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

- AND -

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

REASONS AND DECISION
(Section 127 of the *Securities Act*)

Hearing:	June 18-22, 26-28, September 6-7, 2007	
Decision:	June 20, 2008	
Panel:	Robert L. Shirriff, QC	Commissioner (Chair of the Panel)
	Suresh Thakrar, FICB, ICD.D	Commissioner
	David L. Knight, FCA	Commissioner
Counsel:	Johanna Superina Alexandra Clark	for Staff of the Ontario Securities Commission
	Nigel Campbell Ryder Gilliland	for Roger D. Rowan, Watt Carmichael Inc., Harry J. Carmichael and G. Michael McKenney

TABLE OF CONTENTS

REASONS AND DECISION

I. OVERVIEW

A. Background to the Proceeding

[1] This was a hearing before the Ontario Securities Commission (the "Commission") pursuant to sections 127 and 127.1 of the *Securities Act,* R.S.O. 1990, c. S.5, as amended (the "Act") to consider whether it is in the public interest to make an order against the respondents Roger D. Rowan ("Rowan"), Watt Carmichael Inc. ("Watt Carmichael"), Harry J. Carmichael ("Carmichael") and G. Michael McKenney ("McKenney") (collectively, the "Respondents").

[2] This matter arose out of a Notice of Hearing issued by the Commission on July 28, 2006 in relation to a Statement of Allegations issued by Staff of the Commission ("Staff") on that date with respect to the Respondents and Eugene N. Melnyk ("Melnyk").

[3] On June 5, 2007, an Amended Statement of Allegations was issued by Staff in which the allegations against Melnyk were withdrawn. The reason for the withdrawal was that, on May 18, 2007, the Commission approved a Settlement Agreement between Staff and Melnyk, who had originally been named as a respondent in this proceeding (the "Melnyk Settlement Agreement").

B. Respondents

i) Roger D. Rowan

[4] Rowan was a director of Biovail Corporation ("Biovail") from 1997 until his resignation in 2005, and thus, was an insider of Biovail during that time. He also served as a member of the Audit Committee of Biovail (the "Audit Committee") during his appointment as a director of Biovail.

[5] Rowan is, and was at all material times, the President and Chief Operating Officer ("COO") of Watt Carmichael. He owned approximately 29% of Watt Carmichael as at December 31, 2005. At all material times, Rowan was the registered representative at Watt Carmichael for the Conset, Congor and Southridge Accounts, described in paragraph 20 below.

ii) Watt Carmichael Inc.

[6] Watt Carmichael is, and was at all material times, a broker and investment dealer registered under the Act.

[7] Watt Carmichael is also a participating organization of the Toronto Stock Exchange (the "TSX") and is a member of the Investment Dealers Association (the "IDA").

iii) Harry J. Carmichael

[8] Carmichael is, and was at all material times, the Chairman and Chief Executive Officer ("CEO") of Watt Carmichael and a registered portfolio manager. As at December 31, 2005,

Carmichael owned approximately 44% of Watt Carmichael. He also holds the position of Ultimate Designated Person ("UDP") for Watt Carmichael.

iv) G. Michael McKenney

[9] McKenney is, and was at all material times, the Chief Financial Officer ("CFO") and the Chief Compliance Officer ("CCO") of Watt Carmichael.

C. The Allegations

[10] Staff alleges that the Respondents compromised the integrity of the capital markets through their activities in relation to the trading of Biovail securities held by certain trusts in 2002, 2003 and 2004. The specific allegations against the Respondents are as follows:

(a) While an insider of Biovail, Rowan executed numerous trades in Biovail Securities in the Congor, Conset and Southridge Accounts in 2002, 2003, and 2004 and failed to file any insider reports in respect of these trades contrary to subsection 107(2) of the Act;

(b) Contrary to the public interest and contrary to Ontario securities law, Rowan failed to provide complete and accurate information to Biovail concerning the number of Biovail common shares over which he exercised control or direction. As a result, the disclosure contained in Biovail's management proxy circulars in 2002, 2003 and 2004 was misleading or untrue or did not state facts that were required to be stated or that were necessary to make the statements in the circulars not misleading;

(c) Contrary to the public interest, Rowan engaged in discretionary trading of Biovail securities in the Conset, Congor and Southridge Accounts in 2002 and 2003 during each of the Biovail blackout periods;

(d) Rowan traded Biovail securities held in the Congor, Conset and Southridge Accounts at times when he had knowledge of material undisclosed information contained in Biovail management reports contrary to subsection 76(1) of the Act;

(e) Rowan purported to exercise discretionary trading authority in the Southridge Account when he did not have such discretionary authority, contrary to the Know Your Client requirements set out in subsection 1.5(1) of OSC Rule 31-505 – *Conditions of Registration*, (1999), 22 O.S.C.B. 731 and (2003) 26 O.S.C.B. 7170, referred to as the "Know Your Client" ("KYC") rule ("OSC Rule 31-505"), and contrary to the public interest;

(f) Contrary to the public interest, Rowan and Watt Carmichael provided responses to the IDA's request for information as to the identity of the beneficiaries of the Congor and Conset Trusts which they knew or ought to have known were

misleading or untrue or did not state facts that were required to be stated to make their statements not misleading;

(g) Contrary to the public interest, Rowan made statements to Staff as to the identity of the beneficiaries of the Conset Trust which he knew or ought to have known were misleading or untrue or did not state facts that were required to be stated to make his statements not misleading; and

(h) Contrary to the public interest, Watt Carmichael did not adequately supervise Rowan's trading in Biovail securities in the Congor, Conset and Southridge Accounts. Contrary to the public interest, Carmichael, in his capacity as Chairman and CEO, and McKenney, in his capacity as Chief Compliance Officer, failed to adequately supervise trading by Rowan and to address conflicts of interest despite indications that supervision was required.

II. AGREED FACTS

[11] The following paragraphs 12 to 34, inclusive, are taken from the Statement of Agreed Facts that was entered into evidence at the outset of the hearing, except for paragraphs 15, 16, 19, 33 and 34, which were not disputed by the Respondents.

A. Eugene N. Melnyk

[12] Melnyk was a director of Biovail from 1994 until 2007. Melnyk was CEO and Chairman of the Board of Biovail from December 2001 until October 2004. On June 30, 2007, Melnyk resigned as a director of Biovail for one year pursuant to the Melnyk Settlement Agreement. Melnyk was, at all material times, an insider of Biovail.

B. Biovail Corporation

[13] Biovail is, and was at all material times, a reporting issuer in Ontario within the meaning of the Act. Biovail's securities are listed on the TSX and on the New York Stock Exchange.

C. The Cayman Trusts

[14] In 1996, four trusts were established by Melnyk in the Cayman Islands. They are: the Conset Trust, the Congor Trust, the Southridge Trust (collectively, the "Trusts") and the Archer Trust.

[15] Melnyk was the settlor of the Trusts. Melnyk was also a beneficiary of the Conset, Congor and Southridge Trusts, along with certain family members and others.

[16] On July 24, 2000, Melnyk revocably disclaimed his interest in the Conset and Congor Trusts.

[17] The trustees for the Trusts were institutional trust administrators in the Cayman Islands (the "Trustees").

[18] Certain assets of the Trusts were held by investment companies and consisted, for the most part, of Biovail securities. The investment companies were: Conset Investments Limited ("Conset"), Congor Investments Limited ("Congor"), Southridge Management Limited ("Southridge") and Archer Investments Limited (collectively, the "Investment Companies"). The Investment Companies were incorporated under the laws of the Cayman Islands.

[19] In 1996, Melnyk caused the transfer of approximately 4,900,000 Biovail shares to the Investment Companies. These shares represented about 19% of the outstanding shares of Biovail on the market at that time.

D. The Trust Accounts

[20] In 1996, trading accounts were opened at Watt Carmichael for Congor (the "Congor Account"), Conset (the "Conset Account"), Southridge (the "Southridge Account") and Archer (the "Archer Account"). The Archer Account was later transferred to BMO Nesbit Burns, and has no relevance to these proceedings.

[21] The Congor, Conset and Southridge Accounts at Watt Carmichael are referred to collectively as the "Trust Accounts".

[22] Rowan was the registered representative for the Trust Accounts at Watt Carmichael. He was also the registered representative for the personal trading accounts of Melnyk and his wife at Watt Carmichael.

[23] At all material times, Rowan was an insider of Biovail.

[24] The Congor and Conset Accounts were documented as discretionary trading accounts. The Southridge Account was not documented as a discretionary trading account, although Southridge corporate resolutions granted discretionary authority.

[25] Biovail repurchased its own shares during its 2002 normal course issuer bid through a brokerage account held at Watt Carmichael. Rowan was the registered representative for Biovail's account at Watt Carmichael.

E. Trades from the Trust Accounts

[26] During 2002, the following trades occurred in Biovail securities in the Trust Accounts:

(a) acquisitions of approximately 4,800,000 Biovail common shares at a cost of approximately U.S. $170,000,000, and dispositions of approximately 4,800,000 Biovail common shares for proceeds of approximately U.S. $160,000,000 in the Conset Account;

(b) acquisitions of 9,000 Biovail call options (in respect of common shares of Biovail) at a cost of approximately U.S. $4,000,000 in the Conset Account;

(c) acquisitions of approximately 1,700,000 Biovail common shares at a cost of approximately U.S. $70,000,000, and dispositions of approximately 1,500,000 Biovail common shares for proceeds of approximately U.S. $60,000,000 in the Congor Account;

(d) acquisitions of approximately 600,000 Biovail common shares at a cost of approximately U.S. $25,000,000, and dispositions of approximately 700,000 Biovail common shares for proceeds of approximately U.S. $30,000,000 in the Southridge Account; and

(e) acquisitions of approximately 3,500 Biovail call options (in respect of common shares of Biovail) at a cost of approximately U.S. $2,000,000 in the Southridge Account.

[27] During 2003, the following trades occurred in Biovail securities in the Trust Accounts:

(a) acquisitions of approximately 7,800,000 Biovail common shares at a cost of approximately U.S. $265,000,000, and dispositions of approximately 8,800,000 Biovail common shares for proceeds of approximately U.S. $290,000,000 in the Conset Account;

(b) acquisitions of approximately 12,000 Biovail call options (in respect of Biovail common shares) at a cost of approximately U.S. $4,000,000 in the Conset Account;

(c) the exercise of Biovail call options to purchase 900,000 Biovail common shares at a cost of approximately U.S. $25,000,000 in the Conset Account;

(d) acquisitions of approximately 25,000 Biovail common shares at a cost of approximately U.S. $1,000,000, and dispositions of approximately 650,000 Biovail common shares for proceeds of approximately U.S. $25,000,000 in the Congor Account; and

(e) acquisitions of approximately 800,000 Biovail common shares at a cost of approximately U.S. $25,000,000, and dispositions of approximately 800,000 Biovail common shares for proceeds of approximately U.S. $25,000,000 in the Southridge Account.

[28] During 2004, the following trades occurred in Biovail securities in the Trust Accounts:

(a) acquisitions of approximately 150,000 Biovail common shares at a cost of approximately U.S. $2,000,000, and dispositions of approximately 350,000 Biovail common shares for proceeds of approximately U.S. $6,000,000 in the Conset Account;

(b) dispositions of 1,700 Biovail common shares for proceeds of approximately U.S. $30,000 in the Congor Account; and

(c) dispositions of approximately 375,000 Biovail common shares for proceeds of approximately U.S. $8,000,000 in the Southridge Account.

F. Commissions From Trading in the Trust Accounts

[29] During 2002, trading in the Trust Accounts generated approximately $900,000 in commissions for Watt Carmichael.

[30] In 2003, trading in the Trust Accounts generated approximately $1,400,000 in commissions for Watt Carmichael.

[31] In 2004, trading in the Trust Accounts generated approximately $50,000 in commissions for Watt Carmichael.

G. Insider Trading Reports

[32] Rowan did not file any insider trading reports under section 107 of the Act relating to the trading of Biovail securities in the Congor, Conset, or Southridge Accounts. He did, however, file reports under section 107 of the Act in relation to trades of his personal holdings in Biovail.

H. Biovail Management Information Circulars

[33] Biovail prepared Management Information Circulars in connection with the solicitation of proxies for its annual general meetings of shareholders ("Management Information Circulars"). The following table shows:

(a) the number of Biovail common shares disclosed in such circulars for 2002, 2003 and 2004 as being beneficially owned directly or indirectly by Rowan or over which he exercised direction and control; and

(b) the additional Biovail common shares held in the Trust Accounts for which Rowan was the registered representative which were not disclosed in the Management Information Circulars.

Year	Date of Management Information Circular	Holdings of Biovail Common Shares Disclosed in the Management Information Circular	Additional Undisclosed Holdings of Biovail Common Shares held in the Trust Accounts
2002	April 30, 2002	1,217,953	≥3,982,102
2003	April 30, 2003	1,190,403	≥3,000,966
2004	April 30, 2004	692,366	≥4,040,166

[34] The Biovail holdings disclosed in the 2002, 2003 and 2004 Management Information Circulars included securities held in the Conset Account but not securities held in the Congor or Southridge Accounts.

III. ISSUES

[35] The matter before us raises the following issues:

(a) Whether Rowan breached section 107 of the Act by failing to file insider reports relating to his trades in Biovail securities in the Trust Accounts;

(b) Whether Rowan engaged in conduct contrary to the public interest and contrary to Ontario securities law by failing to provide complete and accurate information to Biovail concerning the number of Biovail securities over which he exercised control or direction;

(c) Whether Rowan engaged in conduct contrary to the public interest by engaging in discretionary trading in Biovail securities in the Trust Accounts during Biovail's blackout periods?

(d) Whether Rowan breached section 76 of the Act by trading in Biovail securities in the Trust Accounts while he was in possession of material undisclosed information concerning Biovail;

(e) Whether Rowan engaged in unauthorized discretionary trading in the Southridge Account, contrary to OSC Rule 31-505 and contrary to the public interest;

(f) Whether Rowan and Watt Carmichael acted contrary to the public interest by misleading the IDA in responding to inquiries regarding the identity of the beneficiaries of the Conset and Congor Accounts;

(g) Whether Rowan acted contrary to the public interest by misleading Staff in response to its inquiries as to the beneficiaries of the Conset Trust;

(h) Whether Watt Carmichael, McKenney and Carmichael failed to adequately supervise Rowan's trading in Biovail securities in the Trust Accounts, contrary to OSC Rule 31-505, IDA Regulation 1300.2 and IDA Policy No. 2; and

(i) Whether the conduct of the Respondents was contrary to the public interest.

IV. WITNESSES

[36] Staff called ten witnesses to testify at the hearing.

[37] John Miszuk ("Miszuk"), the Vice-President, Controller and Assistant Secretary of Biovail, was the lead contact person for the Audit Committee, providing materials to the Audit Committee in 2002 and 2003 and preparing minutes of Audit Committee meetings.

[38] Arlene Fong ("Fong"), is Vice-President Finance of Biovail Laboratories International ("Biovail Laboratories"), which is a wholly owned subsidiary of Biovail located in Barbados. She was a controller at Biovail Laboratories at all material times.

[39] Michael Peter Foley ("Foley"), is currently a professional trader in Barbados for Trimel Investments, a holding company that belongs to Melnyk. From 1999 until 2004, he was a senior trader at Watt Carmichael, supervising twelve sales people and a second trader. He placed most of Rowan's trades.

[40] Michelle Garraway ("Garraway") was the corporate law clerk for Biovail responsible for compliance for insider trading, working on management information circulars and for completing other securities compliance and filings.

[41] Kathie Johnston, a sales compliance officer at the IDA, and Chris Dimitropoulos ("Dimitropoulos"), a manager in the sales compliance department at the IDA, participated in the IDA's sales compliance review of Watt Carmichael in 1999.

[42] Ken Cancellara ("Cancellara"), was the corporate secretary and a senior vice-president of Biovail, and Biovail's General Counsel (later Chief Legal Officer) during the material period.

[43] Guenther Kleberg has acted as Chief Compliance Officer for Merrill Lynch Canada, Wood Gundy, CIBC Securities Inc. and CIBC Investment Services Inc. He was qualified as an expert to give opinion evidence on brokerage practices to meet industry standards in the area of compliance.

[44] Fred Fitzsimmons ("Fitzsimmons") was the lead investigator for Staff.

[45] Rose De Francesca ("De Francesca") was Rowan's assistant from 1999 to 2001.

[46] The Respondents Rowan, Carmichael and McKenney testified, and two other witnesses were also called on behalf of the Respondents.

[47] Shabbir Jeraj ("Jeraj") was a section manager in the credit risk department of the National Bank Correspondent Network ("NBCN"), which succeeded First Marathon Securities ("First Marathon") as Watt Carmichael's carrying broker.

[48] Mark Thompson ("Thompson") joined Biovail in 2001 as associate general counsel, corporate affairs.

V. ANALYSIS

A. Introduction

[49] The following are the unanimous reasons and decision of the Panel, except that Commissioner Thakrar dissents with respect to Part H (Did Rowan conduct unauthorized discretionary trading in the Southridge Account?), Part I (Did Rowan and Watt Carmichael mislead the IDA in providing an incomplete response to inquiries regarding Melnyk's interest in the Trust Accounts?), and Part J (Did Rowan mislead the Commission?).

B. Overall Objectives of the Act

[50] When considering the issues arising from this proceeding, the Panel must consider carefully the purposes of securities regulation. As set out in section 1.1 of the Act, the Commission's mandate is to ensure the protection of the public interest to achieve the following goals:

> (a) to provide protection to investors from unfair, improper or fraudulent practices; and
>
> (b) to foster fair and efficient capital markets and confidence in capital markets.

[51] In pursuing these goals, the Commission must consider fundamental principles as stated in s. 2.1 of the Act, the relevant parts of which are as follows:

> 2.1 In pursuing the purposes of this Act, the Commission shall have regard to the following fundamental principles:
>
> (a) Balancing the importance to be given to each of the purposes of this Act may be required in specific cases.
>
> (b) The primary means for achieving the purposes of this Act are,
>
> i. requirements for timely, accurate and efficient disclosure of information,
>
> ii. restrictions on fraudulent and unfair market practices and procedures, and
>
> iii. requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.

[52] The preamble to subsection 127(1) of the Act states:

> The Commission may make one or more of the following orders if in its opinion it is in the public interest to make the order or orders.

[53] This gives the Commission authority to intervene in Ontario's capital markets when it is in the public interest to do so. The legislature clearly intended that the Commission have a very wide discretion in such matters, as the permissive language of subsection 127(1) allows the Commission to determine whether and how to intervene in a particular case.

[54] In *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)* ("*Asbestos*"), the Supreme Court of Canada observed that the breadth of the Commission's discretion is "evident in the range and potential seriousness of the sanctions it

can impose under section 127(1) of the Act" (at para. 39). The Court described the Commission's public interest jurisdiction as follows (at para. 36):

> The purpose of the commission's public interest jurisdiction is neither remedial nor punitive; it is protective and preventive, intended to be exercised to prevent likely future harm to Ontario's capital markets. The past conduct of offending market participants is relevant but only to assessing whether their future conduct is likely to harm the integrity of the capital markets.
>
> (*Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)* (2001), 199 D.L.R. (4th) 577 (S.C.C.), at para. 39 and 36).

[55] In *Pezim v. British Columbia (Superintendent of Brokers)*, the Supreme Court stated:

> In reading these powerful provisions, it is clear that it was the legislature's intention to give the Commission a very broad discretion to determine what is in the public's interest. To me, this is an additional basis for judicial deference.
>
> (*Pezim v. British Columbia (Superintendent of Brokers)*, (1994), 114 D.L.R. (4^{th}) 385 (S.C.C.) at para. 71.

[56] Further, the Commission has discretion under section 127 of the Act to make an order against a respondent, even where no specific breach of the Act is established (*Re Canadian Tire Corp.* (1987), 10 O.S.C.B. 858 at 930-931; aff'd (1987), 59 O.R. (2d), 79 (Div. Ct.)).

[57] It is the function and duty of the Commission to form an opinion as to the public interest according to the circumstances of the case before it. The Commission has a particularly broad latitude to form an opinion as to the public interest when assessing the conduct of a registrant (*Gordon Capital Corp.* v. *Ontario Securities Commission*), [1991] O.J. No. 934 (Div. Ct) at 7-8; *Re Gordon Capital Corp.* (1990), 13 O.S.C.B. 2035).

[58] Having set out the purposes of the Act, the Commission's mandate and the Commission's jurisdiction under section 127 of the Act, we now turn to our analysis of the alleged breaches of the Act and conduct contrary to the public interest.

C. The Standard of Proof

[59] In this proceeding, Staff makes serious allegations against the Respondents such as insider trading and misleading the IDA and the Commission. Accordingly, we recognize that while the standard of proof is the civil standard of balance of probabilities, the degree of proof required is at the high end of the spectrum of regulatory proceedings.

[60] The degree of proof required in this proceeding is clear and convincing proof based on cogent evidence as articulated in *Investment Dealers Association of Canada v. Boulieris*:

> The degree of proof required in disciplinary proceedings involving a registrant is

such that before a tribunal reaches a conclusion of fact, the tribunal must be reasonably satisfied that the fact occurred; and whether the tribunal is so satisfied depends on the totality of the circumstances including the nature and consequences of the facts to be proved, the seriousness of an allegation made, and the gravity of the consequences that will flow from a particular finding. See *Bernstein v. College of Physicians & Surgeons (Ontario)* (1977), 15 O.R. (2d) 447 (Ont. Div. Ct.), at 470; and *Coates v. Ontario (Registrar of Motor Vehicle, Dealers & Salesman)* (1988), 65 O.R. (2d) 526 (Ont. Div. Ct.), at 536.

Bernstein stands for the proposition that grave charges against a person cannot be established to the reasonable satisfaction of a discipline committee by fragile or suspect testimony. The evidence to establish the charges have [sic] to be of such quality and quantity as to lead a discipline committee acting with care and caution to the fair and reasonable conclusion that the person is guilty of those charges. The degree of proof required must be nothing short of clear and convincing and based upon cogent evidence which is accepted by the tribunal. See *Bernstein* at 485 and *Coates* at 536.

(Footnotes omitted, *Investment Dealers Association of Canada v. Boulieris* (2004), 27 O.S.C.B. 1597 at paras. 33 and 34; aff'd [2005] O.J. No. 1984 (Div. Ct.))

[61] This standard of proof was also applied in *Re ATI Technologies Inc*, an insider trading case.:

While the standard of proof in administrative proceedings is the civil standard of the balance of probabilities, Staff conceded that, this being an alleged breach of subsection 76(1) of the Act, it could only discharge its burden by clear and convincing proof based on cogent evidence.

This standard of proof was recently affirmed in Investment Dealers Assn. of Canada v. Boulieris (2004), 27 O.S.C.B. 1597 (Ont. Securities Comm.) at paras. 33 and 34, affirmed Investment Dealers Assn. of Canada v. Boulieris , [2005] O.J. No. 1984 (Ont. Div. Ct.) where the Commission considered the standard required for proving a serious complaint against a person. The Commission noted in that case that the standard of proof and the nature of the evidence which is required to meet that standard, are integral to the duty of administrative tribunals to provide a fair hearing.

We accept, as a matter of a fundamental fairness, that reliable and persuasive evidence is required to make adverse findings where those findings will have serious consequences for a respondent.

(Footnotes omitted, *ATI Technologies Inc., Re*, 2005 CarswellOnt 5054, 28 O.S.C.B. 8558, at paras. 13-15.)

D. Did Rowan breach section 107 of the Act by failing to file insider reports relating to his trades in Biovail securities in the Trust Accounts?

i) Submissions

Staff

[62] Staff alleges that Rowan, as an insider of Biovail, was required to file insider trading reports with regard to trades in Biovail securities held in accounts for which he had discretionary trading authority, though he was not the beneficial owner of the securities.

[63] There is no suggestion in this case that Rowan had direct or indirect legal or beneficial ownership of the securities in issue. According to Staff, an insider can have control or direction over securities of which the insider is not the beneficial owner if the insider has voting power or investment power. Because the Conset and Congor Accounts were discretionary accounts and Rowan engaged in discretionary trading in the Southridge Account, Staff submits that Rowan had investment power, and, therefore, control or direction, over the Biovail securities held in the Trust Accounts.

[64] Staff submits that Rowan's insider status at Biovail and his control or direction over the Biovail securities in the Trust Accounts gave rise to a reporting obligation under subsection 107(2) of the Act. Staff submits that Rowan was required to file insider reports in respect of trades executed in 2002, 2003 and 2004 in the Trust Accounts. As a result of his failure to do so, Rowan has allegedly breached Ontario securities law.

The Respondents

[65] The Respondents submit that Rowan had no obligation to file insider reports for trades he executed in the Trust Accounts as a registered representative, as such a legal requirement does not exist under securities law in Canada.

[66] The Respondents also submit that the evidence establishes that many of the trades for which it is alleged that Rowan should have filed insider reports were not made pursuant to any discretion on his part. Rather, they submit that many trades were executed on the instructions of the account holders, who retained control or direction, within the meaning of the law, over the Accounts. The Respondents submit that, in discretionary accounts, clients do not give up their authority to make investment decisions.

[67] The Respondents further argue that, in any event, it is the brokerage firm, Watt Carmichael, not the registered representative, as alleged by Staff, that exercises the discretionary authority pursuant to an agreement with the client. Watt Carmichael was not an insider of Biovail and the Respondents submit that its discretionary authority was materially restricted by significant macro-level (in terms of the overall account mandate) and micro-level (in terms of day-to-day trading) restrictions.

[68] The Respondents submit that, at the "macro" level, Watt Carmichael had specific instructions from the holders of the Accounts to maintain a core holding of Biovail securities,

and subject to that restriction, to undertake a trading strategy in shares and options of Biovail with the objective of exploiting volatility in the trading price of Biovail securities to achieve capital gains. Accordingly, the Respondents argue that, while Watt Carmichael had authority to buy and sell shares from time to time, it was always subject to the overriding mandate applying to Biovail holdings.

[69] The Respondents submit that, at the "micro" level, Watt Carmichael's discretion over the Accounts was limited by the overall account mandate, specific buy/sell directions including directions to reduce margin, and margin requirements imposed by NBCN. Further, the limited discretion left with the brokerage firm does not amount to control or direction over the Biovail securities in the Accounts. The Respondents submit that the limited discretion that was retained by Watt Carmichael did not, and cannot reasonably, constitute "control or direction" within the meaning of section 107 of the Act.

[70] The Respondents argue that Staff's position has unsettling consequences that are ultimately inconsistent with the underlying objective of the Act, which is to foster timely, accurate and effective reporting. The Respondents submit that, when a registered representative at a brokerage firm receives an instruction to sell shares of an issuer of which he is an insider (as Rowan did for example on May 20, 2003), he is not exercising control or direction, but rather executing client instructions (i.e. giving effect to the client's control or direction). It is unreasonable for section 107 of the Act to apply to the registered representative in those circumstances, in the Respondents' submission.

[71] Further, the Respondents submit that one of the primary indicators of control or direction over shares is voting control. Neither Watt Carmichael nor Rowan had authority to vote the Biovail securities in the Accounts. The absence of this feature of control or direction weighs against a finding that Rowan exercised control or direction within the ambit of section 107 of the Act.

[72] The Respondents submit that it would be unreasonable to require reporting for unsolicited trades but not for trades that were solicited by the client in discretionary accounts. Such a system of reporting would be confusing and of no assistance to the investing public because it would lead to confusion as to whether a reporting obligation existed for any particular trade. The result would run counter to the Act, which aims to achieve its purposes through "timely, accurate and efficient disclosure of information." (Section 2.1 of the Act.)

[73] The Respondents submit that Rowan's trading in Biovail shares held in the Trust Accounts was known to the TSX, IDA, Biovail's legal department and NBCN, none of which raised any concern about it before Staff brought its allegations.

[74] Finally, the Respondents note that, pursuant to the Melnyk Settlement Agreement, Melnyk agreed to file insider reports for Biovail securities traded by the Trusts. They submit there is no concept of a shared reporting obligation in the Act and it would be unreasonable to establish one. In this matter the policy interest sought under the Act has been met by having insider reports filed by Melnyk only.

ii) The Law

Insider Reporting

[75] During the material period, the term "insider" was defined in subsection 1(1) of the Act to include a director or senior officer of a reporting issuer, as well as any person who beneficially owns, directly or indirectly, or exercises control or direction over more than 10% of the voting securities of the reporting issuer.

[76] There is no dispute that Rowan was an insider of Biovail by virtue of his role as a director of Biovail from 1997 until his resignation in 2005.

[77] The relevant parts of section 107 of the Act provide as follows:

> (a) A person or company who becomes an insider of a reporting issuer other than a mutual fund, shall, within 10 days from the day that he, she or it becomes an insider, or such shorter period as may be prescribed by the regulations, file a report as of the day on which he, she or it became an insider disclosing any direct or indirect beneficial ownership of or control or direction over securities of the reporting issuer as may be required by the regulations.
>
> (b) An insider who has filed or is required to file a report under this section or any predecessor section and whose direct or indirect beneficial ownership of or control or direction over securities of the reporting issuer changes from that shown or required to be shown in the report or in the latest report filed by the person or company under this section or any predecessor section shall, within 10 days from the day on which the change takes place, or such shorter period as may be prescribed by the regulations, file a report of direct or indirect beneficial ownership of or control or direction over securities of the reporting issuer as of the day on which the change took place and the change or changes that occurred, giving any details of each transaction as may be required by the regulations.

[78] The requirement to file insider reports set out in section 107 of the Act serves two purposes:

> (a) a deterrent purpose: insiders are less likely to engage in improper trading if such trading is subject to public scrutiny. Insider reporting allows the market and securities regulatory authorities to monitor insider transactions and take action if improper trading is identified; and
>
> (b) a signaling purpose: investors are provided with information concerning the trading activities of insiders, and, by inference, the insiders' views concerning the prospects of the issuer, thereby enhancing market efficiency.

(See, for example, *Report of the Attorney General's Committee on Securities Legislation in Ontario* (the "Kimber Report"), Toronto: Queen's Printer, 1965), paras. 2.02 – 2.05)

[79] It is well established that "timely, accurate and efficient disclosure of information" is one of the primary means for achieving the purposes of the Act.

[80] The importance of timely and accurate insider reporting was emphasized in the *Hinke* decision, where the Commission stated:

> …the filing of insider reports serves a very important purpose in our securities 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 at paras. 16 and 17.)

[81] In *Re Robinson*, the Commission, discussing the purpose of insider reporting requirements, quoted directly from the Commission's 1994 Notice and Request for Comments regarding proposed legislative changes, including changes to insider reporting requirements:

> These requirements are intended to discourage trading with knowledge of material undisclosed information, and enhance investor confidence in the securities market. Additionally, the reports have been of use to market participants as an indicator of perceptions that insiders have about issuers and their prospects.
>
> (*Notice and Request for Comments on Proposed Refinement of the Early Warning Regime and the Rules Regarding Insider Reporting, Takeover Bids and Control Block distributions as they Apply to Investors in General, Including Portfolio Managers and Portfolio Clients* (1994), 17 O.S.C.B. 4438, quoted in *Re Robinson* (1996), 19 O.S.C.B. 2643 at para. 252.)

"Control or Direction"

[82] In *Re Robinson*, the Commission also addressed the interpretation of the phrase "control or direction" contained in section 107 of the Act, endorsing the following statement from the same Notice and Request for Comments:

> [a] person with "control or direction" over securities includes any person … who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise has *or shares*:
>
> (i) voting power which includes the power to vote, or to direct the voting of, such securities and/or
>
> (ii) investment power, which includes the power to acquire or dispose, or to direct the acquisition of such securities.

(*Notice and Request for Comments on Proposed Refinement of the Early Warning Regime and the Rules Regarding Insider Reporting, Takeover Bids and Control Block distributions as they Apply to Investors in General, Including Portfolio Managers and Portfolio Clients* (1994), 17 O.S.C.B. 4438, at p. 4444, quoted in *Re Robinson* (1996), 19 O.S.C.B. 2643, at para. 253.)

[83] This legal interpretation of the words "control or direction" is now incorporated in a national notice published by Canadian Securities Administrators ("CSA") Staff. Under the heading, "When do I need to add registered holders and in what circumstances?", the notice states:

> You can hold your securities in the following three ways:
>
> (1) You can hold them directly. For example, you can hold the securities in an account with your broker, but the account is in your name.
>
> (2) You can hold them indirectly. For example, you beneficially own common shares in X Co. but the registered owner is another entity such as a holding company, an RRSP, or a family trust.
>
> (3) You can have control or direction over them. You have control or direction over the securities if you, directly or indirectly, through any contract, arrangement, understanding or relationship or otherwise have or share
>
> - voting power, or
> - investment power.
>
> This would include having control or direction over the securities through a power of attorney, a grant of limited trading authority, or management agreement. For example, you set up a trust for your children in which Co. X securities are held. Because of your relationship with your children, you need to report your children's holdings, because you could direct your children to purchase or sell those securities. This may also be the case if your spouse owns the securities, but you have control or direction over those securities.
>
> If you choose either 'Indirect" or "Control or Direction', SEDI will prompt you to add the name of a registered holder. The registered holder is the entity through which you beneficially own the securities, such as an RRSP, holding company, family trust, or the person or company that owns the securities you have control or direction over.
>
> (CSA Staff Notice 55-310, section 4.2.9 (April 2003). See also CSA Staff Notice 55-308, "Questions on Insider Reporting", section 3.5 (November 2002).)

[84] These principles have also been applied in a number of decisions. For instance, in *Re Borealis Explorations Ltd.* ("*Borealis*"), the Alberta Securities Commission (the "ASC") considered the issue of control or direction over securities. In that matter, the respondent Goldenberg was an insider of a public company, Borealis Explorations Ltd. (Borealis) and a partner in a law firm. Goldenberg maintained accounts over which he had trading authority, including an account held in his name in trust. Goldenberg had signing authority over this account but never exercised it, as all the trading in the account was done by Mr. Cox, Borealis' President. The ASC held that it was clear that Mr. Goldenberg and Mr. Cox had joint direction and control over the shares in the account even though the shares notionally belonged to Borealis's creditors:

> With respect to the insider trades outlined in paras. 4 and 5 of the agreed statement of facts, it was suggested that no reporting was required. The Board notes however that s. 147 requires a report when an insider has "direct or indirect beneficial ownership of or control or direction over securities of the reporting issuer". Notwithstanding that the shares in question might have been pledged to certain creditors, or might have notionally belonged to some creditors, it is clear that the respondents Cox and Goldenberg had direction and control over them. Mr. Goldenberg specifically testified that the reason for having them in the Trust Account was to control their release into the market.
>
> With respect to the shares owned by Mr. Goldenberg's law firm, the Board is satisfied that Mr. Goldenberg had direction and control over them. It would seem obvious that when a decision had to be taken as to whether to sell some shares, the partnership would look to Mr. Goldenberg's recommendation. Mr. Goldenberg as an insider had an indirect beneficial ownership as a member of the partnership, and also had direction and control of the shares. Mr. Goldenberg admitted at the hearing that he had a beneficial interest in these shares. The Board is of the view that an insider who has a partial beneficial interest in shares must still report trades under s. 147, even if others with a majority interest in the shares theoretically could overrule the insider's wishes as to whether a trade should take place.
>
> (*Re Borealis Exploration Ltd.* (1993), 2 C.C.L.S. 72, (A.S.C.) paras. 17 and 18.)

[85] In *Re Riley*, the Commission considered a similar set of facts and found that the respondent Riley should have filed insider trading reports in respect of transactions in nominee accounts that were in his name in trust for others. The Commission noted that Riley stated that "he believed at the time that he was not required to report these transactions as he was not the beneficial owner, but he conceded that this was a mistaken view and that he should have filed insider reports with respect to these trades". The Commission went on to find that Riley failed to comply with the reporting requirements contained in section 107 of the Act (*Re Riley* (1999), 22 O.S.C.B. 3549, at para. 19).

iii) Analysis

[86] As stated above, the issue before us is whether, as an insider of Biovail, Rowan was required to file insider trading reports with regard to Biovail securities held in accounts in which he engaged in discretionary trading, even though he was not the beneficial owner of the securities.

[87] There is no dispute that Rowan was an "insider" of Biovail within the definition in subsection 1(1) of the Act. Section 107 of the Act requires an insider to file insider reports in respect of securities of reporting issuers over which the insider has direct or indirect beneficial ownership or "control or direction". Staff submits that Rowan had "control or direction" of the Biovail securities in the Trust Accounts by virtue of his discretionary trading authority.

[88] As stated above, the Respondents argue that the discretionary authority over the Trust Accounts was materially restricted by the account holder, who retained full control or direction at all times. Further, the Respondents submit that while there was authority to buy and sell shares from time to time, it was subject to the overriding mandate to maintain a core Biovail holding.

[89] In our view, these arguments do not reflect the evidence in this case. Rowan was the registered representative for the Trust Accounts and exercised discretionary trading authority over these Accounts. Indeed, during the hearing, Rowan himself acknowledged that he exercised discretionary trading authority over the Trust Accounts and that he did not file insider reports regarding his transactions in Biovail securities in these accounts.

[90] The wording of the "Discretionary Agreement" between Watt Carmichael and the Conset and Congor Trusts with regard to the Trust Accounts is especially informative. It states:

> You shall maintain and operate the Account in the name of the undersigned and *you are hereby authorized and requested to take such action from time to time in connection with the Account as you in your sole discretion*, may consider necessary or desirable for its proper operation and administration and *to that end you shall have full power and authority to invest the funds* which may be in the Account from time to time in all types of securities including (but not so as to restrict the generality of the foregoing) options on securities commonly known as puts and calls, or to hold such funds in whole or in part in the form of cash, as you may deem appropriate, and to sell, exchange or otherwise deal in any such securities which may at any time form the part of the Account subject only to the following restrictions: [none listed]. (emphasis added)

[91] Although the discretionary agreement was accepted by Watt Carmichael, it is noteworthy that in the same agreement, under his signature, Rowan accepted discretionary authority over the Accounts as investment advisor.

[92] Based on the documentary evidence and the testimony of the witnesses, we find that there is clear and convincing evidence that Rowan met the test set out in the *Robinson* decision cited above. That is, Rowan was a person who, directly or indirectly, had or shared investment power

over the Biovail securities in the Trust Accounts, which included the power to "direct the acquisition or disposition" of the securities.

[93] We note that Staff's allegations against Rowan rely on the assumption that it is not the brokerage firm, Watt Carmichael, but rather its employee, Rowan, who actually exercised the discretionary authority over the Accounts.

[94] The Respondents submit that this is not how discretionary accounts operate, and referred us to IDA Regulations 1300.4 and 1300.5:

> 1300.4 No person, other than a partner, director, officer or registered representative (other than a registered representative (mutual funds) or (non-retail)) who has been approved as such pursuant to the applicable By-Laws of the Association, shall effect trades for a customer in a discretionary account and any such permitted trades shall only be effected if:
>
> (a) the prior written authorization has been given by the customer to the Member and accepted by the Member in compliance with regulation 1300.5; and
>
> (b) the account has been specifically approved and accepted in writing as a discretionary account by the designated director, partner, officer, branch manager, futures contract principal or futures contract options principal, as the case may be, who authorized the opening of the account, . . .
>
> 1300.5 The prior written authorization provided for by clause (a) of Regulation 1300.4 shall:
>
> (a) define the extent of the discretionary authority which has been given to the Member;
>
> …
>
> (d) only be terminated by the customer by notice in writing, which notice shall be effective on receipt by the Member except with respect to transactions entered into prior to such receipt; and
>
> (e) only be terminated by the Member by notice in writing, which notice shall be effective not less than 30 days from the date of mailing the notice to the customer by pre-paid ordinary mail at the customer's last address appearing in the records of the Member.

[95] In accordance with these requirements, the Respondents submit that the IDA-approved discretionary agreements for the Congor and Conset Accounts were between the accountholders and Watt Carmichael (not Rowan).

[96] Staff submits that pursuant to IDA Regulations 1300.4 and 1300.5, Rowan was the designated registered representative for the Conset and Congor Accounts. These Accounts were specifically approved and accepted by Rowan as discretionary accounts. The discretion gave broad investment power over the Biovail securities in these Trust Accounts, which power was exercised by Rowan. The Southridge Trust Account was not approved or accepted as a discretionary account but Rowan considered it to be a discretionary account and exercised his discretion in the same manner as he did with the Conset and Congor Trust Accounts. Rowan was also an insider of Biovail. Thus Staff submits Rowan was required to file insider reports of the purchases and sales of Biovail securities in the Trust Accounts.

[97] The Respondents also rely on National Instrument 62-103 ("NI 62-103"), which, in their submission, exempts "eligible institutional investors" that have discretion to vote, acquire or dispose in accordance with the beneficial owner's consent from the insider reporting requirements of section 107 of the Act. Under NI 62-103, eligible institutional investors include:

> An investment manager in relation to securities over which it exercises discretion to vote, acquire or dispose without express consent of the beneficial owner, subject to applicable legal requirements, general investment policies, guidelines, objectives or restrictions…
>
> (National Instrument 62-103 – The Early Warning System and Related Take-Over Bids and Insider Reporting Issues, Part I, Section 1.1).

[98] NI 62-103 defines "investment manager" to include an "entity that is registered or licensed to provide investment counselling, portfolio management or similar advisory services in respect of securities…".and provides these services "for valuable consideration under a contractual arrangement".

[99] The Respondents submit that under NI 62-103, it is the entity that is defined as an eligible institutional investor and that is eligible to report trades under the alternative monthly reporting system established as an alternative to the insider reporting scheme under section 107 of the Act. NI 62-103 does not contemplate that an employee of an eligible institutional investor could be personally responsible for filing insider reports under section 107 of the Act. The Respondent submits that Staff's position is inconsistent with the scheme under NI 62-103, the IDA Regulations respecting discretionary accounts, and standard practice in the industry.

[100] Staff submits that NI 62-103 provides no support for the position advanced by the Respondents. According to Staff, National Instrument 62-103 provides that, in the ordinary course, insiders would be required to comply with the insider reporting requirements and early warning requirements under the Act, but there may be certain circumstances where they are exempt from such a requirement if they meet the criterion in Part 9. Part 9 of NI 62-103 contains the exemption from the insider reporting requirement for eligible institutional investors. In particular, section 9.1 sets out certain requirements in order to rely upon the exemption. There are a number of things that an institutional investor would need to do in order to rely upon that exemption.

[101] Section 5 of Part 9 states:

> If an eligible institutional investor is exempt under subsection (1) from the insider reporting requirement for a reporting issuer, every director or senior officer of the eligible institutional investor who is an insider of the reporting issuer solely as a result of being director or senior officer of the eligible institutional investor is exempt from the insider reporting requirement for the reporting issuer.

[102] Staff submits that subsection (5) provides that if Rowan, who was a director and senior officer of Watt Carmichael, was also an insider of a reporting issuer (Biovail) solely as a result of his being a director or senior officer of Watt Carmichael, he would be exempt from the insider reporting requirements for Biovail. Such is not the case for Rowan, who was an insider of Biovail not because he was a director and officer of Watt Carmichael but because he was a director of Biovail. Thus, in Staff's submission, Rowan remained subject to the insider reporting requirements of the Act.

[103] We agree with Staff's interpretation of IDA Regulations 1300.4 and 1300.5 and NI 62-103.

[104] Finally, we take note of CSA Multilateral Policy 34-202 – "*Registrants Acting as Corporate Directors*" ("MP 34-202"), which states:

> 1.1 Introduction
>
> The position of a representative of a registrant acting as a director of or adviser to a reporting issuer is one that is fraught with the possibility of a conflict of interest. This arises more particularly in regard to questions of insider information and trading, and timely disclosure.
>
> 1.2 Conflict of Interest
>
> The Canadian securities regulatory authorities emphasize that all registrants should be most conscious of their responsibilities in these situations and weigh the burden of dealing in an ethical manner with the conflicts of interest against the advantages of acting as a director of a reporting issuer, many shareholders of which may be clients of the registrant.
>
> (Multilateral Policy 34-202 – *Registrants Acting as Corporate Directors*, (1998), 21 O.S.C.B. 6608, ss. 1.1 and 1.2)

[105] Although the discretionary agreements for the Conset and Congor Accounts were between each of Conset and Congor and Watt Carmichael, we note that in IDA Regulation 1300.3 "discretionary account" is defined to mean ". . . an account of a customer . . . in respect of which a Member or any person acting on behalf of the Member exercises any discretionary authority in trading by or for such account, ..."

[106] We find that Rowan was the registered representative at Watt Carmichael who, in terms of IDA Regulations 1300.4 and 1300.5, effected trades of Biovail securities in the Trust Accounts. Rowan exercised the discretionary trading authority over the Conset and Congor Accounts and engaged in discretionary trading in the Southridge Account, and thus had or shared control or direction over the Biovail securities held in the Trust Accounts. Rowan was also a director and, as such, an insider of Biovail. In these circumstances, we find that Rowan had an obligation to file insider reports with respect to the trades of Biovail securities made in the Trust Accounts. The exemption from filing insider reports provided in NI 62-103 did not extend to him.

iv) Finding

[107] Accordingly, we find that Rowan, as an insider of Biovail by virtue of his role as a director of Biovail, was required to file insider reports with respect to trades of Biovail securities in the Trust Accounts in accordance with subsection 107(2) of the *Act*.

[108] Given the significant volume and frequency of trading in Biovail securities in these Accounts, we find that Rowan repeatedly breached the insider reporting requirements.

E. Did Rowan engage in conduct contrary to the public interest in failing to provide complete and accurate information to Biovail concerning the Biovail securities held in the Trust Accounts?

i) Submissions

Staff

[109] Staff submits that as a director of Biovail, Rowan was required to provide complete and accurate information to Biovail to be disclosed in its 2002, 2003 and 2004 Management Information Circulars.

[110] Staff submits that while the 2002 Management Information Circular stated that Rowan beneficially owned directly or indirectly or exercised control or direction over 1,217,953 Biovail common shares as at April 30, 2002, which included common shares held in the Conset Account, Rowan exercised or shared control or direction over at least another 3,982,102 Biovail common shares held in the Congor and Southridge Accounts as at April 30, 2002.

[111] Staff also submits that while the 2003 Management Information Circular stated that Rowan beneficially owned directly or indirectly or exercised control or direction over 1,190,403 Biovail common shares as at April 30, 2003, which included common shares held in the Conset Account, Rowan exercised or shared control or direction over at least another 3,000,966 Biovail common shares in the Congor and Southridge Accounts as at April 30, 2003.

[112] Staff also submits that while the 2004 Management Information Circular stated that Rowan beneficially owned directly or indirectly or exercised control or direction over 692,366 Biovail common shares as at April 30, 2004, which included shares in the Conset Account,

Rowan exercised or shared control or direction over at least another 4,040,166 Biovail common shares in the Congor and Southridge Accounts as at April 30, 2004.

[113] Staff's position is that Rowan's decision to report the Biovail holdings in the Conset Account, while failing to report the Biovail holdings in the Congor and Southridge Accounts, led to Biovail's disclosure of incomplete and misleading information to the public in its Management Information Circulars. At a minimum, the reporting of only the Conset shares should have prompted further inquiries by Rowan. According to Staff, there is no evidence that Rowan made such inquiries or consulted legal counsel about his responsibilities in this regard, and thus, as a director of a public company, Rowan failed to fulfill an important obligation owed to shareholders and the investing public.

The Respondents

[114] The Respondents do not dispute the evidence about the Biovail holdings in the Trust Accounts. Counsel for the Respondents submits that Rowan had no obligation to report the holdings of Biovail securities in the Trust Accounts because he did not have control or direction over them.

[115] Rowan's evidence is that on the advice of the Biovail's Finance and Legal departments, he listed the securities held in the Conset Account in addition to those which he directly or indirectly beneficially owned or controlled (i.e. Biovail securities held in Rowan Management Ltd. or Rowan's personal account) in the 1998 Management Information Circular. Rowan claims that in subsequent years, he complied with the direction of the Finance and Legal departments that the reporting be consistent from to year to year, and therefore continued to report to Biovail, for purposes of the Management Information Circular, only the number of Biovail securities beneficially held by him and those held in the Conset Account.

[116] However, according to counsel for the Respondents, Rowan was not required to report Biovail securities held in the Conset Account because he did not exercise control or direction over those shares within the meaning of section 107 of the Act.

[117] The Respondents submit that while certain Biovail officers such as Cancellara in particular, have attempted to distance themselves from the Trusts, the evidence, especially that of Thompson and Garraway, shows that senior management at Biovail, in particular those responsible for preparing the Management Information Circulars, knew of the Trusts and knew that Biovail securities in certain of those Trust Accounts were traded by Rowan.

[118] The number of shares listed in the Management Information Circular for 2004 is not 686,466, as reported to Garraway by Rowan's assistant, but 692,366. According to the Respondents, this shows that the Biovail Legal department knew he traded securities for the Trusts, and modified the numbers he provided.

[119] In these circumstances, the Respondents submit that Rowan's evidence that he received advice from Miszuk and Cancellara about the number of Biovail securities to be reported by him in the 1998 Management Information Circular and the instruction that his reporting be consistent from year to year is credible and corroborated. They submit that the allegation that Rowan did, or

could have, misled Biovail as to the number to be included in the Management Information Circulars is inconsistent with the evidence.

ii) The Law

[120] Pursuant to paragraph 86(1)(a) of the Act, Biovail was required to send annual Management Information Circulars to its shareholders. At the time of the conduct at issue, section 176 of Ontario Regulation 1015 required an information circular to contain the information prescribed by Form 30. (That obligation is now contained in Form 51-102F5 under National Instrument 51-102 – Continuous Disclosure Obligations, (2004) 27 O.S.C.B. 3439, as amended.)

[121] Item 5 (para. vii) of Form 30 required disclosure of the following information:

> The number of securities of each class of voting securities of the reporting issuer or of any subsidiary of the reporting issuer beneficially owned, directly or indirectly or over which control or direction is exercised by each proposed director.
>
> (Ontario Regulation 1015, Form 30)

iii) Analysis

[122] In 2002, 2003 and 2004, Biovail filed with the Commission and sent to its shareholders Management Information Circulars which included disclosure of the number of Biovail securities purported to be owned or over which control or direction was exercised by each director, including Rowan.

[123] Rowan testified that he reported his personal holdings and the Biovail securities held in the Conset Account in these documents, but did not include the Biovail securities held in the Congor or Southridge Accounts.

[124] As a director of a reporting issuer, Rowan was required to disclose to Biovail, for inclusion in its Management Information Circulars, the securities that he beneficially owned, directly or indirectly or over which he exercised control or direction. There is no dispute that Rowan, as registered representative, traded heavily in Biovail securities held in the Trust Accounts. Moreover, we note that he signed discretionary agreements as Investment Advisor on behalf of Watt Carmichael for the Conset and Congor Accounts, and Rowan considered that he had discretionary trading authority over the Southridge Account.

[125] We find that Rowan's failure to report the Biovail holdings in the Congor and Southridge Accounts caused the disclosure contained in Management Information Circulars for 2002, 2003 and 2004 to be misleading or untrue or caused them to not state a fact that was required to be stated or that was necessary to make the statements in the circulars not misleading.

[126] The disclosure of only the securities in the Conset Trust in the Management Information Circular, plus the clear instructions on Form 30 to include the number of each class of voting

securities of the issuer over which control or direction is exercised by the proposed director, should, at a minimum, have triggered further inquiries on the part of Rowan with regard to his obligation to disclose his holdings in the Congor and Southridge Accounts. But there is no convincing evidence that Rowan made such inquiries or consulted with legal counsel specifically about his responsibility to make such disclosure. Further, there is no convincing evidence that Rowan received advice from Biovail's Finance or Legal Departments as to the number of shares he should report in the Management Information Circulars.

[127] The reporting issuer is required to give accurate information to its shareholders as to the number of voting securities of the issuer that are beneficially owned, directly or indirectly, or over which control or direction is exercised by each proposed director. Rowan was obliged to file insider reports disclosing the number of voting securities of Biovail of which he had direct or indirect beneficial ownership or over which he exercised control or direction, including, we find, shared control or direction. It is incumbent on a director of a reporting issuer, through the filing of insider reports or otherwise, to ensure that the issuer has accurate, current information as to the director's ownership of or control or direction over securities of the issuer so as to enable the issuer to properly discharge its reporting obligations and failure by a director to do so, is, in our opinion, contrary to the public interest.

[128] On the facts before us, we find that Rowan failed to provide accurate information to Biovail as to the number of Biovail securities that he beneficially owned, directly or indirectly, or over which he exercised or shared control or direction, for disclosure in its 2002, 2003 and 2004 Management Information Circulars.

iv) Finding

[129] Accordingly, we find that Rowan engaged in conduct contrary to the public interest when he failed to provide complete and accurate information to Biovail concerning the number of Biovail common shares over which he exercised or shared control or direction.

F. Did Rowan engage in conduct contrary to the public interest by trading in Biovail securities in the Trust Accounts during Biovail's blackout periods?

i) Submissions

Staff

[130] Staff submits that Rowan engaged in discretionary trading of Biovail securities in the Trust Accounts during Biovail's 2002 and 2003 trading blackout periods (collectively, the "Biovail Blackout Periods") set out in the Biovail Blackout Policy.

[131] Staff submits that at all material times, Biovail had a clear and detailed Blackout Policy in place, and that Rowan knew about the Blackout Policy but disregarded it.

[132] Staff alleges that Rowan traded in large volumes of Biovail securities held in the Trust Accounts during the 2002 and 2003 Biovail Blackout Periods.

[133] Staff submits that Rowan's conduct was contrary to the public interest and fell far below the standards expected of a registrant who held a senior position at a registered broker and investment dealer and who was a member of the Biovail Board of Directors and the Biovail Audit Committee.

The Respondents

[134] There is no dispute that Rowan, as registered representative, traded in Biovail securities held in the Trust Accounts during Biovail Blackout Periods. The Respondents take the position there is no basis in law for Staff's allegation that these trades were contrary to the public interest.

[135] The Respondents submit that corporate blackout policies are internal guidelines only and do not have the force of law. Further, while an issuer can restrict personal trading by its insiders, an issuer's blackout policy cannot extend to trading on behalf of a client by an insider who is a registrant. The Respondents submit there is no law prohibiting an insider of a reporting issuer who is also a registrant from trading the reporting issuer's securities in a client's account. Rather, the public interest is protected by ensuring that the client not benefit from insider information.

[136] Further, the Respondents submit that there is no uniformity in the blackout policies set by each issuer and that issuers have authority to modify or waive compliance with blackout policies where it is appropriate to do so. At a minimum, counsel submits that Biovail consented tacitly (if not expressly) to Rowan trading in the Trust Accounts during blackout periods. The Respondents submit that it would be unreasonable for this Commission, on the facts of this case, to now establish for the first time an offence for not abiding by issuer blackout periods when trading in clients' accounts. Blackout periods are, and should remain, a matter between the issuer and its insiders.

ii) The Law

[137] National Policy 51-201 – Disclosure Standards ("NP 51-201"), provides guidance on "best disclosure" practices. Its purpose provision begins by stating, "[i]t is fundamental that everyone investing in securities have equal access to information that may affect their investment decisions." The policy is intended to prevent "selective disclosure" of material non-public information, which "can create opportunities for insider trading and also undermines retail investors' confidence in the marketplace as a level playing field." (National Policy 51-201 – Disclosure Standards (2002), 25 O.S.C.B. 4492, para.1.1(1))

[138] NP 51-201 states it is not intended to be prescriptive. Companies are encouraged to adopt the suggested measures "flexibly and sensibly to fit the situation of individual companies." (para. 1.1(2))

[139] The best practices encouraged by NP 51-201 include observing "a quarterly quiet period, during which no earnings guidance or comments with respect to the current quarter's operations or expected results will be provided to analysts, investors or other market professionals" [6:10] and adopting an insider trading and blackout period policy [6:11].With respect to blackout periods, it is recommended that trading by insiders, officers and employees "may typically not take place," for example, during a blackout period that surrounds a regularly scheduled earnings

announcement. “However, insiders, officers and employees should have the opportunity to apply to the company’s trading officer for approval to trade the company’s securities during the blackout period.”

[140] The Commission has recognized the importance of adherence by the directors and other insiders to corporate blackout periods. In *Re Melnyk*, the Commission stated:

> [c]orporate 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.
>
> (*Re Melnyk*, (2007), 30 O.S.C.B. 5253, para. 31)

[141] This was also recognized by the Alberta Securities Commission in *Re Seto*, where it stated that:

> We also find it significant that Inter-Tech's Board of Directors, either on their own initiative or at the behest of their financial and other advisers involved in the Precision negotiations, did not implement a trading "blackout period". We would have thought that such a directive would have been a normal practice in these circumstances and consistent with their fiduciary duties to all Inter-Tech shareholders.
>
> (*Re Seto*, [2003] A.S.C.D. No. 270 at para. 49)

iii) Analysis

[142] Companies generally impose blackout periods on management and other insiders because of the increased risk posed by insiders having access to material undisclosed information during such periods. Blackout periods have played an important role in maintaining confidence in the capital markets for a considerable period of time.

[143] At all material times, Biovail had a clear and detailed policy concerning insider reporting and trading blackout periods. The evidence establishes that on December 5, 2001, Biovail circulated a written policy entitled “Insider Trading, Reporting and Blackout Policy” to its Board of Directors, including Rowan. The Biovail Blackout Policy provided a “general explanation of the corporate governance requirements of a public company as well as the insider trading rules and insider reporting requirements under the Securities Act (Ontario)”.

[144] In an introductory section, the Biovail Blackout Policy stated:

> It is illegal for any director, officer or employee of the Company or any subsidiary of the Company to trade in the securities of the Company while in the possession of material non-public information concerning the Company. It is also illegal for any director, officer or employee of the Company to give material non-public

information to others who may trade on the basis of that information. In order to comply with applicable securities laws governing (i) trading in Company securities while in the possession of material non-public information concerning the Company and (ii) tipping or disclosing material non-public information to outsiders, and in order to prevent the appearance of improper trading or tipping, the Company has adopted this Insider Trading Policy for all of its directors, officers and employees, members of their families and others living in their households, 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.

Directors, officers and employees are responsible for ensuring compliance by their families and other members of their households and entities over which they exercise voting or investment control.

This Insider Trading Policy applies to any and all transactions in the Company's securities, including its common shares and options to purchase common shares, warrants and any other type of securities that the Company may issue in the future.

Any breach of the Insider Trading Policy is a serious offense which may lead to discipline by appropriate regulatory authorities, including possible fines and imprisonment. Any failure to adhere to the requirements specified herein also constitute [sic] grounds for immediate dismissal with cause from Biovail.

This memorandum provides a general explanation of the corporate governance requirements of a public company as well as the insider trading rules and insider reporting requirements under the *Securities Act* (Ontario). Each director, officer and employee is expected to review the enclosed materials and agrees to comply with the terms of this policy. Any questions on this policy should be directed to the Legal Department.

[145] With respect to Blackout Periods, the Biovail Blackout Policy stated the following:

Black-Out Periods

There is a mandatory seven (7) days blackout period for all employees of the Company prior to the release of quarterly and annual financial statements which shall continue until two (2) trading days after the time such information has been released to the public.

Additionally, an employee who is working on a particular transaction may be prohibited from selling securities of the Company for an indefinite period. You will be advised if the Company believes that you should not trade in securities of the Company as a result of your involvement in a particular transaction.

> **No insider or employee should trade in shares of Biovail until two trading days after the issuance of any news release in which material information is conveyed.**

[146] The revised Biovail Blackout Policy, issued on April 4, 2003, added the following:

> Moreover, there are instances where, unexpectedly, important issues will arise that may not be disseminated to an Insider at the precise time when they occur. In such circumstances, what the Company must avoid is the real potential that an Insider may be trading in the Company's stock during a period when the Company is involved in either considering or attempting to resolve such issue(s). Unfortunately, the Insider's lack of specific knowledge of such issues does not preclude personal embarrassment and/or potential liability to the Insider and the Company. Accordingly, effectively immediately, if any Member of the Board, Corporate Officer or Divisional Officer, intends to trade in the Company's shares, such person must inform either the Chairman of the Board or the Chief Legal Officer in advance so that a determination may be made as to whether there is any corporate reason to prevent such trading.

[147] With respect to insider trading, the Biovail Blackout Policy stated that every director of Biovail is an insider for the purposes of Insider Trading Rules. Insider information was defined as including but not limited to: (i) information about a significant transaction, such as a new financing; (ii) financial information such as the results from the previous quarter which have not been released to the investment community; (iii) information about a significant event (such as the release of a new product); and (iv) other information which a reasonable person may conclude could have an impact on the price of Biovail securities.

[148] Insiders were told: "Before trading shares in Biovail, you are strongly advised to contact the Legal Department to determine if you may trade in Biovail shares. All persons required to certify trading activities may not trade without the prior approval of the Legal Department."

[149] Further, insiders were required to file an insider report within 10 days following any trade in Biovail securities, including securities of Biovail "which you directly or indirectly acquire…or over which you exercise control or discretion…". Insiders were responsible for providing Thompson with information, "if the securities were indirectly acquired or are securities acquired over which you have control or discretion, the name of the registered holder of such securities."

[150] Rowan testified that he received the Biovail Blackout Policy with Thompson's December 5, 2001 covering letter, and that he knew that there was a mandatory blackout period covering seven days prior to the release of financial results and two trading days following their release.

[151] Through Garraway, Staff introduced correspondence addressed to Rowan and others that announced Blackout Periods in conjunction with releases of quarterly financial results and significant undisclosed transactions. There is no dispute that Rowan received the Blackout Period notices.

[152] During 2002, there were four Biovail Blackout Periods in connection with quarterly earnings announcements, as well as one additional Blackout Period, which subsumed the first two quarterly Blackout Periods. Rowan received Blackout Period notices on February 7, 2007, which announced a Blackout Period "until further notice", and April 24, 2002, which announced that the Blackout Period announced on February 7, 2002 would end at 9:30 a.m. Monday, April 29, 2002.

[153] The following chart summarizes, for each of the Biovail Blackout Periods in 2002, the undisputed evidence about the date and reason for the Blackout Period.

Biovail Blackout Period	Reason for Blackout Period
February 7, 2002 to April 29, 2002	• Q4/2001 earnings announcement (February 12-25, 2002) • Q1/2002 earnings announcement (April 16-29, 2002) • subordinated debt transaction (February 7-April 29, 2002)
July 16, 2002 to July 29, 2002	• Q2/2002 earnings announcement
October 18, 2002 to October 31, 2002	• Q3/2002 earnings announcement

[154] During 2003, there were four Biovail Blackout Periods in connection with quarterly earnings announcements, and two additional Blackout Periods, which subsumed or overlapped with two of the quarterly Blackout Periods. Rowan received Blackout Period notices on February 25, 2003 ("cannot legally trade in Biovail . . . until March 7, 2003"), July 14, 2003 ("until further notice"), July 30, 2003 ("until further notice") and October 22, 2003 (trading could begin on November 4, 2003).

[155] The following chart summarizes, for each of the Biovail Blackout Periods in 2003, the undisputed evidence about the date and reason for the Blackout Period.

Biovail Blackout Period	Reason for Blackout Period
February 21, 2003 to March 6, 2003	• Q4/2002 earnings announcement
April 18, 2003 to May 1, 2003	• Q1/2003 earnings announcement
July 14, 2003 to July 31, 2003	• Q2/2003 earnings announcement
September 30, 2003 to November 3, 2003	• Q3/2003 earnings announcement • additional competition for one of Biovail's generic products, and other matters

[156] The evidence establishes that, in 2002, Rowan engaged in discretionary trading of Biovail common shares in the Trust Accounts during each of the Biovail Blackout Periods. Specifically, there were acquisitions in excess of 2.5 million Biovail common shares at a cost of

approximately U.S. $110 million, and dispositions in excess of 2 million Biovail common shares for proceeds of approximately U.S. $100 million during the 2002 Biovail Blackout Periods.

[157] In 2003, Rowan engaged in discretionary trading of Biovail common shares in the Trust Accounts during each of the Biovail Blackout Periods. Specifically, there were acquisitions in excess of 2.5 million Biovail common shares at a cost of approximately US$90 million and in excess of 2.8 million Biovail common shares were sold for proceeds of approximately US $100 million. Further, more than 11,000 Biovail call options were acquired for proceeds of approximately US$4 million, and 300,000 Biovail call options were exercised at a cost of approximately US$10 million.

iv) Finding

[158] We find there is ample evidence that Rowan engaged in a high volume of discretionary trading in Biovail securities in the Trust Accounts during the Biovail Blackout Periods in 2002 and 2003.

[159] We do not agree with the Respondents that blackout periods are simply a matter between the issuer and its insiders. Issuers establish blackout periods to ensure there will be no trading in the corporation's securities by persons who have access to undisclosed material information until that information has been disclosed to the market and sufficient time has elapsed to permit its evaluation. In this case, Rowan was an insider of Biovail and should have respected the Biovail Blackout Periods.

[160] We find that Rowan's conduct fell below the standards applicable to a registrant who is both in a senior position at a registered broker and investment dealer and a director of a reporting issuer and a member of its Audit Committee. We find that, in the circumstances of this case, Rowan's conduct was abusive of the integrity of the capital markets of Ontario and contrary to the public interest.

G. Did Rowan breach section 76 of the Act by trading in Biovail securities in the Trust Accounts while he was in possession of material undisclosed information concerning Biovail?

i) Submissions

Staff

[161] Subsection 76(1) of the Act prohibits a person in a special relationship with a reporting issuer from purchasing or selling securities once he or she is aware of a material fact or a material change regarding the issuer which has not been generally disclosed. As a director of Biovail, Rowan was in a special relationship with Biovail within the meaning of paragraph 76(5)(c) of the Act.

[162] Staff alleges that Rowan engaged in insider trading contrary to section 76 of the Act when he bought and sold shares in the Trust Accounts while in possession of material undisclosed information. The allegations relate to (a) the fourth quarter 2001 financial statements

and 2001 consolidated financial statements; (b) the first quarter 2002 financial statements; (c) the second quarter 2002 financial statements; and (d) the first quarter 2003 financial statements.

[163] Specifically, in its Amended Statement of Allegations, Staff alleges that Rowan engaged in the following trading of Biovail securities at times when he had knowledge of material undisclosed information contained in the management reports:

(a) from February 19, 2002 to February 21, 2002 inclusive, 20,000 shares were purchased in and sold from the Conset Account and 45,000 shares were purchased in the Southridge Account;

(b) from April 23, 2002 to April 25, 2002, inclusive, 681,500 shares were purchased in the Congor, Conset and Southridge Accounts, 45,000 shares were sold from the Congor Account, 35,000 shares were sold from the Conset Account and 33,000 shares were sold from the Southridge Account;

(c) on July 24, 2002, 59,000 shares were sold from the Conset Account;

(d) on March 3, 2003, 172,600 shares were purchased in the Conset Account; and

(e) from April 25 to April 29, 2003, inclusive, 56,300 shares were purchased in the Conset Account.

[164] Staff submits that Rowan attended a number of Board and Audit Committee meetings and received material information concerning Biovail prior to and/or at the time of certain of these meetings. In particular, during 2002 and 2003, Rowan received Biovail management reports in relation to the upcoming release of Biovail's quarterly earning results. Staff referred us to these management reports.

[165] Staff submits there is clear and cogent evidence that Rowan was in possession of material facts concerning Biovail's financial results prior to the release of this information to the public.

The Respondents

[166] Rowan denied trading or instructing anyone to trade while he was in possession of inside information. The Respondents submit Rowan's evidence was uncontradicted, and that it was corroborated with respect to many of Staff's specific allegations.

[167] The Respondents submit that there was insufficient evidence about when Rowan received the information at issue and that the pattern of trading does not support Staff's allegations. In particular, the Respondents argue that the allegation is based entirely on the most fragile and circumstantial evidence of Miszuk. Miszuk has no knowledge as to when Rowan received inside information, but in several instances, Miszuk's evidence actually disproves Staff's allegations.

[168] The Respondents submit that an allegation of insider trading is very serious, and that Staff has failed to bring clear and convincing proof based on cogent evidence that Rowan traded while in possession of inside information.

[169] Further, the Respondents question the basis for Staff's allegations. In particular, the Respondents note that in its June 6, 2007 decision approving the Settlement Agreement between Staff and Melnyk, the Commission stated: "Based on the Settlement Agreement, we accept the submissions of Staff and counsel for Melnyk that this is not an insider trading case." [para. 20 of Settlement Approval decision]

[170] The Respondents also submit that Staff's five insider trading allegations against Rowan were only particularized in the Amended Statement of Allegations, dated June 5, 2007, just weeks before the start of the hearing, and the Respondents suggest this reflects Staff's lack of confidence in its allegations with respect to trading during Blackout Periods.

ii) The Law

[171] Section 76(1) of the Act prohibits the purchase or sale of securities of a reporting issuer by an insider with knowledge of material facts with respect to the reporting issuer that have not been generally disclosed. National Policy 51-201 *Disclosure Standards* provides guidance on best disclosure practices to ensure that everyone investing in securities has equal access to information which may affect their investment decisions. OSC Policy 33-601 provides registrants with *Guidelines for Policies and Procedures Concerning Inside Information* and MP 34-202 also provides guidance to *Registrants Acting as Corporate Directors*.

[172] During the relevant period, "material fact" was defined in section 1(1) of the Act as "a fact that significantly affects, or would reasonably be expected to have a significant effect on the market price or value of the securities". On April 7, 2003, the definition of "material fact" was amended to read as follows:

> "material fact", when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or the value of the securities;

There is no dispute in this case about the materiality of the facts. The dispute was about whether Rowan was in possession of these facts when the trades occurred.

[173] In *R. v. Woods* ("*Woods*"), Farley J. stated that the offence of insider trading "is in essence not a question of using insider information but of buying or selling securities of a company while possessed of insider information". He broke down the offence into four elements:

(a) the defendant is in a special relationship with the public company;

(b) the defendant purchases or sells securities of that public company;

(c) the defendant has knowledge of material information about that public company;

(d) which material information has not been generally disclosed.

(*R. v. Woods*, [1994] O.J. No. 392 (Gen. Div.) at para. 15)

[174] Justice Farley noted that until February 15, 1988, a person charged with insider trading had to demonstrate that he or she "did not make use of knowledge of material fact…in purchasing or selling securities." That defence is no longer available. (*R. v. Woods*, [1994] O.J. No. 392 (Gen. Div.) at para. 18)

[175] Accordingly, it is not necessary to prove actual use of inside information. An insider's reasons or motivations for trading are irrelevant at law. It is sufficient to establish trading while in possession of undisclosed material information.

[176] It is also unnecessary to establish that the respondent benefited personally from the misuse of inside information.

[177] In the *Woods* decision, the defendant traded for the account of one Richardson. Richardson agreed to allow Woods to arrange for short sales, when Woods convinced him it would be useful to hedge his investment. Woods was found guilty of insider trading for these short sales on Richardson's behalf.

[178] Justice Farley noted that "[w]ithout Woods, there would have been no short sales . . .," and stated:

> The ordinary meaning of 'sell' does not imply a sale of one's beneficial interest. For instance, we have no difficulty in talking of a sales clerk in a department store selling merchandise but it is of course merchandise of the department store/company. Then there is the real estate agent who has sold the house, but it is the house of the vendor. As well one refers to the consignee selling goods, but it is the goods of the consignor which are sold. The section [75(1), now 76(1)] does not state that "no owner shall sell" but rather no person should do so.
>
> (*R. v. Woods*, [1994] O.J. No. 392 (Gen. Div.) at para. 32)

[179] With respect to the interpretation of the insider trading provisions of the Act, Justice Farley stated:

> Given the mischief rule and its application, it appears that the mischief to be corrected in the present instance was that of unequal opportunity in the securities market – i.e. someone in a special relationship with a company (a director) might employ insider information to buy or sell shares of the company to the disadvantage of those without such insider information. It does not seem to me that the person in a special relationship must benefit from the misuse of insider information; this is obvious from the prohibition against tipping since the tippee is the one who benefits.
>
> (*R. v. Woods*, [1994] O.J. No. 392 (Gen. Div.) at para. 36. See also *Re Donnini*, (2002), 25 O.S.C.B. 6225 at paras. 111,112, and 113)

[180] By the same reasoning, we find that subsection 76(1) of the Act also applies to a registrant who is an insider of a reporting issuer and who engages in discretionary trading in the

securities of the issuer in respect of which he is an insider on behalf of the beneficial owner of the securities.

[181] In *Re Danuke*, (1981), 2 O.S.C.B. 31C at 33C, the Commission imposed sanctions on a respondent who traded for the account of one of his clients while in possession of undisclosed material information.

[182] Subsection 76(5) of the Act defines who is in a "special relationship" with a reporting issuer. The definition includes a person who is an "insider" of the reporting issuer. Section 1 of the Act defines "insider" as including "every director or senior officer of a reporting issuer." Rowan admits that the evidence establishes that he was at all material times a person in a "special relationship" with Biovail.

[183] The phrase "generally disclosed" is discussed in subsection 3.5(2) of NP 51-201. This policy explains that information has been generally disclosed if:

> (a) the information has been disseminated in a manner calculated to effectively reach the marketplace; and
>
> (b) public investors have been given a reasonable amount of time to analyze the information.

[184] The time necessary for such analysis varies from case to case, however an insider should generally wait a minimum of one full trading day after the release of the information before trading (*Re Harold P. O'Connor et al.* (1976) Vol. II (O.S.C.B. 149 at 175).

iii) Analysis

[185] For the following reasons, we are not satisfied that Staff has presented clear and compelling proof based on cogent evidence of insider trading.

(a) February 21, 2002 – 2001 Fourth Quarter and 2001 Consolidated Financial Statements

[186] Staff submits that Rowan received the management report dated February 19, 2002 in respect of Biovail's 2001 consolidated financial statements, the draft press release concerning the financial statements, and the 2001 audit report prepared by Ernst and Young, Biovail's auditors. The February 19, 2002 management report, similar to other management reports provided to the Audit Committee in 2002 and 2003, states:

> [t]he following report has been prepared to provide Senior Management with an overview of the financial performance of Biovail Corporation on a consolidated basis and should supplement the Management Reports received from each of the operating business units. The information contained within this report is deemed highly confidential due to the detail in information provided and is intended for Senior Management purposes only.

[187] The February 19, 2002 management report contained an Attachment "B", entitled "Comparative Consolidated Statements of Income (Loss)". Attachment "B" bears the date of February 19, 2002 and time of 12:03 p.m., and on that basis Miszuk testified that "the materials would have been all complete[d] and assembled the afternoon of February 19th and would have been distributed at that time." Miszuk further testified that the materials would generally be sent by same-day courier to committee members in the Greater Toronto Area, otherwise by overnight courier.

[188] The Audit Committee, consisting of Rowan and two others, met at Biovail's office at 4:00 p.m. (i.e. after the markets had closed) on February 20, 2002. Rowan and the other Audit Committee members approved the 2001 fourth quarter and full year 2001 financial statements and the earnings press release.

[189] Miszuk testified that the draft earnings release contained information from the February 19, 2002 management report provided to Rowan, and that the information set out in the press release was "material information."

[190] On February 21, 2002 Biovail issued its press release announcing the 2001 fourth quarter and full year 2001 financial statements.

[191] During the period February 19 to February 21, 2002, inclusive, 20,000 shares were purchased in and sold from the Conset Account and 45,000 shares were purchased in the Southridge Account.

[192] Rowan's direct evidence is that he did not receive the materials for the Audit Committee meeting of February 20, 2002 until he attended the meeting at 4:00 p.m. on that day. Miszuk testified in chief that he believed the materials, which were time-stamped 12:03 p.m., would have been couriered to Rowan on the afternoon of February 19, as this was Biovail's general practice. In cross-examination, Miszuk admitted that he did not personally send out materials to the directors in 2002 and 2003, he had no courier receipts or other records proving when material was sent to the Audit Committee, and there were complaints in 2002 and 2003 about materials not being made available in advance of the meetings.

[193] The evidence regarding the announcement of the fourth quarter results is that it was made before markets opened on February 21, 2002. If, as Rowan testified, he did not have the documentation for the Audit Committee until 4:00 p.m. on February 20, 2002, then he would not have been able to trade on inside information prior to its public disclosure.

(b) April 25, 2002 - 2002 First Quarter Financial Results

[194] Staff's second insider trading submission relates to Biovail's management report dated April 23, 2002 in respect of the 2002 first quarter financial statements, which was sent to Audit Committee members together with the 2001 annual report and the Ernst and Young 2001 audit report. The April 23, 2002 management report contains an Attachment "B" titled "Comparative Consolidated Statements of Income (Loss)". Attachment "B" bears the date April 23, 2002 and time of 1:02 p.m.

[195] On April 25, 2002 Biovail issued its press release announcing the 2002 first quarter interim financial results. Miszuk testified that "certain information from the April 23, 2002 management report would lead into the press release" and that the press release was "material disclosure". In this case, the Audit Committee appears to have met on April 26, 2002 after Biovail issued its press release.

[196] During the period April 23 to April 25, 2002 inclusive, 681,500 Biovail shares were purchased in and 113,000 Biovail shares sold from the Congor, Conset and Southridge Accounts.

[197] Rowan testified that he received the Audit Committee materials only at the meeting itself. This was confirmed by Miszuk, who testified that the Audit Committee was provided with the relevant documents at the Audit Committee meeting of April 26, 2002. This was after information had been released to the public on April 25, 2002.

(c) July 24, 2002 – 2002 Second Quarter Financial Results

[198] Staff submits that on July 24, 2002, a revised management report was issued in respect of the 2002 second quarter interim financial results. The revised report "provides the disclosure on the recent developments that were completed within the interim quarter, consolidated financial results of the Company, income statement balance sheet, cash flow, and a brief MD&A that talks about the Company's performance". Miszuk testified that this document would have been a revised document and that he could not recall if an original document was sent out.

[199] The Audit Committee met on July 24, 2002 at 7:00 p.m. Miszuk testified that prior to the meeting "[t]here would have been a previous notice advising of the meeting date". Based on practice, prior written notice would be provided to the Audit Committee three to five days in advance of the scheduled meeting. The Audit Committee approved the 2002 first quarter interim financial earnings press release.

[200] On July 25, 2002, Biovail issued its press release announcing the second quarter 2002 financial results.

[201] On July 24, 2002, 59,000 Biovail shares were sold from the Conset Account.

[202] There is no evidence that the materials for the July 24, 2002 meeting were distributed prior to the meeting. Indeed, the time-stamp on the report indicates that it was printed at 5:16 p.m., after the close of the markets that day.

(d) March 4, 2003 -2002 Fourth Quarter and 2002 Consolidated Statements

[203] Staff submits that on February 19, 2003, Miszuk notified the Audit Committee of the scheduling of the Audit Committee meeting for March 3, 2003, enclosing the agenda for the meeting. Miszuk testified that in this case the materials were presented to the Audit Committee on March 3, 2003 in the form of a PowerPoint presentation, and that he believed that a management report had not been completed prior to the meeting.

[204] The Audit Committee met on March 3, 2003 at 4:00 p.m. and approved the financial statements and earnings release.

[205] On March 4, 2003, at 7:30 a.m., Biovail issued its press release announcing Biovail's earnings for the 2002 fourth quarter and full year results.

[206] On March 3, 2003, 172,600 Biovail shares were purchased in the Conset Account.

(e) April 29, 2003 – 2003 First Quarter Financial Results

[207] Staff submits that Rowan also obtained inside information with respect to 2003 first quarter financial results. Staff relies on Miszuk, who testified that the management report dated April 25, 2003 addressed to the Audit Committee was sent by courier to Rowan and others. Attachment "B" to the April 25, 2003 management report is entitled "Comparative Consolidated Statements of Income (Loss)" and bears the date of April 25, 2003 and time of 3:34 p.m.

[208] Rowan testified that he was in Italy from about April 23 to May 7, 2003, and did not receive any documentation for the Audit Committee prior to the meeting.

[209] The Audit Committee met on April 28, 2003 at 1:00 p.m. Rowan participated by telephone. The Audit Committee approved the 2003 first quarter interim financial statements and the Biovail press release.

[210] On April 25, 2003, 51,300 Biovail shares were purchased in the Conset Account, and another 5,000 Biovail securities were purchased in Conset on April 28, 2003.

[211] The evidence before us indicates that from April 25 to April 28, inclusive, 56,300 Biovail shares were purchased in the Conset Account. However, we received no clear and convincing evidence that any of these shares were purchased between 1 p.m. and the close of business on April 28, 2003.

iv) Finding

[212] Miszuk testified that Biovail's management reports and financial statements would be prepared in advance of the meetings of the Audit Committee, which would occur approximately six times per annum. These reports would then be sent to the Committee two to three days in advance of the meeting of the Committee. The management report contained an update of all company business for the quarter, including financial results, and would provide the basis of the management discussion and analysis, included in the quarterly financial statements.

[213] However, upon cross-examination, Miszuk conceded that the materials might not have reached the Audit Committee before the meeting occurred, and that he could not prove that the documents did, in fact, reach the Audit Committee members before the meeting began.

[214] Rowan's direct evidence that he did not receive the materials prior to the Audit Committee meetings and that he did not trade or instruct anyone to trade while he was in possession of inside information remains uncontradicted. Staff did not, for example, produce

courier receipts or other documentation as to when the materials were sent out, or call other members of the Audit Committee to testify about when they were given the relevant information.

[215] While substantial trading in Biovail securities took place during the periods in question, we find that the evidence relied upon by Staff to support the insider trading allegations is neither clear nor convincing, and therefore we do not find that Rowan breached the requirements set out in subsection 76(1) of the Act by trading Biovail securities held in the Congor, Conset and Southridge Accounts at times when he had knowledge of material undisclosed information.

(v) Additional Particulars

[216] In addition to Staff's five insider trading allegations discussed above, Staff's written submissions included three additional insider trading allegations that were not included in the Amended Statement of Allegations.

[217] We agree with the Respondents that these additional allegations, which were highly prejudicial to Rowan, should not have been put before us in this manner. We make no findings in relation to these submissions because we agree with the Respondents that they were particularized too late to give the Respondents a fair opportunity to respond.

H. Did Rowan conduct unauthorized discretionary trading in the Southridge Account?

i) Submissions

Staff

[218] Staff alleges that Rowan engaged in discretionary trading in the Southridge Account without having authority to do so, contrary to OSC Rule 31-505 and contrary to the public interest.

The Respondents

[219] The Respondents submit that while the Southridge Account was not documented as a discretionary account, the Southridge Trustees knew and approved of Rowan's discretionary trading and authorized it by corporate resolution. Accordingly, the Respondents submit that Rowan did not exceed the authority granted him by the course of conduct between Watt Carmichael and the Southridge Trust.

ii) The Law

[220] Subsection 1.5(1) of OSC Rule 31-505 requires that "an individual that is registered as a salesperson, officer or partner of a registered dealer" "shall make such enquiries about each client of that registrant as," amongst other things, "are appropriate, in view of the nature of the client's investments and of the type of transaction being effected for the client's account, to ascertain the general investment needs and objectives of the client and the suitability of a proposed purchase or sale of a security for the client."

iii) Analysis

[221] There is no dispute about the main facts; rather, the parties disagree about what inferences and conclusions can be drawn from the facts.

[222] Rowan admits that he engaged in discretionary trading in the Southridge Account. He also admits that the Southridge Account was not opened and documented as a discretionary account. The New Client Application Form, signed by Rowan and a Southridge director on September 24, 1996, included the question, "have you authorized anyone to use discretion in handling your account?" and the direction, "If yes, please complete Discretionary Agreement." The "no" box was checked off, and therefore a Discretionary Agreement was not completed, and the account number did not contain a letter "D" denoting a discretionary account. A second New Client Application Form, signed by Rowan and Southridge on August 20, 2002, also indicated the account was not discretionary.

[223] However, Rowan testified that he believed he had discretionary authority over the account. He relies on the resolution passed by the Southridge Board of Directors on September 23, 1996 giving him discretionary authority over the Account. He also relies on the course of conduct between Watt Carmichael and Southridge over a number of years. He claims that Southridge only objected to certain options transactions, though he communicated with the Southridge representatives frequently and Southridge received regular reports on his trading in the Account.

[224] Rowan submits that the failure to properly document the discretionary nature of the account was an administrative error. We reject this.

[225] We received evidence of a number of occasions when the Southridge representatives faxed or telephoned Rowan to complain about unauthorized trading or to reiterate that all transactions must be approved in advance because the account was non-discretionary. The evidence suggests a concern Rowan was receiving instructions from Melnyk.

[226] For example, on September 25, 1998, Joan M. Link ("Link"), a Southridge representative, wrote to Rowan, stating:

> Please note that, whilst Southridge Management Ltd. must provide you with instructions before any transactions occur on the account, the directors would like to be advised at any time should you wish to make investment recommendations, namely at any time you think it advisable that we sell Biovail shares. I would be grateful if you could confirm that you are still in agreement to act in this capacity.

[227] On October 2, 1998, Link made a note to file in relation to Melnyk wanting to open an options account with Watt Carmichael to raise cash. The memo refers to a telephone conversation between Link and Paula Glick ("Glick") (who Fong testified was Rowan's assistant at that time). Link notes that she asked Glick "to ensure that nothing occurs on the account" and confirmed that all transactions require prior approval from the Trustee. The point was repeated in Link's October 5, 1998 faxed memo to Rowan and Glick, which confirmed that "the directors are not in a position to complete the form nor to trade in options" and were awaiting a proposal

from Fong, Melnyk's assistant. In that same memo, Link stated, "To reiterate, any transactions which occur on Southridge Management Ltd.'s brokerage account held with Watt Carmichael requires our approval prior to execution".

[228] Link's note to file, dated October 6, 1998, indicates that Southridge had received the account opening documentation for an options account at Watt Carmichael.

[229] On October 13, 1998, Fong faxed the following note to Link, on Melnyk's letterhead:

> Further to our telephone conversation, this fax is to confirm Mr. Melnyk's wish to sell the equivalent number of Biovail shares in order to raise additional cash of US$500,000. In return, Mr. Melnyk has authorized the attached promissory note for US$500,000.
>
> Please send Roger Rowan at Watt Carmichael instructions to sell Biovail shares in order to raise the additional US$500,000 and to transfer these funds to a Southridge Trust Account.
>
> Upon receipt of these funds and the previously requested US$4,500,000, please wire the funds as per the attached fax (2 pages) from Eugene Melnyk.
>
> If you have any questions, please do not hesitate to contact me.

[230] Link's note to file on October 27, 1998 included the following:

> I reviewed the transaction advice slips received from Watt Carmichael and noted that 600,000 shares of Beta Brands Inc. were purchased. I asked Roger to confirm that this was actually for the account of Southridge, which he did. I then asked who issued these instructions and Roger confirmed that it was the settlor of the trust. Roger indicated that the settlor mentioned to him that he would be in contact with us to sort out the situation. I reiterated to him that this was not in accordance with the account mandates and that I would speak to my manager to determine the best course of action. I confirmed to him that this was a similar situation which has occurred before which was unacceptable to the directors. I mentioned that the directors would always consider investment advice from him (Roger) in his capacity as investment manager and could issue instructions quickly.

[231] This evidence makes it impossible for us to conclude that administrative error was the reason the Southridge Account was not documented as a discretionary account. Nor do we accept Rowan's evidence that Southridge was only concerned about options trading and not about his other discretionary trades. We find that Link repeatedly conveyed a concern about discretionary trading. For example, her November 2, 1998 memo states: "I confirmed with Roger that transactions on the Southridge Management Ltd. can only occur with the authority of the directors. EM does not have any authority to provide instructions for execution to Roger Rowan." On cross-examination, Rowan said he believed this was in the context of option strategies he had presented, but he conceded that the memo did not indicate any such limitation.

[232] Further, we received evidence of a chain of e-mails between Rowan, counsel for Southridge and Southridge representatives in November and December 2004. Rowan initiated the correspondence on November 11, 2004 with an e-mail to Southridge counsel requesting that they provide a letter to Watt Carmichael with the following suggested text:

> This letter will confirm during the time that the Southridge Account has been at your firm, commencing in 1996, the Trustees of the Trust have instructed Mr. Roger Rowan to use full discretionary trading authority in operating the account. While Mr. Rowan provided the Trustees of Southridge with various trading strategies from time to time upon request, the mandate Mr. Rowan was given by the Trustees was to trade the securities in this account at his discretion and to provide the Trustees with copies of all trade confirmations and monthly statements summarizing the trading activities which they received by mail.

[233] On November 24, 2004, counsel for Southridge responded by e-mail, relaying Southridge's response. The Southridge representative reportedly wanted an explanation why the letter was necessary, "since their relationship with you had been in place since 1996." However, Southridge ultimately refused to issue the letter, stating, in a November 25, 2004 e-mail:

> According to our records which include the most recent account forms for Watt Carmichael executed in 2004, the account is non-discretionary therefore we cannot execute the letter provided.

[234] In a subsequent e-mail dated December 8, 2004, a Southridge representative stated that based on her review of the file, "we have always considered this to be a non-discretionary account." Stating, "reference has been made to this in the past," she particularly noted a Southridge letter to Rowan in February 2000 reiterating that he was not authorized to trade without written consent.

[235] On December 22, 2004, Southridge advised "no further trading is permitted on our account without our express written authorization." As requested, Rowan confirmed by return fax that he had received the letter and would not trade without express written authorization.

[236] Based on the documentary evidence we received, we do not accept Rowan's evidence that this correspondence in November and December 2004 was the first time there was an issue about the discretionary or non-discretionary nature of the account.

[237] However, Southridge did not close or transfer the file, despite their concerns, and the evidence from the Southridge file, noted above, establishes that the Trustees knew about Rowan's discretionary trading in the account throughout the period the account was open. In addition, we were given no reason to reject Rowan's undisputed evidence that Southridge authorized various transactions from time to time and that they received confirmations of every transaction as well as month-end statements.

[238] In our view, the evidence suggests that Southridge may not have taken a consistent approach in handling the Watt Carmichael account. In addition, the evidence suggests that Rowan received trading instructions from Melnyk as well as Southridge. Rowan admitted

knowing Melnyk was the settlor of the Trust, and it is apparent from the Southridge correspondence that the Trustee did too.

[239] For whatever reason, the Trustees of the Southridge Trust did not take decisive action to bring the unauthorized trading to an end.

[240] In any event, based on the limited submissions of the parties, we are not satisfied that unauthorized discretionary trading contravenes the KYC rule, which is silent on this point. The gist of that rule is that the registrant shall make such enquiries of his client as are appropriate ". . . to ascertain the general investment needs and objectives of the client and the suitability of a proposed purchase or sale of a security for a client."

[241] The trading mandate for the Southridge Account (i.e. the general investment needs and objectives of the client and the suitability of the trading proposed for the account) was established when the Southridge Account was opened. It was to maintain a core holding of Biovail securities and, subject to that, to maintain a trading strategy in shares and options of Biovail with the objective of exploiting volatility in the trading price of Biovail securities to achieve capital gains.

[242] It may be arguable that Rowan's conduct was in breach of the trading account agreement with the client but it was not a breach of the investment objectives of the client or the nature or type of securities to be bought and sold within the account.

[243] Thus, we find that Rowan's activities did not constitute a breach of subsection 1.5(1) of OSC Rule 31.505.

[244] We note that IDA Regulation 1300.4 sets out clear rules for discretionary trading, as follows:

> No person, other than a partner, director, officer or registered representative (other than a registered representative (mutual funds) or (non-retail)) who has been approved as such pursuant to the applicable By-laws of the Association, shall effect trades for a customer in a discretionary account and any such permitted trades shall only be effected if:
>
> (a) the prior written authorization has been given by the customer to the Member and accepted by the Member in compliance with Regulation 1300.5; and
>
> (b) the account has been specifically approved and accepted in writing as a discretionary account by the designated director, partner, officer, branch manager, futures contract principal or futures contract options principal, as the case may be, who authorized the opening of the account,
>
> and provided that any such person permitted to effect discretionary trades shall have actively dealt in, advised in respect of or performed analysis with respect to

the securities or commodity futures contracts or options which are to be traded on a discretionary basis for a period of two years.

[245] Regulation 1300.5 sets out the requirements for the "prior written authorization provided for by clause (a) of Regulation 1300.4."

[246] However, as Staff did not allege a breach of Regulation 1300.4 in its Amended Statement of Allegations and neither party gave written or oral submissions on that rule, we decline to consider it.

iv) Finding

[247] For the reasons given, Commissioner Thakrar dissenting, we are not satisfied that Rowan traded in breach of subsection 1.5(1) of OSC Rule 31-505. However, we want to be clear that we do not approve of Rowan's handling of this Account.

[248] Ensuring appropriate documentation of the client's instructions and the authority granted is amongst the most fundamental obligations of a registrant. Careful documentation is especially important when a registrant engages in discretionary trading, which exposes the investor to greater risks. For this reason, a registrant may not engage in discretionary trading without the prior written authorization of the client which is specifically approved and accepted in accordance with IDA rules and regulations. This requirement is intended to protect not just sophisticated institutional investors but also less sophisticated retail investors, who may not monitor their account statements as effectively to ensure a registrant's compliance with instructions. Indeed, the securities regime squarely places the burden on the registrant, not the investor, to ensure compliance with the investor's wishes.

[249] Because the Southridge Account was not identified as a discretionary account, it was not included in the IDA Review in 1999, which considered, amongst other things, whether Melnyk owned a control block of Biovail securities. The failure to properly document the Southridge Account as a discretionary account had significant regulatory consequences in this case.

I. Did Rowan and Watt Carmichael mislead the IDA in providing an incomplete response to inquiries regarding Melnyk's interest in the Trust Accounts?

i) Submissions

Staff

[250] Staff alleges that Rowan and Watt Carmichael provided information they knew to be incomplete and misleading in response to the IDA's queries concerning the beneficial owners of the Congor and Conset Accounts.

[251] Staff relies on the following evidence.

[252] On December 23, 1999, the IDA sent Watt Carmichael its draft sales compliance review report. The report included, as a priority item, a requirement that Watt Carmichael provide

"copies of the formal trust agreements for both the Conset and Congor Accounts" and "state the identity of the beneficial owners of these accounts." The requirement was explained as follows:

> Given that Eugene Melnyk deposited the Biovail shares to the Conset and Congor Accounts and that the proceeds of the Biovail sales in the Conset Account were wired to Mr. Melnyk, we are not satisfied with the Member's contention that Mr. Melnyk does not have any interest in these accounts.
>
> Further, as the legal opinions on file are based on certificates from two offshore secretaries, we are not satisfied with the assertion that the Congor and Conset Accounts do not form part of a control block of Biovail. Thus, in the absence of trust documents and other supporting documentation, the Association believes that the Biovail holdings in these accounts are part of Mr. Melnyk's control position. In addition, if these accounts are part of a control block, then the use of margin is not permitted on the Biovail positions and the debit balances in these accounts relating to the Biovail positions represent a 100% capital charge.

[253] The same requirement appears in the IDA's final report, dated January 21, 2000.

[254] Carmichael responded on behalf of Watt Carmichael in a letter dated March 29, 2000, enclosing letters dated October 31, 1996 (Conset) and November 15, 1996 (Congor) from Stewart & Associates, Biovail's Canadian counsel, stating that the Conset and Congor investment companies did not hold a control block of Biovail securities. Carmichael also stated that further documentation from New York counsel was expected and would be provided to the IDA.

[255] Dimitropoulos responded on behalf of the IDA by letter dated May 24, 2000. The IDA was not satisfied with Watt Carmichael's response because the legal opinions from Stewart & Associates were the same opinions the IDA had considered as part of its sales compliance review and rejected because they were based on certificates from the offshore secretaries of the Trusts. The IDA asked that the letter from New York counsel be forwarded as soon as possible and reiterated its request for the identities of the beneficial owners of the Congor and Conset Accounts and for further documentation that they did not hold control positions in Biovail. The Southridge Account was not part of the IDA's sales compliance review.

[256] A June 7, 2000 memorandum from Rowan to Melnyk enclosed the IDA's May 24, 2000 letter and continued:

> Eugene, can we provide the IDA with some suitable response to get them to go away.Ie.,
>
> 1. Was there any documentation submitted to the SEC when BVF was listed on the NYSE which clarified the status of the trusts ie., that stated they are <u>not</u> part of the control block?
>
> 2. Is there a trust agreement available that would satisfy the IDA?

3. If you do not wish to disclose the beneficiaries to the IDA (I don't see any harm in doing so), is there some declaration we can provide the IDA which states that Eugene Melnyk is not a beneficiary of the trust [sic] and therefore has no beneficial ownership in them.

If we can provide the above, I am confident that we can get the IDA to go away. Please call me regarding this.

[257] On July 17, 2000, Fong sent two faxes to Rowan (the "Fong Faxes"). On the first fax cover sheet, on Melnyk's letterhead, is a note which states:

Hi Roger,

Please find attached a copy of the letter from Congor Trust.

We are still awaiting receipt of the one from Conset Trust.

Hope this is what you are looking for.

Arlene.

[258] Attached to the fax cover sheet was the Trustee's cover letter of the same date to Fong, stating "Further to our telephone conversation attached is a copy of the letter requested by Mr. Melnyk." The attached letter of the same date (the "Congor Letter"), which is addressed to Melnyk, lists the beneficiaries of the Congor Trust. Melnyk is listed amongst the beneficiaries.

[259] Fong's second fax to Rowan, on Biovail letterhead, was sent about three hours later on July 17, 2000. The cover sheet includes a handwritten note, "Hi Roger, Here is the letter from Conset. Arlene." The attached letter from the Trustee (the "Conset Letter") is addressed to Melnyk and states: "As requested, we confirm that in respect of The Conset Trust, which was established by you as Settlor on 23rd September 1996, the Beneficiaries include the following." The list does not include Melnyk.

[260] On July 19, 2000, Watt Carmichael suspended trading in the Conset and Congor Accounts, except for margin purposes, and advised the IDA accordingly.

[261] On July 24, 2000, Melnyk revocably disclaimed his interest in the Trusts.

[262] In an unsigned letter, dated July 31, 2000 and addressed to Dimitropoulos, Andrew Levander ("Levander"), Melnyk's U.S. counsel, stated:

Under the law of the Cayman Islands, which governs those trusts, the identity of the beneficiaries of the Trusts is a matter of strictest confidence. Nonetheless, we have recently received written confirmation from each of the respective trustees of The Congor Trust and The Conset Trust that Eugene Melnyk is not a current beneficiary of either trust.

[263] The letter was not forwarded to the IDA.

[264] However, on August 10, 2000, McKenney forwarded to the IDA another letter from Levander to Dimitropoulos, this one dated August 1, 2000 (the "Final Levander Letter"), which was substantially similar to the July 31, 2000 letter but stated, "we have been authorized to confirm that Eugene Melnyk is not a beneficiary of either trust"; the word "current" no longer appears in the sentence. Watt Carmichael did not forward the list of beneficiaries required by the IDA.

[265] Dimitropoulos responded by letter dated August 14, 2000, stating the matters raised in the IDA's report had now been satisfactorily resolved.

[266] Staff submits that at the time the Final Levander Letter was forwarded to the IDA, Rowan and Watt Carmichael had in their files both the Congor Letter and the Conset Letter, each dated July 17, 2000.

[267] Staff submits that Watt Carmichael's offices were small, with only one fax machine and few support staff, and that consequently the chances of the Congor Letter and the Conset Letter both arriving unnoticed are remote.

[268] Further, Staff relies on evidence that Rowan received numerous faxes from the Trustees instructing him to wire significant funds out of the Trust Accounts and into accounts held in Melnyk's name. In fact, in the period between January of 1999 and March of 2000, Rowan sent over US$42,500,000 and $842,000 from the Trust Accounts to Melnyk-related accounts. Staff also relies on De Francesca's evidence that Rowan and Melnyk spoke by telephone "three or four times per day." Staff submits that Rowan and Melnyk communicated frequently about his accounts.

[269] Further, as the registered representative assigned to the Trust Accounts, Rowan must have known that NBCN, Watt Carmichael's carrying broker, treated the three accounts as one for the purposes of lending on margin. NBCN treated the accounts in this way because it believed that they had a common owner, Melnyk. Jeraj testified that NBCN "identified that [the Trust Accounts] did belong to the same client" and that the source of this belief was the Trust Accounts documentation provided by Watt Carmichael.

[270] Staff submits that by providing the Final Levander Letter and not the Congor and Conset Letters, Rowan and Watt Carmichael misled the IDA. Staff submits that the duty to provide full and true disclosure to a regulator applies equally to the IDA as it does to the Commission.

[271] Staff does not agree with the Respondents' submission that they were not obliged to identify the beneficiaries of the Trust Accounts for the IDA. Staff submits that the Respondents were under a Know Your Client obligation at all material times, even if the OSC Rule 31-505 did not require identification of beneficiaries at that time. In any event, Staff submits that even if the IDA had no power to ask for this information, once Rowan and Watt Carmichael undertook to respond, they were bound to do so fully and truthfully. By not tendering the Congor Letter, Rowan and Watt Carmichael failed to do so, in Staff's submission.

[272] On this basis, Staff argues that Rowan knew that the information contained in the Final Levander Letter concerning Melnyk's status as a beneficiary of the Congor Trust was inaccurate. Staff submits that to forward the Final Levander Letter without making further inquiries was to seriously mislead the regulator. At a minimum, the Final Levander Letter should have prompted further inquiries concerning the apparent discrepancies with the information provided in the Congor Letter and with NBCN's credit treatment of the Trust Accounts.

The Respondents

[273] The Respondents submit that an allegation of misleading the IDA is a serious accusation and needs to be supported by clear and compelling evidence, which Staff has not called in this case.

[274] The Respondents submit there is no basis for any allegation against Watt Carmichael in this regard.

[275] With respect to Rowan, the Respondents rely on Rowan's evidence that he did not see the Fong Faxes until after he was interviewed by Staff in 2005, and Fong's evidence that the letters were requested by Melnyk and she did not discuss them with Rowan. In addition, Rowan testified that he had not seen the trust agreements at the time he responded to the IDA.

[276] According to the Respondents, the evidence adduced by Staff regarding this allegation is vague and far from the best evidence available. Staff's investigator gave hearsay evidence regarding the discovery of the Congor Letter by Katherine Schindler ("Schindler"), Rowan's assistant at Watt Carmichael, in 2005, and provided no evidence about when Watt Carmichael received it.

[277] The Respondents also submit that Staff could have called Schindler and Melnyk to testify in support of Staff's allegations, but failed to do so. The Respondents submit that the Commission should consider the possibility that Rowan was misled by Melnyk, and should infer from Staff's failure to call Melnyk to testify on the matter that Melnyk could not have contradicted Rowan's evidence.

[278] The Respondents further submit that the IDA had no power to compel the disclosure of the beneficial owners of a trust during the material period. This request went beyond the KYC rule of the time. In any event, although Rowan stated that he would have provided the Congor letter to the IDA if he had been aware of it, the Respondents submit he would have been under no obligation to do so.

[279] Finally, the Respondents submit that the Final Levander Letter, which was prepared on Melnyk's instruction, was exactly what the IDA had requested, and did not reflect any intent to mislead.

ii) The Law

[280] It is crucial to the implementation of the securities regulatory system, including the self-regulatory system, that registrants provide full and accurate responses to inquiries from their regulator. As expressed by the Ontario Court of Appeal:

> The [Commission] is charged with the statutory obligation to do its best to ensure that those involved in the securities industry provide fair and accurate information so that public confidence in the integrity of the capital markets is maintained. It is difficult to imagine anything that could be more important to protecting the integrity of capital markets than ensuring that those involved in those markets, whether as direct participants or as advisers, provide full and accurate information to the [Commission].
>
> (*Wilder et al. v. Ontario Securities Commission* (2001), 53 O.R. (3d) 519 (C.A.) at para. 22)

[281] Similarly, this statement by the Ontario Court of Appeal applies to the duties of an IDA member when responding to an IDA inquiry.

iii) Analysis

[282] We must decide whether or not Rowan was aware of the Congor Letter and the Conset Letter and if so, whether he misled the IDA by failing to provide them. Rowan's claim that he was unaware that the letters were in his files raises an issue of credibility.

[283] Though Staff has presented evidence that, in Staff's submission, gives rise to an inference that Rowan must have seen the letters or been aware of them, we are not convinced.

[284] Rowan testified that he did not recall seeing the Congor Letter or the Conset Letter until they were presented to him by Staff. He suggested his assistant may have filed them away without showing them to him.

[285] Though Staff suggested there is an inconsistency between Rowan's and McKenney's testimony at the hearing and McKenney's hearsay statement to OSC investigators in his June 2005 interview about what Rowan told him during the course of the OSC investigation, we are not satisfied there is any significant discrepancy.

[286] De Francesca was in the best position to testify about whether she received the faxes and gave them to Rowan, but Staff did not question her on this issue while she was on the stand. Nor did Staff call Schindler, Rowan's assistant at Watt Carmichael, who, according to Fitzsimmons, discovered the faxes in Watt Carmichael's files in 2005.

[287] Further, Fong testified that the letters were requested by Melnyk and she did not discuss them with Rowan.

[288] In short, Staff asks the Panel to make an inference (that Rowan saw the faxes) where none should be needed.

[289] Although it could be argued that Rowan, based on the history of his dealings with the Trust Accounts, the Trustees and Melnyk, had a reasonable basis for suspecting that Melnyk was a beneficiary of one or more of the Trusts, we did not see clear and compelling evidence that Rowan knew the identity of any beneficiary of the Trusts when Watt Carmichael responded to the IDA's enquiry.

[290] Misleading the IDA is a serious allegation that would require clear and convincing proof based on cogent evidence. We are not satisfied that Staff has met its burden.

iv) Finding

[291] For the reasons given, Commissioner Thakrar dissenting, we are not satisfied that Staff presented clear and convincing proof based on cogent evidence that Rowan was aware of the Fong Faxes or knew that Melnyk was a beneficiary of the Conset and Congor Trusts. We are not satisfied that Rowan or Watt Carmichael provided misleading responses to the IDA enquiry.

J. Did Rowan mislead the Commission?

i) Submissions

Staff

[292] Staff submits that, when interviewed by Staff in February 2005, Rowan gave misleading answers to Staff's questions. Staff's questions and Rowan's answers were as follows:

> Q. Who is the beneficial owner of Conset Investments?
>
> A. My understanding is there are a number of beneficiaries of the trust. I don't have a list of the beneficiaries.
>
> Q. Who would have that?
>
> A. The trustees would certainly have that.
>
> Q. What is your understanding as to who the beneficiaries are?
>
> A. I don't know who the beneficiaries are. My understanding is it's a number of individuals, and I don't know who any of the beneficiaries specifically are.

[293] According to Staff, at the time that he gave these answers, Rowan had in his possession or control the Conset Letter dated July 17, 2000, from the Conset Trustees to Melnyk listing the beneficiaries of the Conset Trust. The information was not provided to Staff at the time of his examination.

[294] Staff submits that Rowan's failure to provide the Commission with information on what he knew to be an important point constitutes a further example of misleading regulatory authorities. As a registrant, and as a senior officer of a registrant, this wrongdoing is particularly serious.

The Respondents

[295] The Respondents submit that this allegation is merely duplicative of the first allegation that Rowan misled the IDA by not providing the Conset Letter in response to the IDA's enquiry. Rowan denies having seen the Conset Letter at the time it was sent in July 2000. Alternatively, he submits that even if he had seen the Conset Letter, his answer to Staff in 2005 – that he did not know who the beneficiaries were – was entirely reasonable because the information available to him was that the Account holders were refusing to disclose beneficial ownership, citing Cayman Island confidentiality laws.

ii) Analysis

[296] For the reasons given above, we are not satisfied that Rowan was aware of the Conset and Congor Letters or that he knew who the beneficial owners of the Trust Accounts were in 2000, when the IDA required Watt Carmichael to provide this information. The questions put by Staff during its interview in 2005 were in the present tense. None of the questions probed Rowan's knowledge of the identity of the beneficiaries in 2000. It is fair to assume that, from Rowan's perspective, he was being asked who the beneficiaries were as at the time of the interview, namely February 2005. Neither Rowan nor Watt Carmichael had been dealing with the Trust Accounts since some time in the second quarter of 2004, and there is no convincing evidence that Rowan knew who the beneficiaries were at the time of the interview. We conclude, therefore, that there is no convincing evidence that his answers were misleading.

iii) Finding

[297] For the reasons given, Commissioner Thakrar dissenting, we are not satisfied that Rowan misled the Commission when he was interviewed by Staff in February 2005.

K. Did McKenney, Carmichael and Watt Carmichael, fail to adequately supervise Rowan's trading in Biovail securities in the Trust Accounts?

i) Submissions

Staff

[298] Staff alleges that McKenney, Carmichael and Watt Carmichael did not adequately supervise Rowan's trading in Biovail securities in the Trust Accounts.

[299] Staff alleges that Carmichael, in his capacity as Chairman, CEO and UDP, and McKenney, in his capacity as CCO, failed to adequately supervise trading by Rowan and to address conflicts of interest despite indications that supervision was required. Specifically, Staff alleges that Carmichael and McKenney knew or should have known that:

(a) Rowan had multiple roles as a director of Biovail and member of Biovail's Audit Committee, and as the President of Watt Carmichael and the registered representative for the Trust Accounts;

(b) Rowan engaged in discretionary trading of Biovail securities in the Trust Accounts in 2002 and 2003; and

(c) Rowan, as a director of Biovail, was required to cease trading in Biovail securities during the Biovail Blackout Periods.

[300] Further, Staff notes that that the Trust Accounts were held in the name of offshore investment corporations, collectively held a very large position in Biovail shares, were highly concentrated in Biovail shares, and conducted very active trading in Biovail shares, all of which Staff submits constituted additional risk factors that called for greater supervision of the Accounts.

[301] Staff alleges that in spite of the clear risks posed by Rowan's positions as a director of Biovail and registered representative for the Trust Accounts, McKenney and Carmichael failed to ensure that:

(a) Rowan filed insider reports relating to his trading of Biovail securities in the Trust Accounts;

(b) Rowan ceased trading in Biovail shares in the Trust Accounts during Biovail Blackout Periods; and

(c) Rowan ceased trading in Biovail shares in the Trust Accounts during periods when he was in possession of material undisclosed information about Biovail.

[302] Staff submits that Watt Carmichael's policies and procedures were inadequate to properly supervise Rowan's trading.

[303] With only a few exceptions, Staff does not accept that the trades at issue were made in response to margin calls by Watt Carmichael's carrying broker. Further, Staff does not accept that Watt Carmichael's carrying broker was responsible for supervising trading in the Trust Accounts. Staff submits that the carrying broker agreements in force during the period at issue in this case expressly state that the broker, Watt Carmichael, is responsible for compliance with applicable law and self-regulatory organization requirements, including but not limited to obtaining account opening documentation, following KYC rules, and determining the suitability of trading activity and the nature of securities purchased.

[304] In addition, Staff does not accept that the IDA's failure to raise supervisory concerns with Watt Carmichael during its sales compliance reviews indicates the IDA was satisfied with Watt Carmichael's accounts supervision. Staff submits that the supervisory failures alleged by Staff involve issues that are not routinely reviewed in sales compliance reviews and that in a "non-financial" audit, there is no expectation that a sales compliance review will inspect every aspect of a client's business.

[305] In any event, Staff submits that the IDA did ask questions about Watt Carmichael's supervision of trading in the Trust Accounts, and that the Final Levander Letter provided in response (Watt Carmichael's letter to the IDA dated August 10, 2000, discussed above at paragraph 263 and following) was misleading. We have rejected this allegation, for reasons given above at paragraphs 281-290 above.

[306] Finally, Staff submits that the actions and views of the IDA do not bind the Commission, which has authority to determine whether a registrant and its officers have fulfilled their supervisory responsibilities under Rule 31-505 and sole jurisdiction to determine whether a respondent has acted contrary to the public interest. Accordingly, Staff submits that McKenney, Carmichael and Watt Carmichael, not the IDA, bore responsibility for supervising Rowan's trading in the Trust Accounts.

The Respondents

[307] The Respondents submit that the "failure to supervise" allegations against McKenney and Carmichael are unfounded and over-reaching. These allegations, which have an injurious impact on the unblemished reputations of McKenney and Carmichael, are particularly unfortunate, in the Respondents' submission, in light of the abundant evidence that the IDA was satisfied with the way Watt Carmichael did its business.

[308] According to the Respondents, all the witnesses who testified about supervision standards, including Kleberg (Staff's expert witness), and Johnston and Dimitropoulos (the IDA representatives called by Staff), confirmed that there is no industry standard requiring compliance officers to monitor whether a registrant who is an insider of a reporting issuer is filing insider reports of trades in securities of the issuer and complying with issuer blackout periods, and that is why the IDA's sales compliance review did not concern these issues. The Respondents submit that if the Panel now decides to impose such a requirement, it should not be the standard for judging the conduct of McKenney and Carmichael in past years, especially considering that the IDA approved the supervision provided by Watt Carmichael.

[309] The Respondents submit that the allegation against Carmichael is even less well-founded than the allegation against McKenney. As the UDP, Carmichael was responsible for ensuring that Watt Carmichael had appropriate policies and procedures in place and qualified personnel to supervise compliance. The Respondents submit that Carmichael fulfilled these obligations, and that Watt Carmichael's policies were crafted in consultation with, and expressly approved by, the IDA. In the Respondents' submission, there is no basis for this allegation against Carmichael, who has had 45 years of experience in the industry.

ii) The Law

[310] OSC Rule 31-505, IDA Regulation 1300.2 and IDA Policy No. 2 require IDA members to supervise trading in client accounts and to implement procedures and policies to ensure that client accounts are supervised. Section 3.1 of Rule 31-505, entitled "Supervisory Terms", provides as follows:

> A registered dealer shall supervise each of its registered salespersons, officers and

> partners and a registered adviser shall supervise each of its registered officers and partners in accordance with Ontario securities law and terms or conditions imposed by the Director or the Commission on the registration of the salesperson, officer or partner of the dealer or the officer or partner of the adviser requiring that the actions of the registered salesperson, officer or partner of the registered dealer or the registered officer or partner of the registered adviser be supervised in a particular manner.
>
> (OSC Rule 31 – 505)

[311] Further, IDA Regulation 1300.2 provides as follows:

> Each Member shall designate a director, partner or officer or, in the case of a branch office, a branch manager reporting directly to the designated director, partner or officer who shall be responsible for the opening of new accounts and the supervision of account activity. Each such designated person shall be approved by the applicable District Council and, where necessary to ensure continuous supervision, the Member may appoint one or more alternates to such designated person who shall be so approved. The director, partner or officer as the case may be, shall be responsible for establishing and maintaining procedures for account supervision and such persons, or in the case of a branch office, the branch manager shall ensure that the handling of client business is within the bounds of ethical conduct consistent with just and equitable principles of trade and not detrimental to the interests of the securities industry.

[312] Proper supervision by registrants is a critical component of the securities regulatory system. As stated by the Alberta Securities Commission in *Re Roche Securities Ltd.*, [2004] A.S.C.D. 400 ("*Roche*"):

> The issue here turns on the objectives underlying the concept of registration. As we noted earlier, the Act as a whole aims to protect investors and to foster market fairness, market efficiency and investor confidence. Registrants have a special, and in some ways privileged, role in the securities regulatory framework. They are entrusted to use their expertise and knowledge in such a way that investors, and the capital market, are served competently and ethically.
>
> The responsibilities of individual registrants such as securities salespersons or brokers are complemented and supplemented by the responsibility of the registered dealers who employ them. Those dealers must ensure that the business conducted on their behalf by their personnel is conducted appropriately.
>
> In this context, the notion of "supervision" may be seen as shorthand for the array of systems, procedures, checks and balances that firms put in place to ensure that trading and other activities carried on with and for firm clients proceed fairly and in accordance with applicable regulatory requirements and norms. Registered firms, and their supervisory and compliance procedures, serve as gatekeepers for

> dealings between the firms and the world outside. When they do their job, misconduct or simple error on the part of individual personnel can be deterred or, failing that, detected promptly before harm (or further harm) to investors and the capital market generally.
>
> Some of the procedures are identified generally in section 30 of the ASC Rules, but that provision need not and should not be viewed as an exhaustive and definitive prescription.
>
> A registered dealer cannot disassociate itself from the actions of its personnel, and least of all from the actions of its most influential personnel. Whenever misconduct can be attributed to individuals in connection with trading activity conducted for, on behalf of or through the registered dealer that employs them, it seems to us natural to inquire into the adequacy of the dealer's supervision of the individuals.
>
> (*Re Roche Securities Ltd.*, [2004] A.S.C.D. No. 400, at para. 149-153)

[313] As noted above, Canadian Securities Administrators recognized the inherent danger of having registrants acting as corporate directors in MP 34-202. – *Registrants Acting as Corporate Directors*, which states:

> The position of a representative of a registrant acting as a director of or adviser to a reporting issuer is one that is fraught with the possibility of a conflict of interest. This arises more particularly in regard to questions of insider information and trading, and timely disclosure.
>
> (Multilateral Policy 34-202 – Registrants acting as Corporate Directors, ss. 1.1 and 1.2)

[314] OSC Policy 33-601 – *Guidelines for Policies and Procedures Concerning Inside Information* ("OSC Policy 33-601") contains a discussion of the measures that registrants are required to adopt in order to deal with inside information that members of their firms may possess. Section 2.1 of this Policy sets out that:

> (1) While the selection and implementation of policies and procedures by a registrant to prevent contravention of subsection 76(1) of the Act must be determined by the registrant having regard to its business activities, a registrant should consider establishing written policies and procedures in the following areas:
>
> (a) education of employees;
>
> (b) containment of inside information;
>
> (c) restriction of transactions; and

(d) compliance.

(2) In the view of the Commission, the board of directors and senior officers of a registrant should be responsible for ensuring that appropriate policies and procedures for the business activities of the registrant are adopted, maintained and enforced.

(OSC Policy 33-601 – *Guidelines for Policies and Procedures Concerning Inside Information*, (1998), 21 O.S.C.B. 617)

iii) Analysis

Kleberg's Evidence

[315] We accept Kleberg's expert evidence only as it related to industry standards for brokerage compliance practices.

[316] Kleberg testified about the division of supervisory responsibilities that is mandated within securities brokerages. Each firm must have a UDP who is responsible for the firm's overall compliance with regulatory requirements as well as overseeing the development and implementation of its compliance practices and procedures. However, the UDP is not operationally responsible for day-to-day compliance activities.

[317] A firm must also have a CCO who bears primary responsibility for supervising the firm's accounts as well as developing and implementing its compliance policies and procedures. In Kleberg's words, the CCO is responsible for creating awareness of compliance issues within the firm, monitoring adherence with regulatory requirements and ensuring compliance with such requirements.

[318] Kleberg also stressed that compliance policies and procedures must be reflective of and responsive to a firm's particular business. Kleberg testified about IDA Policy No. 2 (Minimum Standards for Retail Account Supervision), which states: "This Policy establishes minimum industry standards for retail account supervision." It also states:

> Members are required to know and comply with Association and other self-regulatory organization by-laws, rules, regulations and policies *and applicable securities legislation* which may apply in any given circumstance. [emphasis added]

[319] Kleberg testified that OSC Policy 33-601, which requires written policies and procedures dealing with the containment and monitoring of inside information, should guide registrants in setting out their responses to the possession of inside information.

[320] Kleberg testified that he had examined Watt Carmichael's Policies and Procedures Manual to examine its treatment of insider information containment. His conclusion was that "it did not address the appropriate procedures".

[321] Kleberg concluded that these Trust Accounts warranted especially close supervision and required effective policies and procedures. In his words, the Trust Accounts were "screaming for attention". He highlighted the salient features of the Trust Accounts from a supervisory perspective:

(a) the accounts held a very large position in Biovail securities;

(b) the accounts were highly concentrated in Biovail securities;

(c) the accounts conducted very active trading in Biovail securities;

(d) the registered representative assigned to the accounts was an insider of Biovail; and

(e) the registered representative held discretionary trading authority over the accounts.

[322] Kleberg acknowledged that industry standards would not generally require the CCO to monitor adherence to corporate blackout periods by a brokerage client who is an insider of a reporting issuer. However, it was Kleberg's opinion that where a registered representative who is also an insider of a reporting issuer ("RR/insider") has discretionary authority to trade in securities of the reporting issuer, close supervision by the CCO is required to ensure that an RR/insider does not trade in the issuer's securities during the issuer's blackout periods. Kleberg stated that this monitoring would not be difficult since the CCO could simply ask the reporting issuer to notify him of any blackout periods.

[323] Kleberg explained at the hearing that a CCO should monitor all trading by an RR/insider for compliance with the blackout periods. After discussing blacklisting and grey listing, Kleberg stated:

> In this situation, it's a little bit more complex because usually, one does not have a situation where the insider happens to be a registrant who services clients as well. So I have to extend my comments by saying the insider in this case, who is also a registrant, should not only [not] trade for his own account. He should not give advice during the blackout period and he should not do discretionary trading on behalf of clients during the blackout period.

[324] Kleberg testified that industry standards would require that all Biovail trades at Watt Carmichael be monitored during such periods.

[325] Staff submits that McKenney should at least have met the industry standard and monitored Biovail trading in all accounts at the firm. This monitoring was required to ensure that Rowan did not transmit any inside information concerning Biovail to other investment advisors or clients.

[326] Part of the close attention required was the need to verify that Rowan was filing reports under section 107 of the Act for each transaction in Biovail securities in the Trust Accounts.

Kleberg expressed the opinion that, given the unique characteristics of these accounts, a CCO should verify that insider reports are filed. Further, he should document the steps he takes to verify the filings.

[327] Even if the RR/insider assures the CCO that the transactions are being reported, the CCO should still verify this information. As Kleberg explained, this would be easy to do by periodically checking the insider reporting website.

[328] Kleberg also testified that the UDP should ensure that his CCO carries out his responsibilities in this area including supervising the filing of insider reports.

iv) Findings

[329] For the following reasons, we find that Carmichael, McKenney and Watt Carmichael failed to supervise Rowan's trading in Biovail securities in the Trust Accounts.

McKenney

[330] The CCO is responsible for creating awareness of compliance issues within the firm, monitoring adherence with regulatory requirements and ensuring compliance with such requirements.

[331] McKenney testified that he was aware that:

(a) Rowan was a director of Biovail, a member of its Audit Committee, and the registered representative for the Trust Accounts;

(b) Rowan conducted discretionary trading in Biovail securities in the Trust Accounts; and

(c) Rowan was an insider of Biovail and thus required to comply with its trading blackout periods and insider reporting requirements.

[332] McKenney also admitted being aware of the concentration of Biovail securities in the Trust Accounts, the unusually high volume of trading in the Biovail securities in the Trust Accounts, that these were offshore accounts and that Melnyk was the settlor.

[333] Nevertheless, in spite of the clear risks, McKenney failed to properly supervise Rowan's trading in the Trust Accounts. In particular, McKenney, as CCO, failed to ensure that:

(a) Rowan filed insider reports relating to his trading in Biovail securities in the Trust Accounts;

(b) Rowan ceased trading in Biovail securities in the Trust Accounts during Biovail Blackout Periods; and

(c) Rowan ceased trading in Biovail securities in the Trust Accounts during periods where he was in possession of material undisclosed information concerning Biovail.

[334] We find that McKenney made only sporadic and inadequate attempts to determine when Rowan had knowledge of information not generally disclosed.

[335] McKenney testified that he did not monitor Rowan's compliance with the Biovail Blackout Periods because in his opinion he was not required to do so.

[336] McKenney testified that he monitored Rowan's trading in Biovail securities at times when Rowan was in possession of material undisclosed information concerning Biovail. He stated that he determined when Rowan was in possession of such information in two ways:

(a) when Rowan informed him that he was in possession of such information; and

(b) when it came to his attention that Rowan was about to leave the office to attend a Biovail Board of Directors or Audit Committee meeting.

[337] McKenney testified that, once notified that Rowan was in possession of material undisclosed information concerning Biovail, he would alert the Watt Carmichael trading desk that no trades in Biovail securities were to be entered in accounts for which Rowan was the registered representative until further notice.

[338] McKenney stated that such restrictions were only imposed on accounts for which Rowan was the registered representative. He testified that he did not monitor the trading in Biovail securities in any other accounts at Watt Carmichael during such periods.

[339] We find that McKenney did not properly monitor Rowan's possession of inside information. It is insufficient for a CCO to accept information provided by a registered representative at face value. As Kleberg explained, industry standards dictate that trust in a registered representative should always be accompanied by independent checks of the information provided:

> When I go to the registrant and ask him a question, then I trust that he tells me the truth, but there has to be the occasional reasonable verification.

[340] It was also inappropriate for McKenney to rely on happenstance to find out that Rowan was leaving the office to attend a Biovail Board or Audit Committee meeting. McKenney relied entirely on reporting by the registered representative with no independent verification. Such an approach could easily miss, for example, Biovail meetings that were conducted by conference call. In fact, McKenney admitted that he would not have known of such meetings.

[341] The measures imposed in response to Rowan's admitted possession of such information were equally insufficient. For example, McKenney stated that he only monitored trading in Biovail securities in accounts controlled by Rowan. This approach was adopted even in the face of a statement in Watt Carmichael's Policy and Procedures Manual that "all trading activities of

Watt Carmichael Inc. will be affected whenever Watt Carmichael Inc. is in receipt of insider information".

[342] As Chief Compliance Officer of Watt Carmichael, McKenney was responsible for supervising Rowan's trading to ensure compliance. We find he failed to do so.

Watt Carmichael

[343] Carmichael testified that in his opinion, Watt Carmichael's Policies for information containment and monitoring for insider trading were adequate for its business, including supervision of the Trust Accounts.

[344] In our view, the evidence demonstrates that Watt Carmichael's compliance policies, procedures and practices were inadequate in that they failed to address the inherent risk in Rowan's dual role as registered representative for the Trust Accounts with discretionary trading authority and as an insider of Biovail.

[345] In particular, Watt Carmichael failed to adequately supervise Rowan's trading in Biovail securities in the Trust Accounts, in that Watt Carmichael failed to ensure the containment of inside information, failed to ensure Rowan's compliance with insider trading and disclosure rules and the Biovail Blackout Policy, and failed to properly document its compliance activities.

Carmichael

[346] Carmichael, as Chairman, CEO and acknowledged UDP of Watt Carmichael, is responsible for the firm's overall compliance with regulatory requirements, and for overseeing the development and implementation of its compliance practices and procedures.

[347] Carmichael testified that the Trust Accounts came to his attention in 1996 or 1997 and that he knew that:

(a) Melnyk was the settlor of the Trusts;

(b) the Trust Accounts held mostly Biovail shares;

(c) Rowan was a director of Biovail, a member of its Audit Committee, and the registered representative for the Trust Accounts;

(d) Rowan conducted discretionary trading in Biovail securities in the Conset and Congor Accounts;

(e) there was a high volume of trading in the Trust Accounts; and

(f) Rowan was an insider of Biovail and thus required to comply with its trading blackout periods and insider reporting requirements.

[348] Carmichael admitted that he was aware of Biovail's quarterly and annual reports because Biovail was a client, and that he received a daily trading blotter that showed the trading activity in the Accounts under Rowan's registered representative number.

[349] Carmichael testified that Watt Carmichael did not monitor Rowan's compliance with the Biovail Blackout Periods because in his opinion it was not required to do so.

[350] Carmichael testified that Watt Carmichael relied on Rowan to disclose when he had inside information and could not trade.

[351] We find that Carmichael, given his knowledge of the unique nature of the Trust Accounts, should have ensured that Watt Carmichael had adequate policies, procedures and practices in place to ensure Watt Carmichael's compliance with its responsibilities referred to in paragraph 345 above.

[352] As Chairman, CEO and UDP, Carmichael was ultimately responsible for ensuring that Watt Carmichael had appropriate policies, procedures and practices in place, and for ensuring that McKenney, as Chief Compliance Officer, satisfied his oversight responsibilities. We find that Carmichael failed to fulfill this responsibility as Chairman, CEO and UDP, contrary to the public interest.

iv) Finding

[353] In light of the evidence, we conclude that McKenney, Carmichael and Watt Carmichael failed to adequately supervise Rowan's trading in Biovail securities in the Trust Accounts.

VI. CONCLUSION

[354] For these Reasons we find that:

(a) Rowan breached section 107 of the Act by failing to file insider reports in respect of trades in Biovail securities that he executed in the Trust Accounts;

(b) Rowan engaged in conduct contrary to the public interest by failing to disclose to Biovail the Biovail securities held in the Trust Accounts over which he exercised control or direction;

(c) Rowan engaged in conduct contrary to the public interest by trading in Biovail securities in the Trust Accounts during Biovail's Blackout Periods;

(d) Rowan did not breach section 76 of the Act;

(e) Rowan did not contravene OSC Rule 31-505 (Know Your Client) by conducting unauthorized discretionary trading in the Southridge Account;

(f) Rowan and Watt Carmichael did not mislead the IDA;

(g) Rowan did not mislead the Commission;

(h) McKenney, Carmichael and Watt Carmichael failed to adequately supervise Rowan's trading in Biovail securities in the Trust Accounts; and

(i) the conduct of the Respondents with regards to paragraphs (a), (b), (c) and (h) was contrary to the public interest.

[355] The parties shall contact the Office of the Secretary within 10 days of this decision to set a date for a sanctions hearing, failing which a date will be fixed by the Office of the Secretary.

Dated at Toronto, this 20th day of June, 2008.

"Robert Shirriff" *"David Knight"*

Robert L. Shirriff, QC David L. Knight, FCA

COMMISSIONER THAKRAR (DISSENTING IN PART):

A. Introduction

[1] I concur with my colleagues' conclusions, except that I am respectfully unable to concur with respect to Staff's allegations that:

(a) Contrary to the public interest, Rowan and Watt Carmichael provided responses to the IDA's request for information as to the identity of the beneficiaries of the Congor and Conset Trusts which they knew or ought to have known were misleading or untrue or did not state facts that were required to be stated to make their statements not misleading;

(b) Contrary to the public interest, Rowan made statements to Staff as to the identity of the beneficiaries of the Conset Trust which he knew or ought to have known were misleading or untrue or did not state facts that were required to be stated to make his statements not misleading; and

(c) Rowan purported to exercise discretionary trading authority in the Southridge Account when he did not have such discretionary authority, contrary to the Know Your Client requirements set out in subsection 1.5(1) of OSC Rule 31-505 –

Conditions of Registration, (1999), 22 O.S.C.B. 731 and (2003) 26 O.S.C.B. 7170, referred to as the "Know Your Client" ("KYC") rule ("OSC Rule 31-505"), and contrary to the public interest.

[2] I concur with my colleagues that Staff bears the burden of presenting clear and compelling proof based upon cogent evidence in support of each of its allegations. I am also mindful of the seriousness of these allegations and of the consequences of these findings for the Respondents. However, viewing the evidence in its totality, I find that Staff presented compelling evidence in support of these allegations. I therefore conclude that, contrary to the public interest, Rowan and Watt Carmichael misled the IDA, that Rowan misled the Commission, and that Rowan engaged in unauthorized discretionary trading in the Southridge Account.

[3] My reasons follow.

B Did Rowan and Watt Carmichael mislead the IDA in providing an incomplete response to inquiries regarding Melnyk's interest in the Trust Accounts?

i) Introduction

[4] Staff alleges that contrary to the public interest, Rowan and Watt Carmichael provided responses to the IDA's request for information as to the identity of the beneficiaries of the Congor and Conset Trusts which they knew or ought to have known were misleading or untrue or did not state facts that were required to be stated to make their statements not misleading.

[5] Rowan testified that he did not see the Fong Faxes until shown them by Staff. He also testified that he did not know of Melnyk's beneficial interest in the Trusts until after he was interviewed by Staff in 2005.

[6] In my view, Staff presented compelling evidence that Rowan was aware of the Fong Faxes and the Congor and Conset Letters and knew that Melnyk was a beneficiary of the trusts at the time of the IDA enquiries in 2000.

[7] My reasons are as follows.

ii) The Congor Letter and the Conset Letter were requested for the IDA

[8] I find it significant that the Fong Faxes, including the Congor Letter and the Conset Letter, were addressed to Rowan during the IDA's 1999 sales compliance review of Watt Carmichael (the "Review"). In fact, they were sent in response to a request from Rowan to Melnyk relating to the Review.

[9] On December 23, 1999, Dimitropoulos, the Manager of Sales Compliance at the IDA, sent McKenney the IDA's draft report resulting from its completed Review, noting that the draft report sets out "a number of items that require your attention," including a requirement that Watt Carmichael provide copies of the trust agreements for the Congor and Conset accounts.

[10] The final IDA report, sent to Carmichael on January 21, 2000, with copies to Rowan and McKenney, indicated that the IDA's concerns were not yet resolved. Under the heading "Supervision of Account Activity", the report identified the following as "[t]he priority item which the Member firm must address and resolve":

> **2.3 Trading Concerns – IDA Regulation 1300.1 and 1300.2; IDA Policy No. 2 Sections II and IV – *Priority Item***
>
> A review of two off-short corporate accounts noted various concerns as follows:
>
> Conset Investments Ltd. – [Account Number] – R.R. Roger Rowan
>
> Account documentation does not provide enough information to determine the beneficial owner(s). The corporate resolution indicates that the Secretary is a third party corporate secretary. The RR indicated that the CEO of Biovail, Eugene Melnyk, "donated" the Biovail stock to this account under the terms of a trust and is the Settlor of the trust. No trust agreement was on file. As of May 31, 1999, the account held over US$20 million dollars worth of Biovail stock. It was also noted that as of may 31, 1999, the US margin account had a debit balance of US$2,882,952.78. With the exception of 4.7% of the portfolio holdings, all other holdings were Biovail. In addition, it was noted that the account sold 110,000 Biovail shares for total proceeds of US$4,364,093.60 on April 5, 6, 14, 15 and 19, 1999 and then on April 13 and 14, 1999 wired US$2,500,000 to a bank account in New York that belonged to Eugene Melnyk.
>
> Congor Investments Ltd. – [Account Number] – R.R. Roger Rowan
>
> The account documentation on file with the Member does not provide enough information to determine the beneficial owner(s). The corporate resolution indicates that the Secretary is a third party corporate secretary. The RR indicated that the CEO of Biovail, Eugene Melnyk, "donated" the Biovail stock to this account under the terms of a trust and is the Settlor of the trust. No trust agreement was on file. As of May 31, 1999, the account held over US$17 million dollars worth of Biovail stock. It as also noted that as of May 31, 1999, the US margin account had a debit balance of US$2,709,428.35 with Biovail being the only security held in the account.
>
> **Requirement**
>
> Given that Eugene Melnyk deposited the Biovail shares to the Conset and Congor accounts and that the proceeds of the Biovail sales in the Conset account were wired to Mr. Melnyk, we are not satisfied with the Member's contention that Mr. Melnyk does not have any interest in these accounts.
>
> Further, as the legal opinions on file are based on certificates from two off-shore secretaries, we are not satisfied with the assertion that the Congor and Conset accounts do not form part of a control block of Biovail. Thus, in the absence of

> trust documents and other supporting documentation, the Association believes that the Biovail holdings in these accounts are part of Mr. Melnyk's control position. In addition, if these accounts are part of a control block, then the use of margin is not permitted on the Biovail positions and the debit balances in these accounts relating to the Biovail positions represent a 100% capital charge.
>
> The Member is required to provide the Association with copies of the formal trust agreements for both the Conset and Congor accounts. Also the Member is required to state the identify of the beneficial owner of these accounts.

[11] Dimitropoulos testified that if Melnyk was a beneficial owner of the Conset and Congor Accounts, there would be several ramifications: "the clients would have been deemed to be insiders of Biovail", "the debit balances against the security would have been one hundred percent capital charge", "there would have been no loan value on Biovail due to the control position", and any capital charge would result in "a capital hit against Watt Carmichael."

[12] Johnston, the sales compliance officer who participated in the IDA review testified "that the Accounts were carrying a large debit balance on margin", and if Melnyk had some type of interest in the Accounts, this would have raised a number of issues: "these accounts were being given margin and so if in fact the Biovail shares were part of his control block position, number one, they would have been violating control block distribution rules any time they made a sale. Number two, they wouldn't have been allowed to have margin. So there would have been an immediate capital hit either to the client if they couldn't put up margin that was required or it could potentially put the firm into some type of early warning from a capital position because of the fact that they were granting margin that would not be allowed under IDA rules".

[13] Carmichael's March 29, 2000 response to the IDA on behalf of Watt Carmichael was as follows:

> Please find enclosed two letters from Stewart & Associates the Canadian Counsel for Biovail Corp. to First Marathon Securities Limited (now National Bank Financial) rendering a legal opinion the shares deposited in the accounts Conset Investments Limited and Congor Investments Limited are not "control block" securities. At the time the accounts were opened First Marathon did ask for confirmation for margin purposes that they were not control block and asked for the enclosed letters. We believe that this is so and rely on these letters to continue with margin eligibility in the accounts.
>
> Regarding trust agreements between Conset, Congor and Biovail and/or Mr. Melnyk, indication is that perhaps this has nothing to do [with] the relationship between Watt Carmichael, Conset and Congor as these offshore accounts are set up as separate Limited Companies with Officers and Directors with the powers of those positions. If Conset or Congor issue instructions to pay funds other than to them directly we feel this [is] there [sic] concern as long as we have the documentation and the proper signatures to do so.

> While having said the above we are expecting more documentation from legal counsel in New York to further enhance our position and to forward on to you. We are pleased to meet with you in the near future on the above if it is your wish.

[14] As my colleagues noted, the IDA was not satisfied. In his May 24, 2000 letter to Carmichael on behalf of the IDA, Dimitropoulos stated:

> The Member's response did not satisfy the Association's request to identify the beneficial owner(s) of the Congor and Conset accounts. In addition, the Member did not provide sufficient documentation to prove that the Congor and Conset accounts do not form part of a control block of Biovail. The response included copies of two legal opinions from Stewart & Associates, however these legal opinions were the same documents that we had reviewed during the 1999 SCR. In fact, Item 2.3 of the 1999 SCR had stated "as the legal opinions on file are based on certificates from two off-shore secretaries, we are not satisfied with the assertion that the Congor and Conset accounts do not form part of a control block of Biovail."
>
> We further disagree with the Member's assertion that, if Conset or Congor issue instructions to pay funds to third parties, the Member should not be concerned as long as it has the proper signatures and documentation. We believe that the Member does have a duty to ensure that its clients are not involved in any violation of the Securities Act. As mentioned in our 1999 SCR, the activities surrounding Mr. Eugene Melnyk's involvement in the Conset and Congor accounts do raise concerns regarding the beneficial ownership of these accounts since it appears that the Biovail holdings in these accounts may form part of Mr. Melnyk's control position.
>
> Finally, your response indicated that the Member is expecting more documentation from legal counsel in New York. Please forward these documents to the Association as soon as possible. In addition, please forward any further documents that would identify the beneficial owners of the Conset and Congor accounts and documents to ascertain whether the Biovail holdings in these account form part of Mr. Melnyk's control position in Biovail.
>
> Your immediate attention and a written response to the above items are appreciated. . . .

[15] My colleagues have noted Rowan's June 7, 2000 memo to Melnyk, which was as follows:

> Re: IDA Letter regarding Conset and Congor Accounts
>
> Attached is a copy of the letter dated May 24/00 from the IDA regarding the above accounts.

> Eugene, can we provide the IDA with some suitable response to get them to go away.Ie.,
>
> 1. Was there any documentation submitted to the SEC when BVF was listed on the NYSE which clarified the status of the trusts ie., that stated they are not part of the control block?
>
> 2. Is there a trust agreement available that would satisfy the IDA?
>
> 3. If you do not wish to disclose the beneficiaries to the IDA (I don't see any harm in doing so), is there some declaration we can provide the IDA which states that Eugene Melnyk is not a beneficiary of the trust [sic] and therefore has no beneficial ownership in them.
>
> If we can provide the above, I am confident that we can get the IDA to go away. Please call me regarding this.

[16] This memo shows that Rowan was well aware of the reasons for the IDA's questions. It also provides the context for the Fong Faxes. In my view, Rowan would have expected a response to this request, which concerned a critical outstanding issue raised in the IDA Review.

[17] The first of the Fong Faxes consisted of three documents, all of which were dated July 17, 2000: a fax cover sheet from Fong to Rowan, a letter from Coutts (Cayman) Limited ("Coutts"), the Trustee for the Congor Trust, to Fong, and a letter from Coutts to Melnyk.

[18] The fax cover sheet is on Melnyk's letterhead, and includes the following typewritten note under the subject line, "Beneficiaries – Congor and Conset Trusts":

> Hi Roger,
>
> Please find attached a copy of the letter from Congor Trust.
>
> We are still awaiting receipt of the one from Conset Trust.
>
> Hope this is what you are looking for.
>
> Arlene.

[19] Coutts' cover letter of the same date is addressed to Fong and states:

> Further to our telephone conversation attached is a copy of the letter requested by Mr. Melnyk.

[20] The attached letter from Coutts (the "Congor Letter") is addressed to Melnyk, and, under the subject line, "The Congor Trust", states:

> Further to your request I can advise that the beneficiaries of the Trust are as follows:

The first name on the list is Melnyk's, and several of the other names appear to belong to Melnyk's family members. The Congor Letter concludes:

> I trust this information is sufficient for your purpose, although please let either Lesley or myself know if you require anything further.

[21] The second Fong Fax consists of two documents: a fax cover sheet and a letter from Caledonian Bank & Trust Limited ("Caledonian"), the Trustee for Conset.

[22] The fax cover sheet is on the letterhead of Biovail Laboratories Incorporated and the date and time imprint indicates it was sent about three hours after the first Fong Fax on July 17, 2000. The cover sheet includes the following handwritten note:

> Hi Roger,
>
> Here is the letter from Conset.
>
> Arlene.

[23] The attached letter from Caledonian, also dated July 17, 2000 (the "Conset Letter") is addressed to Melnyk under the subject line, "Re: The Conset Trust". It states:

> As requested, we confirm that in respect of The Conset Trust, which was established by you as Settlor on 23rd September 1996, the Beneficiaries *include* the following: [emphasis added]

[24] The list does not include Melnyk. It appears to include members of his family.

[25] Fong's covering letters make it clear she is responding to Rowan's memo to Melnyk, and that the Congor Letter and Conset Letter were intended to be provided to the IDA. We received no evidence that Rowan followed up on his June 7, 2000 memo to Melnyk. In my view, the most probable explanation is that the two Fong Faxes were Melnyk's response.

[26] If the Conset Letter and the Congor Letter had been forwarded to the IDA, I find it likely that the IDA would have concluded that Melnyk was a beneficiary of the Conset Trust and would most likely have asked whether he was also a beneficiary of the Congor Trust, because of the careful wording of the letter from Caledonian.

[27] If the IDA had concluded that the Biovail securities in the Conset and Congor Accounts were part of a control block, this would have impacted the marginability of the Biovail securities in the Trust Accounts. This could have had serious consequences for Rowan and Watt Carmichael. As the monthly statements for the Trust Accounts showed, Rowan's trades in Biovail securities in these accounts generated significant commissions for him and the firm. Rowan engaged in heavy trading of Biovail securities in the Trust Accounts during the period in dispute. McKenney described the volume in these accounts as "pretty astounding" and said no other Watt Carmichael account came anywhere near it in terms of volume of trading.

[28] In fact, during 2002, 2003 and 2004, the three Trust Accounts at Watt Carmichael traded on an aggregate basis nearly 33 million shares of Biovail with a value in excess of US$1.1 billion, and purchased nearly 25,000 call options for $10 million. The evidence indicated that over $2.3 million in commissions was paid to Watt Carmichael in relation to Biovail trading in the Trust Accounts over the same period, and commissions were also earned in relation to the other Biovail and Melnyk-related accounts at Watt Carmichael. In addition to potential loss of revenue, there would have been serious implications on marginability and capital requirements for Watt Carmichael.

[29] In my view, certain correspondence after July 17, 2000 appears to be a reaction to the Conset and Congor Letters with respect to whether Melnyk was a beneficiary of the Trust Accounts.

[30] On July 19, 2000, two days after the Fong Faxes were directed to Rowan, McKenney wrote a memo to Rowan, copied to Carmichael and the Watt Carmichael trading desk, suspending trading in Conset and Congor Accounts until further notice, except for trading for margin purposes with approval from Watt Carmichael's compliance department. McKenney forwarded the memo to Dimitropoulos at the IDA on the same day, advising that the documents requested in his May 24, 2000 letter were expected "very promptly".

[31] On July 24, 2000, Melnyk sent letters to the trustees of the Conset Trust and the Congor Trust revocably disclaiming his interest in the Trusts (the "Disclaimer Letters"). The two letters are identical, except for the name of the Trust and trust administrator. The Disclaimer Letters confirm that Melnyk was a beneficiary of both Trusts at that time. The Congor Disclaimer Letter to Coutts will be quoted because it resolves any uncertainty left by the wording of the Congor Letter:

> As you are aware, I am the Settlor and a member of the Discretionary Class of Beneficiaries of the Congor Trust, which was created by Deed of Settlement dated 23 September 1996. Clause 12(a) of the Deed of Settlement permits a beneficiary to disclaim his interest in the Settlement in whole or in part.
>
> Pursuant to that power, and any other power which would enable me to do so, I hereby revocably disclaim my entire interest in the Congor Trust. Please note that this disclaimer of interest is revocable and may be revoked by me by letter in writing to you during the existence of the Congor Trust.
>
> Please sign and date a copy of this letter acknowledging your receipt and agreement.

[32] On July 31, 2000, one week after Melnyk wrote the Disclaimer Letters, Rowan received the Draft Levander Letter and discussed it with McKenney.

iii) The Revision of the Levander Letter

[33] The Final Levander Letter is addressed to Dimitropoulos, and states:

> We have been asked to respond to your letter dated May 24, 2000 regarding the identity of "the beneficial owner(s) of the Congor and Conset accounts" at Watt Carmichael, Inc. As you are undoubtedly aware, the actual owners of those two accounts are, respectively, The Congor Trust, and The Conset Trust. Both of those trusts were settled, i.e., established, by Eugene Melnyk under the laws of the Cayman Islands approximately four years ago. Each trust has as its trustee a different major financial institution: Caledonian Bank & Trust Limited is the trustee of The Conset Trust and Coutts (Cayman) Limited, the Cayman subsidiary of the Coutts Group, which, in turn, is part of NatWest, is the trustee of The Congor Trust.
>
> Under the law of the Cayman Islands, which governs those trusts, the identity of the beneficiaries of the Trusts is a matter of strictest confidence. Nonetheless, we have recently received written confirmation from each of the respective trustees of The Congor Trust and The Conset Trust regarding the current beneficiaries of the Trusts, and 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.

[34] McKenney's covering letter to Dimitropoulos, dated August 10, 2000, states:

> I am responding on behalf of Mr. Harry J. Carmichael.
>
> ITEM 2.3 – Trading Concerns
>
> Please find a letter to your attention from Mr. Andrew J. Levander of Swidler Berlin Shereff Friedman LLP, New York. Mr. Levander concludes verbally that because Mr. Melnyk is not a beneficiary or a trustee of Conset or Congor that the shares are not Control Stock.
>
> Mr. Levander let it be known that he would be happy to talk to you about the contents of the letter for further clarification and any other issues related to your concerns about Congor and Conset.
>
> The account suspension remains in place.

[35] Dimitropoulos responded by letter to Carmichael, copied to McKenney, dated August 14, 2000, stating:

> Thank you for the response dated August 10, 2000 to Item 2.3 of our 1999 Sales Compliance Review of Watt Carmichael, Inc. All matters raised in the Association's report have now been satisfactorily resolved. Thank you for your attention to our report.
>
> We wish to notify you, however, that copies of your August 10th correspondence and Mr. Andrew J. Levander's letter have been forwarded to the Ontario Securities Commission for its consideration.

[36] On April 25, 2005, the Commission summoned Craig Schleyer, who was filling McKenney's compliance role at Watt Carmichael at that time because McKenney was ill, to attend for examination and produce several documents, including the Fong Faxes and "a draft letter dated about July 2000 from a Mr. Andrew Levander."

[37] Fitzsimmons, a Commission investigator, testified that these specific requests were prompted by Staff's interview of Schindler, who replaced De Francesca as Rowan's assistant. Schindler told Staff she found the Fong Faxes and the draft Levander letter in Watt Carmichael's files when preparing for her examination. Fitzsimmons also testified that the Fong Faxes and the Draft Levander Letter were produced to Staff by Watt Carmichael's counsel in response to the section 11 summons.

[38] The Draft Levander Letter, which was unsigned, was dated July 31, 2000 and addressed to Dimitropoulos. It was substantially similar to the Final Levander Letter, except for a crucial sentence. The Draft Levander Letter states:

> . . . we have recently received written confirmation from each of the respective trustees of The Congor Trust and The Conset Trust that Eugene Melnyk is not a *current* beneficiary of either trust. [emphasis added]

[39] The Draft Levander Letter was not sent to the IDA. In contrast, the Final Levander Letter, which was sent to the IDA, states:

> . . . we have recently received written confirmation from each of the respective trustees of The Congor Trust and The Conset Trust regarding the *current* beneficiaries of the Trusts, and we have been authorized to confirm that Eugene Melnyk is not a beneficiary of either Trust. [emphasis added]

[40] I find that the change in wording is significant, and suggests a careful revision.

[41] On the reverse of the Draft Levander Letter is found a handwritten telephone number which Fitzsimmons ascertained and McKenney admitted was the number for McKenney's cottage.

[42] Rowan testified that he received and reviewed the Draft Levander Letter on or about July 31, 2000, the date it was sent to Watt Carmichael along with a note from Levander stating this was the letter he intended to send the IDA.

[43] On receiving the letter, Rowan testified: "I believe I telephoned Mike, Michael McKenney – he was on holidays at the time – and I indicated to him that we had received a draft copy of the letter that we hoped would satisfy the IDA." He denied discussing possible changes to the draft with McKenney or Levander or anyone else. He testified that McKenney's response was: "we need a hard copy of the letter forwarded to the IDA and a copy to us and he would deal with lifting the suspension of the accounts when he returned from holidays and we had that original letter on file."

[44] McKenney denied seeing the draft letter at that time. He agreed the telephone number was his. When asked why his phone number was on the letter, McKenney's testimony referred back to Rowan's evidence, as follows:

> Well, as Mr. Rowan said, he phoned me at the time. I don't recall him phoning me though but he said he phoned me and asked me about the letter. I would imagine that he wanted the trading restriction lifted because we had this letter now, but I didn't know at the time that it was a draft letter or anything like that.

[45] McKenney denied communicating with Levander about the wording of the letter and testified he had never had any correspondence with or spoken with Levander.

[46] I found Rowan's and McKenney's testimony evasive with respect to their telephone conversation about the Draft Levander Letter. I find it more likely that Rowan and McKenney, as senior officers of Watt Carmichael, discussed the wording of the letter and that the letter was revised as a direct or indirect result of their discussions. The timing of these events is significant. Rowan received the Draft Levander Letter on July 31, 2000, about seven weeks after he wrote his June 7, 2000 memo to Melnyk requesting documentation for the IDA, and only two weeks after the Fong Faxes, including the Conset Letter and the Congor Letter, were sent to Rowan, and shortly after Watt Carmichael's suspension of trading in the Conset and Congor Accounts. Even if I accept that Rowan did not receive and was unaware of the Fong Faxes when they were received by Watt Carmichael, I have no doubt Rowan would have followed up on his June 7, 2000 memo and would have become aware of the Fong Faxes and their contents after receiving the Draft Levander Letter, and that he would have been aware of the reason for the revised wording of the Final Levander Letter.

iv) Rowan and Melnyk Communicated Frequently

[47] When Rowan was asked to explain why he would not have received the Fong Faxes, though they were directed to him, he said:

> Well, all material coming into the office by fax or, indeed, by mail did not come immediately to me. It went to my assistants, whoever that was at the time, and they would pass certain material on to me and other material they would simply file, *depending on what it is*.[emphasis added]

[48] Rowan's testimony that he did not receive and was not aware of the Fong Faxes is inconsistent with the other evidence we heard about Watt Carmichael's business.

[49] There is no dispute that Watt Carmichael's offices were small, with only one fax machine and few support staff, and that the Fong faxes were addressed to Rowan and subsequently found in Watt Carmichael's files.

[50] Contrary to Rowan's testimony that he had "occasional discussions" with Melnyk, as the settlor, about the Trust Accounts and about the personal accounts of Melnyk and his wife, De Francesca, Rowan's assistant at the time, testified that she faxed monthly statements for the Trust Accounts to Melnyk or Fong. She also testified that Melnyk called Rowan "three or four times

per day." Rowan testified in chief that he and Melnyk would only speak that often when Melnyk was on a "road show" presenting Biovail to investors. On cross-examination, when confronted with De Francesca's testimony, Rowan said: "some days I would talk to him three or four times a day and sometimes I would talk to him once a day or once every two weeks."

[51] I find De Francesca's evidence more credible because it is more consistent with the other evidence we heard about the close business relationship and frequent contacts between Rowan and Melnyk. Rowan testified that he met Melnyk in the late eighties and they became "quite familiar" with each other over the next seven or eight years, such that Melnyk approached him to stand for election to the Biovail Board of Directors. Rowan was elected to the board in June 1997 and remained a member of the Board of Directors at the time of the hearing. He was also appointed to Biovail's Audit Committee.

[52] We received undisputed evidence that the Trusts, acting on Melnyk's instructions, sent Rowan numerous faxes ordering him to wire large amounts of money from the Trust Accounts to Melnyk's various accounts. For example, the Respondents did not challenge Staff's evidence that Rowan transferred over US$42,500,000 and $842,000 from the Trust Accounts to Melnyk's accounts between January of 1999 and March of 2000. On cross-examination, Rowan denied that the wire transfers caused him to wonder if Melnyk had a beneficial interest in the Trust Accounts. I find this implausible.

[53] The evidence shows that Rowan's and Watt Carmichael's business was heavily dependent on a high volume of telephoned, faxed and e-mail communication with Melnyk and the Trusts. Apart from Rowan's evidence about the Fong Faxes, we heard no evidence to suggest that any other documents went astray at Watt Carmichael.

[54] The Fong Faxes concerned an IDA enquiry that could have had significant implications if the IDA had concluded that Melnyk had a beneficial interest in the Congor and Conset Accounts and that the Accounts formed part of a control position in Biovail securities. Rowan and Watt Carmichael earned significant commissions from the Trust Accounts, the personal accounts of Melnyk and his wife, and other Biovail-related accounts.

[55] In these circumstances, Rowan's testimony that an assistant might have filed away the Fong Faxes without showing them to him is implausible, in my view. I therefore find it much more likely that Rowan received and read the Fong Faxes or, at the very least, was made aware of their contents.

v) The Conset, Congor and Southridge Accounts were Treated as One for Margin Purposes

[56] Jeraj, a manager at NBCN, Watt Carmichael's carrying broker, had dealings with the Trust Accounts throughout the period in dispute. He testified that NBCN treated the Conset, Congor and Southridge Accounts as a single account for purposes of making margin/concentration calls since at least May of 1998. Jeraj explained that NBCN had imposed margin limits on the accounts, considered together, beyond what industry standards would have imposed, because the accounts held only Biovail securities. He testified further that the margin

limit was set, and subsequently increased, by agreement with Watt Carmichael. He testified that the margin calls in these accounts were concentration calls.

[57] Jeraj explained NBCN's computerized memos for the Trust Accounts, which were entered into evidence. They include numerous margin calls. Jeraj explained that NBCN would discuss the options with Watt Carmichael. Though details of communications are not included in the memos, Jeraj explained that NBCN would send an e-mail to Rowan or McKenney with respect to any margin calls. He testified that the reference to "Roger" in relation to a margin call on April 9, 2002 indicated communication with Rowan in which it was agreed that the margin call would be covered in the "next couple days." The memos also include similar references to "Roger" or "RR" on November 9, 2000, March 21, 2001 and February 6, 2002. There are also references to "Mike" or "Mike M", and Jeraj explained that these referred to McKenney.

[58] When asked why NBCN consolidated the Trust Accounts for margin/ concentration purposes, Jeraj explained, "These accounts were not linked in the sense of – they were separate accounts. We identified that they did belong to the same client. So having done that, from a risk point of view, we had to address all of them together." Asked further who was the client, Jeraj answered "I believe it was Mr. Melnyk." Jeraj was then asked why NBCN identified Melnyk as the owner, despite the fact these were three separate accounts held by investment companies behind which was a trust. Jeraj explained that NBCN has "a process where we review all of our large clients," and "if they came to us, asking for a loan, then we would scrutinize it even more and go and take a look at the file and see who the client is, in order to better understand who we're dealing with." He explained that NBCN would have based their analysis on documents obtained from Watt Carmichael.

[59] Rowan testified that NBCN treated the three accounts as one for credit purposes because of the high concentration of Biovail securities, and did not care what the debit balance was in any one of the three accounts, as long as the total debit balance for the three accounts was within the margin limit. He did not agree with the suggestion that there was a concern about all three accounts being connected to Melnyk, though he admitted NBCN was aware he had settled the trusts.

[60] McKenney also understood that NBCN had placed "a money cap on the three accounts as a whole" because of the concentration in Biovail securities. He testified that he would refer NBCN's margin/concentration calls to Rowan, who would bring them back onside by selling some stock, usually Biovail. McKenney testified that Watt Carmichael would sell Biovail stock from the Trust Account with the highest debit balance in order to meet a margin/concentration call, even if that were not the account in relation to which the call was made.

[61] I do not accept Rowan's and McKenney's explanation for NBCN's treatment of the Trust Accounts because there would be no basis in law for treating the Trust Accounts as one just because each held a high concentration of Biovail securities, unless the Accounts had common ownership. I accept Jeraj's explanation.

[62] We heard no evidence to suggest that Rowan or anyone else at Watt Carmichael objected to NBCN's decision to treat the Trust Accounts as one account for margin and concentration

purposes. In fact, Watt Carmichael did the same when it responded to margin/concentration calls by selling Biovail securities from whichever one of the accounts had the highest debit balance.

vi) Conclusion

[63] Rowan denied receiving or knowing about the Fong Faxes and denied knowing that Melnyk was a beneficiary of the Conset and Congor Trusts until after he was interviewed by Staff in 2005. In my view there is clear and compelling evidence to the contrary:

(i) Rowan had a longstanding business relationship with Melnyk as the registered representative for the personal accounts of Melnyk and his wife at Watt Carmichael as well as other Biovail-related accounts and as a member of the Biovail board and Audit Committee.

(ii) Rowan and Melnyk communicated frequently, by telephone, e-mail and fax, including numerous wire transfers from the Trust Accounts to various Melnyk-related accounts.

(iii) NBCN treated the Conset, Congor and Southridge Accounts as one for margin and concentration purposes. This decision was based on documents provided by Watt Carmichael and we heard no evidence that Watt Carmichael objected. In fact, Watt Carmichael responded to margin/concentration calls on any one of the Accounts by liquidating Biovail securities from whichever account had the highest debit balance.

(iv) Rowan was involved in the IDA review, and advised the IDA he had no trust agreement on file. He was well aware of the IDA's concerns.

(v) The issues were serious, because Rowan and Watt Carmichael earned significant commissions from the Trust Accounts, and because if the IDA concluded that the Congor and Conset Trust were owned by Melnyk and that Melnyk held a control position in Biovail, there would have been serious implications, including capital charges against Watt Carmichael.

(vi) When the IDA was not satisfied by the Stewart letters, Rowan wrote to Melnyk on June 7, 2000 asking for "some suitable response to get the IDA to go away," and the Fong Faxes, which were sent on July 17, 2000 in response to Rowan's request, were directed to Rowan and subsequently found in Watt Carmichael's files.

(vii) On July 31, 2000, Rowan received the Draft Levander Letter and discussed it with McKenney. On August 1, 2000, the Final Levander Letter, including a significant revision, was prepared, and on August 10, 2000, McKenney sent the Final Levander Letter to the IDA. Even if I accept that Rowan did not receive and was unaware of the Fong Faxes and the Conset and Congor Letters when they were received by Watt Carmichael, I have no doubt Rowan would have become aware of their contents in discussing the Draft Levander Letter, and that he was aware of the reason for the revised wording of the Final Levander Letter.

[64] Since the three accounts were held by three different Trusts, the only reasonable inference arising from the history of trading, the significant margin activity in the Accounts, the

cross-netting of Account balances for margin purposes, and the significant wire transfer of funds from the Trust Accounts to Melnyk-related accounts, is that Rowan and Watt Carmichael knew or should have known Melnyk had a beneficial interest in all three Accounts.

[65] We are entitled to assume, absent credible evidence to the contrary, that the Fong Faxes, which were addressed to Rowan, in response to his request to identify the beneficiaries of the Congor and Conset Trusts, with respect to a critical outstanding issue raised in the IDA Review, were received and read by Rowan. In my view, the weight of the evidence in this case gives rise to a strong inference that Rowan had received the Fong Faxes, or was aware of their contents, knew of Melnyk's beneficial interest in the Trust Accounts, understood the significance of the Final Levander Letter and was directly or indirectly involved in its revised wording. I find the evidence clear, cogent and compelling.

[66] For these reasons, I conclude that Rowan and Watt Carmichael provided responses to the IDA's request for information as to the identity of the beneficiaries of the Congor and Conset Trusts which they knew or ought to have known were misleading or untrue or did not state facts that were required to be stated to make their statements not misleading.

C. Did Rowan mislead the Commission?

i) Introduction

[67] Further, based on the evidentiary record viewed as a whole, I conclude that Rowan misled the Commission when he was interviewed by Staff in February 2005.

[68] Staff alleges that contrary to the public interest Rowan made statements to Staff as to the identity of the beneficiaries of the Conset Trust which he knew or ought to have known were misleading or untrue or did not state facts that were required to be stated to make his statements not misleading.

[69] For convenience, Staff's questions and Rowan's answers are repeated here:

> Q. Who is the beneficial owner of Conset Investments?
>
> A. My understanding is there are a number of beneficiaries of the trust. I don't have a list of the beneficiaries.
>
> Q. Who would have that?
>
> A. The trustees would certainly have that.
>
> Q. What is your understanding as to who the beneficiaries are?
>
> A. I don't know who the beneficiaries are. My understanding is it's a number of individuals, and I don't know who any of the beneficiaries specifically are.

[70] In concluding that Rowan's answers were misleading, I rely on the evidence we received about the IDA Review, Rowan's trading in the Trust Accounts in 2002, 2003 and 2004, and the Commission's enquiries in 2004.

ii) The IDA Review

[71] For the reasons given above, I conclude that when Watt Carmichael provided the IDA with the Final Levander Letter on August 10, 2000, Rowan had received the Fong Faxes, or was aware of their contents, knew of Melnyk's beneficial interest in the Trust Accounts, understood the significance of the Final Levander Letter and was directly or indirectly involved in its revised wording.

[72] Given the significance of the IDA review and the ensuing correspondence, and given the importance of Melnyk's business to Rowan and Watt Carmichael, I do not accept that the matter would have been forgotten by February 2005.

iii) Trading in the Trust Accounts in 2002, 2003 and 2004

[73] Once the IDA advised Watt Carmichael that its concerns had been satisfied on August 14, 2000, the trading suspension was lifted and Rowan resumed trading as registered representative in the Conset, Congor and Southridge Accounts. The evidence, including evidence about Watt Carmichael's commissions from the Trust Accounts, indicates Rowan traded heavily in the Trust Accounts at least until early 2004.

[74] Moreover, in late 2004, Rowan attempted to obtain a letter from R&H stating that the Southridge trustees had given him full discretionary trading authority from 1996, when the Account was opened. Finally, on December 22, 2004, R&H advised that "no further trading is permitted on our account without our express written authorization." As requested by the trustees, Rowan confirmed by return fax that he had received the letter and would comply. This exchange of correspondence occurred less than two months before Rowan was interviewed by Commission Staff.

[75] Though my colleagues refer to a five-year gap between the end of the IDA Review and Rowan's interview at the Commission in February 2005, I conclude these were matters of current interest to Rowan throughout the intervening period.

[76] Moreover, Rowan would have known of the Commission's enquiries long before he was interviewed.

[77] The IDA letter, dated August 14, 2000, from Dimitropoulos to Watt Carmichael, advised that the Final Levander Letter, along with McKenney's August 10, 2000 letter, had been forwarded to the Commission.

iv) The Commission Enquiries in 2004

[78] By February 2005, when Rowan was interviewed, the Commission had been making active enquiries for about a year. On March 31, 2004, the Commission issued an Order under

section 19(3) of the Act requiring Watt Carmichael to produce a number of documents, including the "identity of the persons who have a direct or indirect interest" in the Congor and Conset Accounts. The Order was extended by Order of April 13, 2004. On April 23, 2004, Schleyer forwarded a letter from Coutts to Rowan, dated April 14, 2004, with respect to Congor, and a letter from Caledonian to Rowan, dated April 19, 2004, with respect to Conset. Neither Coutts nor Caledonian provided the information, both relying on Cayman secrecy laws, and Watt Carmichael's covering letter added nothing further. On July 8, 2004, the Commission issued another section 19(3) Order, this time for all copies of e-mail sent or received by Rowan in relation to Congor, Conset, Melnyk, Biovail and Archer. As the President and COO of Watt Carmichael and the registered representative on the Congor and Conset Accounts, Rowan would have been involved in responding to these requests. Staff's questions in February 2005 would not have been a surprise for Rowan.

(v) Conclusion

[79] It is crucial to the securities regulatory system that registrants provide full and accurate responses to inquiries from the regulator. As stated by the Ontario Court of Appeal in *Wilder*:

> The [Commission] is charged with the statutory obligation to do its best to ensure that those involved in the securities industry provide fair and accurate information so that public confidence in the integrity of the capital markets is maintained. It is difficult to imagine anything that could be more important to protecting the integrity of capital markets than ensuring that those involved in those markets, whether as direct participants or as advisers, provide full and accurate information to the [Commission].
>
> (*Wilder et al. v. Ontario Securities Commission* (2001), 53 O.R. (3d) 519 (C.A.) at para. 22)

[80] I find that Rowan's answers to Staff's questions about the beneficiaries of the Conset Trust were evasive and incomplete. Even if Rowan had not been aware of the Fong Faxes providing the Conset and Congor Letters, there is no dispute that he was aware of the Stewart Letters, the Draft Levander Letter and the Final Levander Letter. He was also aware that Melnyk was the settlor of the Trusts, that Melnyk donated Biovail stock (19 percent of the outstanding shares of Biovail in 1996 when he established the Trusts), and that the Trusts were offshore. He was also aware of the Trustees' reliance on Cayman secrecy laws, the numerous significant funds transfers he executed from the Trust Accounts to Melnyk-related accounts, and the fact that both Watt Carmichael and NBCN treated the Trust Accounts as one for margin and concentration purposes. From this, I conclude that Rowan should have known that Melnyk was one of the beneficiaries of the Conset and Congor Trusts.

[81] Rowan's answers to Staff's questions were misleading and incomplete, and fell far short of what is expected of a registrant and the President and COO of a registrant. I conclude that Rowan made statements to Staff as to the identity of the beneficiaries of the Conset and Congor Trusts which he knew or ought to have known were misleading or untrue or did not state facts

that were required to be stated to make his statements not misleading, contrary to the public interest.

D. Did Rowan conduct unauthorized discretionary trading in the Southridge Account?

[82] Staff alleges that Rowan engaged in discretionary trading without authority, contrary to the Know Your Client rule and contrary to the public interest.

[83] I concur with my colleagues that the Southridge Account was not opened and documented as a discretionary account, and that on a number of occasions the Southridge trustees complained to Rowan about unauthorized trading or reiterated that the account was non-discretionary and therefore all transactions must be approved in advance. I also concur that the lack of documented discretionary authority did not result from administrative oversight, as claimed by Rowan.

[84] In my view, there was evidence that Rowan was also trading in the Southridge Account on Melnyk's instructions, in addition to instructions from the account holders, the Trustees of the Southridge Trust. Further, the evidence, viewed in its totality, suggests that the Biovail securities in the Conset, Congor and Southridge Accounts may have formed part of a control position held by Melnyk. Biovail's Management Information Circulars for 2000, 2001, 2002, 2003 and 2004 show that Melnyk beneficially owned, directly or indirectly, or exercised control or direction over 19.6 percent, 18.8 percent, 16.7 percent, 16.5 percent and 14.5 percent (respectively) of the total outstanding common shares of Biovail. As we heard in the evidence, this excluded the Biovail shares held in the Trust Accounts.

[85] I find it significant that Melnyk was the settlor and a beneficiary of the Southridge Trust. Indeed, there was undisputed evidence that NBCN and Watt Carmichael treated all three Trust Accounts as one for margin/concentration purposes. Further, the failure to document Southridge as a discretionary account had significant regulatory implications. Had the IDA known that Rowan was engaging in discretionary trading in the Southridge Account, as well as the Conset and Congor Accounts, it would likely have made further enquiries into whether Melnyk had a controlling interest in Biovail securities held in the Trust Accounts.

[86] Subsection 1.1(2) of OSC Rule 31-505 is subtitled "Recognized Self-Regulatory Organization" and reads as follows:

> A member of the Investment Dealers Association of Canada may comply with a requirement of this part by complying with a Regulation, rule, regulation, policy, procedure, interpretation or practice of the Investment Dealers Association of Canada dealing with the same subject matter as that requirement that has been approved by the Commission and published by the Investment Dealers Association of Canada.

[87] OSC Rule 31-505 sets out a number of rules governing new accounts and supervision, including section 1.5, "Know your Client and Suitability." In my view, ascertaining the scope of trading authority granted by the client is fundamental to the Know your Client rule. In my view,

IDA Regulations 1300.4 and 1300.5 operationalize section 1.5 of OSC Rule 31-505 at self-regulatory organization and Member level, pursuant to 1.1(2) of OSC Rule 31-505.

[88] Whatever "mixed messages" Rowan may have received from various representatives of the trustees, it was his obligation under Ontario securities law to ensure his trading was authorized by the Trustees of the Southridge Trust. In addition, ensuring a client's instructions and authority, including proper documentation, is amongst a registrant's most fundamental obligations and critical to the integrity of the capital markets. Ontario securities law places the burden of compliance on the registrant, not the investor.

[89] As a registrant and a senior officer of a registrant, Rowan is expected to be aware of his obligations under Ontario securities law, including OSC Rules and IDA Regulations, by which he is bound. I conclude that by engaging in discretionary trading in the Southridge Account without the required discretionary authority from the account holder (Southridge Trust), he acted contrary to the public interest.

Dated at Toronto, this 20th day of June, 2008.

"Suresh Thakrar"

_____

Suresh Thakrar, FICB, ICD.D