

# FOCUS

ON

## Administrative Law



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Eugene Melnyk speaks at a Biovail annual and special meeting of shareholders in Toronto in 2007. Melnyk was CEO of Biovail at the time.

## Exploring the limits of public interest

### Ontario Securities Commission finds Biovail CEO allowed the issuance of misleading information

TOM CURRY AND KATE MORRIS

A panel of the Ontario Securities Commission (OSC) recently released its decision in the long-running *Biovail* legal drama. The ruling concludes that Eugene Melnyk, former CEO of Biovail Corp., did not contravene s. 122 of the Ontario *Securities Act* by issuing a misleading press release, but that he did act "contrary to the public interest" in allowing misleading information to be issued. The OSC had accused Melnyk and three other former executives of misleading investors about Biovail's earnings, but as the company and other employees had previously reached settlements with the commission, Melnyk was the sole remaining respondent.

The allegations against Melnyk in *Biovail Corp. (Re)*, (2010), 33 OSCB 8914, arose from an Oct. 1, 2003 multi-vehicle accident involving a Biovail truck which was transporting the popular anti-depressant drug Wellebutrin XL from Biovail's manufacturing facility in Mani-

toba to North Carolina for sale by GlaxoSmith-Kline (GSK). In the months preceding the accident, it had become clear to Biovail executives that their earnings would not meet the U.S.\$260 to \$300 million forecast for the third quarter of 2003.

Seeing the accident as an opportunity to explain the shortfall, executives at Biovail blamed the incident for millions of dollars in lost revenue, issuing public statements about its earnings forecast immediately after the accident in two news releases, a conference call with analysts and at investor presentations throughout October 2003. The statements inflated the financial impact of the accident by U.S.\$5 to \$15 million.

The commission alleged that these statements were misleading or untrue "in a material respect," contravening s. 122(1)(b) or alternatively s. 122(1)(a) of the Act. As the Act does not define "in material respect," the commission used the "reasonable investor standard" as the test for materiality, namely whether there is a substantial likelihood that a reasonable

investor would consider the statement to be important in making an investment decision.

The panel noted that this was a relative concept which varies with the size and nature of the issuer, the nature of the information, the volatility of the company's securities and prevailing market conditions. Applying the test, the commission determined that the statements attributing the anticipated shortfall to the accident and inflating the financial loss were misleading or untrue in a material respect, concluding that a reasonable investor would have considered the statements important in making an investment decision about Biovail's shares.

Despite this, the commission held that Melnyk did not contravene Ontario securities law. The panel determined that subs. 122(1)(b) only specifically applies to documents that are "required to be filed" with regulators. News releases were not among those documents in 2003, although that rule was subsequently amended in March 2004. Second, the releases

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## Biovail

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were not “submitted” to the commission within the meaning of subs. 122(1)(a), as merely filing the documents on the System for Electronic Document Analysis and Retrieval (SEDAR) does not constitute submission.

Nevertheless, the commission made a general finding that Melnyk’s actions were contrary to the public interest, because

he “knew or ought to have known” that the statements made by Biovail were misleading, untrue or omitted facts. The panel reluctantly accepted that Melnyk may not have known the details of the delivery agreement between Biovail and GSK, the terms of which caused the shipment to be irrelevant for third-quarter financial results, writing that “[W]hile we are sceptical of Melnyk’s testimony in this respect, we are prepared to give

him the benefit of the doubt.”

However, the panel emphasized Melnyk’s status within the company at the relevant time, concluding that he “had a heavy responsibility as Chairman and CEO to ensure that Biovail did not make inaccurate, misleading or untrue public statements.”

The commission strongly dismissed Melnyk’s submission that it was not authorized to apply the “public interest” criteria on the grounds that it was

not established that Melnyk had engaged in “abusive or egregious conduct” — considered a requirement in cases where neither the *Securities Act* nor the regulations have been violated. Where market conduct engages the animating principles of the Act, the panel ruled, the commission does not need to conclude that an abuse has occurred in order to exercise its public interest jurisdiction. The commission held that there is an

essential public interest in ensuring that all public statements made by reporting issuers and others are accurate and can be relied on by investors in making investment decisions, emphasizing that a “sound disclosure system is one of the underpinnings of the securities regulatory system.”

This ruling is likely to fuel the long-running debate on how the commission applies its public interest jurisdiction when no specific breach of securities laws is established. Indeed, on Nov. 3, Melnyk released a statement that he is appealing the decision on the grounds that the panel “failed to apply a long line of consistent authority in Commission proceedings dating back at least three decades” and that it can “only exercise its public interest jurisdiction against a Respondent if that Respondent has engaged in conduct that is abusive of the capital markets.”

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*Biovail* goes to the heart of the question of the true intent of self-regulation: is it professional benefit or public protection? By reaffirming the rationale behind its existence in *Biovail*, the OSC has tried to position itself within an acceptable range of self-government justified as a safeguard of the public interest. The question on appeal will be whether in so doing, the OSC has failed to recognize the individual rights at stake and the equal need for their protection. ■

Tom Curry joined Lenczner Slaght LLP in Toronto as a partner in October 2002, after practising in the litigation section of another firm since 1986. He has a proven record of success in commercial litigation, class actions, arbitrations, business disputes and administrative law. Kate Morris is a Harold Fox Scholar at Lenczner Slaght LLP. She completed her Graduate Diploma in Law and Bar Vocational Course at BPP Law School (London) in 2010 and is now a member of Middle Temple.

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