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

Web site: www.osc.gov.on.ca

IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, CHAPTER S.5, AS AMENDED (the Act)

AND

IN THE MATTER OF
EUGENE N. MELNYK, ROGER D. ROWAN, WATT CARMICHAEL INC., HARRY J. CARMICHAEL AND MICHAEL MCKENNEY

Hearing:	August 8 and 9, 2006		
Order:	August 8, 2006		
Reasons:	September 29, 2006		
Panel:	Paul M. Moore, Q.C.	-	Vice Chair and Chair of the Panel
	Robert L. Shirriff, Q.C.	-	Commissioner
Counsel:	Kent Thomson James Doris	-	for Eugene N. Melnyk
	Nigel Campbell	-	for Roger D. Rowan, Watt Carmichael Inc, Harry J. Carmichael and Michael McKenney
	Johanna Superina	-	for Staff of the Ontario Securities Commission

REASONS

INTRODUCTION

[1] We heard, in camera, two motions by Mr. Melnyk:

– one for the immediate disclosure to the respondents by staff of materials (requested materials) generated under section 13 of the Act in an investigation ordered under section 11 of the Act that staff intended to disclose to the respondents several weeks hence with all other materials staff is obliged to disclose prior to the hearing on the merits under Rule 3.3 of our Rules of Practice; and

– the second for an order permitting the use by Mr. Melnyk of the requested materials to refresh his memory in preparation for an interview of him by the United States Securities and Exchange Commission (SEC) in a few days hence in an investigation the SEC currently has underway.

[2] We decided that in the circumstances, the words "as soon as is reasonably practicable" in Rule 3.3(2) required staff to disclose to the parties the requested materials on the day following the hearing of the first motion.

[3] We decided that the intended use by Mr. Melnyk of the requested materials would not place him in contempt of the Commission or result in any breach by him of section 16(2) of the Act or of any implied undertaking to the Commission as to the use by him of the requested materials.

[4] We also decided, with the consent of the parties to the proceeding, that it was in the public interest that our decision and these reasons not be held in camera, but that they be placed on the public record and be disclosable.

REQUESTED MATERIALS

[5] The requested materials are transcripts and accompanying exhibits from staff's examinations under section 13 of the Act of current and former employees, directors, officers or partners of Watt Carmichael Inc. in an investigation ordered under section 11 of the Act.

THE ISSUES

[6] The motions required us to address three issues:

(1) What do the words "as soon as is reasonably practicable" in Rule 3.3(2) mean in actual practice?

(2) Does a parallel investigation by the SEC into the same matters that are the subject of a concurrent proceeding by the Commission have any impact on the obligations

of staff under Rule 3.3(2) (the disclosure obligation)?

(3) Is the use by Mr. Melnyk of the requested materials solely for the purpose of refreshing his memory in preparation for his interview by the SEC contrary to section 16(2) of the Act or contrary to his implied undertaking to the Commission as to use of the requested materials when disclosure of them is made to him pursuant to the disclosure obligation?

THE MOTION FOR IMMEDIATE DISCLOSURE

[7] Rule 3.3(2) provides:

> In the case of a hearing under section 127 of the *Securities Act* and subject to Subrule 3.7, staff of the Commission shall, as soon as is reasonably practicable after service of the notice of hearing, and in any case at least 10 days before the commencement of the hearing, make available for inspection by every other party all other documents and things which are in the possession or control of staff that are relevant to the hearing and provide copies, or permit the inspecting party to make copies, of the documents at the inspecting party's expense.

[8] Staff did not dispute its disclosure obligation regarding the requested materials.

[9] Staff had the requested materials in its possession and could disclose them to the respondents in a day or so without undertaking herculean efforts that would be disruptive of staff's normal operations.

[10] However, staff intended to perform its disclosure obligation in due course after it had collated and organized all material it would be disclosing. This would be at a time well before the minimum 10 days prior to the hearing on the merits provided for in Rule 3.3(2).

[11] Staff submitted that disclosure of an organized and complete disclosure package would be of benefit to the respondents, in keeping with staff practice, and in sufficient time for the respondents to prepare a full answer and defence to the allegations against them in the proceeding.

[12] Staff submitted that the reason Mr. Melnyk wanted immediate disclosure of the requested materials was not for the purpose of preparing a full answer and defence to the allegations in the proceeding before the Commission, but for the unauthorized use of the requested materials to prepare for his interview by the SEC.

[13] Mr. Melnyk argued that he was entitled to the disclosure immediately since staff could not show that immediate disclosure was not reasonably practical and that his limited use of the requested materials to prepare for his interview by the SEC would not be contrary to section 16(2) of the Act or any implied undertaking to the Commission restricting his use of the requested materials; or that if it would, we should permit such use having regard to the unique circumstances of this case.

[14] We decided to deal first with the issue of the timing of disclosure under Rule 3.3(2) and, secondly, if we ordered disclosure prior to the examination of Mr. Melnyk by the SEC, with the issue of permitted use.

[15] In *R v. Stinchcombe* [1991] 3 S.C.R. 326 at 332, Justice Sopinka found that in a criminal case the obligation to disclose is triggered by a request by the accused that may be made at any time after the charge.

[16] Rule 3.3(2) deals with the disclosure obligation found in *Stinchcombe* and applies it to proceedings under section 127 of the Act.

[17] A proceeding under section 127 is commenced with the issue of a notice of hearing and the disclosure obligation arises under Rule 3.3(2) when the notice of hearing is served. The Rule requires staff to fulfil its disclosure obligation as soon as is reasonably practicable. Staff and respondents usually agree on a schedule for disclosure.

[18] But when a respondent requests specific disclosure on an expedited basis, it then becomes a question of fact as to what is possible and practical taking into account reasonable time and effort by staff and its current workload. When a specific request is made, reasons for delay based on staff's customary practice, considerations of what staff believes will be in the best interest of the respondents, or the potential misuse by a respondent of the disclosure are not determinative as to when it would be reasonably practical for staff to deliver the requested disclosure.

[19] In the case before us, staff acknowledged that it could make the disclosure of the requested materials without herculean efforts by the close of business on August 9.

THE MOTION AS TO USE

[20] Staff submitted that a respondent provided with disclosure under Rule 3.3(2) that is covered by section 16(2) of the Act and permitted by section 17(6) of the Act or an order of the Commission under section 17(1) of the Act may only use the disclosure in the proceeding before the Commission.

[21] Staff acknowledged that Mr. Melnyk could use the requested materials to provide a full answer and defence in the proceeding, but not to prepare himself for his interview by the SEC. Specifically, staff submitted that the intended use by Mr. Melnyk was for a collateral purpose and not permitted.

[22] Staff submitted that there is a common law implied undertaking to the Commission restricting the use of the requested materials once it is disclosed under Rule 3.3(2) and section 17(6) or by order of the Commission under section 17(1). Mr. Melnyk agreed with this submission.

[23] Staff submitted that the SEC investigation and any proceeding in the United States that might flow from it are not the proceeding before the Commission and that there was no evidence before us as to what matters the SEC was investigating.

[24] Staff submitted that the SEC practice for its investigations is not to provide persons whom the SEC may interview with transcripts of others who may have been interviewed because the SEC does not want persons examined to be able to tailor their testimony to take into account the testimony of others.

[25] Staff further submitted that the practice of the SEC for its investigations is similar to the practice of the Commission in its investigations under section 11.

[26] In staff's view, allowing Mr. Melnyk to use the requested materials for a collateral purpose, namely to prepare for his interview by the SEC, would permit SEC practice to be circumvented and – although this was not expressly stated, we believe staff was implying this – could impair co-operative efforts by the SEC and the Commission in future investigations.

[27] Staff referred us to Memorandums of Understanding between the Commission and the SEC which contemplate co-operation between SEC staff and Commission staff in investigations.

[28] Staff referred us to section 11(1) of the Act which reads:

> 11.(1) Investigation order – The Commission may, by order, appoint one or more persons to make such investigation with respect to a matter as it considers expedient,
>
> (a) for the due administration of Ontario securities law or the regulation of the capital markets in Ontario; or
>
> (b) to assist in the due administration of the securities laws or the regulation of the capital markets in another jurisdiction.

[29] In this case, as permitted in section 11, the Commission identified matters to be investigated and appointed some persons who are SEC staff and some persons who are Commission staff to carry out the investigation into the matters.

[30] Mr. Melnyk argues that there are unique circumstances in this case.

[31] The section 11 orders authorizing the investigation by staff specify the matters to be investigated. The orders appoint members of Commission staff and members of SEC staff to conduct the investigation. They provide that the fruits of the investigation by Commission staff or by SEC staff may be shared by the Commission and the SEC.

[32] Interviews by the SEC in its investigation have been conducted by members of its staff appointed by the section 11 orders at which members of Commission staff were present. Transcripts from interviews by SEC staff and examinations by Commission staff have been shared. Indeed, the SEC has copies of the requested materials.

[33] The transcript from Mr. Melnyk's interview by the SEC will be made available to Commission staff and may be used by Commission staff in the proceeding before the Commission. In addition, Mr. Melnyk and staff have agreed that each may rely on the transcripts from SEC interviews in the proceeding before the Commission as if Commission staff had conducted these interviews, under oath, in Ontario. Finally, according to Mr. Melnyk's counsel,

Commission staff had intended to be in attendance at the SEC interview of him until Mr. Melnyk objected.

[34] Consequently, Mr. Melnyk argued, the SEC investigation and the proceeding before the Commission are so inextricably intertwined that they should be considered as one. They deal with the same matters. To the extent that the SEC investigation may also cover other matters is not relevant for our consideration because the requested materials are only relevant to the common matters.

[35] With reference to the purpose of the implied undertaking rule, namely the protection of privacy, counsel for all current employees, officers, directors or partners of Watt Carmichael who have been examined by Commission staff has confirmed that they do not object in any way to the use of the requested materials in the preparation of Mr. Melnyk for his SEC interview.

ANALYSIS

[36] The implied undertaking rule is a recognized principle of law in Ontario and applies to Commission proceedings. (*A. Co. v. Naster* (2001), 143 O.A.C. 356 at para. 23 (Div. Ct.)).

[37] The implied undertaking rule prohibits the use of information obtained in a proceeding's discovery process for "any purpose collateral or ulterior to the resolution of the issues in that [proceeding]." (*Naster*, at para. 22). "[T]he respondents in the proceedings can demand to inspect the words of any documents produced by … [although] they are bound under pain of sanction by the Commission not to use the information for any purpose outside the matter of the investigation." (*Naster*, at para. 24).

[38] Mr. Melnyk sought to inspect the words of the requested materials and not to use the requested materials for any purpose outside the matters that are the subject of the collaborative investigation by staff of the Commission and the SEC and which, since the commencement of the proceeding, are the subject of the proceeding.

[39] *Goodman v. Rossi* (1995), 24 O.R. (3d) 359 (C.A.) is the leading Ontario authority on the scope and purpose of the implied undertaking rule. The Court of Appeal stated "[t]he primary rationale for the imposition of the implied undertaking is the protection of privacy." (para. 29)

[40] Although we have no evidence before us from the SEC as to the purpose and nature of the SEC investigation, we know that members of SEC staff have been appointed by the section 11 orders to investigate the matters that are the subject of the proceeding before the Commission and that the requested materials are likely only to be relevant to the matters identified in the section 11 orders.

[41] We agree with Mr. Melnyk that, in the circumstances, the intended use by him of the requested materials in preparing for his examination by the SEC will not be a breach of section 16(2) of the Act or any implied undertaking as to use.

[42] We agree with staff and Mr. Melnyk that there are restrictions on the use by Mr. Melnyk of the requested materials and that the implied undertaking as to use continues.

[43] In the words of section 16(2) of the Act, the requested materials "are for the exclusive use of the Commission or of such other regulator as the Commission may specify" and, subject to disclosure to the respondents as permitted under section 17(6) of the Act, use of the requested materials continues to be restricted to "the exclusive use of the Commission".

[44] Disclosure of the requested materials to the respondents under section 17(6) of the Act permits use of them by the respondents in the proceeding before the Commission. In the special circumstances of this case, where the SEC investigation is, at least in part, into the matters that are the subject of the Commission proceeding, where the SEC examiners include persons appointed by the section 11 orders, where the fruits of the SEC and Commission examinations are shared by the SEC and the Commission, and where the transcript of the SEC interview of Mr. Melnyk will be made available by the SEC to Commission staff for possible use in the proceeding, use of the requested materials in the proceeding before the Commission also includes the proposed use by Mr. Melnyk.

[45] Commission staff's practice and the operation of sections 11 to 17 of the Act are similar to SEC practice in its investigations. However, once a proceeding under section 127 of the Act is commenced, the disclosure obligation of Commission staff is triggered.

[46] Although Commission staff may continue to investigate the matters that resulted in the commencement of the proceeding, the fruits of its investigation will be subject to the disclosure obligation.

[47] The difficulty facing staff is that once the proceeding in this matter was commenced, the application of the rules changed. This does not mean that the requirements of section 16 do not continue or that the implied undertaking as to use ceases to apply or that staff's investigation could not continue. But it does mean that all documents and things which are in the possession and control of staff that are relevant to the proceeding must be disclosed to the respondents and that staff will be limited to proving the allegations in the proceeding unless additional allegations are made.

[48] The fact that the SEC's investigation is on-going and has not yet resulted in a proceeding by the SEC does not mean that our disclosure rules should be suspended and does not prevent the limited use by Mr. Melnyk of the requested materials in the unique circumstances of this case.

[49] Since we concluded that the proposed use of the requested materials by Mr. Melnyk is a permitted use, we did not believe it was necessary to issue an order relieving Mr. Melnyk from his obligations under his implied undertaking as to use. But if it were necessary, we would have so ordered.

Dated at Toronto, this 29th day of September, 2006.

"Paul M. Moore" "Robert L. Shirriff"

Paul M. Moore, Q.C. Robert L. Shirriff, Q.C.