislature of Ontario has accepted this theoretical position Johnston writes-

Presumably the legislative draftsman sought what he conceived to be the best of both worlds: the director should not be made to appear as an implied guarantor of the success of a promotion but the statute should ensure that he retains the power to nip in the bud a venture which he had reason to believe would be wasteful and not financially viable.<sup>247</sup>

Thus the legislature has intended to give the investing public the benefits of the both theories. It enacted the *OSA* primarily as a disclosure statute requiring the OSC to emphasize disclosure so that the investors can make their own investment decisions.<sup>248</sup> The OSC is not allowed generally to decide, on behalf of the investors, the merit of an offering and thereby to provide full paternalistic protection to them.<sup>249</sup> It may interfere only in extreme cases affecting public interest.<sup>250</sup> If the OSC were granted the full blue sky jurisdiction, it would encounter at least two formidable problems. First, the OSC would have to appoint experts of various fields concerned with security. "The result would be an economy heavily subject to public regulation, to a much greater extent than Canadians have been accustomed."<sup>251</sup> Second, since the public would rely on its

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<sup>246</sup> For the brief history of adopting "Amphibianism" in other provinces of Canada, see Goulet, *supra* note 16, at 83-89.

<sup>247</sup> D.L. Johnston, *Canadian Securities Regulation*, (Toronto: Butterworths, 1977), at 159.

<sup>248</sup> See the text accompanying *infra* note 511.

<sup>249</sup> See the text accompanying *infra* note 511.

<sup>250</sup> See the text accompanying *infra* note 510.

<sup>251</sup> *Supra* note 247, at 160.

judgment, it could claim compensation from the OSC in the event of such assessment proving wrong with resultant loss to the public.<sup>252</sup>

However, under the new theoretical arrangement the investing public is not totally deprived of the advantage of merit determination. For this purpose it may rely on the underwriter<sup>253</sup> of an issue who passes on the soundness of the issue before entering into an (underwriting) agreement<sup>254</sup> with the issuer. An underwriter does not take the prospectus disclosures as true. He rather is supposed to check and confirm the truth in them. Based on extensive inquiry he then certifies the completeness and accuracy of the information disclosed in the prospectus.<sup>255</sup> A good underwriter will, after such inquiry, underwrite an issue of a company “with a solid record of earnings, good management, and better than average growth prospects”<sup>256</sup>. He does so because his success in the security world depends on “a reputation for making good investment

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<sup>252</sup> *Supra* note 247, at 19.

<sup>253</sup> 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.” : *supra* note 16, at 586.

<sup>254</sup> “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 16, at 586. An agreement by the underwriter of a firmly underwritten issue is know “underwriting agreement”, whereas a best efforts underwriter’s agreement as “agency agreement” : *supra* note 16, at 217.

<sup>255</sup> See the text accompanying *infra* note 463.

<sup>256</sup> E. L. Winter, *A Complete Guide to making a Public Stock Offering*, (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1962, at 28.

recommendations”.<sup>257</sup> Because of this role the underwriter is called “the gatekeeper of public interest”.<sup>258</sup> But the fact of the underwriter’s role does not nullify the need of blue skying by the OSC. There may be circumstances requiring administrative interference. For example, the OSC may require officers’ and directors’ or promoters’ shares to be held in escrow and may impose an embargo on the transfer of shares without its permission so that they can equally share the risk in the market with the shareholders.<sup>259</sup> Administrative interference may also be necessary to impose limits on the underwriting commission, if it is not fixed by law.<sup>260</sup> In addition, such interference may be necessary where a unreasonable advantage is given to the underwriter by the issuer, e.g., the issuer may agree to sell securities to the underwriter, in the event of the issue being undersubscribed, at a price less than the public offering price.<sup>261</sup> Probably in contemplation of such situations the legislature felt the need to equip the OSC with discretionary powers in respect of prospectus registration with a view to ensuring that “the public offering is being made on a fair and equitable basis”<sup>262</sup>. As to how the OSC is equipped to accomplish the given task Bray writes,

(t)he legislation provides the body, the regulations the clothing, while life and purpose are given to the whole by the guide lines within which the Commission (OSC) exercises its discretionary powers. These guide lines

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<sup>257</sup> *Ibid.*, at 28-29.

<sup>258</sup> *Supra* note 16 at 238.

<sup>259</sup> See the text accompanying *infra* note 311 and 312.

<sup>260</sup> W.M. Prifti, *Securities: Public and Private Offerings*, (St. Paul, Minn.: West Publishing Co., 1974), at 42.

<sup>261</sup> See *ibid.* at 36 and 40.

<sup>262</sup> Lennox, *supra* note 227.

are to be found in its published decisions and policy declarations. ...since 1949.<sup>263</sup>

### 2.2.3.2 Bangladesh

Bangladesh is a component of erstwhile British India. During their 200-year reign the British introduced their laws and legal system in this colony.<sup>264</sup> When they wound up their Rule in 1947, two countries, India and Pakistan, came into being under the *Indian Independence Act of 1947*<sup>265</sup> with the same laws and legal system. East Pakistan, the eastern wing of Pakistan, achieved independence as the People's Republic of Bangladesh in 1971. After independence, it adopted all laws that were in force on the day of declaration of independence, 25 March 1971, by the *Laws Continuance Enforcement Order, 1971*. Thus Bangladesh succeeded the laws and legal system of English or common law origin which were adopted in the Indian sub-continent.<sup>266</sup>

After independence, in the area of corporate and securities laws Bangladesh adopted *The Companies Act, 1913*<sup>267</sup>, *The Capital Issues (Continuance of Control) Act, 1947*<sup>268</sup> and *Securities and Exchange Ordinance, 1969*<sup>269</sup>. Of them *The Companies Act, 1913* was the almost verbatim reproduction of the (English) *Companies*

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<sup>263</sup> Bray, *supra* note 245, at 447.

<sup>264</sup> For the details of the Indian legal system, see V.D. Kulshreshth, *Landmarks in Indian Legal and Constitutional History*, (Lucknow: Eastern Book Company, 1981); M.P. Jain, *Outlines of Indian Legal History*, (Bombay: N.M. Tripathi Private Ltd., 1972).

<sup>265</sup> 10 & 11 Geo. VI c. 30.

<sup>266</sup> See, for a brief account of the Bangladesh laws and legal system, A.B.M. Mafizul Islam Patwari, *Legal System of Bangladesh*, (Dhaka: Humanist and Ethical Association of Bangladesh, 1991).

<sup>267</sup> Act No. VII of 1913.

<sup>268</sup> Act No. XXIX of 1947.

(*Consolidation*) Act of 1908.<sup>270</sup> Since the latter, as described above, was based on disclosure theory, the former had the same basis. *The Capital Issues Act, 1947* was passed by the British authority during the second World War “to channelize investment into war related industries”<sup>271</sup>. *The Companies Act 1913* contained provisions concerning the contents of a prospectus while *The Capital Issues Act* provided the procedure of its approval by the Controller of Capital Issues (CCI). With regard to approval, however, there occurred a shift from the original position of English law. If an issuer filed a prospectus with required contents, the CCI, as a policy, reviewed the merit of the issue.<sup>272</sup> This approval procedure continued even after the repeal of *The Capital Issues Act* in 1993, when the Securities and Exchange Commission (SEC)<sup>273</sup> was established in place

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<sup>269</sup> *Supra* note 157.

<sup>270</sup> *In re Mirza Ahmed*, 1924 *M.W.N.* 582 cited in Patwari, *supra* note 266, at 77.

<sup>271</sup> M.F. Ahmed, *Stock Market Behavior in Bangladesh*, (Dhaka: Bureau of Business Research, University of Dhaka, 1992), at 12.

<sup>272</sup> See *ibid.*, at 15.

<sup>273</sup> Before 1993 the securities market in Bangladesh was regulated jointly by the Controller of Capital Issues, the Registrar of Joint Stock Companies, the Bangladesh Bank and the Chief Controller of Insurance. The development of the capital market was faltering under that system. For instance, as of 31 December 1989 the market capitalization of securities in proportion to the Gross National Production (GNP) stood only 2.5%, whereas it was 9% in India. The administration was in a very lax state. The investors got neither the information about the present financial position nor of the future prospects of the companies. The companies did not even file their annual financial statements to the stock exchanges. Nor did they allot shares timely in the event of initial offerings. All these and others sapped down the investors confidence in the securities market. Given these circumstances it was felt necessary to establish a single body to regulate the security industry in Bangladesh. This gave the way to the *Securities and Exchange Commission Act, 1993* under which the Securities and Exchange Commission (SEC), the present regulatory body, was established. SEC, a corporation without share capital, is the administrative tribunal with respect to the security industry in Bangladesh. : see *supra* note 271, at 22-24.

of the CCI through passage of the *Securities and Exchange Commission Act, 1993*.<sup>274</sup> In the same year an amendment was brought to the *Securities and Exchange Ordinance, 1969* incorporating the provision of prospectus approval procedure as contained in *The Capital Issues Act, 1947*.<sup>275</sup>

After the establishment of the SEC in 1993 it was expected that it would be able to effectively regulate the share market. But that expectation remains unfulfilled mainly because of the fact that it is composed mostly of retired civil servants without knowledge of or experience in regulation of securities market.<sup>276</sup> Hence, from the very beginning it was the subject of public criticism, e.g. it takes an unreasonably long time to review a prospectus<sup>277</sup>, its assessment of an issuer's financial projections very often turns out to be wrong<sup>278</sup>, and its officers registering securities are corrupt<sup>279</sup>. The criticism culminates with the occurrence of the 1996 share market scam.<sup>280</sup> With this backdrop the Government of Bangladesh directed its attention to improving the share market and, to that end, adopted the Capital Market Development Program (CDMP) supported by the

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<sup>274</sup> Act No 15 of 1993.

<sup>275</sup> The amendment was made by the *Securities and Exchange (Amendment) Act, 1993* (Act No. 16 of 1993). By this amendment sections 3-8 of *The Capital Issues Act, 1947* were inserted, in effect, as sections 2A-2F into the *Securities and Exchange Ordinance, 1969*.

<sup>276</sup> See the *Muktokantho* (a Bengali national daily), (17 July 1998) at 9.

<sup>277</sup> *Supra* note 38.

<sup>278</sup> *Supra* note 39.

<sup>279</sup> *Supra* note 40. Also see *supra* notes 41-43 and the accompanying texts.

<sup>280</sup> *Supra* note 11.

loan of the Asian Development Bank (ADB).<sup>281</sup> The SEC paid heed, with regard to primary market reform, to the following finding of the *ADB Report*:

Market participants claim that there is considerable delay in securing approval for IPOs from SEC. This is caused principally by SEC still applying a system based on merit regulation, insisting on fixing the price of new securities issues. A large number of applications have been stuck up in processing, at one point reaching as many as 60 proposed IPOs.<sup>282</sup>

As such, the SEC has given up its policy of merit regulation and has adopted instead the full disclosure philosophy as the basis of securities regulation in Bangladesh.<sup>283</sup>

#### 2.2.4 CONCLUSION

Bangladesh followed the blue sky theory of securities regulation until 1998. Since then it has radically changed its theoretical position and has been following the disclosure theory. On the other hand, Ontario law is based on a mixture of the disclosure theory and the blue sky theory. Both the jurisdictions have taken their respective stands to boost public confidence in the markets. The theoretical position of Bangladesh advocates that investment decisions be made by the investors themselves in light of the information disclosed and that the securities commission do not interfere under any situations. The latter, however, requires that while the investors decide their own fate considering the disclosures the securities commission be vigilant at the same time, lest public interests be hampered. Thus the fundamental distinction between the

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<sup>281</sup> *Supra* note 10.

<sup>282</sup> *Supra* note 10, at 13-14.

theoretical footings of Ontario and Bangladesh centers around the role of the respective securities commissions apropos of prospectus registration.

## **2.3 PROSPECTUS DISCLOSURE AND THE ROLE OF THE OSC AND THE SEC- COMPARISON OF THE LAWS**

### **2.3.1 INTRODUCTION**

In this Sub-Section a discussion will be undertaken, from a comparative perspective, of the laws of Ontario and Bangladesh relating to prospectus disclosure and the role of the respective securities commissions. The basic rules of disclosure are considered first. Second, prospectus contents and their enforcement provisions are compared. Finally, a comparative discussion of the role of the OSC and the SEC with regard to prospectus disclosure is made.

### **2.3.2 PROSPECTUS DISCLOSURE**

#### **2.3.2.1 Basic Rules of Disclosure**

Section 56 of the *OSA*<sup>284</sup> contains two basic principles of prospectus disclosure. First, a prospectus must provide “full, true and plain” disclosure of all

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<sup>283</sup> The texts accompanying *supra* notes 44 and 45.

<sup>284</sup> *OSA*, R.S.O. c. S.5, as am. S.O. 1994, c. 11, s. 367.

“material facts” concerning the securities issued or proposed to be distributed.<sup>285</sup> 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.”<sup>286</sup> 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,<sup>287</sup> 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 manner. Second, the prospectus must comply with the requirements of the *OSA*<sup>288</sup>, and must contain or be accompanied by financial statements, reports or other documents that are required by the *OSA* or regulations.<sup>289</sup> This means that a prospectus must, in order to fulfill 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.<sup>290</sup>

Unlike the *OSA*, the securities regulation in Bangladesh does not lay down any general provision relating to prospectus disclosure requirements. While it requires an issuer to publish a prospectus to offer securities to the public, it does not clearly say how

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<sup>285</sup> *Ibid.*, s. 56(1).

<sup>286</sup> *OSA*, R.S.O c. S.5, s. 1(1) “material fact”.

<sup>287</sup> See *Ontario Securities Act Regulation (OSAR)*, R.R.O. 1990, Regulation 1015, Forms 12-15.

<sup>288</sup> *OSA*, R.S.O. c. S.5, as am. S.O. 1994, c. 11, s. 367, s. 56(1).

<sup>289</sup> *Ibid.*, s. 56(2).

<sup>290</sup> See Alboini, *supra* note 77, at 15-11.

much disclosure the issuer should make through the prospectus. With regard to the responsibility of the SEC in this connection the *PIR*, however, provides that the SEC shall “ensure that full and fair disclosures are made in the prospectus... .”<sup>291</sup> From this provision it may be gathered that an issuer is obligated to make full and fair disclosure and the SEC shall ensure it only. However, the meaning of “full and fair disclosure” is not defined. The word “full” meaning “complete”<sup>292</sup> also occurs, as seen above, in the general (prospectus) requirement principle of Ontario law. The word “fair” does not appear in the said Ontario principle which instead contains the words, “true and plain”, in addition to “full”. Does the Bangladesh requirement of “full and fair” disclosure stand, in the same sense, for the Ontario’s “full, true and plain” disclosure? Kinney’s *Law Dictionary* uses the word “fair” to mean “Just; equitable; equal; proper”<sup>293</sup> and *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.”<sup>294</sup> In the present context, having regard to the policy reason of disclosure provision (investor protection)<sup>295</sup>, it may be argued that it would be appropriate

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<sup>291</sup> *PIR*, r. 7.B(i).

<sup>292</sup> J. Kendrick Kinney, *Law Dictionary and Glossary*, (Colorado: Fred B. Rothman & Co., 1987), s.v. “full”.

<sup>293</sup> *Ibid.* s.v. “fair”.

<sup>294</sup> *Supra* note 172, s.v. “fair”.

<sup>295</sup> This interpretation is based on the principle of interpretation that “(a) statute should be construed to harmonize with the intention of the Legislature and the aim and object of the statute.” *Re Ontario Securities Commission and Brigadoon Scotch Distributions (Canada) Ltd.*, (1970) 3 O.R. 714, at 717 (per Hartt J.) quoting Maxwell as follows:

to take “fair” to mean “just” or “proper” or “impartial and honest”, each of which is synonymous or close to synonymous with the word “true”. But neither of the dictionaries uses “fair” to connote “plain” or clearly understandable, a word that occurs in the general principle of Ontario law. Thus it may be said that the phrase “full and fair” disclosure under Bangladesh law means full and true disclosure, but not plain disclosure.

But full and true disclosure of what? Although there is no general provision in Bangladesh law as in Ontario law in this regard, the *PIR* provides at one place that

In addition to the information specifically required by this rule, the prospectus shall contain all *material information* necessary to enable investors and their investment advisers to make an informed assessment of the business engaged in, or to be engaged in, by the company, its assets and liabilities, its financial position, its profits and losses and its future prospects and the rights attaching to the securities being offered...<sup>296</sup>

The draftsman has specified a set of information<sup>297</sup> necessary for the purpose of enabling the investing public to make investment decisions and has kept it open for the issuer to include all other information provided it is “material” for the same purpose. In other words, the draftsman has specified that information which, in his opinion, is “material”

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The true meaning of any passage, it is said, is to be found not merely in the words of that passage, but in comparing it with other parts of law, ascertaining also what were the circumstances with reference to which the words were used, and what was the object appearing from those circumstances which the legislature had in view. : Maxwell on *Interpretation of Statutes*, 11<sup>th</sup> ed. (1962), at 19.

<sup>296</sup> *PIR*, r. 7.A.(1). (emphasis added).

and has made it obligatory for the issuer to include in the prospectus all “material” information which is in the knowledge of the issuer but was not visualized by the draftsman at the time of making the law. Thus it may be argued that all information, both specified and unspecified, must be “material” for the decision-making by the investors. In other words, in Bangladesh a prospectus must make full and true disclosure of all material information.

The *PIR* refers to the purpose of “material information”, but does not define the term. As stated above, the purpose of such information is to help the investors assess the issuer’s business, assets and liabilities, financial position and so on, but what is the ultimate effect of such assessment? After assessment of the issuer’s business, etc. in light of the information disclosed in a prospectus, if an investor thinks it to be profitable to make an investment in securities, the investor can be expected to purchase the securities offered at a fixed price. But if the assessment gives them a different idea (i.e., the investment would not be profitable), an investor may not be prepared to invest at all. Thus the “material information” has direct bearing on the price or value of securities offered by the issuer and, therefore, resembles the term “material fact”<sup>298</sup> defined by the *OSA*.

Like the *OSA* the *CA* enjoins every issuer to comply with the form and contents of prospectus prescribed by it. Under the merit review system the *CA* was the

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<sup>297</sup> For discussion of the specific information required by the *PIR*, see Section 2.3.2.2, below.

<sup>298</sup> See the text accompanying *supra* note 286.

only the law providing for prospectus form and contents. But it does not provide for full disclosure. To bridge up this gap the *PIR* has been made. It is a piece of delegated legislation and, therefore, subordinate to the *Companies Act, 1994*.<sup>299</sup> With respect to prospectus disclosure these two should be read together.

In view of the foregoing discussion it may be concluded that with regard to the first general rule the laws of Ontario and Bangladesh differ in that while Ontario law requires full, true and plain disclosure, Bangladesh law calls for, in effect, full and true disclosure only but not plain disclosure. Apropos of the second rule, namely compliance with the securities regulation, the laws of Ontario and Bangladesh are similar.

### **2.3.2.2 Contents of Prospectus**

The *OSA* prescribes four different forms for different types of companies specifying, in particular, various non-financial matters to be contained in a prospectus. Those are forms 12, 13, 14 and 15, applicable to industrial, finance, natural resources and mutual funds companies respectively. It also calls for financial statements and reports to be added in the prospectus.<sup>300</sup> In Bangladesh, as aforesaid, Parts I and II of Schedule III of the *CA* in combination with the *PIR* provide the form and contents of a prospectus, both non-financial and financial. The SEC may, however, ask for information in addition to

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<sup>299</sup> While the *Companies Act, 1994* is enacted by the legislature the *Public Issue Rules (PIR)* is made by the SEC “(i)n exercise of the powers conferred (on it) by section 33 of the Securities and Exchange Ordinance, 1969 (Ordinance XVII of 1969), and in suppression of all guidelines and orders made in this behalf ...”. :The Preamble to the *PIR*.

<sup>300</sup> *Supra* note 288.

that provided in a prospectus filed by an issuer for its approval.<sup>301</sup> The following will compare the contents of a prospectus in Bangladesh with those of an Ontario prospectus of an industrial company, which is prepared according to Form 12<sup>302</sup>, because Form 12 is the most commonly used format in Ontario.<sup>303</sup> The purpose of this section is to show whether both laws, though broadly requiring full disclosure, provide for the disclosure of similar categories of particular information.

#### **2.3.2.2.1 Non-financial Matters**

The prospectuses in Ontario and Bangladesh contain some broad categories of information-items.<sup>304</sup> In the following unnecessary details of the items similar in both laws will be avoided; rather emphasis will be placed on the differences between them.

#### **Category I: Share, Price, Market And Underwriting**

With regard to this category both the laws, despite some minor differences, are similar principally as follows:

- (a) Under the Ontario law the first page of a prospectus must set out the selling price, underwriting discounts or commissions and proceeds to the issuer both per unit and in

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<sup>301</sup> *PIR*, r. 7.A.(2).

<sup>302</sup> *OSAR*, R.R.O. 1990, Regulation 1015, s. 40.

<sup>303</sup> See *supra* note 57, at 73.

<sup>304</sup> For the broad categorization of items occurring in Form 12, see *supra* note 57, at 75-76.

total amount.<sup>305</sup> In Bangladesh the same information is asked to be disclosed in the cover page of a prospectus.<sup>306</sup> The main purpose of this item is to help the potential investors assess the degree of risk involved in the issue offered. For example, investors can assess risks involved in an issue from the underwriting commissions stated in a prospectus. It is a principle of determining underwriting commission that “the more difficult the issue is to sell, the larger will be the percentage of the issue proceeds paid to the underwriter for his services”<sup>307</sup>.

- (b) Both laws ask for description of shares, debt obligations or any other securities being offered by the prospectus. For example, Ontario law requires that the prospectus must provide an account or specification of the class of shares offered, together with the details about various rights attaching to them, viz. dividend rights, voting rights, liquidation or distribution rights, pre-emptive rights, conversion rights, redemption rights, provision as to variation of these rights and liability to further calls by the issuer.<sup>308</sup> If any of these rights is subject to any restriction or qualification imposed by any rights of any other class of securities, information of such other securities must be furnished in the prospectus.<sup>309</sup> Bangladesh law calls for description of similar rights to and limitations on shares being offered.<sup>310</sup>

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<sup>305</sup> OSAR, R.R.O. 1990, Regulation 1015, Form 12, Item 1-Distribution Spread.

<sup>306</sup> PIR, r. 7.B.(1).

<sup>307</sup> P. E. McQuillan, *Going Public in Canada*, (Toronto: The Canadian Institute of Chartered Accountants, 1971), at 118..

<sup>308</sup> OSAR, R.R.O. 1990, Regulation 1015., Form 12 Item 17(a).

<sup>309</sup> *Ibid.*, Form 12 Item 17 Ins. 2

<sup>310</sup> PIR, r. 7.B.(18).

(c) An Ontario prospectus is required to provide information about sale of the securities among the sponsors (e.g. directors and officers of the issuer company).<sup>311</sup> In this respect, it also requires disclosure of particulars of escrowed shares. The particulars include classes of the shares held in escrow, their designation, number and percentage. The name of the depository, and the date of and the conditions of the release of the shares from escrow must be disclosed.<sup>312</sup> It may be noted that shares held in escrow cannot be transferred without the OSC's permission. In Bangladesh a description of securities sold to the sponsors is required.<sup>313</sup> Such securities are subject to a lock-in period for three years from the date of publication of a prospectus or from the start of commercial operation, whichever is later.<sup>314</sup> By virtue of this provision securities held by the issuer's promoters, directors and officers are kept in abeyance for three years. During that period such persons are prohibited from freely transferring their shares. They have to bring the fact of any transfer of such securities to the knowledge of the SEC within seven days of such transfer.<sup>315</sup> This is to prevent any sudden unloading of a huge number of securities held by the sponsors who are in a better possession of market information (including issuer's inside information) compared to the general investors. This mechanism keeps the SEC informed of any transactions made by the sponsors, which may help it detect if any insider trading has

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<sup>311</sup> OSAR, R.R.R. 1990 Regulation 1015, Form 12 Items 24 and 28.

<sup>312</sup> *Ibid.*, Item 25.

<sup>313</sup> PIR, r. 7.B,(14)(b).

<sup>314</sup> PIR, r. 9.

<sup>315</sup> Order No. SEC/Section-7/98-136.

taken place. It may be noted that the lock-in provision like the screw provision of Ontario evidences that the SEC has some blue sky jurisdiction in this regard, albeit it relates mainly to the control of the secondary securities market.

- (d) In Ontario Item 26 of Form 12 requires a disclosure of the names, addresses and holdings of the principal holders of each class of voting securities<sup>316</sup>. A principal shareholder means a shareholder (a person or company) who owns of record and/or beneficially,<sup>317</sup> directly or indirectly, more than 10% of any class of voting securities. If any such shareholders are affiliates<sup>318</sup> or associates<sup>319</sup> of the any other person or company, details about such relationship must be disclosed.<sup>320</sup> In addition, the prospectus must disclose the percentage of each class of voting securities held, directly or indirectly, by the issuer's directors and senior officers, as a group, without specifics about them. The purpose of such disclosure is to inform the public how the principal shareholder(s) will control the voting of the issuer and thereby save them

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<sup>316</sup> Section 1(1) of the *OSA*, R.S.O. 1990, c.S.5 defines voting security as "any security other than a debt security of an issuer carrying a voting right either under all circumstances or under some circumstances that have occurred and are continuing."

<sup>317</sup> Voting shares held by a person or company as a trustee for the benefit of the children of a settler of the trust may be an example of beneficial ownership of shares.

<sup>318</sup> E.g., a company which is a subsidiary of some other company or both are controlled by same person or company.: see Goulet, *supra* note 16, at 563.

<sup>319</sup> E.g., relative, spouse of a person, or a partner of a person or company.: see *OSA*, s. 1(1).

<sup>320</sup> The purpose of asking for such information is to unearth the identity of any person or company who controls the principal shareholder. Therefore, it has 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 *Tricor Holdings Co. Ltd.*, [October 1988] 11 *OSCB* 4059 at 4088.

from manipulation, the primary purpose of securities laws.<sup>321</sup> In Bangladesh similar kinds of information are asked where a person owns, beneficially or of record, 5% or more of the securities of the company.<sup>322</sup> There is no provision calling for the disclosure of the relationship where such a principal shareholder is an affiliate or associate of any other person or company.

- (e) Item 2 of Form 12 requires setting out of the plan of distribution, that is, whether securities are being offered through underwriters or by the company as a security issuer. If they are offered through underwriters, the prospectus must name them, describing briefly the nature of their obligations to take up and pay for the securities, specifying the date by which they will do that.<sup>323</sup> The prospectus must disclose whether the underwriters, as principals, are committed to take up and pay for all of the securities, or whether they, as agents under a “best efforts” arrangement, will take up and pay for only such securities as they may sell to the public.<sup>324</sup> If the underwriting, based on firm commitment or “best efforts” method, is subject to a “market out” clause, the prospectus must contain a statement to that effect.<sup>325</sup> A “Market out” clause is a statement to the effect that the underwriter’s obligation may be terminated

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<sup>321</sup> *Tricor Holdings Co. Inc., ibid.*

<sup>322</sup> *PIR*, r.7.B.(14).

<sup>323</sup> *OSAR*, R.R.O. 1990, Regulation 1015, Form 12 Item 2(a).

<sup>324</sup> *Ibid.* Ins. 1. “A “best efforts offering” is an offering of securities of an issuer by an underwriter, acting as agent, which agrees to use its best efforts to sell the securities, but which is not bound to purchase any securities for its own account and normally does not guarantee the successful placement of all of the offered securities”.: Goulet, *supra* note 16, at 565.

at its own depending on the market condition or otherwise. From this item the investors can know of the type of underwriting and thereby determine the risk in their investments. When it is a “best efforts” issue, the investors may find “generally more risk”<sup>326</sup> in purchasing the securities, “since the underwriter has no contractual obligation which might help to steady, at least temporarily, an after-market price”.<sup>327</sup> Similarly, although a “market out” clause in a prospectus has become pretty much standard in Canada, it may be a matter of concern for the investors in apprehension of the fate of their investments after the termination of the underwriter’s obligations.

In Bangladesh a company making an IPO is required to appoint one or more underwriters to underwrite the securities on a firm commitment basis.<sup>328</sup> A prospectus must refer to the name(s) of the underwriter(s), followed by a guarantee by the directors of the underwriters financial ability to meet their obligations.<sup>329</sup> It does not require any “market out” clause. Although from these provisions it seems to appear that Bangladesh law does not envisage “best efforts” underwriting, a close reading of clause 5(a) of Schedule III Part I of *CA, 1994* reveals that there is scope of “best efforts” underwriting as well. Clause 5(a) requires that where securities are offered to the public for subscription, the prospectus must state “the *minimum amount* which in the opinion of the directors or of the signatories of the memorandum must be raised by the issue of those

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<sup>325</sup> *OSAR*, R.R.O. 1990, Regulation 1015, Form 12 Item 2 Ins. 2, supplemented by National Policy No. 12.

<sup>326</sup> P. E. McQuillan, *supra* note 307, at 119.

<sup>327</sup> *Ibid.*

<sup>328</sup> *PIR*, r. 15.

shares ... .”<sup>330</sup> A statement of minimum amount requirement in a prospectus is made when an issue is underwritten on best efforts basis. Thus in explaining Item 5 (the “Use of Proceeds” derived by the issuer from the sale of the securities) one Canadian author writes, “If the offering is not firmly underwritten, but is a best efforts offering, the *minimum amount* required to accomplish the purposes in the prospectus must be specified, ...”<sup>331</sup>. This means that when an issue is fully underwritten, there is no question of “minimum amount”. From this discussion it may be concluded that in Bangladesh law there is scope for making both firm commitment and best efforts underwritings.

### **Category II: Summary Of Prospectus**

Item 4 of Ontario Form 12 underlines the need of a summary of information contained in the body of the prospectus. It is usually given immediately after the cover page. The summary must highlight the merits and risks of the investment.<sup>332</sup> This includes risk factors and the governing state of affairs of the issuer of the securities.<sup>333</sup> The summary page is usually followed by a table of contents of the prospectus which can lead the readers to the text. Bangladesh law, on the other hand, does not provide for inclusion of any summary in the prospectus. In practice, however,

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<sup>329</sup> CA, sch. III pt. I cl. 11.

<sup>330</sup> *Ibid.*, cl. 5(a) (emphasis added).

<sup>331</sup> *Supra* note 16, at 145. (emphasis added)

<sup>332</sup> OSAR, R.R.O. 1990, Regulation 1015, Form 12 Item 4 Ins. 1.

<sup>333</sup> *Ibid.*

“Summarized Information” is provided, though in very short compared to Ontario. Such information includes particulars of the company, risk factors and use of proceeds.<sup>334</sup>

### **Category III: Use Of Proceeds**

Item 5 of Form 12 requires a prospectus to bear a statement of the estimated net proceeds after deducting the underwriting costs, which the issuer will gain from the sale of securities to be offered. As well, be it a firmly underwritten or a best efforts offering, it is required to reasonably specify the principal purposes for which the said proceeds are intended to be used and the roughly estimated amount for each purpose. In case the actual proceeds are insufficient to serve those purposes, a statement is necessary defining how the funds will be used along with the order of priority of their use.<sup>335</sup> If any other funds, in a material amount, are to be applied concurrently with the sale proceeds, the amount and sources of those other funds must be made public.<sup>336</sup> Although Bangladesh law asks for an account of how the company will use the net sale proceeds to meet the purposes of an offering, be it a firmly underwritten offering<sup>337</sup> or

<sup>334</sup> See *prospectus*, Samata Leather Complex Limited, *The Daily Star* (a national daily), (29 June 1998) 17.

<sup>335</sup> OSAR, R.R.O. 1990, Regulation 1015, Form 2 Item 5 Ins. 2.

<sup>336</sup> *Ibid.*, Ins. 3.

<sup>337</sup> *PIR*, r. 7.B. (4)(a). For instance, the prospectus of Samata Leather Complex Limited discloses the utilization of the IPO proceeds, in the Summarized Information, as follows:

<u>Particulars</u>	<u>Tk. in .000</u>
Plant, machineries and equipments	20,000
Working Capital	27,600
Preliminary and IPO expenses	4,000
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best efforts offering<sup>338</sup>, it lacks any provisions requiring an explanation of how they will be expended to fulfill the purposes in order of priority in the event of a shortage of funds compared to the actual needs.

Under Ontario law, where any material amount of the sale proceeds is designed to be used to meet indebtedness, the prospectus must clarify the use of the debt money provided that money was borrowed within two years back from the date of the issue.<sup>339</sup> If a material part of the said proceeds is to be expended to acquire assets outside the ordinary course of business, it must give a brief description of the particulars of such assets, their purchase price and their vendors.<sup>340</sup> If the securities partially constitute the consideration for acquisition of any of such assets, it must also provide, *inter alia*, “brief particulars of the designation, number or amount, voting rights (if any)”<sup>341</sup>. By contrast, Bangladesh law does not contain any provision calling for disclosure of the use of debts where the proceeds will be expended to repay such debts. Also, it does not require the particulars of any assets, if purchased with the money raised by the sale of securities. However, it asks for the disclosure of the terms of contracts covering the company

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Total Utilization of Fund.... 51, 600, *supra* note 334. One recent prospectus merely states, without details, that “The proceeds will be utilized for expanding our banking business over a period of two years. : *prospectus*, Prime Bank Limited, (Dhaka: 29 August 1999), at 5.

<sup>338</sup> CA 1994, sch. III pt. I, cl. 5(a).

<sup>339</sup> *Ibid.*

<sup>340</sup> *Ibid.* Ins. 4.

<sup>341</sup> *Ibid.*

affairs, such as land purchase.<sup>342</sup> Where any property is purchased and any part of the consideration consists of securities, Bangladesh law, like its Ontario counterpart, requires that particulars of the vendors, the amount so payable in kind, nature of title or interest in that property, etc. must be disclosed.<sup>343</sup>

Item 5(b) requires a prospectus to embody a statement of “the particulars of any provisions or arrangements made for holding any part of the net proceeds of the issue in trust or subject to the fulfillment of any conditions”. In compliance with this requirement, if an offering is a best efforts one, the prospectus must mention the required minimum amount, and any subscriptions received must be held by a trust company or other acceptable depository until the minimum amount is received<sup>344</sup>. The purpose of such provision is to assure the investors that if the minimum subscription is not received within a particular time limit stipulated in the contract between the trust company and issuer, the investors money will be returned.<sup>345</sup> Bangladesh law does not, however, provide for depositing of subscription funds in any depository until the minimum amount is received and, therefore, there is no system of returning money to the subscribers when a particular issue is undersubscribed.

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<sup>342</sup> *PIR*, r. 7.B.(4)(c).

<sup>343</sup> *CA 1994*, sch. III pt. I, cl. 12(1).

<sup>344</sup> *OSC Policies*, s. 5.1.

<sup>345</sup> *Ibid.*

Where the issuer is a related issuer<sup>346</sup> or connected issuer<sup>347</sup> of the underwriter, an Ontario prospectus must disclose what type of relationship or connection exists between the issuer and the underwriter and how much of the sale proceeds of securities “will be applied, directly or indirectly, for benefit of the underwriter or any related issuer of the underwriter”<sup>348</sup>. A cross-reference to Item 30 must also be made in this connection. It requires, *inter alia*, details about the amount of indebtedness and security for it, “where the issuer has any indebtedness to the underwriter or any related issuer of the underwriter and that indebtedness is the basis on which the issuer is a connected issuer of the underwriter”<sup>349</sup>. Though there is no similar specific provision in Bangladesh law, it contains a general provision calling for information about any loan taken by the issuer, either from a subsidiary or associate concern or from any *other* party

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<sup>346</sup> The term “related issuer” has been defined to mean, “in respect of a person or company,

- (a) any other person or company that influences the person or company,
- (b) any other person or company that is influenced by the person or company,
- (c) any other person or company in like relation to a person or company referred to in clause (a) or (b) or any such other person or company, or
- (d) any person or company designated by the (Ontario Securities) Commission as a related issuer of the person or company in accordance with subsection 220(1)”:  
OSAR, R.R.O., Regulation 1015, s. 219.

<sup>347</sup> “Connected issuer” is defined to mean, “in respect of a registrant, an issuer that has, or any related issuer of which has, any indebtedness to, or other relationship with, the registrant, a related issuer of the registrant, or a director, officer or partner of the registrant or a related issuer of the registrant, that, in connection with a distribution of securities of the issuer, is material to a prospective purchaser of the securities”. : *Ibid.*

<sup>348</sup> *Ibid.* Form 12 Item 5(c).

<sup>349</sup> *Ibid.* Form 12 Item 30 Ins. 2.

or parties, giving full details of all related parties to the transaction.<sup>350</sup> The words “any other party” may include the underwriter or any other person or institution having control over the underwriter. Thus this provision seems to have the same effect of the Ontario’s related or connected issuer provision, but it lacks the methods of meeting such indebtedness.

In summary, Bangladesh law requires the disclosure of the methods and purposes of the use of proceeds and thereby conforms to Ontario law. However, it lacks provisions that require the depositing of the subscription money in a trust company for returning to the investors in the event of a “best efforts” issue being undersubscribed.

#### **Category IV: Risk Factors**

To help investors clearly comprehend the risks involved in and the speculative nature of the investment enterprise, the *Ontario Securities Act Regulation* requires disclosure of the factors that render the investment in securities a risk or speculation.<sup>351</sup> Such factors include relevant government regulations, environmental requirements, the risk of product liability, the necessity for and possible shortage of further funding and so on.<sup>352</sup> Such factors are mentioned in the Summary and then detailed under a separate caption.<sup>353</sup> Likewise, Bangladesh law requires disclosure of the risk factors to the potential investing public, which include, among others, poor financial

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<sup>350</sup> *PIR*, r.1.B.(7)(7).

<sup>351</sup> *OSAR*, R.R.O. 1990, Regulation 1015, Form 12 Item 10.

<sup>352</sup> *Supra* note 16, at 148.

conditions, industry risks, market and technology-related risks and potential or existing government regulations.<sup>354</sup> However, in practice, such factors are often presented in a summary and incomprehensible manner. For instance, sample risk factors contained in a prospectus includes the following:

- ii) The company has full reliance on export in the international market.
- iii) Any new technology which drastically reduces the labour input may change the competitiveness of Bangladesh.<sup>355</sup>

What can investors discern from this? If the company has full reliance on international market, how can it be an investment risk? The statements require some clarification so that investors, particularly lay investors, can understand the investment risks involved. For example, as highlighted, new technology reducing labor input may change the competitiveness of Bangladesh, but as a result of whose use of technology? How does it affect the issuer in particular? These questions are important to the investing public, but answers are not available here as the language and meaning are vague.

## **Category V: Current Status And History**

### **Share And Loan Capital Structure**

Item 7 deals with share and loan capital structure of the issuer. It calls for detailed particulars about the equity capital, secured loan, and unsecured long-term loan

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<sup>353</sup> See *prospectus*, Husky Injection Molding Systems, 28 Oct. 1998, at 34-35.

<sup>354</sup> *PIR*, r. 7.B.(3).

<sup>355</sup> *Supra* note 334.

capital which extends beyond one year.<sup>356</sup> A prospectus must contain, among other things, a description of the priority of indebtedness, the terms of their repayment and the security against the loans.<sup>357</sup> In addition, it must state the minority interests in preference shares, if any, and common shares of the issuer and in its consolidated and unconsolidated subsidiaries.<sup>358</sup> Under Bangladesh law there is no requirement to give an equity capital structure, though description of loans borrowed by the issuer is called for.<sup>359</sup> In practice, a section furnishing information about both equity and loan capital is included in prospectuses.<sup>360</sup>

### **Description Of Business And Property**

In Ontario, according to Form 12 Item 9, it is necessary for a prospectus to describe the issuer's and its subsidiaries' past and future business, with the general development of the business for the last five years. It must include an account of the principal products or services, as the case may be. It must also contain a brief description of the principal properties (e.g., plants, buildings, sales headquarters, etc.) of the issuer and its subsidiaries defining the nature of title or encumbrance (e.g., mortgage), where

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<sup>356</sup> OSAR, R.R.O. 1990, Regulation 1015, Form 12 Item 7(1) Ins. 1.

<sup>357</sup> *Ibid.*, Ins. 1 and 4 together.

<sup>358</sup> *Ibid.*, Item 7(3) and 7(4).

<sup>359</sup> PIR, r. 7.B.(7)(b)(7).

<sup>360</sup> See for instance, the prospectus of Samata Leather Complex Limited, which contains a very brief description of share capital only under the caption of "Capital Structure": *Supra* note 334, at 17. At two other places it mentions only the amount of long term loan under the sub-head of "Means of Finance". It does not even refer to the kind of loan, i.e. whether secured or unsecured, the terms of their repayment and particulars of security against them, if any. Nothing is also said about the minority interest in the share capital. *supra* note 334 at 20.

any of them is not held in fee or is held subject to any encumbrance.<sup>361</sup> The purpose of the description of business is to inform the investors about what goods are produced or what services are rendered by the company. The statement about the issuer's property is intended to "reasonably inform investors as to the suitability, adequacy, productive capacity and extent of utilization of the facilities used in the enterprise"<sup>362</sup>. Similarly, a Bangladesh prospectus must give a general description of the development and operation of the issuer's business, which include its products or services, sources of raw materials, sources and requirement of power, gas and water, etc.<sup>363</sup> It also must describe the issuer's property with particulars of its location, nature of the issuer's title in it and encumbrances, if any, to which it is subject.<sup>364</sup>

### **Material Contracts<sup>365</sup>**

Item 33 of Ontario Form 12 calls for particulars of all material contracts ( e.g., underwriting agreements) entered into by the issuer or its subsidiaries within the two years from the date of the preliminary prospectus or *pro forma* prospectus. Particulars so required cover the dates of, parties to, consideration and nature of the contracts<sup>366</sup>. The prospectus must give a reasonable time and place for inspection of such contracts during

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<sup>361</sup> OSAR, R.R.O. 1990, Regulation 1015, Form 12 Item 12.

<sup>362</sup> *Ibid.*, Inst.

<sup>363</sup> PIR, r. 7.B.(5). See the *prospectus*, Bionic Seafood Exports Ltd., (Dhaka, 25 August 1999), at 7-9.

<sup>364</sup> *Ibid.*, r. 7.B.(6). See *Prospectus, ibid.*

<sup>365</sup> A "material contract" refers to "any contract that can reasonably be regarded as presently material to the proposed investor in the securities being offered". : OReg., Form 12 Item Ins. 1. It, however, does not include a contract made in the ordinary course of business of the issuing company. : *Ibid.*, Ins. 2, and CA, sch. III pt. II cl. 16(2).

the distribution of the securities being offered. Such disclosure may, however, be dispensed with by the Director of the OSC, if he or she thinks it to be unnecessary for the protection of investors.<sup>367</sup> In Bangladesh a prospectus must describe the date of, parties to and general nature of every material contract entered into within two years or more than two years before the date of the prospectus.<sup>368</sup> It must also indicate a reasonable time and place for their inspection.<sup>369</sup> Unlike those of Ontario, Bangladesh prospectuses are not, however, required to disclose the consideration of material contracts. In practice, the required particulars of material contracts are not usually disclosed.<sup>370</sup>

### **Promoters**

An issuer in Ontario is obliged to give the name of any promoter, the nature and amount of value received or to be received by him or her or it from the issuer

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<sup>366</sup> OSAR., R.R.O. 1990, Regulation 1015, Form 12 Item 33 Ins. 3.

<sup>367</sup> *Ibid.*, Ins. 4.

<sup>368</sup> CA 1994, sch. III pt. I cl. 16(1) and cl. 16(2).

<sup>369</sup> *Ibid.*, cl. 16(3).

<sup>370</sup> For instance, one prospectus reads as follows:

The following are material contracts not being in the ordinary course of business which have been entered into by the company.

#Underwriting Agreement between the Company and the Underwriters.

# Issue Management Agreement between the Company and the Manager to the Issue, AAA Consultants & Financial Advisers.

Copies of the aforementioned contracts and documents...may be inspected on any working day during office hours at the Company's Registered Office. *supra* note 334, at 9

It does not give the dates of the contracts, the name of the underwriters, nor the consideration of the contracts as it is not required by the concerned law.

or from any of its subsidiaries.<sup>371</sup> The issuer must also state the nature and amount of the consideration received or to be received by it or its subsidiary from the promoter for that amount.<sup>372</sup> In addition, if the issuer or any of its subsidiaries has received or will receive any property from the promoter, it will be incumbent on it to state the acquisition cost and the principle of determination of that cost.<sup>373</sup> In Bangladesh, as in Ontario, the issuer must state the amount or benefit paid or given, or to be paid or given to any promoter and also the consideration for that amount or benefit.<sup>374</sup> In addition, it must disclose if it has received any assets from the promoters who provide the price and the method of determining that price.<sup>375</sup> In this respect the requirements under both jurisdictions are similar with the effect that the investors will have knowledge of the issuer's interest and obligations in relation to the promoters.

As discussed above, the Items falling within the category of "Current status and History", seem to call for similar kinds of information. However, in respect of some matters Bangladesh law lacks provisions, e.g., equity capital disclosure, but in practice such information are provided.<sup>376</sup> There are some other items under both laws, which have not been discussed, but are similar in effect, e.g., "Intercorporate

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<sup>371</sup> OSAR, R.R.O. 1990, Regulation 1015, Form 12 Item 15(a).

<sup>372</sup> *Ibid.*

<sup>373</sup> *Ibid.*, Item 15(b).

<sup>374</sup> CA, sch. III pt. I cl. 15, and PIR, r. 7.B.(13)(a).

<sup>375</sup> PIR, r. 7.B.(13)(b).

<sup>376</sup> See *supra* note 334 and the accompanying text.

Relationship”<sup>377</sup>. But an important Item, namely “Dividend Record”<sup>378</sup>, is missing in Bangladesh law, and is not disclosed in practice either. From the Dividend Record the investors can know how much dividends or what percentage of dividends the issuer has declared and given in previous years and if there was any discrepancy between the declaration and actual disbursement.

### **Category VI: Management**

#### **Directors And Officers, Executive Compensation And Indebtedness**

An Ontario prospectus is required to list the names and home addresses in full of all directors and officers of the issuer.<sup>379</sup> Alternatively, it must give solely their municipality of residence or postal addresses. It must indicate all positions and offices held by such people and their principal occupations within five preceding years.<sup>380</sup> Similarly, in Bangladesh a prospectus must contain the names, addresses, descriptions and occupations of the directors and officers, their positions and offices in the company, experience in business and family relationships among themselves, if any.<sup>381</sup> According to Item 22, an Ontario prospectus must add a Statement of Executive Compensation as per Form 40, which includes annual compensation (salary, bonus, etc.) and long-term

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<sup>377</sup> See *OSAR*, R.R.O. 1990 Regulation 1015, Form 12 Item 27, and *CA 1994*, sch. III pt. I, cl. 22 and *PIR*, r. 7.B.(7)(b)(17). In connection with Bangladesh law, see for practice, *supra* note 310 and *Prospectus*, Beximco Knitting Limited, in the *Ittefaq*, (25 June 1994) 15.

<sup>378</sup> *OSAR*, R.R.O. 1990 Regulation 1015, Form 12 Item 20.

<sup>379</sup> *Ibid.*, Form 12 Item 21.

<sup>380</sup> *Ibid.*

compensation (stocks under option, compensation for retirement, resignation or other termination of employment) of the chief executive officer (CEO) and other “Named Executive Officers”<sup>382</sup>. Bangladesh law requires a prospectus to state the yearly remuneration<sup>383</sup> and compensation for the loss of office<sup>384</sup> of officers and directors. But nowhere has “remuneration” been defined.<sup>385</sup>

Item 23 of Ontario Form 12 asks for detailed disclosure of the indebtedness of directors, executive officers, senior officers, nominee directors, and their associates and affiliates to the issuer or any other entity. A Bangladesh prospectus must disclose in detail if any loan has been given by the issuer to or taken from any director or any person connected with the director.<sup>386</sup> Unlike an Ontario prospectus it does not require the disclosure of any fact of indebtedness of such persons to any entity other than the issuer.

### **Interest Of Management And Others In Material Transactions :**

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<sup>381</sup> CA 1994, sch. III pt. I cl. 3(1) and PIR, r. 7.B.(8).

<sup>382</sup> 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.

<sup>383</sup> PIR, r. 7.B.(11).

<sup>384</sup> CA 1994, sch. III pt. I cl. 3(2).

<sup>385</sup> In practice, remuneration paid to executives and aggregate amount of remuneration paid to the officers and directors are stated in corporate prospectuses. See, for example, *supra* note 337 at 24, and *supra* note 363, at 16.

<sup>386</sup> PIR, r. 7.B.(10)(f).

Under Item 29 of Ontario Form 12, a prospectus is necessary to provide a brief description of any material interests of the company management and others in any material transaction during the last three years or in any material proposed transactions, to which the company or any of its subsidiaries was or will be a party. “Management” is defined to include any director, senior officer of the issuer, principal shareholder, and their associates or affiliates. While this item requires disclosure of any material interest received or to be received by the company management and others in any material transaction in general, under Bangladesh law only the interests received or to be received particularly by directors or promoters in the promotion of the company or in any property acquired by the company must be made public<sup>387</sup>. Thus a provision requiring disclosure of interest of the management in various transactions is absent in Bangladesh law.

### **Miscellaneous Category**

Item 34 requires disclosure of all other material facts than those categorized in rest of the items discussed above. This is “the catch-all provision, to ensure that no information is omitted merely because it cannot easily be categorized”<sup>388</sup>. Likewise, Bangladesh law, as already discussed, contains a provision requiring other material information in addition to those specified therein.<sup>389</sup> The non-compliance with environmental laws by the issuer may be an example of such information. In both

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<sup>387</sup> *Ibid.*, cl. 18.

<sup>388</sup> Johnston and Rockwell, *supra* note 57, at 76.

<sup>389</sup> See the texts accompanying *supra* notes 296-298.

jurisdictions a corporation or its management is liable with heavy penalties for breaching environmental obligations ( e.g., by polluting air, spills)<sup>390</sup>, which harms the reputation of the corporation's business. Such penalties and disrepute are shared by the securities holders in that damages are paid out of the corporate earnings which affect the amount of

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<sup>390</sup> In Ontario corporate environmental liability arises under common law and statutory laws. Under common law a company may be held liable applying the tort principles of strict liability (e.g. for escape of noxious gases), negligence and nuisance (e.g. discharging noxious fumes). Under the *Environmental Protection Act (EPA)*, R.S.O. 1990, c. E.19, a discharge of contaminant or causing or permitting discharge of contaminant into natural environment below a prescribed limit (s.14(1)) or above that limit (s. 6(1)), and "spills" into environment (ss. 91-93) by a company gives rise to its liability. In Bangladesh, on the other hand, environmental wrongs committed by a company may be redressed under common law, national constitution and statutes. A company may be held liable for committing environmental negligence or nuisance under common law. If such a wrong amounts to an infringement of any of the fundamental rights to life (Arts. 31 and 32), property (Art. 40) and trade (Art. 42) entrenched under the *Constitution of the People's Republic of Bangladesh*, then it will attract the writ jurisdiction of the Supreme Court of Bangladesh. ( Art. 102). Thus, for instance, environmental matters were addressed in the garb of fundamental rights in *Dr. Mohiuddin Farooque v. Bangladesh and others*, 1 B.L.C. (AD) (1996) 189-219, and *Dr. Mohiuddin Farooque v. Bangladesh*, 48 D.L.R.. 438-446. A mischief of discharging pollutants by a company in excess of prescribed limit will come within the purview of s. 9 of *The Bangladesh Environmental Conservation Act (BECA)*, 1995. On being found guilty an Ontario company may be fined a maximum amount of \$50,000 for the first convictions and \$100,000 for the subsequent convictions for each day the offense occurs. (*EPA*, R.S.O. 1990, c. E.19, s. 186). Moreover, the courts may impose additional penalty equal to the monetary benefit received by or accrued by the a corporation. (*EPA*, R.S.O. 1990, c. E.19, s. 189). The courts may also order such a company to prevent or decrease or eliminate the effects on natural environment of the offence. (*EPA*, R.S.O. 1990, c. E.190). Where the management is liable, corporeal punishment may be imposed (*EPA*, s. 193). In Bangladesh, on the other hand, there is no defined amount of fines for commission of environmental wrongs other than discharging pollutants in excess of the prescribed limit. It depends on the discretion of the courts. In respect of discharge of pollutants exceeding limit the concerned personnel of the company will be liable to be punished with imprisonment for a period not more than five years or with fine not more than 100000 taka (approx. Can. \$3000) (*BECA*, ss. 15 and 16).

their dividends and the disrepute hampers the business resulting in less earnings. Furthermore, they adversely impact the secondary market and, as result, the value of the securities is likely to decline. Thus it may be concluded that corporate environmental non-compliance has an effect on the price of securities and, therefore, is subject to disclosure: “[E]nvironmental non-compliance would likely be considered a material fact under Canadian Securities legislation if the non-compliance had a significant effect on the value of the securities”<sup>391</sup> Therefore, an author observes in this connection that “Material facts are, however, broader than just balance sheet considerations and will clearly encompass environmental factors.”<sup>392</sup>

It may be summarized that the laws of Ontario and Bangladesh require, in general, disclosure of all material facts and, in particular, similar categories of facts. An issuer is solely responsible to disclose each and every piece of information, specified or not, having a bearing on the price or value of securities. That a particular matter is not specified in the law does not mean the matter need not be disclosed.<sup>393</sup>

### **2.3.2.1.2 Financial Matters**

#### **Financial Statements**

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<sup>391</sup> M. E. Deturbide, “Corporate Protector or Environmental Safeguard? The Emerging Role of the Environmental Audit”, 5 J.Env..L.& Pract.. 1 at 10 note 29. To meet the full disclosure requirement environmental auditing is suggested by this author as a due diligence defence for corporations in Canada.

<sup>392</sup> S.H.T. Denstedt and S.R. Miller, “Due Diligence in Disclosing Environmental Information for Securities Transactions”, (1995) 33 Alta. L. Rev. 231, at 239.

In addition to the non-financial matters discussed above, a prospectus both in Ontario and Bangladesh must contain certain financial statements. In Ontario such statements are prepared according to the generally accepted accounting principles (GAAP) in Canada<sup>394</sup>, which are defined in the *Canadian Institute of Chartered Accountants (CICA) Handbook*.<sup>395</sup> The financial statements required of an Ontario prospectus include an income statement<sup>396</sup>, a statement of surplus<sup>397</sup>, a statement of changes in financial position<sup>398</sup> and a balance sheet.<sup>399</sup> The OSC Director may, however, exempt the issuer from the requirement of any of these statements.<sup>400</sup> In Bangladesh the requisite statements include a summary statement of earnings<sup>401</sup>, balance sheets<sup>402</sup>, profit & loss statements and cash flows statements.<sup>403</sup> They are to be prepared and presented as per international accounting standards (IAS) adopted by the Institute of Chartered Accountants of Bangladesh (ICAB).<sup>404</sup>

In Ontario a prospectus contains together, in a consolidated form, the statement of income for each of the last five financial years and the statement of retained

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<sup>393</sup> For the liability of an issuer with respect to prospectus misrepresentation, see Johnston and Rockwell, *supra* note 57 at 179-183.

<sup>394</sup> OSAR, R.R.O. 1990, Regulation 1015, s. 2(1).

<sup>395</sup> National Policy No. 27, sub-pts. 3.1 and 3.2.

<sup>396</sup> OSAR, R.R.O. 1990, Regulation 1015, s. 53(1)(a).

<sup>397</sup> *Ibid.*, s.53(1)(b).

<sup>398</sup> *Ibid.* s. 53(1)(c).

<sup>399</sup> *Ibid.*, s. 53(1)(d). The financial statements required of a mutual fund prospectus are somewhat different.: see *ibid.*, s. 54.

<sup>400</sup> *Ibid.*, s. 53(6).

<sup>401</sup> PIR, r. 7.B.(20)(a).

<sup>402</sup> *Ibid.*, r. 7.B.(20)(b)(i).

<sup>403</sup> *Ibid.*, r. 7.B.(20)(b)(ii).

earnings. They include income from sales and other sources, expenses under different heads, amount of dividends, if any, and the surplus or deficit at the end of each year.<sup>405</sup> In Bangladesh each of the income statement, and the profit and loss statements, is prepared for a period of the last five financial years and their contents are similar with those of an Ontario prospectus.<sup>406</sup> The Ontario prospectus discloses cash-flows of the issuer from the operating, investing and financing activities.<sup>407</sup> The Bangladesh prospectus also contains a cash-flows statement for the same period with cash-flows from similar broad sources.<sup>408</sup> The balance sheet in the Ontario prospectus must be as at a date not more than 120 days prior to the date of issuance of the receipt of the preliminary prospectus or other date permitted or required by the Director.<sup>409</sup> It must be accompanied by a balance sheet for the corresponding date of the previous financial year.<sup>410</sup> Where the balance sheet is as at a date other than the financial year end, the said balance sheet as at the corresponding date of the previous year may be omitted if the prospectus contains comparative balance sheets as at the most financial year end and as at the immediately preceding financial year end.<sup>411</sup> Bangladesh law differs from Ontario law in this respect. A Bangladesh prospectus must provide balance sheets for the five preceding financial years.<sup>412</sup> All these financial

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<sup>404</sup> *Ibid.*, r. 7.B.(20).

<sup>405</sup> See *supra* note 353, at 40.

<sup>406</sup> For contents of profit and loss accounts, see *supra* note 334, at 19.

<sup>407</sup> See *supra* note 353, at 41.

<sup>408</sup> For contents of cash-flow statement, see *supra* note 334.

<sup>409</sup> OSAR, R.R.O. 1990, Regulation 1015, s. 53(1)(d)(i).

<sup>410</sup> *Ibid.*, s. 53(1)(d)(ii). See *supra* note 253, at 39.

<sup>411</sup> *Ibid.*, s. 53(2).

<sup>412</sup> PIR, 7.B.(20)(b)(i)..

statements, under both the systems, are followed by notes thereto explaining the items and figures, where necessary.<sup>413</sup>

Both the laws of Ontario and Bangladesh require that the financial statements be audited and the audited statements to be accompanied by auditor's reports.<sup>414</sup> The Ontario auditor's report must be prepared in accordance with the generally accepted auditing standards (GAAS) recommended in the *CICA Handbook*<sup>415</sup> and any applicable provision of the Ontario securities regulation. The *CICA Handbook* requires that "(t)he examination should be performed and the report prepared by a person or persons having adequate technical training and proficiency in auditing, with due care and with an objective state of mind"<sup>416</sup>. In addition to this condition, an auditor must not be unacceptable to the Director.<sup>417</sup> *National Policy No. 3* defines who is unacceptable as an auditor. An auditor is unacceptable if he/she or his/her partner, employer, employee, or associate is a director, officer or employee or security holder of the issuer or its affiliates. In Bangladesh an audit report must be prepared by an auditor who is a regular member of the ICAB applying the international standards of auditing (ISA) as contained in the *Members Handbook* published by the ICAB.<sup>418</sup> Like Ontario, in Bangladesh an auditor

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<sup>413</sup> See *supra* note 353, at 43-49, and *supra* note 334, , at 19-20.

<sup>414</sup> *OSAR*, R.R.O. 1990, Regulation 1015, s. 2(5), and *CA 1994*, sch. III pt. II cl. 24 and *PIR*, r.7.B.(20).

<sup>415</sup> *Supra* note 396. Canadian Institute of Chartered Accountants, *CICA Handbook*, vols. I-III ( Toronto: CICA, 1997).

<sup>416</sup> *CICA Handbook, Ibid.*, Section 5100.

<sup>417</sup> *OSA*, sub-sec. 61(2)(i).

<sup>418</sup> *PIR*, r. 7.B.(20). Here "international auditing standards" refer to the auditing standards issued by the International Auditing Practices Committee of the International Federation

must be qualified within the meaning of the *Companies Act (CA) 1994*. Accordingly, persons including an officer or employee, partner or debtor of the issuer, director or member of its managing agent are disqualified from being the issuer's auditor.<sup>419</sup>

From the foregoing discussion it can be seen that the laws of Ontario and Bangladesh require similar kinds of financial statements with similar contents. Financial statements in Ontario are prepared applying the GAAP contained in the *CICA Handbook* while in Bangladesh those are prepared according to the IASs adopted by the ICAB. Audit reports are prepared according to the GAAS and ISAs in Ontario and Bangladesh respectively. The (Canadian) Accounting Standards Board, in pursuance of its objective of international harmonization of accounting standards, works with the IASC to minimize differences between the IASs and the corresponding Accounting Recommendations contained in the *CICA Handbook*.<sup>420</sup> A comparison between the IASs and Handbook recommendations done by the Board shows that they "correspond very closely, with the result that application of one set of standards often results in compliance with the other."<sup>421</sup> Simultaneously the Assurance Standard Board (ASB) compares the International Standards on Auditing (ISAs) with the corresponding *CICA Handbook* standards.<sup>422</sup> Compliant with the ISAs the *Handbook* is modified unless Canadian position is *fundamentally* different from the international standing with regard to any

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of Accountants. : *The Securities and Exchange Rules, 1987* (am. No. SEC/Section-7/SER/03/132), sub-rule 12(2), explanation to sub-rule 2.

<sup>419</sup> *CA 1994*, s. 212(2).

<sup>420</sup> *CICA Handbook*, *supra* note 415, ss. 1501.02.

<sup>421</sup> *Ibid.* s. 1501 appendix.

particular matter.<sup>423</sup> Thus the GAAP and the GAAS contained in the *CICA Handbook* are similar with the IASs and ISAs respectively which, as seen above, are followed by Bangladesh in preparing financial statements. In other words, in preparing the financial statements and auditing reports both Ontario and Bangladesh follow, at least in theory, the same principles and standards.

It may be noted at this point that the requirement of applying IASs and ISAs was introduced in Bangladesh in late 1997<sup>424</sup> following the recommendation of the *ADB Report*.<sup>425</sup> The ICAB is still in the process of adopting these standards. It has not been able to keep pace with the latest changes and improvements occurring at the international level.<sup>426</sup> Also, there remain contradictions between the domestic laws and the standards.<sup>427</sup> Moreover, there are some practical difficulties in the application of IASs

<sup>422</sup> *Ibid.* s. 5101.04.

<sup>423</sup> *Ibid.* s. 5101.04.

<sup>424</sup> See No. SEC/Section-7/SER/03/132 dated 22 Oct. 1997.

<sup>425</sup> See *ADB Report*, *supra* note 10, at 14.

<sup>426</sup> For example, as of 25 June 1998 the ICAB did not adopt the IAS 7 (revised in 1992) on cash-flow statements which was issued by the International Accounting Standards Committee (IASC) replacing the original IAS 7 : M.H. Kabir, "International Accounting Standards -IAS 1 (Revised 1997)- Presentation of Financial Statements", ( a paper presented in a seminar on International Accounting Standards- IAS (Revised 1997), ICAB, Dhaka, 25 June 1998) (unpublished) at 14.

<sup>427</sup> For example, with regard to preparation of a balance sheet IAS 1(revised 1997) requires current and non-current assets, and current and non-current liabilities. It uses the term "non-current" to include tangible, intangible and operating and financial assets (e.g., investments) of long term nature while "current" assets include inventories, trade and other receivable, etc. On the other hand, the *CA 1994* (sch. XI, s. 185) and the *Securities and Exchange Rules, 1987 (SER)* (sch., r. 12.(2) as am. 22 Oct. 1997) use the term "fixed" assets to include tangible and intangible assets grouping investments, loan and advances separate from the fixed assets. Thus differ explanations of terms and order of presentation as contained in the IAS and the *CA* and *SER*. Again, in making cash-flow

in Bangladesh. For example, often conflict arises between the provisions of IASs and the income tax law of Bangladesh triggering double taxation. Additional hassles are created by the tax authorities. This is reflected as follows:

[T]he Income Tax Authorities on many occasions, misunderstand and misinterpret the disclosure & information presented in FSs. More disclosures, no doubt, bring transparency. But more transparency causes more trouble, and is costlier in Bangladesh. One will face least trouble and pay less for not being transparent (because of practices and mindset of the people, particularly in the revenue administration).<sup>428</sup>

In order to avoid “trouble” companies in Bangladesh, in practice, tend not to present full and true financial information notwithstanding the requirement of compliance with the IAS.<sup>429</sup> This is very natural for a company not to “forgo voluntarily the financial advantages of avoiding accurate financial reporting”<sup>430</sup>. It is a common allegation in Bangladesh that companies do not produce full and true financial statements.<sup>431</sup> Thus “accounting and auditing standards in Bangladesh vary widely between theory and practice.”<sup>432</sup> For this both the issuer and auditors are liable.<sup>433</sup>

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statements the IAS encourages to use “direct” or “indirect” method, but the *SER* requires only the “direct” method. : Kabir, *ibid.*, at 12-14.

<sup>428</sup> Kabir, *supra* note 426. at 16.

<sup>429</sup> For a complaint of corporate tax evasion, see *Financial Express* (a national daily), (17 July 1998) 1.

<sup>430</sup> “Freestyle Not to Let Loose” *B. Account.* 67, (Oct.-Dec. 1996) at 73.

<sup>431</sup> See the text accompanying *supra* note 49 . Also see M.H.R. Khan and S. R. Howlader, “Bangladesh Securities Market- Challenges and Prospectus”, (1984) *D. U. Stud.*, Pt. C, at 132.

<sup>432</sup> *Supra* note 44 at 6-7.

<sup>433</sup> See M.M.Hoque, “Capital Market Development in Bangladesh- Problems and Prospects”, *Challenges of Market Economy*, (Dhaka: The Institute of Chartered Accountants of Bangladesh, 1994), at para. 6.04.

Trading in securities “is one in which opportunities for dishonesty are of constant occurrence and ever present”<sup>434</sup>. Ontario is also affected by this tendency of securities trading. Recently the Chairman of the OSC, David Brown, revealed a good number of instances of “aggressive” accounting and auditing practices.<sup>435</sup>

In some cases, the issue is overstatement of current income, perhaps by use of aggressive and inappropriate revenue recognition practices. In others, it is understatement of current income, whether through excessive “one time” charges for reorganizations and restructurings or unreasonably short amortization periods for so called acquired in-process research and development, thus making the future look better.<sup>436</sup>

The OSC Chair referred to some public comments which reflect the public’s concern: “the need ... to sustain equity prices has afflicted corporate behaviour ... and there are many dubious accounting practices regarding how earnings results are prepared.”<sup>437</sup>

### **Financial Forecasts/Projections**

In Ontario, according to *National Policy No. 48*, a “Future-Oriented Financial Information” (FOFI) may be published in a preliminary prospectus and a final prospectus.<sup>438</sup> It discloses “information about prospective results of operations, financial position or changes in financial position (of the issuer), based on assumptions about

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<sup>434</sup> *Archer v. SEC*, 133 F.2d 795, 803 (8th Cir. 1943), cert. denied, 319 U.S. 767.

<sup>435</sup> D. A. Brown, “Public Accounting at a Crossroads”, remarks (June 1999) 22 O.S.C.B. 3507.

<sup>436</sup> *Ibid.* at 3507.

<sup>437</sup> *Ibid.*

<sup>438</sup> FOFI may also be used in other documents, e.g., rights offering circular, some offering memoranda, take-over bid circular, issuer bid circular, etc.

future economic conditions and courses of action”<sup>439</sup>. FOFI may either be a forecast or a projection.<sup>440</sup> Both of them reflect the issuer’s planned courses of action normally during a maximum period of 24 months with the only difference that “Hypotheses”<sup>441</sup> are additionally used to prepare a projection.<sup>442</sup> A projection, based on hypotheses, is less reliable<sup>443</sup> and, therefore, the prospectus with a projection must caution (in bold type) the investors that “there is significant risk that actual results will vary, perhaps materially, from the results projected”<sup>444</sup>.

Using a forecast or projection in a prospectus is the option of the issuer.<sup>445</sup> If, however, FOFI is used in the prospectus, it must be accompanied by an auditor’s report without any reservations.<sup>446</sup> The issuer has an obligation to compare previous FOFI to the actual results and to update it and then to disclose both the comparisons and updates.<sup>447</sup> It is encouraged that the updates be accompanied by auditor’s report.<sup>448</sup> The issuer is responsible for the publication of FOFI.<sup>449</sup> In practice, a tendency of fluctuations between FOFI and actual results is observed. An OSC survey shows that as of 1994 only

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<sup>439</sup> *National Policy No. 48*, pt. 2.

<sup>440</sup> *Ibid.*

<sup>441</sup> “Hypotheses” are defined as “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”. : *ibid.*

<sup>442</sup> See *ibid.* pt. 2 and sub-part 4.2.

<sup>443</sup> *Ibid.* sub-part 5.2.

<sup>444</sup> *Ibid.* sub-rule 5.1.

<sup>445</sup> *Ibid.*, pt. 1.

<sup>446</sup> *Ibid.*, sub-part 9.1.

<sup>447</sup> *Ibid.* pts. 6 and 7.

<sup>448</sup> *Ibid.*, sub-part 9.1.

<sup>449</sup> *Ibid.* pt. 1.

23% of the (selected) seasoned issuers<sup>450</sup> and 18% of the start-up issuers<sup>451</sup> were able to gain results (net earnings) better than FOFI.<sup>452</sup>

In Bangladesh there are no legal provisions or guidelines for making any financial forecast or projection in a prospectus. There is, however, a liability provision for fraudulent forecast in CA.<sup>453</sup> From this a scope of making financial forecast may be assumed. In practice, almost all prospectuses in Bangladesh carry financial forecasts for five subsequent years<sup>454</sup>, whereas an Ontario FOFI can be for a maximum period of two years.<sup>455</sup> Unlike Ontario, no audit reports on these forecasts are attached to such prospectuses. In these prospectuses the terms “forecast” and “projection” are interchangeably used with a caution at the top ( though not in bold type like Ontario): “These are forecast, not actual. Actual may vary from forecast. Prospective investors should read the forecast carefully before taking investment decision”<sup>456</sup>. Sometimes a forecast is highlighted even without such a caution.<sup>457</sup> Again, some prospectuses mention

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<sup>450</sup> Seasoned issuers are those who have a significant operating history.

<sup>451</sup> Start-up issuers refer to issuers without a significant operating history.

<sup>452</sup> “FOFI in Prospectuses- An OSC Staff Survey”, (Jan. 1994) 17 O.S.C.B. 6 at 7.

<sup>453</sup> See CA 1994, s. 147.

<sup>454</sup> E.g., *prospectus*, Samata Leather Complex Ltd., in *The Ittefaq*, 29 June 1998, at 9 and 20; *prospectus*, Mona Food Industry Ltd., in *The Share Bazar* (Bengali national fortnightly), 3:17 (1 Nov. 1997) 23; *prospectus*, Gachihata Aquaculture Farms Ltd., *The Share Bazar* (Bengali national fortnightly), 3:17 (1 Nov. 1997) 23., at 34-36. But in some recent prospectuses no forecast or projections are found. See for example, *Prospectus*, Bionic Seafood Exports Ltd., *supra* note 363, and *Prospectus*, Prime Bank Ltd., *supra* note 337.

<sup>455</sup> *Supra* note 378 pt. 4.2.

<sup>456</sup> *Supra* note 334, at 20.

<sup>457</sup> See *prospectus*, Gachihata Aquaculture Farms Ltd, *supra* note 454, at 35.

the bases of the assumption of the forecast,<sup>458</sup> while others do not.<sup>459</sup> In practice, according to one survey, 95% of the issuing companies failed to gain their projection targets during the period of 1993-97.<sup>460</sup> This failure rate is similar to that of Ontario.<sup>461</sup>

### 2.3.2.2.3 Certificates

*OSA* requires a prospectus to contain certificates by the issuer, underwriter(s) and the auditors. The issuer's certificate signed by the chief executive officer (CEO), chief financial officer (CFO) and any two directors (other than the CEO and CFO) states that "(t)he foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus"<sup>462</sup>. The underwriter's certificate is similarly worded with the difference that the certification starts with "(to) the best of our knowledge, information and belief"<sup>463</sup>. In addition, an auditor's certificate must accompany the prospectus.<sup>464</sup> It states that "(i)n our opinion, these financial statements present fairly, in all material respects, the financial position of the Company"<sup>465</sup>.

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<sup>458</sup> See *prospectus*, Samata Leather Complex Ltd., *supra* note 334, at 20.

<sup>459</sup> *Supra* note 454, at 35)

<sup>460</sup> Gachihata Aquaculture Farms Ltd, *Share Bazar*, *supra* note 38, at 5.

<sup>461</sup> See *supra* notes 450-452.

<sup>462</sup> *OSA*, s. 58(1). Also, for specimen, see *supra* note 353, at 50.

<sup>463</sup> *Ibid.*, s. 59(1). Also see *supra* note 353, at 51.

<sup>464</sup> *OSAR.*, R.R.O. 1990, Regulation 1015, s. 2(5).

<sup>465</sup> *Supra* note 353, at 38.

In Bangladesh, the issuer's and underwriter's certificates are not required by law to accompany a prospectus. The only requirement is the auditor's certificate.<sup>466</sup> Those two certificates are, however, used in practice.<sup>467</sup> The auditor's report certifies, *inter alia*, that (t)he annexed Balance Sheet and Profit and Loss Account exhibit a true and fair view of the state of the Bank's affairs"<sup>468</sup>. This is similar to an Ontario auditor's certificate as both of them attest the "fair" state of the issuer's financial affairs.

#### 2.3.2.2.4 Statement Of Purchaser's Rights

In Ontario a prospectus must embody a statement of a purchaser's rights<sup>469</sup>, namely rights to prospectus delivery and withdrawal from purchase,<sup>470</sup> and rights to damages against civil liability.<sup>471</sup> Under the first right provision, a dealer<sup>472</sup> must send the latest prospectus or an amendment thereto to the purchaser either before entering

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<sup>466</sup> See *CA, 1994*, sch. III pt. I cl. 24 and *PIR*, r. 7.B.(20).

<sup>467</sup> For example, the issuer's certificate as contained in a prospectus states, among others, that "(w)e also confirm that full and fair disclosure has been made in this prospectus, to enable the investors to make an informed decision for investment" The underwriter's certificate reads, *inter alia*, thus-"We confirm that...all information as are relevant for our underwriting decision has been received by us and that draft prospectus forwarded to the Commission has been approved by us": *Prospectus, Prime Bank Ltd.*, *supra* note 337, at 1 and 3. This certification does not, unlike Ontario, directly confirm the "full, true and plain" disclosure. But as it approves the draft prospectus in general and the issuer's certificate in particular as a component of the prospectus, it indirectly endorses the true and fair disclosure in the prospectus certified by the issuer.

<sup>468</sup> *Prospectus, Prime Bank Ltd.*, *supra* note 337, at 41.

<sup>469</sup> *OSA, R.S.O. 1990, c.S.5, s. 60.*

<sup>470</sup> *Ibid.*, s. 71.

<sup>471</sup> *Ibid.*, s. 130.

into the agreement of purchase and sale or by the end of the second day after entering into such agreement (excluding weekends and holidays).<sup>473</sup> The purchaser then has two days to review the disclosure in the prospectus and to decide whether to withdraw from the purchase. A withdrawal decision is made by simply giving a written notice to the dealer.<sup>474</sup> Secondly, the purchaser has also a right of action for damages or, instead of damages, a right of rescission of the purchase, if the dealer fails to deliver him or her (purchaser) a copy of prospectus or amendments thereto as required under section 71(1).<sup>475</sup> A prospectus, stating these rights, 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”<sup>476</sup>.

Bangladesh law does not require such a statement of the purchasers’ right nor is it, in practice, contained in a prospectus. In Bangladesh securities are offered to the public publishing the final prospectus in two national dailies within ten days from the date of receipting by the SEC.<sup>477</sup> The public can also procure copies of prospectuses from the issuer, stock exchanges, SEC, underwriters and other market intermediaries.<sup>478</sup> The intending purchasers apply in prescribed forms to the issuer for allotment of securities.

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<sup>472</sup> “A dealer is a person or company that trade in securities as principal or agent and includes an underwriter or registered securities issuer with respect to a prospectus”. : *supra* note 16, at 257.

<sup>473</sup> OSA, R.S.O. 1990,c. S.5, s. 71(1).

<sup>474</sup> *Ibid.*, s. 71(2).

<sup>475</sup> *Ibid.*, s. 133.

<sup>476</sup> *Supra* note 353, at 37.

<sup>477</sup> PIR, r. 4(1).

<sup>478</sup> *Ibid.*, r. 4(4)(a).

After allotment is made, no purchaser can rescind the purchase under the securities legislation, but can claim for damages if the prospectus contains any untrue statement.<sup>479</sup> However, no damages suit for prospectus misstatement has yet been reported, the SEC takes administrative actions only.<sup>480</sup> The probable reason is that litigation is costly and time consuming in Bangladesh.<sup>481</sup>

### 2.3.3 ROLE OF THE SECURITIES COMMISSIONS

As said earlier, in Ontario the distribution of securities presupposes a prospectus to be accepted by the Ontario Securities Commission (OSC) unless filing of a prospectus is exempted by the statute or an exemption order has been granted by the OSC. Where an exemption is not available, an issuer must file a preliminary prospectus with the OSC with full, true and plain disclosure of material facts and accompanied by requisite documentation including the board of directors' resolution approving it, technical reports, auditor's comfort letter and financial statements except the auditor's or accountant's report(s).<sup>482</sup> If it seems to substantially comply with the requirements of the

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<sup>479</sup> Investors have a right to compensation available through the court of law for prospectus misstatement against, *inter alia*, -

(a) every person who is a director of the company at the time of the issue of the prospectus;

(b) every person who is a promoter of the company; and every person who has authorized the issue of the prospectus (e.g., an expert). : *The Companies Act (CA), 1994*, s. 145.

<sup>480</sup> *Supra* note 48.

<sup>481</sup> *Supra* note 51.

<sup>482</sup> See, for example, *OSA*, R.S.O. 1990, c. S.5, s. 54, *OSAR*, R.R.O. 1990, Regulation 1015, ss. 53-55 and *OSC Policies*, ss. 5.1 and 5.7.

securities legislation<sup>483</sup>, the Director shall issue a receipt right away.<sup>484</sup> Thereafter the Director entrusts two members of the Corporate Finance Branch, usually prospectus lawyer and prospectus accountant, to review the preliminary prospectus and to determine whether it constitutes full, true and plain disclosure of all material facts.<sup>485</sup> After such review the issuer is given a comment letter requiring it to make corrections to defaults, if any. After removing the defaults, the issuer can file the final prospectus attaching supporting documents and receive the receipt for it.<sup>486</sup>

In between the issuance of preliminary receipt and the final receipt (“waiting period”)<sup>487</sup> a dealer<sup>488</sup> is allowed to make communications to any person or company (e.g., through newspaper, or radio or television) identifying the security, its price, the place where and the person from whom the security can be purchased.<sup>489</sup> The dealer is also allowed to distribute the preliminary prospectus and to solicit expressions of interest from potential parties for the purchase of security.<sup>490</sup> The dealer must supply a

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<sup>483</sup> OSA, *ibid.*, s. 54(1).

<sup>484</sup> *Ibid.*, s. 55. This section reads- “The Director shall issue a receipt for a preliminary prospectus forthwith upon the filing thereof”.

<sup>485</sup> Alboini, *supra* note 77 at 15-9.

<sup>486</sup> OSA, R.R.O. 1990, c. S.5, s. 61(1).

<sup>487</sup> *Ibid.*, s. 65(1).

<sup>488</sup> See for the definition of “dealer” *supra* note 472.

<sup>489</sup> *Ibid.*, s. 65(2)(a).

<sup>490</sup> *Ibid.* s. 65(2)(b) and 65(2)(c).

copy of the preliminary prospectus to every interested party.<sup>491</sup> No sale of security is, however, permissible in this period because

[I]t would defeat the whole idea of having a prospectus with statutory liability for misrepresentations in a prospectus. If representations were allowed prior to the finalization of the prospectus the investor would not be protected by the statutory liability provision if representations were false.<sup>492</sup>

Through the above process of distribution if the dealer receives an order or subscription from any party, he or she must deliver a (final) prospectus and amendments thereto upon which that party may either confirm or reject the purchase. Thus the final receipt is the key to the purchase and sale of securities.

In Bangladesh, if an issuer intends to offer securities to the public for sale, it must file an application, including a prospectus, to the Securities and Exchange Commission (SEC) for its approval before the prospectus is released to the press for publication.<sup>493</sup> The application is vetted by the SEC, which will comment on its “incompleteness” generally within 15 days of submission.<sup>494</sup> Thereafter within thirty days the incompleteness must be removed and the complete application must be filed by the issuer.<sup>495</sup> If, however, no comment on the incompleteness is communicated to the issuer within fifteen days, the application shall be deemed to be complete unless the issuer is

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<sup>491</sup> *Ibid.*, s. 66.

<sup>492</sup> M. R., *The Securities Regulation in Canada*, (Scarborough: Carswell, 1992), at 108.

<sup>493</sup> *SEO*, s. 2B and *PIR*, rr. 3 and 4..

<sup>494</sup> *PIR*, r. 18(2). “Incompleteness” should be read with regard to the form and contents of a prospectus as the SEC does not determine the merits of an issue.

<sup>495</sup> *Ibid.* r. 18(3).

notified that the SEC needs additional time.<sup>496</sup> Within sixty days of receipt of a complete application, the SEC shall issue a letter of consent subject to such conditions as it may think fit, if such application is *acceptable* to the SEC, or the SEC shall issue a rejection order with reasons upon which the applicant may apply for review to the SEC. The SEC's decision after review is final.<sup>497</sup> The word "acceptable" should be construed with reference to the completeness of the application. The condition of acceptability is attached to a complete application that is received by the SEC after its correction by the issuer according to the comment letter. This is not added to an application which is judged by the SEC to be complete from the very beginning. Thus the said acceptability condition does not mean that the SEC has a "blue sky" type jurisdiction. This is confirmed by another provision which requires the following statements to be contained on the front cover page of a prospectus:

Consent of the Securities and Exchange Commission has been obtained to the issue/offer of these securities under the Securities and Exchange Ordinance, 1969, and Public Issue Rules, 1998. It must be distinctly understood that in giving this consent the Commission does not take any responsibility for the financial soundness of the company, any of its projects or the issue price of its share or for the correctness of any of the statements made or opinion expressed with regard to them, responsibility for which lies on the issuer, its directors, investment adviser, issue manager, valuer and/auditor. It is, however, the Securities and Exchange Commission's responsibility to ensure that full and fair disclosures are made in the prospectus in terms of the Public Issue Rules, 1998, so that the investors can make informed investment decisions.<sup>498</sup>

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<sup>496</sup> *Ibid.*, r.18(5).

<sup>497</sup> *Ibid.*, r. 18(7).

<sup>498</sup> *PIR*, r. 7.B.(1)(i).

In respect of any queries about the prospectus the public is directed by another statement to consult a “broker or dealer, bank manager, lawyer, professional adviser”.<sup>499</sup>

However, when the SEC accepts an application and issues a Consent Order allowing the publication of a prospectus, the issuer must file with the Registrar of Joint Stock Companies (RJSC) the final application along with its enclosures including the Consent Order of the SEC. The RJSC checks whether the necessary documentation is enclosed, prescribed fees are paid and the prospectus is duly signed by the directors. Then, if satisfied, the Registrar will register the prospectus.<sup>500</sup> Within ten days of receiving consent to the issuance of a prospectus, it is advertised amongst the public in general inviting applications for purchase of securities offered.<sup>501</sup>

From the above discussion the laws of Ontario and Bangladesh may seem to conform in that each of the OSC and the SEC, after vetting, gives consent to a prospectus provided they are satisfied that the information required by the law concerned have been furnished and that neither of the institutions judges the merit of the securities proposed to be offered. But Ontario law requires the OSC to go beyond the statutory requirement of disclosure and to refuse receipting a prospectus in “public interest”<sup>502</sup> in general and on some defined grounds<sup>503</sup> in particular.

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<sup>499</sup> *Ibid.*, r.7.B.(1)(h).

<sup>500</sup> *CA, 1994*, s. 138.

<sup>501</sup> *PIR*, r.4(1).

<sup>502</sup> *OSA, R.S.O. 1990 c. S.5.*, s. 61(1).

<sup>503</sup> *Ibid.*, s. 61(2).

Section 61(1) of the *OSA*, incorporated in 1978<sup>504</sup>, provides that “the Director shall issue a receipt for a prospectus ... unless it appears to the Director that it is not in the public interest to do so.” But it does not define the term, “public interest”. *Black’s Law Dictionary* defines it to mean, *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.”<sup>505</sup> The power is bestowed on the OSC to decide “what the public interest is and whether the issuance of the given receipt is contrary to that public interest.”<sup>506</sup> For instance, in one case the OSC interprets the term to connote “not only the interest of residents of Ontario, but the interest of all persons making use of Ontario capital markets.”<sup>507</sup> In this connection it may be noted that in forming its opinion as to public interest the OSC must take into account “the exigencies of the individual cases that come before it”.<sup>508</sup>

Today the “public interest” phenomenon has become a cornerstone of the securities legislation in Ontario and in other provinces of Canada for the purpose of protecting the investing public. There are many cases in which the OSC has shown its concern and refused to accept prospectuses on this ground. Even before formal insertion of this provision the OSC exercised its discretion, under the previous *Securities Act*, in

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<sup>504</sup> *OSA*, R.S.O. 1978 c. 47 s. 60(1).

<sup>505</sup> *Black’s Law Dictionary*, *supra* note 172, *s.v.* “public interest”.

<sup>506</sup> Alboini, *supra* note 77, at 15-29.

<sup>507</sup> Per McKinlay J.A. in *Asbestos Corp.*, [1992] 15 O.S.C.B. 4973 at 4999, 58 O.A.C. 277, 97 D.L.R. 144, 10 O.R. (3d) 577 (Ont. C.A.).

public's interest. In *Rivalda Investment Corporation Ltd.*,<sup>509</sup> 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."<sup>510</sup> Therefore, on the public interest ground it declined to accept the prospectus of the company until qualified directors were appointed. The OSC gave its reasonings as follows:

The Securities Act is primarily a disclosure statute but Section 44(1) (now s. 61(1) and 61(2) ) does give the Director a discretion in accepting prospectuses. This power must be exercised with caution. The Director or the Commission, should not, except in the clearest cases, impose their judgment on the merits of an issue, in place of the judgment of the investing public. The decision to purchase securities offered for sale must be that of the purchaser. However, there are situations where the Director and the Commission are entitled under the discretion in Section 44, to require that certain safeguards be adopted for the benefit of the public.

The inexperience of the Directors in the present case in our view calls for the imposition of some safeguards beyond that of disclosure. One hesitates to leave the responsibility for the investing of funds provided by the public solely in the hands of these inexperienced persons.<sup>511</sup>

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<sup>508</sup> *Ontario (Securities Commission) v. Mitchell*, [1957] O.W.N. 595 at 599, cited in *Gordon Capital Corp. v. Ontario Securities Commission* (1991), 1 Admin. L.R. (2d) 199, at 211 (Ont. Div. Ct.) (per Craig J.).

<sup>509</sup> [Dec. 1965] O.S.C.B. 2.

<sup>510</sup> *Ibid.*, at 3.

<sup>511</sup> *Ibid.*, at 4.

That the *OSA* is not merely a disclosure statute was also upheld in subsequent decisions. In *Great Pines Mines Ltd.*,<sup>512</sup> for example, the OSC's power to issue policy statements<sup>513</sup> as guidelines for exercising its discretion was questioned. Could the OSC issue and maintain such policies under the discretion provision (section 44) of the then *Securities Act*? The OSC relied on *Rivalda* and said that it had the necessary authority in view of the broad discretion provided under section 44 and in the

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<sup>512</sup> [Feb. 1966] *O.S.C.B.* 7.

<sup>513</sup> With regard to the Director's discretion under s. 61 various prospectus guidelines are laid down in Policy 5.1, which include the following:

1. "Under s. 61(2)(c) of the *Securities Act* (Ontario) (the "Act") requires the Director of the Ontario Securities Commission to refuse to issue a receipt for a prospectus where it appears to him that proceeds received from the sale of securities to be paid to the treasury of the issuer, together with other resources, will be insufficient to accomplishing the purposes stated in the prospectus. One major resource is people. Sufficient of the directors and officers of the issuer should have knowledge and experience in the business for which funding is to be sought so that the Director will not conclude that the human and other resources are insufficient to accomplish the purpose stated in the prospectus. Where such knowledge and ability is not apparent in the directors and officers the Director may be satisfied where it is shown that the issuer has contracted for such services."
2. "In a "best efforts" offering, the minimum subscriptions necessary to accomplish the purposes embodied in the prospectus must be specified. Section 27(1)7 [38(1)(7)] of the regulations made under the Act (the "Regulation") restricts this offering period to a maximum of 60 days or, with the consent of the Director and those already subscribing, for a longer period. During this period any subscriptions received must be held by a trust company or other acceptable depository who will, when the minimum amount necessary is received, turn it over to the issuer or will, if the minimum is not received within the time specified, return the money to the individual subscribers."

light of the purpose of protecting the investing public. Justice Kelly commented such an authority to be “a self-conferred extension of the power exercisable, under section 44”<sup>514</sup>.

The OSC justified its authority interpreting the word “self-conferred” as follows:

(T)he Legislature having failed to specify the grounds upon which the director could and the grounds upon which he could not exercise what is on its face an unfettered discretion to refuse to accept a prospectus, the Commission had, lacking the guidance of the Legislature, been forced to work out those grounds for itself.<sup>515</sup>

In *United Security Fund*<sup>516</sup> the Deputy Director of Filings refused to issue a receipt because the proposed Fund lacked the basic principle upon which mutual funds are based, namely diversification and liquidity. On appeal the Commission held that

We are of the view that it is not in the public interest to accept this prospectus. As presently framed the essential element of diversification is lacking. Liquidity, from the point of view of Canadian investor, is questionable. The decision of the Deputy Director Filings will therefore be affirmed.<sup>517</sup>

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3. “Where securities of a class may be partially redeemed or repurchased, the manner of selecting the securities to be redeemed or repurchased should be clearly stated.”

<sup>514</sup> In *Great Pines*, *supra* note 512, the OSC quoted Justice Kelly from the *Report of the Royal Commission to Investigate Trading in the Shares of Windfall Oils and Mines Limited*, saying as follows:

In absence of a clear delineation of its purpose, responsibilities and powers, over the years, the Securities Commission has, by administrative practice, established a workable control over the issue of securities of those companies required by The Securities Act to file prospectuses. This has been accomplished by a self-conferred ... extension of the power exercisable, under Section 44, to reject prospectuses. (at 95)

<sup>515</sup> *Great Pines*, *ibid.*

<sup>516</sup> [Sept. 1971] *OSCB* 133.

In *Loki Resources Inc.*<sup>518</sup>, it was determined that the issuer had no resources, properties or prospects nor even any intention to acquire any. The Director, therefore, decided that in absence of any assets or business activities or any expectation therefor, any disclosure by the issuer would be meaningless. Similarly, existence of business was considered in *Inland National Capital Ltd.*,<sup>519</sup>. In that case the prospectus indicated, among others, that Inland Ltd. had limited assets with no plan for future. It also had debts and lack of funding. The OSC refused to issue receipt in the public interest interpreting the financial position as amounting to non-existence of business.

In *Tricor Holdings Co. Inc.*<sup>520</sup> because the company was controlled by a convict, the Director refused to accept the prospectus. He based his decision on section 61(2)(e) which provides for refusal of receipting a prospectus when the past conduct of the issuer or an officer, director, promoter or controlling shareholder forms reasonable grounds for belief that “the business of the issuer will not be conducted with integrity and in the best interests of its security holders”. On appeal the majority of the Commission upheld the decision of the Director, but the minority dissented on the ground that there was no evidence that the actual business of the issuer had not been conducted with integrity. The majority maintained that:

So to hold would reflect a narrow view of the legislation and would be inconsistent with prior Commission decisions and the decisions of the courts. But if clause 60(2)(e) [now s. 61(2)(e)], narrowly construed, did

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<sup>517</sup> *Ibid.*, at 134.

<sup>518</sup> (Feb. 1984), 8 O.S.C.B. 583.

<sup>519</sup> (1996), 19 O. S. C. B. 773.

<sup>520</sup> *Tricor Holdins*, *supra* note 320.

not strictly apply the Director would still be obliged to consider the public interest test under subsection 60(1) [now s. 61(1)].<sup>521</sup>

*Med-Tech Environmental Ltd.*<sup>522</sup>, addressed the central issue whether a private company exemption could be used to issue special warrants. The Director determined that a special warrant offering was, in substance, a single distribution under a prospectus and therefore a public offering. As such special warrants could not be distributed under the camouflage of the private company exemption. The Director's decision was prodded by the spirit of investor protection. In her own words:

The Private Company Exemption does not require the investor to have a specified level of investment expertise, nor does it require that the investor be provided with independent investment advice. There is unlikely to be a dealer involved so there will be no dealer familiar with the transaction to whom the investors may go for advice with respect to the prospective investment. Also, in these circumstances, there is a risk that the investor is not someone who is truly able to protect their own interests without the benefit of the protection that the prospectus and registration regimes of the Act provide.<sup>523</sup>

It has been observed in the preceding discussion that unlike the SEC the OSC, legally empowered, does, in practice, exercise its discretion in giving approval to prospectuses in addition to its responsibility of ensuring the fulfillment of the disclosure requirement under the *OSA* because "public interest" constitutes "the paramount

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<sup>521</sup> *Ibid.*, at 4091.

<sup>522</sup> [May 1996] 19 O.S.C.B. 2679.

<sup>523</sup> *Ibid.*, at 2681.

consideration” for the OSC<sup>524</sup>. It does so always keeping in mind the tenet of investor protection. Thus it can be concluded, in the words of Alboini, that

(In Ontario) (f)ull, true and plain disclosure of all material facts in accordance with the Act and Regulation does not guarantee the issuance of a receipt. The manner in which the Director has exercised his or her considerable discretion, and the existence of certain provisions in the Act and Regulation have resulted in the administration of the Act going beyond a purely disclosure approach and into the realm of a “blue sky” system.<sup>525</sup>

As such the following statement required to be inscribed on the outside front cover page of a prospectus has become superfluous<sup>526</sup>:

No securities commission or similar authority in Canada has in any way passed upon the merits of the securities offered hereunder and any representation to the contrary is an offence.<sup>527</sup>

While a general discretion, as discussed above, has been conferred on the Director under s. 61(1) in the fashion of “public interest”, s. 61(2) requires the Director to refuse a receipt for a prospectus under some specified circumstances. “The Director is the judge of whether such circumstances exist, and this has the effect of conferring additional discretion upon the Director.”<sup>528</sup> A brief discussion of those grounds ensues below.

### **Material Non-compliance and Misstatement**

Three situations come within this prohibition as contained in s. 61(2)(a) where the Director can refuse to accept a prospectus. In the first place, if the Director is of

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<sup>524</sup> *Terence Edward Robinson*, [1996] 19 O.S.C.B. 2643 at 2669.

<sup>525</sup> Alboini, *supra* note 77, at 15-27

<sup>526</sup> See *ibid.*, 15-12.

<sup>527</sup> OSAR, R.R.O. 1990 Regulation 1015, reg. 51.

the opinion that the prospectus or any document accompanied by it does not comply, in any *substantial* respect, with any requirement of the *OSA* or *OSAR*, the Director can exercise the refusal power.<sup>529</sup> The word “substantial” qualifies the situation, so minor non-compliance with any requirement of prospectus should not trigger the refusal of receipt. Information about the principal shareholders is, for example, a substantial requirement of the *OSAR* forms.<sup>530</sup> The non-fulfillment of this requirement may, therefore, be a ground of the Director’s exercising of such power. The Commission sets out the guidelines in this respect as under:

Issuers ... should organize themselves in a manner which will enable them to obtain and disclose information concerning principal security holders. If, however, the issuer has exercised reasonable efforts to obtain the information concerning the principal security holder and has been unable to do so, the Commission may, in appropriate circumstances, issue a receipt for the prospectus and may exercise its powers to deny access to Ontario capital markets to the principal security holder which has not disclosed the required information.<sup>531</sup>

Secondly, the Director may not receipt a prospectus where the prospectus or any document required to be filed therewith contains any statement, promise, estimate or forecast that is misleading, false or deceptive.<sup>532</sup> For instance, in *Farmers & Merchants Mutual Funds Ltd.*,<sup>533</sup> a prospectus was not accepted because the fact that a company had

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<sup>528</sup> Alboini, *supra* note 77, at 15-32.2.

<sup>529</sup> *OSA*, s. 61(2)(a).

<sup>530</sup> See the text accompanying *supra* note 311.

<sup>531</sup> *Supra* note 320.

<sup>532</sup> *OSA*, R.S.O. 1990 c. S.5, s. 61(2)(a).

<sup>533</sup> [April 1962] O.S.C.B. 4. Also see *Great Divide Explorations Limited*, [July-August 1965] O.S.C.B. 10.

undertaken services as a trust company, when it was not legally a trust company, was misleading. Thirdly, the prohibition on accepting a prospectus applies when a prospectus or any document required to be filed therewith contains a misrepresentation.<sup>534</sup> In *M & M Porcupine Gold Mines Ltd.*,<sup>535</sup> a contract effecting disposition of certain property had been negotiated before filing the prospectus and entered into before the final prospectus was accepted, but the issuer did not include that fact in the prospectus. Therefore, the Director held the prospectus having the effect of concealing material facts and ordered cessation of the primary distribution based on the prospectus.

### **Unscrupulous Consideration**

Section 61(2)(b) of the *OSA* requires the Director to refuse a prospectus on the ground that 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. For instance, in *Harvard Growth Fund Ltd.*,<sup>536</sup> the Commission, on appeal, did not accept a prospectus for filing by a mutual fund company because it appeared to the Commission that a provision contained in it permitting the promoters to purchase shares at figure less than

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<sup>534</sup> *OSA*, R.S.O. 1990 c. S.5, s. 61(2)(a). “Misrepresentation” is defined in *OSA*, R.S.O. 1990 c. S.5, s. 1(1) “misrepresentation” as

- (a) an untrue statement of material fact, or
- (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made.

For the definition of “material fact”, in this context, see the text accompanying *supra* note 286.

<sup>535</sup> [Dec. 1965] O.S.C.B. 10.

net asset value was unconscionable. The Commission took into consideration that the *OSA* is not exclusively a disclosure statute and that the mutual funds are primarily directed to those who are least experienced in assessing the merits of securities. It then assessed the unconscionability of the right granted to the promoters in the following words:

One cannot say, at this moment, what the eventual benefit to the promoters may be, but there is an unlimited possibility for future benefit. ... In addition to the potential benefit the promoters may receive from the increase in the value of the fund, their profit also increases according to the number of the shares sold to the public. A portion of each dollar invested by the public accrues to the benefit of the promoters regardless whether the net asset value of the fund increases or not.<sup>537</sup>

### **Inadequate Proceeds**

Under section 61(2)(c) the Director has the authority to determine whether the proceeds from the sale of securities proposed to be offered by the prospectus, together with other resources of the issuer<sup>538</sup>, would be sufficient to accomplish the purpose of the issue as stated in the prospectus. If the Director considers the proceeds to be insufficient, the Director may reject the prospectus. Thus in *St. Anthony Mines Ltd*<sup>539</sup>, where the issuer was carrying on a costly business, mining exploration, the Director estimated that though the funds then available were sufficient to complete the initial step of the proposed

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<sup>536</sup> [Sept. 1965] O.S.C.B. 7.

<sup>537</sup> *Ibid.*, at 9.

<sup>538</sup> Other resources include people, e.g., directors, officers of the issuer. See *supra* note 513, para. 1.

<sup>539</sup> [Oct. 1966] O.S.C.B. 23.

exploration, the money likely to be raised by the sale of the unissued shares would fall short of the requisite funding. As such the Director refused to accept the prospectus.

### **Pecuniary Condition and Previous Performance**

The OSA empowers the Director not to receipt a prospectus in consideration of the financial condition<sup>540</sup> or the past conduct<sup>541</sup> of the issuer or an officer, director or promoter or a person or company or combination of persons or companies holding a sufficient number of securities to affect materially the control of the issuer. As described earlier, the prospectus form(s) asks for an account of the past and present state of the issuer's business and ownership of property, names and addresses and positions held, in the past and at present, by the directors and officers, etc. Beyond the disclosure of such information the Director will determine whether the issuer or the persons specified can be reasonably be expected to be financially responsible in carrying out the business<sup>542</sup> or whether from their past conduct it can be expected that the issuer's business will be conducted with integrity and in the best interest of the security holders.<sup>543</sup> If the Director, after such determination, forms a negative impression, the Director may decline receipting the prospectus. In other words, the Director will resort to these provisions when "it is relatively clear that the persons in question are experiencing financial difficulties, or have been subject to disciplinary or enforcement proceedings in

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<sup>540</sup> OSA, R.S.O. 1990 c. S.5, s. 61(2)(d).

<sup>541</sup> *Ibid.*, s. 61(2)(e).

<sup>542</sup> *Tricor Holdings. supra* note 320.

securities or criminal matters”<sup>544</sup>. These provisions, “derived from various consumer protection statutes in Ontario”<sup>545</sup>, are meant to “ensure a minimum standard of quality for the offering itself or the issuer offering the securities”<sup>546</sup>.

### **Required Agreements**

As discussed earlier, there is an obligation on the issuer to disclose information concerning shares held in escrow.<sup>547</sup> Despite that provision the *OSA* clothes the Director with power to look into whether there is any need of executing an escrow agreement. If the Director is of the opinion that such an agreement is required but has not been done, the Director may not issue a receipt until that agreement is not executed.<sup>548</sup> Thus in *Kolvox Communications Inc.*<sup>549</sup>, the Director underlined the need of escrowing a substantial number of control block shares and refused to accept the prospectus until an agreement to that effect is accomplished. The Commission upheld that decision upon a review motion by the issuer. The Director can also exercise the refusal power on the ground that the issuer has not made an agreement to the effect of holding the sale proceeds in trust pending distribution of securities, albeit the issuer, in the Director’s

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<sup>543</sup> *Tricor Holdings*, *supra* note 320 and the accompanying text, at 4091.

<sup>544</sup> *Alboini*, *supra* note 77, at 15-37.

<sup>545</sup> *Ibid.*, at 15-36.

<sup>546</sup> *Ibid.*

<sup>547</sup> See the text accompanying *supra* notes 311 and 312..

<sup>548</sup> *OSA*, R.S.O. 1990 c. S.5, s. 61(2)(f). See in this connection OSC policies 5.2 and 5.9 which set out the circumstances necessitating an escrow of shares of an industrial company and the escrow requirements for a natural resource company respectively.

<sup>549</sup> [March 1994] 17 *O.S.C.B.* 1521.

judgment, should have done such an agreement.<sup>550</sup> In the guise of this power the Director can, for example, require the issuer of a best efforts offering, as already dwelt upon, to escrow the proceeds until all or a minimum number of securities are sold.<sup>551</sup>

### **Unacceptability of Professionals**

If 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, the Director will refuse to accept that prospectus.<sup>552</sup> Though the Director has discretion, as seen above, to assess the financial fitness and past conduct of the issuer and certain persons involved in the issuer's business, this provision has given greater discretion to "the Director to make subjective assessments about persons involved in the preparation of a prospectus, and (thereby) ... to refuse to issue a receipt for a prospectus"<sup>553</sup>. Thus if an audit is not done according to the generally accepted auditing standards, that will be a ground of prospectus refusal.<sup>554</sup>

As the OSC can refuse prospectus receipt on certain grounds discussed above, it may lead one to the conclusion that the OSC has a limited "blue sky" jurisdiction. In fact, it enjoys much discretion when it decides whether a particular circumstance merits the application of its discretion on any of those grounds. In addition,

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<sup>550</sup> *OSA*, R.S.O. 1990 c. S.5, s. 61(2)(g).

<sup>551</sup> *OSC Policy* 5.1.

<sup>552</sup> *OSA*, R.S.O. 1990 c. S.5, s. 61(2)(i).

<sup>553</sup> Alboini, *supra* note 77, at 15-40.

<sup>554</sup> See *Price Waterhouse*, [April 1990] 13 O.S.C.B. 1473.

the “public interest” provision further expands this jurisdiction. In practice, as appears from the foregoing discussion, the OSC takes such a broader view in the application of this jurisdiction.<sup>555</sup>

Lest the OSC become unscrupulous or tyrannical in the exercise of this power, the Legislature has subjected the OSC decisions to judicial appeal. The *OSA* requires the Director to give the person or company filing the prospectus an opportunity to be heard before issuing a refusal order.<sup>556</sup> A person or company who is directly aggrieved by a decision of the Director may seek and be entitled to a hearing and review thereof by the Commission.<sup>557</sup> Such a person or company may prefer an appeal to the Divisional Court from the review decision of the Commission.<sup>558</sup> Before refusal the Director may refer to the Commission for determination a question involving public interest under s. 61(1) or a new or novel question of interpretation under s. 61(2) which might result in such refusal.<sup>559</sup> Before referral, however, the Director should “make every effort to resolve its comments (relating the question) through discussion with those responsible for filing the prospectus. Only when it is clear that such discussion will not be productive should consideration be given to (such) a referral”<sup>560</sup>. Upon referral the Commission, after holding a hearing of the parties, determines the question and refers it

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<sup>555</sup> Alboini, *supra* note 77, at 15-34.

<sup>556</sup> *OSA*, R.S.O. 1990 c. S.5, s. 61(3).

<sup>557</sup> *Ibid.*, s. 8.

<sup>558</sup> *Ibid.*, s. 9.

<sup>559</sup> *Ibid.*, s. 61(4).

<sup>560</sup> *Chancellor Futures Fund II*, [Feb. 1980] O.S.C.B. 77, at 77-78.

back to the Director for final consideration.<sup>561</sup> The Director must act upon the decision of the Commission subject to any order of the Divisional Court on appeal.<sup>562</sup>

#### **2.3.4 SUMMARY**

The foregoing discussion may be put in a capsule form as follows:

- (a) Under both the jurisdictions of Ontario and Bangladesh a prospectus is required mainly for sale of securities from an issuer's treasury. Unless an exemption is available, an issuer must qualify a prospectus with the respective securities commission for the purpose of furnishing information to the potential investors so that they can make informed decision on investment.
- (b) Bangladesh is based on the disclosure theory while Ontario law on the combination of the disclosure and merit review theories. So far disclosure is concerned the former requires full and fair disclosure of all material information through prospectus to the public, which, in effect, conforms to the Ontario requirement of full and true disclosure of all material facts. The two laws, however, differ in that Ontario law calls for plain disclosure, but Bangladesh law does not.
- (c) According to the said broad requirement of disclosure both the laws of Ontario and Bangladesh set out various categories of information, financial and non-financial. Ontario prospectus Form 12 enlists 34 items of non-financial items to be contained in a prospectus. Some of the information required by the Ontario form are absent in the

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<sup>561</sup> OSA, R.S.O. 1990, c. S.5, s. 61(7).

Bangladesh form, but are contained in prospectuses in practice, e.g., equity capital structure. There are some other matters which are totally absent both in law as well as in practice, e.g., dividend record, returning money to the investors in the event of a best efforts issue being undersubscribed. Each of the laws, however, contains a miscellaneous item in the respective form having “catch-all” effect. As a result, an issuer is obligated to disclose material facts even not specified by the laws for incorporation into the prospectuses.

Both in Ontario and Bangladesh same kinds of financial statements, reports and certificates are provided in the respective prospectuses. The Ontario income and cash-flow statements and the Bangladesh loss and profit , and cash-flow statements cover the same length of time, namely five years. In Ontario balance sheets are prepared for current year and immediately previous year , in Bangladesh they are made for five preceding years. In Ontario financial statements and audit reports are prepared according to the GAAP and GAAS, and in Bangladesh they are prepared according to IAS and ISA respectively. In practice, it is doubted if any full and true financial disclosure made in prospectuses in any of the jurisdictions.

In Ontario forecasts/projections are made for 24 months only, while in Bangladesh they cover a 5-year period subsequent to the issue. Unlike Bangladesh's, Ontario forecasts/projections are required to be supported by an auditor's report.

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<sup>562</sup> *Ibid.*, s. 61(8).

- (d) In Ontario both vetting and receipting of prospectuses are performed by the OSC, while in Bangladesh vetting and approval is done by the SEC and receipting by the RJSC. In Ontario during the “waiting period” the public can have knowledge of the issue. The public has a right to compensation, if no prospectus is supplied. A member of the public can enter into a purchase agreement with the dealer, and can also terminate that agreement, at its own, after the final prospectus is delivered, if any misrepresentation is made in the prospectus. A statement of such right is also made in the prospectus in Ontario. In Bangladesh a prospectus, after approval, is published giving 15 days for application for allotment of shares. But if shares are allotted, a purchaser cannot cancel the purchase. Of course, he or she has the right to compensation, if a prospectus contains any misrepresentation.
- (e) The OSC is empowered to review the merit of an issue and refuse receipts on “public interest” ground in general and on some specified grounds in particular. In Bangladesh the SEC does not have such power either in law or in practice.

### **3 CRITICAL EVALUATION OF THE COMPARISONS**

#### **1. Absence of Specific Items**

As already discussed, Bangladesh law provides for full and fair disclosure of all material information, which, in effect, is similar to the full and true disclosure of Ontario law. To fulfill this requirement both the laws prescribe almost a similar set of items to be contained in a prospectus. But some items, though required by the Ontario form, do not have any place in the Bangladesh form. For example, as aforementioned, provisions of dividend record and underwriters responsibility in a best efforts offering are missing in Bangladesh form. From the dividend record of an issuer the intending investors can make a tally of the percentages of the promised dividends and the actually declared/disbursed dividends. If it is found that the issuer could disburse the promised percentage of dividends or an amount close to it, the investors would feel comfortable to invest in the proposed project. If the tally gives a reverse picture, they may not have an interest to invest. The dividend record is an important item that should be subject to disclosure and a clear provision in this respect should, therefore, be put in a Bangladesh prospectus. Secondly, the Bangladesh law does not require information about best efforts underwriting, whereas, as pointed out previously, there is a scope of such underwriting under the *CA, 1994*. An underwriter is most unlikely to agree to fully underwrite the offering of a new issuing company because he may have doubts if all of the issuer's securities would be purchased by the public. The investing public may have an idea of the

performance of the companies that have issued securities earlier. As such when a company with a good past record offers securities, the public may be expected to be more enthusiastic and confident to purchase those securities. But when an issuer is quite a dark horse in the market, the public is not likely to eagerly invest in its securities. In consideration of this fact an underwriter may be reluctant to fully underwrite a new issuer's securities. Rather the underwriter may agree to underwrite on the best efforts basis. In that case, to quote Prifti,

the underwriter acts as an agent for the company and simply uses its best efforts to try to sell as many securities as he can. If none is sold, there is no liability to the underwriter and no proceeds to the company. When securities are sold, the net proceeds are remitted to the issuer-company, the underwriting commission being withheld.<sup>563</sup>

Keeping in view this practical situation Ontario law, as discussed earlier, requires, in respect of a best efforts offering, the issuer to disclose the minimum amount to be raised for running a proposed project. It also requires the issuer to deposit that amount in a trust company so that in case the required amount of money is not raised, the subscription money can be returned to the investors. Since Bangladesh law does not contain any such provision, the public may not have faith in the issuer and may fear if the issuer, absconds with the public money or if the minimum amount is not raised and he starts business with money below the minimum amount and fails to successfully carry on the business ultimately incurring loss. If such a provision is incorporated in the law, that will help

bolster the public confidence in the market. Thus Ontario law in this respect seems to be better than Bangladesh law.

Though there is a provision for fixed underwriting of issues and the underwriter is under obligation to subscribe securities in the event of undersubscription<sup>564</sup>, in practice this obligation is not always carried out. When a fully underwritten issue is undersubscribed, the underwriter who is obligated to purchase the unsold securities at a fixed rate charges more commissions.<sup>565</sup> In some cases the underwriter proposes to buy the remaining securities at lower price than the face value. Thus such securities of 100 taka value each has to be sold by the issuer to the underwriter at only 70-80 taka. As a result, a lesser amount of funds is raised and the issuer cannot defray the costs of the investment project and fails to make profits.<sup>566</sup> The investors purchase shares at a price higher than the underwriter does. Once they have subscribed, their money is locked in the hands of the issuer who cannot make profits. This is one of the reasons why the investors have lost their confidence in the securities market of Bangladesh. In this connection the disclosure of the interest of the promoters and management of the issuer in material transactions, which is not required by Bangladesh law, deserves special attention of, for example, a director of the issuing company is also a director of the underwriting company, when an issue is undersubscribed and the

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<sup>563</sup> William M. Prifti, *Securities: Public and Private Offerings*, (St. Paul. Minn.: West Publishing Co., 1974), at 80.

<sup>564</sup> *PIR*, r. 15(2).

<sup>565</sup> *Share Bazar*, *supra* note 38, at 3.

<sup>566</sup> *Ibid.*, at 3-4.

underwriter buys the remaining securities at a lower price than the price at which the investors have purchased, that director will gain a benefit from that buy. Or he or she may play a role in influencing the issuer to sell those securities at the lower price proposed by the underwriter. Thus that Bangladesh law does call for information about the interest of the promoters and management in material transactions is a colossal oversight.

Though it may be argued that under the miscellaneous item provision of the *PIR* such matters as are mentioned above are subject to disclosure, specific provisions relating to them will facilitate the disclosure. From such categorization the issuers can learn what they are obliged to disclose and the investors can also know what sorts of information they are legally entitled to be furnished through a prospectus. If such categorization did not have any justification, merely a general provision calling for disclosure of all material information like the miscellaneous one would have been laid down in the law giving all the responsibility to the issuer. But the law-makers have preferred specific disclosure so that the investors understand the risk involved in the security offered for sale. So, specific provisions effecting disclosure of the aforementioned matters are of great value.

It has also been observed that both the laws require similar kinds of financial statements to be furnished in respective prospectuses and that the veracity of those statements is questionable. Sometimes the issuers prepare, contrary to the purpose

of prospectus in general<sup>567</sup>, false or partially true statements and the auditors overlook them. In this manner the auditors become accomplices to the issuer-clients paying no heed to the public interest, even though they have, as the US Supreme Court maintains, “a public responsibility transcending any employment relationship with the client”<sup>568</sup>.

However, in spite of the fact that both jurisdictions are experiencing problems of non-compliance with the requirement of full and true disclosure particularly of financial information, the Ontario position may be argued to be better in consideration of two factors. First, the OSC, in the exercise of its public interest mandate, may refuse to issue receipt where any questionable accounting or auditing practices come to its view.<sup>569</sup> Thus, for example, the OSC staff refused to receipt a prospectus where an issuer wanted certain costs, previously spent as incurred, to be treated as costs of creating an internally generated intangible asset. The effect of the recognition of such intangible was to make a profit instead of loss. The OSC staff considered such recognition having little or no justification. Another ground of the refusal was that the issuer “inappropriately” recognized certain revenue before it had earned. The auditor of the issuer failed to buttress the issuer’s position with reasoned arguments.<sup>570</sup> In the same vein, the Director may refuse receipting if the FOFI provided in a prospectus is not acceptable in public

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<sup>567</sup> “Its (prospectus’s) primary purpose is not to be a sales tool or to “hype” the offering corporation and its securities, but rather to provide truthful and complete information to the investor ..... ”. : Goulet, *supra* note 16, at 122.

<sup>568</sup> *Supra* note 435, at 3509.

<sup>569</sup> *Ibid.*

<sup>570</sup> *Ibid.*, at 3506.

interest. Thus in *Petro-NIM 1988 Limited Partnership*<sup>571</sup> the Director refused to issue a receipt by reason of the inclusion in the prospectus of certain FOFI in the nature of a forecast without the Director's permission. The Commission confirmed the Director's decision in the public interest. But since in Bangladesh the SEC does not have such power, there is no scope for looking into the merit of financial disclosure. This is a serious defect of Bangladesh law, which will be further dealt with *infra*.<sup>572</sup> Secondly, in Ontario after securities have been distributed, if any misrepresentation is found in the prospectus disclosure the investors have a right of action for damages.<sup>573</sup> They may invoke justice in an individual or class capacity. The settlement of such a matter may not take an unreasonably long time. The Bangladesh investors have a similar right,<sup>574</sup> but to avail of that right is difficult. There is no court of law specially meant to deal with securities matters. The general courts are overburdened with cases. A host of matters remain undisposed for years. The disposal of a case takes five to ten years. Added to this is the fee-burden for legal counseling. Moreover, the ultimate fate of the action is uncertain and unknown. All these factors hinder the investors, individually or collectively, from resorting to the legal system in Bangladesh. However, in such situations the SEC may apply its administrative mechanism provided for under the *PIR* and impose penalty on the responsible issuer or its representative.<sup>575</sup> But this does not

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<sup>571</sup> [Sept. 1988] 11 O.S.C.B. 3731.

<sup>572</sup> See the discussion accompanying the *infra* notes 590-99.

<sup>573</sup> *Supra* notes 469-476.

<sup>574</sup> *Supra* notes 477-481 and the accompanying texts.

<sup>575</sup> *PIR*, r. 19. Also see *supra* note 51.

help the investors who have lost their money or have not received the forecast dividends because of false financial statements. The money received by the SEC as fines is deposited in the government treasury; none goes into the pockets of the investors. Preventive measures by the SEC, that is merit determination, may be necessary in Bangladesh.

## **2. No Plain-Disclosure Provision**

As already discussed, another drawback in Bangladesh law is that unlike Ontario it does not call for plain disclosure of material information. In practice, sometimes information is presented in prospectuses in highly technical terms. For example, a guideline used in preparing the financial statements of a company has been stated as follows: “Fixed Assets except Land & Land Development are depreciated on *reducing balance method*.”<sup>576</sup> Persons having good knowledge of accounting can understand such an expression, but people with little learning in accounting may not. Moreover, in practice, prospectuses are published in English which is a foreign language for the people of Bangladesh. It is difficult or impossible to read a prospectus in English for those investors who have little or no learning in the English language. This is another barrier to understanding a prospectus. Ontario law provides for plain disclosure so that a prospectus can be “*read* by investors generally and not only by security analysts and other

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<sup>576</sup> *Supra* note 334, at 19.

trained persons”<sup>577</sup>. Readability, in the present context, means that a prospectus must be understandable. In other words, information must be presented in such a manner so that even lay investors can read and understand it. The following (US) SEC’s instruction that forms the basis of Ontario law is relevant.

The purpose of the prospectus is to inform the investors. Hence, the information set forth in the prospectus should be presented in clear, concise, *understandable* fashion. Avoid unnecessary and irrelevant details, repetition or the use of unnecessary technical language. . . .<sup>578</sup>

In this connection it may be acknowledged that security is an “intricate merchandise”<sup>579</sup> and may not be so plainly presented to be “intelligible by school children”<sup>580</sup>. In other words, lay investors may not understand prospectus disclosure, specially financial disclosure:

There are also the perennial questions of whether prospectuses, once delivered to the intended reader, are readable, and whether they are read. The cynics answer to both questions is ‘No’; the true believer’s is ‘Yes’; probably a more accurate answer than either would be: ‘Yes’- by a relatively small number of professionals or highly sophisticated non-

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<sup>577</sup> *Kimber Report*, *supra* note 233, para. 5.09. (emphasis added).

<sup>578</sup> *Ibid.*, (emphasis added). The SEC instruction for plain disclosure has been carried forward by the United States Securities and Exchange Committee, *Disclosure to Investors: A Reappraisal of Administrative Policies Under the 1933 and 34 Act* (1969) (popularly called and hereinafter referred to as *Wheat Report*). The *Wheat Report* has been echoed by the judiciary in *Feit v. Leaseco Data Processing Equipment Corp.*, 332 F. Supp. 544, (ED NY 1971) at 565-566.

<sup>579</sup> H.R. Rep. No. 85, 73d Cong. 1st Sess. (1933) 8, cited in Loss and Cowett, *Blue Sky Law*, *supra* note 212, at 1. This report was based to prepare the bill that became the *Securities Act, 1933*.

<sup>580</sup> “New Approaches to Disclosure in Registered Security Offerings- A Panel Discussion”, (1973) 28 Bus. Law. 505 at 528.

professionals; 'No' - by the great majority of those investors who are not sophisticated.<sup>581</sup> ...

But this does not negate the need for plain disclosure for two reasons. First, such disclosure will help the sophisticated investors comfortably understand the prospectus disclosure and make sober investment decisions. The securities legislation is meant to protect the "investors", not only lay investors. So, the sophisticated investors will benefit from plain disclosure. Secondly, if the unsophisticated investors themselves do not understand, they may purchase the services of the securities brokerage firms, securities consultants, lawyers or other intermediaries who may advise them whether an investment in a particular security would be profitable in light of the prospectus disclosures. This process of passing information through the intermediaries to the investors has been termed by the *Wheat Report* as "filtration" of information:

Indeed, it was recognized from the beginning that a fully effective disclosure policy would require the reporting of complicated business facts that would have little meaning for the average investors. Such disclosures reach average investors through a process of filtration in which intermediaries (brokers, bankers, investment advisers, publishers of investment advisory literature and occasionally lawyers) play a vital role.<sup>582</sup>

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<sup>581</sup> M.H. Cohen, "Truth in Securities" Revisited, (1966) 79 Harv. L. Rev. 1340, at 1351-1352. One recent survey in USA shows that many investors are unable to understand correctly even basic questions about investment. The knowledge of 64% of them in financial matters is described as "Only fair" or "poor". 49% do not know that diversification of investment reduces risk. : Princeton Survey Research Associates, *The Investor Protection Trust Investor Knowledge Survey: A Report on the Findings* (1996), cited in Thomas W. Joo, "Who Watches the Watchers? The Securities Investor Protection Act, Investor Confidence, and the Subsidization of Failure", *supra* note 31, at 1132, note 295.

The importance of such “filtration” to investors protection in Bangladesh has been underscored as follows:

There is a dark spot here between the information given out by the companies and corporations and the investors’ ability to choose these lines of investments.

There is a need for collecting many other information about the company and analysing those information before the investors can decide to invest. ... This kind of information processing work cannot be done by all potential investors. It has to be done by the brokerage firms. It is the brokerage firms which do these work and present the investors with their recommendations to purchase or not purchase.<sup>583</sup>

Of course, in Bangladesh no notable professional firms have yet been established.<sup>584</sup> To improve their services training programs may be conducted by the SEC.

Thus if the plain disclosure provision is added to the full and fair disclosure requirement of the *PIR* and the “filtration” system is improved, both sophisticated and unsophisticated investors may get the benefits of the disclosure regime in Bangladesh. They will gradually get used to taking risks, and making profits and enduring losses.<sup>585</sup> Various investment opportunities will be available to the investors from which they will make their choices according to their varying abilities to bear risk:

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<sup>582</sup> *Wheat Report, supra* note 578, at 52.

<sup>583</sup> K. U. Ahmad, *supra* note 43.

<sup>584</sup> See *Share Bazar, supra* note 38, at 35.

<sup>585</sup> In this process investors will learn investing taking the normal business risk of profit and loss just like the children who learn walking through walk-and-stumble process. If the children are kept in arms, they will not learn walking. They must be allowed to walk and stumble and, through this process, to learn walking. At the same time it is the parents’ responsibility to watch out if any life-threatening danger lies on their way, which they must remove to save the children’s lives.

“Investors have differing abilities to bear risk. Although no investor wants to bear a loss on his or her investment, some are better able, financially and psychologically, to assume general risk.”<sup>586</sup>

In the present context, risk refers to investment risk free from fraud. Investment risk is of two types: external risk and transactional risk.<sup>587</sup> The former is commonly thought of business investment but is not directly connected with the investment transaction. It includes the risk that the economy will enter a recession or that the “bear” will turn out the “bull” from the market or that a change will take place in the issuer’s management.<sup>588</sup> Transactional risk, unlike external risk, is directly connected with the investment transaction itself. It includes two types of risk- fraud risk and structural risk. Fraud risk takes place through omission or misstatement of material fact. Structural risk results from the terms of the investment offering itself, e.g., underwriting commission, voting rights, options and warrants.<sup>589</sup> Under the disclosure regime investors are protected against fraud risk: “Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman”.<sup>590</sup> Thus there remain only the external risk and structural risk to be borne by investors.

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<sup>586</sup> *Supra* note 181, at 148 note 50. This risk bearing capabilities should be given way, otherwise economic development will be thwarted. See *infra* note 591.

<sup>587</sup> Gordor, *supra* note 181 at 145.

<sup>588</sup> *Ibid.*

<sup>589</sup> *Ibid.*, at 146.

<sup>590</sup> L.D. Brandeis, *Other People’s Money and How the Bankers Use It*, (Washington: National Home Library Foundation, 1933) at 62. Brandeis has recently been cited as a

### 3. Want of Paternalistic Protection

As seen above, under disclosure regime investors are, as a general rule of securities business, supposed to bear external and structural risks, but to what extent?

They should be expected to bear those risks which are “normal” external and structural risks. Paternalistic protection is not desirable against such risks because that will blunt the risk-bearing abilities of the investors, which will eventually affect economic development.<sup>591</sup> But risks which are likely to jeopardize public interest should be

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justification of mandatory disclosure as a fraud prevention mechanism in Toronto Stock Exchange, *Interim Report of the Committee on Corporate Disclosure, Toward Improved Disclosure (1995)* (hereafter *Allen Report*), at 24. But at the same time it is contended by some scholars that disclosure alone cannot prevent fraud. They referred to some major fraud cases that took place in USA after the 1933 and 1934 securities acts, e.g., *Re Equity Funding Corp. of America Securities Litigation*, 603 F.2d 1353; *Re OPM Leasing Services Inc.*, 769 F.2d 911.: see, for example, F.H. Easterbrook and D.R. Fischel, “Mandatory Disclosure and the Protection of Investors”, (1984) 70 *Virg. L. Rev.* 669, at 670. Most recently a critique goes to the extent of eclipsing the role of disclosure as a means of preventing fraud. For instance, at one place it says, “Indeed, any effectiveness mandatory disclosure might have in preventing fraud occurs primarily because mandatory disclosure is coupled with a criminal prohibition against fraud.” : C.J.H. Donald, “A Critique of Arguments for Mandatory Continuous Disclosure”, (1999), 62 *Sask. L. Rev.* 85, online:QL (SASL), at para. 13. For critique of mandatory disclosure from Australian perspective, see J. Azzi, “Disclosure in Prospectus” (Aug. 1991) *Co. and Sec. L.J.* 205 at 205.

<sup>591</sup> “A registration system can fail in two ways. If the investor purchases a security with more risk than the investor is willing to bear, then the registration system is skewed to much in favor of the issuer, not enough investor protection is provided. When, however, the investor is precluded from purchasing a high risk security (which is done under blue sky system), even though the investor is willing and able to accept the risk that the security represents, the system is weighted too much in favor of protection, economic expansion and innovation will be retarded.” : *supra* note 181, at 149 note 54.

precluded from coming to the market as “unacceptable” or “abnormal” risks. But that is not possible under disclosure system:

Under the disclosure approach, administrators can control issuers to prevent risk but not to prevent structural or external risk. Once those risks are fully disclosed, the administrators’ power over issuers ends. Merit review, through its preclusion approach to protection, however, gives administrators the power to control issuers even in the areas of structural and external risks. With preclusion power, administrators can prevent *unacceptable* structural and external risks, regardless of how they are disclosed. This power can provide investors with important protections greater than those that are possible under a disclosure system alone.<sup>592</sup>

For example, such an “unacceptable” risk situation may occur when issuers of bad repute are allowed to offer securities. Such issuers may not do fair dealings with public money. In respect of such risks a securities commission should not limit itself to the disclosure review only, rather should prevent such risks, refuse consent to the offering of securities. This point has been recognized recently in Ontario by the *Allen Report* which states:

In fact, there are no pure “merit” “disclosure” regimes as neither is capable of addressing all potential abuses. It would be unrealistic to expect a securities commission to do a “due diligence” examination of each company that wanted to raise money from the public to ensure that the enterprise was viable. Even if such an examination were made, if there were no detailed disclosure requirements, potential investors would not be able to determine whether the price of the public offering was attractive. It would be equally improbable that a securities commission in a disclosure regime would approve a prospectus that said, truthfully, that the promoters of the company intended to abscond with the proceeds of the public offering, or that the company’s business enterprise had no hope of success.<sup>593</sup>

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<sup>592</sup> Gorder, *supra* note 181 at 150 (footnote omitted and emphasis added)

<sup>593</sup> *Allen Report*, *supra* note 590, at 25.

Earlier the *Kimber Report* conceded, by indication, the paternalistic role of the OSC in the event of “abnormal” or “unacceptable” business risks. It states:

At all times, it must be made clear that the risks that are being evaluated by the capital market are *normal* business risks of success or failure, and every effort must be made to ensure that the public understands those risks. *This is not to suggest that the public must be protected against itself*, rather, it is a matter of ensuring that the investing public has the fullest knowledge to enable it to distinguish the different types of investment activity available. In such circumstances, the public would have reasonable assurance that its losses are genuine economic losses, just as its gains are genuine economic gains.<sup>594</sup>

A close reading of this paragraph imparts the idea that paternalistic protection is not suggested as long as “normal” business risks are involved in an offering. In other words, such protection is appropriate where occurs an “abnormal” or “unacceptable” business risk. This led the report to recommend entrusting the OSC with discretionary powers.<sup>595</sup> The report’s recommendation has been materialized by incorporating the OSC’s discretionary power provisions into the *OSA*. By virtue of that power the OSC can, as already discussed, refuse to receipt a prospectus in the public interest in general and on some specific grounds in particular which also relate to public interest protection so that the contemplated “abnormal” risks situations can be addressed.

It is a serious defect and shortcoming both from the investor protection and economic development perspectives that Bangladesh law does not contain such a

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<sup>594</sup> *Kimber Report*, *supra* note 233, at para. 1.12. (emphasis added).

<sup>595</sup> See *supra* note 240-243.

blue sky provision. For example, it has been reported that the SEC allowed some companies, which had failed to comply with their underwriting commitments within the time-frame as determined in the underwriting agreement, to offer IPOs in Bangladesh. This created confusion amongst the investors.<sup>596</sup> How can investors be protected in such situations? Should the SEC allow such discredited companies to come to the market and play with public money? There is possibility that they will not be fair in their dealings with the investors. They may not keep their commitment of providing dividends to them on time or they may even flee with their money forever.<sup>597</sup> Thus, for example, recently it was reported that 10 subsidiary companies of a large holding company of Bangladesh, Beximco Ltd., had defaulted in paying dividends within the stipulated period of 60 days from the date of declaration, though they declared the dividends last year. The SEC has failed to take any steps against the defaulters. The Chairman of SEC has said that penalizing such big companies may impact the market adversely, whereas the SEC has penalized many other small companies on the same ground. It is also reported that the market has not improved since May 1999 when the complaint of the non-payment of dividends was made to the SEC.<sup>598</sup> Under the given circumstances, the public interest philosophy should suggest that such companies be precluded from offering securities so

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<sup>596</sup> “Defaulters allowed to offer IPOs” *The Bangladesh Observer* (a national daily), (3 Feb.1998)1 and 12.

<sup>597</sup> A member of the public complains that money raised by the public limited companies has been “swindled, cheated misused or siphoned off by many chairmen, directors, executives of those public limited companies ”: M. Rahman, *supra* note 49.

<sup>598</sup> “SEC Bends Securities Law” *The Daily Star*, online:<<http://www.dailystarnews.com>,> 20 Oct., 1999.

that public confidence can be sustained. Mere disclosure review should not be the sole function of the SEC. It should, it is suggested, be well armed with discretionary powers to review merits of the offerings in addition to disclosure review so that no “rotten egg”<sup>599</sup> can enter the market to cause food poisoning to the investors. Granting such discretionary powers to administrative bodies is, in general, an essential trait of modern statehood.<sup>600</sup> Particularly in the security administration practical necessity and convenience of discretion is overemphasized:

The exercise of discretion is an essential tool for the effective supervision of an industry as complex as the securities industry. From a practical point of view, it would be impossible for the Commission (OSC) to carry out its mandate, in either a long-term or day-to-day sense, without the broad discretionary powers delegated to it by the Act and Regulations.<sup>601</sup>

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<sup>599</sup> While commenting on the US securities statute (which is completely a disclosure statute), Sommer called it a “rotten egg statute”. He went on, “You could sell all the rotten eggs you wanted if you told people fully how rotten they were. Alas, a lot of rotten eggs were sold under this statute and you suspect that a lot of them are continuing to be sold.” “New Approaches to Disclosure in Registered Security Offerings- A Panel Discussion”, *supra* note 580, at 505.

<sup>600</sup> Condon writes:

A distinctive feature of the modern state is the extent of governance devolved onto specialized tribunals. Administrative statutes, which grant these tribunals their power, are characterized by the grant of significant discretionary powers to the relevant agency.”

*Supra* note 225, at 89-90. Also see D.J. Galligan, *Discretionary Powers*, (Oxford: Newyork: Clarendon Press; Oxford University Press, 1986); B.P. Bellmore, “The Ontario Securities Commission as an Administrative Tribunal” (1967) 5 Osgoode Hall L. J. 210; J.M. Evans, H.N. Janisch & D.J. Mullan, *Administrative Law: Cases, Text and Materials*, 4th ed. (Toronto: Edmond Montgomery, 1995). Patrick Moyer, “The Regulation of Corporate Law by Securities Regulators: A Comparison of Ontario and the United States”, (1997) 55(1) U.T.Fac.L.Rev. 43, online:QL (UTFL), para. 32 note 112.

Under the proposed jurisdiction the SEC, like the OSC<sup>602</sup>, would be entitled to define what constitutes “public interest” in a given circumstance. It will be able to issue policy statements as guidelines for the issuers which would facilitate exercising of its power. But those statements must not be treated as laws.<sup>603</sup>

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<sup>601</sup> *Ainsely Financial Corporation* (Aug. 1993), 16 O.S.C.B. 4077, at 5010.

<sup>602</sup> In *Ainsely, ibid.* at 5001 it was said that “[i]t is beyond dispute that the Commission (OSC) is entitled to particular judicial deference and “a particularly broad latitude in formulating its opinion as to the public interest in matters relating to (securities).” (note omitted)

<sup>603</sup> This point came before the court for determination in *Ainsely*. In this case the extent and nature of the OSC’s power of promulgation of policies within its public interest jurisdiction was challenged. It was alleged that the OSC promulgated policy 1.10 which assumed the effect of law and, therefore, violated the basic principle that “Policy Statements do not have the force of law and are not intended to have such effect”. *Ainsely, ibid.* at 5004. The impugned policy was held to be have been made outside the statutory mandate of the OSC. “[T]he Commission must be exercising a public interest discretion entrusted to it ... within the scope of its statutory mandate.” *Ainsely, ibid.* at 4091. As an explanation of why the OSC policies should not have the effect of substantive law the following quote by the court is interesting:

It is vitally important to recognize, however, that the ‘public interest power’ was never intended to be, nor could it be logically be construed to be unlimited in nature. Had the legislature intended it to be unlimited, then it need not have troubled itself with the task of devising a Securities Act. The Ontario legislature, for example, need only have created the Ontario Securities Commission, ceded to it plenary powers, and instructed it to act ‘in the public interest’. It need not have outlined in great detail precisely that which the Lieutenant Governor in Council can (and ,implicitly, that which he cannot) do to add to the statutory rules by way of regulation. That the provincial legislatures have both created legislative law and limits to the regulatory powers is not merely accidental.

While it is clear that the ability to act remedially ‘in the public interest’ cedes some residual discretionary authority to the regulators, it was obviously the intention of the legislature not to delegate to the Ontario Securities Commission the power to make substantive law of a legislative or regulatory character. Indeed, had the legislature wished to do so, it

It was described that the SEC had the blue sky jurisdiction, but it failed to provide the benefits of its power to the public. The concerned officials could not even correctly assess the financial projections and some of them were alleged to be dishonest.<sup>604</sup> Therefore, before vesting the proposed power to the SEC it is an imperative to ensure that it is composed of professionally efficient and morally upright persons. Traditionally, in most cases, the Chairman and members of the SEC<sup>605</sup> are appointed

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could have easily accomplished that objective by giving the OSC rule-making authority like that possessed by the SEC in the United States. However much this might be a good idea, it has not been done. *It is thus impossible to escape the conclusion that policy statements must not be used [to] create substantive legal requirements of a legislative or regulatory character. Any other conclusion would be inconsistent with the Rule of Law.*" J. G. MacIntosh, "The Excessive Use of Policy Statements by Canadian Securities Regulators", (1992), 1 Corporate Fin. 19, at 20, cited in *Ainsely, ibid.*, B. 4077., at 5005. (emphasis in original quote).

However, following this case a task force (The Ontario Task Force on Securities Regulation) was entrusted to assess, *inter alia*, its implications and to recommend proper legislative responses to it. The Report of the task force (*Daniels Report*) recommended that the OSC be given rule-making power. A. Anand, D. Johnston and G. Peterson, *Securities Regulation- Cases, Notes & Materials*, (Toronto and Vancouver: Butterworths, 1999) at 56-60. The Ontario legislature adopted the recommendation of the *Daniels Report* and vested the OSC with rule-making power. Johnston and Rockwell, *supra* note 57 at 46.

<sup>604</sup> *Supra* notes 39-40.

<sup>605</sup> The SEC consists of two strata, Commission and Staff. The Commission is composed of the Chairman, four permanent members and two part-time members. The Commission (permanent) members are appointed by the Government and the part-members are nominated by the Ministry of Finance and the Bangladesh Bank, the central bank, respectively. The Staff consists of officers and employees appointed by the Commission. *SECA, 1993*, s. 5(1) and 5(2). The Commission is assigned with the responsibility of, *inter alia*, registration of securities market intermediaries, approval of the issuance of securities and exemption therefrom ( *SECA.*, ss. 8(2), s.23, *PIR*, s. 18), conducting

from amongst retired civil servants<sup>606</sup> who do not have any knowledge of or experience in securities industry<sup>607</sup>. This practice of the Government evidences a deviation from the strict compliance with law which requires the Government to give priority to persons with standing in the securities industry or in some closely related fields. The Government seems to overexercise its discretion in this regard.<sup>608</sup> Political considerations influence

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investigation and inquiry, hearing appeal from an officer's decision or order, ( *SECA*, 21) and enforcement of administrative sanctions (*SEO*, 22 and *PIR*, 19)

<sup>606</sup> Rashid, S.M., "SEC-te ki dakhkha byaktider sthan habe na" ("Will not There be any Place for the Skilled Persons in the SEC?") *Muktakantha* (a Bengali national daily), (17 July 1998) at 9.

<sup>607</sup> See *Star Magazine*, *supra* note 44 at 7.

<sup>608</sup> S. 5(4) of the *SECA*, 1993 requires that

"the Chairman and other full-time members shall be appointed from amongst the persons of capability and standing who have shown capacity in dealing with problems relating to company matters, securities markets or have special knowledge or experience of law, finance, economics, accountancy and such other disciplines as, in the opinion of the Government, shall be useful to the Commission.

The wording of this sub-section shows that with regard to the disciplines from which people should be selected to the offices of the Commission the Legislature has ascribed priority, by specification, to the security, company, law, finance, economics and accountancy. The Legislature's intent seems to be that if people from these fields are available, the Government must give preference to them because it considers their appointment would be "useful" to the Commission. The discretion applies where people from the specified fields are not available. Again, before exercising the discretion the Government must determine what the Legislature has intended to mean by the phrase "such other disciplines". The words "such other" point to disciplines which are similar to the specified ones. This interpretation is based on the rule of *ejusdem generis* which requires general words following particular words pertaining to a class, category or genus to be construed to refer to the similar kind of things as are entailed by the particular words. In light of this argument the Government may select persons from fields similar to those specified provided such fields are useful to the Commission in the opinion of the Government. In short, the Government may choose persons for the offices of the Commission who are from the similar kind of disciplines as are specified and whose service would be useful to the accomplishment of the functions of the Commission.

appointments to the SEC. It has become a neo-political culture in Bangladesh that whichever party comes to power politicizes all possible institutions by placing its pro-party men regardless of whether they are fit or unfit. The same consideration influences replacement decisions as well.<sup>609</sup> This proclivity may hinder the SEC from becoming

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While appointing persons to the offices of the Commission the Government must satisfy these two conditions.

<sup>609</sup> Under s. 6(1) of the *SECA* the Chair or a full-time member shall be removed by the Government from the office if he or she

- (a) is, or at any has been, adjudicated as insolvent by a competent court;
- (b) is of unsound mind and stands so declared by a competent court;
- (c) has been convicted of a criminal offence involving moral turpitude;
- (d) has, *in the opinion of the Government*, so abused his position so as to render his continuation in office detrimental to public interest;
- (e) is appointed a director or official of a company or any other organization registered with the Commission. (emphasis added).

A condition has been attached to this sub-section that before taking an action under clause (d) or (e) against the Chair or any full-time member a hearing must be held. [s. 6(2) ]. Under this provision the tenure of the Chair or any full-time member is secure unless he or she is liable on any of the specified grounds. His or her liability would not, however, result *ipso facto* in the vacation of the office. The Government must first take a positive action of removing the a commissioner; unless this is done, the Commissioner will not be liable to quit his or her office. : See K.R. Chandratre, B. Acharya, S.D. Israni and K. Sethuraman, *Bharat's Compendium on SEBI Capital Issues & Listing*, vol. 1 (New Delhi: Bharat Publishing House, 1996) at 12. Since mostly political consideration forms the criterion of the Government action, it is questionable whether the it will take any "positive action" against its pro-party person in spite of his or her actual liability under on any of the said grounds. Besides, clause (c) invites special attention. The applicability of that clause depends on the subjective judgment of the Government that a particular commissioner has abused his or her position and that that abuse is deleterious in "public interest". There is no objective standard of public interest. Whether an abusive act makes a commissioner's holding of the office harmful in public interest is determinable by the Government. And that determination depends on the Government's political liking for or disliking against a particular commissioner. Though a right of appeal has been granted by section 6(2) mentioned above, it can help little an alleged commissioner because the Government is not, by law, bound to accept the explanation of the commissioner, it may disregard the explanation and remove the commissioner unless and until the removal order is vitiated by the court of law. Thus, for instance, previously two Commission

professionally efficient. Given the esoteric nature of the securities industry people having standing or at least an orientation to securities as a discipline should be chosen, as a top priority, for the offices of the Commission<sup>610</sup> and their tenure should be secure.

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members were removed by the Government and subsequently the removal order was annulled by the court of law, but that could not benefit the victims because by the time of the court decision their office tenure was over. *Supra* note 606. By contrast, the OSC commissioners hold their office “at pleasure” of the Lieutenant General in Council who can turn them out remove before the formal end of their tenure. This seems to be a sword hanging over the head and may fall on the neck any moment, but has not yet cut anyone’s neck since the birth of the OSC. This evidences the long deep-rooted sound political practice in Canada. To the contrary, with regard to the given situations in Bangladesh it may be said that political masters, as the executives, drive the legal vehicle with discretionary brakes and may, depending on their political will, reach their selfish political goal derailing from the leeway and goal intended by the legislature.

<sup>610</sup> In Ontario there are not statutorily defined criteria for selecting people for the offices of the Commission, though the *Kimber Report* recommended a Chair with a legal background and commissioners with special skill or experience in security matters, such as accounting, brokering, investment dealing and financial analysis. However, in practice, selection is made from amongst people with backgrounds in fields related to security and commodity futures industry, e.g., lawyers, accountants, security analysts, dealers and investors. : *1992 Annual Report of the OSC* excerpted in H. L. O’Brien, *Securities Regulation Cases and Materials*, (Halifax: Faculty of Law, Dalhousie University, Fall 1995), at 301.

## **4 EPILOGUE**

### **4.1 CONCLUSION**

Bangladesh is pursuing solely a disclosure regime while Ontario has an amphibious system that reflects both the disclosure and merit regimes. Though both have a disclosure review system, Bangladesh lacks some significant requirements that are essential to make the disclosure meaningful. Ontario law requires prospectus disclosure to be full, true and plain, but Bangladesh law does not call for plain disclosure which is a must for investors, specially the lay ones, to understand the information furnished in a prospectus, either by themselves or with the aid of securities market intermediaries. Some important non-financial matters, though required by Ontario law, are missing in Bangladesh law (for example, dividend record). Both jurisdictions face troubles in respect of true disclosure of financial matters in particular. Misstatement or false statement of financial information is common. Ontario law, however, provides two safeguards which may mitigate, if not eliminate, the degree of the problem. It allows investors to repudiate the security sale contract or/and claim damages invoking the jurisdiction of civil courts. Secondly, the OSC staff keeps vigilant eyes on the disclosure and sometimes refuses to issue a prospectus receipt where the staff deems it necessary in public interest. The staff exercises this power to ensure that a proposed investment project is free from “abnormal” or “unacceptable” business risks. Investors are expected to bear “normal” business risks only and to make their own investment decisions in light of the information made

available through prospectuses. Bangladesh law provides for civil remedy for prospectus misstatements, but heavy litigation costs and excessive delay in the disposal of suits are the barriers to invoking the remedy the provision. Secondly, the SEC does not have any “blue sky” type of jurisdiction. As a result, the investors are deprived of protection against “abnormal” business risks.

It is encouraging that Bangladesh has made a shift from merit to disclosure regime. In this regime the investors have available various investment opportunities with varying risks. They choose which of those risks they can bear depending on their own financial and psychological capabilities. In choosing the investment risks the investors needs professional advisors’ help. Therefore, for obtaining the benefits of the disclosure regime development of the intermediary bodies is a must. As well, the underwriters must play their role sincerely to verify the soundness of the securities offered. At the same time, however, the SEC should have the “blue sky” jurisdiction to discern “abnormal” risks involved in an investment enterprise. Moreover, the access to legal justice for redressing securities fraud must also be ensured by the state. By introducing the disclosure approach the Government of Bangladesh has opened the field of competition for investment in the securities industry, which was absent in the previous “blue sky” system. It had in mind that this would mobilize resources into various production sectors, which would ultimately affects national economic development. But unless a sense of security can be instilled that the prospectus disclosures underwritten by the underwriters are true, that the services by the intermediaries are reliable, and that the SEC is ever

vigilant against an intrusion of unacceptable or abnormal risks in the market, the mere introduction of the disclosure system in Bangladesh will not help. The SEC has a greater role to play in this regard. As a watchdog it should not only to watch, but should also bark and bite, where necessary, for investor protection and economic development of the country. To that end, the SEC must be reconstituted with professionally capable persons.

## **6.2 RECOMMENDATIONS**

From the above discussion Ontario law appears to excel Bangladesh law. Ontario law may be borrowed, where proposed, to bring about improvements of Bangladesh law. To that effect the following recommendations may be put forward for consideration:

1. To fulfill the full disclosure requirement there should be added provisions calling for information about the issuer's past dividend record. In respect of best efforts offerings it should be required by law that the security sale price be deposited in a trust company. If the minimum amount needed for conducting the proposed project and fixed by the underwriting agreement is raised by sale, it may then be received by the issuer. If, however, it is not, the investors will get their money back. Another provision should be added to the concerned law that if an issue firmly underwritten is undersubscribed and the underwriter refuses to purchase the remaining securities at the face value at which the investors have purchased, the issues must notify the SEC. Thereupon the SEC may, after giving an opportunity of being heard, fine the underwriter and disqualify him for five

years from underwriting any further issue. Again, if it is reported that the issuer has sold securities at a lesser price, the SEC must, subject to a hearing, fine it and disqualify it for five years from offering any issue.

2. In order that the investors, with or without the aid of market intermediaries, can understand the prospectus disclosure, it is recommended that a provision requiring plain disclosure in Bengali be inserted in the *Public Issues Rule (PIR)*. At the same time, to ensure that the market intermediaries can provide correct investment advise to the investors, the SEC should conduct a training program. The provisions concerning the qualifications<sup>611</sup> required for registration as intermediaries should be strictly enforced to ensure entry of qualified persons or institution to this profession.

3. As there is no court of exclusive jurisdiction to deal with security matters, one Division Bench of the High Court Division of the Supreme Court of Bangladesh, should be given original jurisdiction, as in company matters, to receive disputes for decision, e.g. misstatement or false statement in prospectus. This is recommended for two reasons: first, security being a discipline of an esoteric nature, should be dealt with by the highest court of the land. The lower courts do not have any grasp on this field, as they are concerned with general matters of civil and criminal nature. Though there is a specialized commercial court, *Artha Reen Adalat* (Court of Financial Debt), it is not recommended that it deal with security matters because it does not have any orientation to securities

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<sup>611</sup> E.g., educational qualifications, financial competence and professional training and experience. : s. 3B and s. 4 of the *SEC (Stock-Dealer, Stock-Broker and Sub-Broker)*

matters and also it is otherwise overburdened with cases under its present jurisdiction.

The second reason for proposing jurisdiction to be given to the Division Bench of the High Court Division is that in disposal of suits the Division Bench would require, as in other matters, less time compared to the courts of subordinate jurisdiction.

4. The SEC, like the OSC, may be granted a discretionary jurisdiction to review the merit of securities and to refuse consenting to the application in the public interest in general and on the similar grounds on which the OSC can refuse receipting in particular. This would strengthen the SEC to safeguard the investor interest which is the principal objective of the securities legislation in Bangladesh. The decisions of the SEC under the proposed jurisdiction should be made subject to judicial review by the proposed court (viz., High Court Division Bench) in order to “to safeguard notions of fair play, substantial justice and due process”<sup>612</sup>. This would strike a balance between the investors’ interest and the security industry in Bangladesh.

5. Since securities, as a discipline, is understandable by persons having particular orientation to security or closely related fields, in choosing people for the offices of the Commission of the SEC the Government should give priority to those who have standing in the fields specified by the statute, namely securities, law, finance, economics and accountancy. The Government should not normally exercise its discretion in this regard. Similar consideration should be made by the Commission in appointing officials of the

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*Regulation, 1994; s. 5 of the SEC (Merchant Banker and Portfolio Manager) Regulation, 1996.*

<sup>612</sup> Smith, *supra* note 149, at 464.

SEC. Additionally, at the time of selection of both commissioners and officials special regard should be had to the moral stature of the appointees. To this effect required amendment should be made to the law concerned.

6. In order that the commissioners may work with the sense of security of their tenure the provision effecting removal by the Government on the ground of abuse of position should be amended. The amendment may be made to the effect that if a three-member inquiry committee headed by a sitting judge of the High Court Division of the Supreme Court of Bangladesh finds a commissioner guilty of abusing his or her office or position, the Government of Bangladesh shall issue a removal order after giving him or her an opportunity of being heard. The proposed amendment will subject the Government's subjective opinion about a commissioner's guilt of position-abuse to an objective scrutiny by an inquiry committee and thereby reduce the likelihood that the present provision be used capriciously.

By the above recommendations a fundamental reform is suggested in the securities regulation of Bangladesh, namely a compromise between the disclosure and merit review approaches. Both of these approaches have their own merits. To follow the extreme line of either approach is to miss the advantages of the other. The principal benefit of the disclosure regime followed by Bangladesh is that it encourages competition for investment among the public offering various (investment) opportunities, which has the effect of mobilizing resources towards productive areas. These opportunities carry

both “normal” and “abnormal” business risks. Under the proposed system the investors of Bangladesh will bear normal business risks and the SEC will preclude the abnormal business risks. Thus the investors will have double protection, which will, it is expected, increase their confidence in the securities industry of the country.

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Note: (a) "dailystarnews" stands for the news in *The Daily Star* (a national daily of Bangladesh) put on the website.

(b) "secbd" stands for the Securities and Exchange Commission (of Bangladesh).