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

AND

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

REASONS REGARDING THE SETTLEMENT AGREEMENT ENTERED INTO BY OSC STAFF AND EUGENE N. MELNYK SIGNED MAY 16-17, 2007

Hearing and Decision: May 18, 2007

Reasons: June 6, 2007

Panel:	James E. A. Turner	-	Vice-Chair and Chair of the Panel
	Margot C. Howard	-	Commissioner
	Carol S. Perry	-	Commissioner
Counsel:	Kent Thomson James Doris Sean Campbell	-	for Eugene N. Melnyk
	Johanna Superina Alexandra Clark	-	for Staff of the Ontario Securities Commission

REASONS FOR DECISION

Background

[1] On May 18, 2007, we convened a hearing to consider the terms of a settlement agreement (the "Settlement Agreement") entered into between Staff of the Commission ("Staff") and Eugene N. Melnyk ("Melnyk") relating to matters arising from a Notice of Hearing and Statement of Allegations dated July 28, 2006. The Settlement Agreement was signed by Staff on May 16, 2007 and by Melnyk on May 17, 2007. The hearing on the settlement was held in camera and we received submissions from Staff and counsel for Melnyk. After considering all of the materials submitted and the submissions made, we concluded that it was in the public interest to approve the Settlement Agreement. At that time, the hearing was made public and the Chair of the Panel provided an oral summary of our reasons for decision and indicated that written reasons would be prepared. These are the written reasons for our decision.

[2] We mention for the record that this Panel considered an earlier proposed settlement between Staff and Melnyk on May 8, 2007, which we did not approve as being in the public interest.

[3] Except as otherwise indicated, the capitalized terms used in these reasons are used as those terms are defined in the Settlement Agreement.

Relevant Facts Set Out in the Settlement Agreement

[4] The facts and circumstances agreed to by Staff and Melnyk in connection with this settlement are set out in the Settlement Agreement. We will not summarize all of the relevant facts and circumstances in these reasons. We will note, however, some of the background facts that were important to us in considering the Settlement Agreement. It is important to recognise that the facts set out in the Settlement Agreement are not findings of fact by this Panel. Rather, they are facts agreed to by Staff and Melnyk for the sole purpose of the Settlement Agreement. We relied upon the facts set out in the Settlement Agreement in approving that agreement.

[5] The Settlement Agreement states that in 1991 and thereafter, Melnyk created certain trusts in the Cayman Islands, primarily for the benefit of his family. Except as noted below, during 2002, 2003 and 2004, the period during which the trading involved in this matter occurred, Melnyk was also a beneficiary of the Trusts. Melnyk revocably disclaimed his interest as a beneficiary in two of the Trusts by letter dated July 24, 2000. During 2004 and 2005, Melnyk settled four new trusts, known as the STAR trusts, for the benefit of his wife and children and requested the trustees of the earlier Trusts to transfer the shares of the relevant companies holding Biovail shares to the New Trusts. The Trustees complied with that request. According to the Settlement Agreement, Melnyk is not a beneficiary of the New Trusts and holds no interest, contingent or otherwise in the assets of the New Trusts.

[6] Melnyk did, however, have certain relationships with the Trusts. In this respect, the Settlement Agreement provides as follows:

> "From the time that the Trusts were established in 1996, Melnyk maintained

certain relationships with the Trusts and engaged in certain activities involving the Trusts, including the following:

(a) Melnyk was the settler of each of the Trusts;

(b) Prior to August of 2000, Melnyk and members of Melnyk's family were beneficiaries of each of the Trusts. Thereafter, as explained more fully below, Melnyk revocably disclaimed his interest in the Congor and Conset Trusts, but had the power to re-acquire his interest in those Trusts at any time;

(c) Melnyk was asked for and provided recommendations to the Trustees in relation to the opening of the Accounts and, on occasion, concerning the transfer of Biovail securities between the Accounts;

(d) On a few occasions in 2002 and 2003, Melnyk was asked for and provided his recommendations to the Trustees in relation to certain acquisitions or dispositions of Biovail securities held in the Accounts;

(e) As set out above, at the time of the creation of the Trusts in 1996 and the New Trusts in 2004 and 2005, Melnyk recommended that assets be transferred into and out of the Trusts, and the Trustees complied with these requests;

(f) Between April 1998 and December 2003, Melnyk requested and received from the Trusts unsecured loans in the amounts of US $88,375,778 and CDN $4,050,830. Melnyk provided the Investment Companies with promissory notes requiring him to repay the loans together with interest calculated at a rate of 6% per annum. The repayment dates of the loans have been extended several times. Melnyk represents that his requests for loans were declined by the Trustees from time to time, and that from time to time he has repaid amounts outstanding on these loans;

(g) As at December 22, 2003, the outstanding amounts owed by Melnyk on these loans were US $100,184,324.39 and CDN $5,150,864.85. Melnyk knew or should have known that his requests for loans in certain circumstances could reasonably be expected to trigger sales by the Trusts of Biovail securities" (paragraph 26 of the Settlement Agreement).

[7] Melnyk transferred a very substantial number of shares of Biovail (or its predecessor) to the Evergreen Trust between 1991 and 1995. The number of shares of Biovail held by the Trusts varied over the relevant period. In 1996, Melnyk requested that the trustees of the Evergreen Trust transfer approximately 4.9 million shares of Biovail to the Investment Companies owned by the Trusts, representing approximately 19% of the outstanding shares of Biovail at that time.

The Settlement Agreement also states that the 2002 Biovail management proxy circular failed to disclose the existence and material terms of the Trusts including the fact that the Trusts held approximately 12.7 million Biovail shares in addition to the approximately 25.1 million shares beneficially owned or controlled by Melnyk and disclosed by him. The 2003 Biovail management proxy circular failed to disclose the existence and material terms of the Trusts including that the Trusts held approximately 12.7 million Biovail shares in addition to the approximately 26.1 million Biovail shares beneficially owned or controlled by Melnyk and disclosed by him. The point is that the Trusts held a very substantial number of Biovail shares at the time of the relevant management proxy circulars and at the time the trading which is the subject matter of this hearing occurred in 2002, 2003 and 2004. As at February 2006, the New Trusts held approximately 9.4 million Biovail shares.

[8] Roger D. Rowan ("Rowan") was a fellow director of Biovail with Melnyk. Rowan was the registered representative for certain of the Accounts established by the Trusts. The Settlement Agreement states that "at all material times, Rowan exercised discretionary trading authority" over certain of the Accounts (paragraph 14 of the Settlement Agreement). A very substantial portion of the trading identified in the Settlement Agreement occurred in those Accounts over which Rowan had trading authority.

[9] During 2002, 2003 and 2004, the Trusts traded, on an aggregate basis, in excess of 37 million shares of Biovail with a value in excess of one billion dollars and also purchased call options to acquire additional shares of Biovail. Staff's position was that whether or not the Trusts profited from this trading was not relevant to the issues before us; it is unclear based on the Settlement Agreement and the submissions made to us whether the Trusts did profit from the trading.

[10] Melnyk was generally aware of the trading by the Trusts in shares of Biovail. The Settlement Agreement states that:

> "During the material time and from time to time, Melnyk or his assistant received copies of the monthly account statements sent to the Trustees for all of the Accounts including the Watt Carmichael Accounts. Melnyk represents that on occasion, copies of these statements were sent to him or his assistant several months after they were generated. Melnyk further represents that he typically reviewed summaries of the statements rather than the statements themselves. In circumstances when Melnyk had reviewed detailed trading information contained in the brokerage statements, he either knew or should have known that Rowan was engaged in trading in Biovail securities in the Watt Carmichael Accounts during the Biovail Blackout Periods in 2002 and 2003" (paragraph 49 of the Settlement Agreement).

[11] We note, based on the terms of the Settlement Agreement, that Melnyk did not exercise control or direction over the shares of Biovail held by the Trusts. The Settlement Agreement states that:

> "Melnyk engaged in conduct that was contrary to the public interest when he failed to provide complete and accurate information to Biovail regarding the

> Trusts' and the New Trusts' holdings of Biovail securities. As a consequence, while Biovail's management circulars between 1996 and 2006 (the "Management Circulars") did disclose the number of Biovail securities which Melnyk beneficially owned directly or indirectly or over which he exercised control or direction, the Management Circulars did not disclose:
>
> (a) Melnyk's relationship with the Trusts and New Trusts; and
>
> (b) The number of Biovail securities held by the Trusts and the New Trusts.
>
> The disclosure contained in the Management Circulars was therefore incomplete and misleading" (paragraphs 42 and 43 of the Settlement Agreement).

[12] With respect to his dealings with the Investment Dealers Association of Canada ("IDA"), Melnyk knew in the period from January to August 2000 that the IDA was requesting information with respect to the Congor and Conset Accounts, including Melnyk's involvement in those Accounts and the names of the beneficial owners of those Accounts.

[13] The Settlement Agreement indicates that, in letters dated July 24, 2000 from Melnyk to each of the Congor and Conset Trustees, Melnyk revocably disclaimed his interest as a beneficiary in the Congor and Conset Trusts. By making that disclaimer revocable, Melnyk meant that he could at any time revoke the disclaimer by letter in writing to the Trustees and thereby again become a beneficiary of those trusts. On August 1, 2000, Melnyk's U.S. legal counsel provided Watt Carmichael (the broker and member of the IDA of which Rowan was the President and Chief Operating Officer) with a letter addressed to the IDA which stated, in part, that "… we have been authorized to confirm that Eugene Melnyk is not a beneficiary of either Trust. Nor, of course, is he a trustee of the Trusts" (paragraph 62 of the Settlement Agreement). As stated in the Settlement Agreement, "Melnyk knew or should have known that the August letter would be provided to the IDA … and that it contained statements that were incomplete and misleading in responding to the IDA's inquiry" (paragraph 65 of the Settlement Agreement).

Applicable Law

[14] We do not believe that there is any disagreement as to the legal principles that should be applied by us in considering the Settlement Agreement. We will summarize them briefly.

[15] The role of a Commission panel reviewing a settlement agreement is not to require the sanctions it would impose after a contested hearing for what is proposed in the settlement agreement, but rather to ensure that the agreed sanctions are within acceptable parameters and that the settlement agreement, as a whole, is in the public interest. Significant weight should be given to the agreement reached between adversarial parties, as a balancing of factors and interests will have already taken place in reaching the settlement agreement (*Re Sohan Singh Koonar et al.* (2002), 25 O.S.C.B. 2691 at 2692; and *Re Pollitt* (2004), 27 O.S.C.B. 9643 at para. 33). We note that our role is not to renegotiate the terms of the Settlement Agreement or to suggest changes to the facts, statements or sanctions set forth in the Settlement Agreement. Our

role is to decide whether to approve the Settlement Agreement, as a whole, on the terms presented to us.

[16] On the question of the sanctions to be imposed on a respondent in a particular matter, the Commission has emphasized that the guiding principle in imposing sanctions is as follows:

> […] the role of this Commission is to protect the public interest by removing from the capital markets – wholly or partially, permanently or temporarily, as the circumstances may warrant – those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts, particularly under section 118 of the Act. We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing, we must, of necessity, look to past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be […] (*Re Mithras Management* (1990), 13 O.S.C.B. 1600 at 1610 and 1611).

[17] In *Re Belteco Holdings* (1998), 21 O.S.C.B. 7743, the Commission set out a series of factors it would consider when imposing sanctions on a respondent, including:

- the seriousness of the allegations proved;
- the respondent's experience in the marketplace;
- whether or not there has been a recognition of the seriousness of the improprieties; and
- whether or not sanctions may deter not only those involved in the case being considered, but any like-minded people from engaging in similar conduct in the capital markets.

(*Re Belteco Holdings*, *supra* at 7746.)

[18] The Commission's decision in *Re M.C.J.C. Holdings* (2002), 25 O.S.C.B. 1133 elaborated on these factors, listing additional considerations which relate to the circumstances of individual respondents:

- the size of any profit (or loss avoided) from the illegal conduct;
- the size of any financial sanction or voluntary payment when considered with other factors;
- the effect any sanction might have on the livelihood of the respondent;
- the restraint any sanction might have on the ability of the respondent to participate without check in the capital markets;

- the respondent's experience in the marketplace;
- the reputation and prestige of the respondent;
- the shame, or financial pain, that any sanction would reasonably cause to the respondent; and
- the remorse of the respondent.

(*Re M.C.J.C. Holdings*, *supra* at 1136.)

[19] That decision did stress, however, that these were only some of the factors to consider, observing that, "[t]here may be others, and perhaps all of the factors we have mentioned would not be relevant in this or another particular case" (Re *M.C.J.C. Holdings, supra* at 1136).

[20] Based on the Settlement Agreement, we accept the submissions of Staff and counsel for Melnyk that this is not an insider trading case. Moreover, the Settlement Agreement does not conclude that Melnyk had any obligation to file insider trading reports in respect of the trading by the Trusts, other than the reports required to be filed by Melnyk under Multilateral Instrument 55-103 ("MI 55-103"). Nonetheless, one of the principal regulatory concerns that arises from the circumstances of this case is whether given the knowledge or involvement of Melnyk and Rowan in the trading by the Trusts, insider reports should have been filed. Based on the facts and statements set forth in the Settlement Agreement, Melnyk had no legal obligation to file insider trading reports, other than pursuant to MI 55-103, and it is not for us to speculate as to Rowan's legal position; that will be determined separately in a hearing currently scheduled to begin before the Commission on June 18, 2007. As a matter of principle, however, our securities laws recognize the importance of timely public reporting of trading by insiders, and the disclosure of share ownership or control by them, and we cannot ignore those fundamental principles in considering the circumstances of this matter and the terms of the Settlement Agreement.

[21] Disclosure is a cornerstone principle of securities regulation. Everyone investing in securities should have equal access to information that may affect their investment decisions. The Commission has recognized the importance of timely and accurate insider reporting:

> "[…] the filing of insider reports serves a very important purpose in our regulatory regime. They are designed to foster fair and efficient capital markets and to protect public confidence in our markets. The filing of insider reports is underscored by principles of disclosure and transparency with respect to trading by insiders."
>
> *Re Hinke* (2006), 29 O.S.C.B. 4171

Discussion and Analysis

[22] We have based our decision in this matter, as we are required to do, on the facts as set forth in the Settlement Agreement and the submissions made to us during the hearing. We believe that we are entitled to express our views on the facts and circumstances, and the

sanctions, set out in the Settlement Agreement. We have assumed that all of the facts relevant to our decision are contained in the Settlement Agreement, to the extent that Staff and Melnyk have been able to agree to them. We have resisted the temptation to speculate on matters outside the terms of the Settlement Agreement. We have given due weight to the fact that Staff and Melnyk have negotiated the Settlement Agreement in good faith and that there would have been give and take and active negotiation in settling the terms of, and entering into, the Settlement Agreement. We have relied upon the judgement of Staff in not advancing any of the other matters originally raised in the Notice of Hearing and the Statement of Allegations.

[23] With respect to the trading by the Trusts, we note that, while Melnyk may not have directed that trading or have exercised control or direction over it, he was aware of the trading and we have no doubt that he could, as a practical matter, have exercised control over it and could have stopped it if he wished. We believe that to be the case regardless of the legal status of the Trusts, who the trustees of the Trusts are or were and whoever may have had the legal right to direct trading on behalf of the Trusts through the Accounts.

[24] The trading by the Trusts involved trading in millions of shares of Biovail, with a value in excess of one billion dollars, as well as the purchase of call options to acquire shares of Biovail. That trading occurred over an extended period of three years. The Settlement Agreement states that a substantial portion of the trading was conducted by Rowan who, as noted above, was a fellow member of the board of directors of Biovail with Melnyk. Both Melnyk and Rowan were insiders of Biovail during all of the relevant time.

[25] Based on the Settlement Agreement, at a minimum, Melnyk knew that an insider of Biovail, Rowan, was trading on behalf of family trusts established by Melnyk millions of shares of Biovail over an extended period, without any public disclosure of that trading, without the filing of insider trading reports and without disclosure of the Trusts' ownership of shares of Biovail. We believe that Melnyk should have questioned how that was possible and consistent with applicable securities laws. Based on the facts before us, Melnyk did not take sufficient steps either to ask that question or to determine the answer.

[26] We consider it manifestly contrary to the public interest for the chairman, a director and a major shareholder of a public company to have had knowledge of such extensive trading, in all of the circumstances of this case, and not to have taken greater steps to ensure that there was full compliance with applicable securities laws. We cannot countenance a decision of the Commission that suggests that trading such as this can occur, with the knowledge and involvement of an insider, through offshore family trusts established by that insider, without appropriate public disclosure and the making of necessary filings. Our insider reporting rules, and other requirements related to disclosure by insiders of their share ownership, are important elements of our securities law regime and disclosure of insider trading information is considered by many market participants to influence their own investment decisions. We do not discount the impact that public knowledge of the trading by the Trusts might have had on investment decisions made by investors and other shareholders of Biovail.

[27] We are also very concerned by the fact that Melnyk misled the IDA in its investigation related to two of the Trusts and the Accounts. The Settlement Agreement indicates that Melnyk knew that the IDA was investigating his relationship to two of the Trusts and the trading in the

Accounts by such Trusts. He knew, or was reckless in not knowing that, as of July 23, 2000, he was a beneficiary of the Congor and Conset Trusts. He took the questionable step on July 24, 2000 of revocably disclaiming his interest as a beneficiary in those Trusts.

[28] We do not give credence to the revocable disclaimer as anything other than an intentional or reckless attempt by Melnyk to mislead the IDA through his legal counsel's letter of August 1, 2000. Melnyk knew that the IDA was attempting to determine his relationship to the Congor and Conset Trusts. In the circumstances, he misled the IDA and failed to disclose to the IDA relevant information. As stated in the Settlement Agreement:

> "In particular, the IDA was not informed of the following facts: that Melnyk had previously been listed as a beneficiary in the deeds of settlement for the Congor and Conset Trusts, the identity of the other beneficiaries of the Trusts (which included members of Melnyk's immediate family); and the fact that Melnyk had revocably (rather than irrevocably) disclaimed his interest in the Congor and Conset Trusts on July 24, 2000 and could therefore reacquire his interest in those Trusts at any time" (paragraph 66 of the Settlement Agreement).

[29] Melnyk should have taken steps not only to disclose the matters referred to above but also the other facts of which he was aware linking him to the relevant Trusts. The onus was on him to make full disclosure to the IDA and not to mislead the IDA in its role as a securities regulator. We note that the IDA enquiries with respect to the Accounts occurred in 2000, well before the trading by the Trusts that is the subject matter of the Settlement Agreement. Those enquiries should have alerted Melnyk and Rowan to the securities law issues surrounding the Trusts and trading by them in the shares of Biovail.

[30] We also note that if Melnyk had reviewed the Biovail corporate trading policy, that it clearly applied to trading by "all of its directors, officers and employees, members of their families […] and investment partnerships and other entities (such as trusts and corporations) over which such directors, officers or employees have or share voting or investment control" [emphasis added] (paragraph 44 of the Settlement Agreement).

[31] Corporate black-out policies form an important element of securities law compliance by public companies and their insiders. There should be a heavy onus on any insider who trades, or recommends trading, during a black-out period to demonstrate that he or she did so without knowledge of any material fact or material change. We note that there is no suggestion in the Settlement Agreement that any insider traded with knowledge of undisclosed material information.

[32] As stated in the Settlement Agreement, Melnyk violated Ontario securities law by failing to file insider trading reports as required by MI 55-103. In addition, Melnyk acted contrary to the public interest:

(a) when he failed to provide complete and accurate information to Biovail regarding the Trusts' and the New Trusts' holdings of Biovail securities; as a consequence, Biovail's management proxy circulars between 1996 and 2006 failed to disclose:

1. Melnyk's relationship with the Trusts and New Trusts; and

2. the number of Biovail securities held by the Trusts and the New Trusts;

(b) by permitting very substantial trading in shares of Biovail by offshore trusts established by him for the benefit of his family without taking greater steps to ensure whether there was full compliance with applicable securities laws and by failing to direct Rowan to refrain from trading in Biovail shares during the Biovail Blackout Periods; and

(c) by authorizing his U.S. legal counsel to send the August 1, 2000 letter to the IDA, which letter, in the circumstances in which it was sent, was incomplete and misleading.

Sanctions

[33] The sanctions imposed by the Settlement Agreement are fully described in that agreement and include (i) payment by Melnyk to the Commission of an administrative monetary penalty in the amount of $750,000 and of $250,000 representing a portion of the costs of the Commission's investigation in relation to this matter, (ii) an order that Melnyk cease to be a director of Biovail for a period of one year, (iii) a reprimand, (iv) various undertakings with respect to the making of appropriate filings and public disclosure now and going forward, (v) the sending by Melnyk of a letter of apology to the IDA, and (vi) agreement by Melnyk to cooperate with Staff in the hearing of this matter which will proceed against Rowan.

[34] In considering the sanctions imposed under the Settlement Agreement, we note that it was submitted to us that the sanctions imposed under that agreement far exceed the sanctions previously imposed by the Commission in similar cases. While we agree with that statement, in our view, there were no other reasonably comparable circumstances that provided any useful guidance to us.

[35] It was important to us in considering the sanctions imposed under the Settlement Agreement that there be full and adequate disclosure now and going forward of Melnyk's interests in and involvement with the New Trusts and of any future trading by the New Trusts in securities of Biovail. We consider the order that Melnyk cease to be a director of Biovail for a period of one year to be important as a matter of principle to emphasize that we consider that the conduct of Melnyk in all the circumstances fell below the standard that we would expect of a director of a public company and a person of his standing in the business community. We are, however, satisfied that Melnyk understands the seriousness with which we view his conduct in this matter, regrets that conduct and wishes to put these matters behind him.

[36] We were significantly influenced in considering the Settlement Agreement by whether in our view the sanctions imposed would deter other insiders from engaging in similar conduct. At the end of the day, we concluded that the sanctions provided for were sufficient to achieve the Commission's objective of specific and general deterrence.

[37] There are a number of benefits that arise as a result of our approval of the Settlement

Agreement. First, as noted above, we are satisfied that the terms of the Settlement Agreement will have an appropriate deterrent effect. Settling this matter now also avoids the substantial costs and expenses of a contested hearing on the merits with respect to Melnyk's conduct in the circumstances. The settlement also removes any uncertainty as to what the outcome of any such proceeding would have been. In addition, by means of the Settlement Agreement, some terms are imposed that go beyond what could have been imposed by the Commission at the conclusion of a contested hearing. For instance, Melnyk has agreed to co-operate with Staff, including by being a witness, in connection with the hearing scheduled to commence on June 18, 2007 with respect to Rowan's conduct in this matter. That agreement may be of significant value to Staff. Melnyk has also agreed to obtain an undertaking of the New Trusts that the New Trusts will treat themselves as insiders of Biovail going forward and that they will file insider trading reports with respect to all future trading in securities of Biovail (as long as Melnyk is an insider of Biovail or Melnyk and the New Trusts are, on a combined basis, insiders of Biovail).

[38] In conclusion, after considering the terms of the Settlement Agreement and the submissions made to us by Staff and counsel for Melnyk, we concluded that the terms of the Settlement Agreement are reasonable and that the sanctions imposed by that agreement are within acceptable parameters given the conduct of Melnyk. Accordingly, we approved the Settlement Agreement as being in the public interest.

Dated at Toronto, this 6th day of June, 2007.

"James E. A. Turner"

James E. A. Turner

"Carol S. Perry"

Carol S. Perry

"Margot C. Howard"

Margot C. Howard