Goodmans LLP Update

Corporate Securities Law

October 8, 2010

OSC Releases Decision in Melnyk Case

On September 30, 2010, the Ontario Securities Commission released its decision in the case against Eugene Melnyk, the founder and former Chairman and Chief Executive Officer of Biovail Corporation. OSC Staff had alleged that:

- statements made by Biovail regarding the financial implications of an in-transit loss of a valuable shipment of pharmaceuticals were, in a material respect and at the time and in the light of the circumstances under which they were made, misleading or untrue,
- Mr. Melnyk had authorized, permitted or acquiesced in Biovail's alleged misstatements, and
- Mr. Melnyk had thereby violated Ontario securities law and engaged in conduct contrary to the public interest.

A three-member panel of the OSC concluded that although Mr. Melnyk had not contravened Ontario securities law, his conduct was contrary to the public interest.

Background

On September 30, 2003, three trucks left Biovail's manufacturing facility in Manitoba carrying a substantial amount of Wellbutrin XL, an anti-depressant drug manufactured by Biovail for delivery to a customer in North Carolina. The following afternoon, one of the trucks was involved in an accident outside Chicago, resulting in the damage to a portion of the truck's shipment.

Two days later, Biovail issued a press release announcing that preliminary results for its third quarter indicated that revenues for the quarter would be below previously-issued guidance and that the loss of revenue and income associated with the loss of the Wellbutrin shipment had contributed significantly to this unfavourable variance. Bioval estimated that the revenue associated with the shipment was in the range of $10 to $20 million. The OSC panel determined that the statements were misleading and untrue, that Biovail repeated these statements in subsequent press releases and analysts' calls and that Biovail failed to clarify the statements in subsequent disclosures. Biovail eventually reported in March 2004 that the actual revenue loss from the accident was $5.0 million, though it did not make clear that the accident affected its fourth quarter results and not those of its third quarter.

In its decision, the panel concluded that:

- there was a substantial likelihood that a reasonable investor would have considered these statements, taken together, important in making an investment decision with respect to Biovail's shares,
- Mr. Melnyk knew or should have known by the time the second press release referencing the accident (issued five days after the initial release) was issued:

  - that any revenue attributed to the Wellbutrin shipment was properly attributable to the fourth quarter under the contract governing the shipment and the accident could not have impacted Biovail's third quarter financial results, and

  - that the $10 to $20 million estimate of the revenue associated with the shipment was misleading or untrue, and

- Mr. Melnyk knew or should have known that Biovail's statements were, in a material respect and at the time and in the light of the circumstances under which the statement was made, misleading or untrue.

Notwithstanding this finding, the panel concluded that Mr. Melnyk did not contravene Ontario securities law as the press release in which the materially misleading or untrue statements were repeated was not, at that time, required to be filed under Ontario securities law (which is an essential element of liability under Section 122(1) of the Ontario *Securities Act*).[1] Nonetheless, the panel exercised the Commission's public interest juris-

[1] National Instrument 51-102 has since been amended to require that reporting issuers file a copy of any news release issued by it that discloses information regarding its historical or prospective results of operations or financial condition for a financial year or interim period. That section came into effect on March 31, 2004, after the events that gave rise to the Melnyk proceeding, and therefore had no application in that proceeding.

diction under Section 127 of the *Securities Act* to find that Mr. Melnyk's conduct was contrary to the public interest.

"*...in a material respect*" – the Reasonable Investor Standard

Under Section 122(1) of the *Securities Act*, a statement in a document required to be filed or furnished must be misleading or untrue in a material respect in order for it to contravene securities laws. The *Melnyk* decision is noteworthy for the statement by the OSC that the appropriate standard of materiality for a document, such as a press release, that is a disclosure document intended to be relied upon by investors in making investment decisions is the "reasonable investor" standard. Under this standard, a statement would be material if there is a substantial likelihood that a reasonable investor would consider it to be important in making an investment decision. The Commission cautioned that its adoption of this standard in the *Melnyk* matter should not be interpreted as suggesting that the reasonable investor standard is the only appropriate standard of materiality for purposes of Section 122(1). The circumstances in which the words "in a material respect" apply will vary and those circumstances may require a different standard of materiality.

Interestingly, the adoption of the reasonable investor standard could be interpreted to result in a lower threshold for quasi-criminal liability under Section 122(1) of the *Securities Act* [2] than for civil liability under Part XXIII (addressing prospectuses, etc.) or Part XXIII.1 (addressing secondary market disclosure). For a statement to attract civil liability, it must relate to a fact that would reasonably be expected to have a significant effect on the market price of an issuer's securities. By contrast, for a statement to fall under the scope of Section 122(1) and potentially result in a person being subject to a fine, imprisonment or both the statement need only be important to an investor in making an investment decision (which does not necessarily mean that it should reasonably be expected to have a significant impact on market price).

Disclosure and Public Interest Jurisdiction

The OSC's decision in the *Melnyk* case also illustrates the breadth of its interpretation of its public interest jurisdiction under Section 127 of the *Securities Act*. The panel cautioned that there should be no doubt in the minds of market participants that the Commission is entitled to exercise its public interest jurisdiction where any inaccurate, misleading or untrue public statement is made, whether or not that statement contravenes Ontario securities law.

The *Melnyk* decision affirms the Commission's view that:

- there is a public interest in ensuring that all public statements made by reporting issuers and others are accurate and not misleading or untrue and can be relied upon by investors in making investment decisions,
- there must be a reasonable basis for any forward-looking information or estimate and, if there is significant uncertainty with respect to a statement, that uncertainty should be specifically disclosed and discussed,
- the inclusion in a press release of a general "safe harbour" warning that any forward-looking information contained in such release is subject to risks and uncertainties will not protect a statement in the press release from allegations that it was misleading or untrue in a material respect, and
- more is expected of officers and directors with superior qualifications, such as experienced business people, and more is expected of inside directors who have much greater involvement in corporate decision-making and much greater direct access to corporate information.

Please contact any member of Goodmans' Corporate Securities Group to discuss this decision.

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[2] A breach of Section 122(1) of the Act is punishable by a fine of up to $5 million and/or a prison term of up to five years less a day