3.1.2 Biovail Corporation et al.

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

AND

IN THE MATTER OF
BIOVAIL CORPORATION, EUGENE N. MELYK,
BRIAN H. CROMBIE, JOHN R. MISZUK AND
KENNETH G. HOWLING

HEARING HELD PURSUANT TO SECTIONS 127 and 127.1 OF THE ACT

SETTLEMENT HEARING RE: BIOVAIL CORPORATION

HEARING:	Friday, January 9, 2009		
PANEL:	Suresh Thakrar	–	Commissioner and Chair of the Panel
	Paul K. Bates	–	Commissioner
	Margot C. Howard	–	Commissioner
APPEARANCES:	Johanna Superina Alexandra Clark Caitlin Sainsbury	–	for Staff of the Ontario Securities Commission
	Larry Lowenstein Alex Cobb	–	for Biovail Corporation

ORAL RULING AND REASONS

The following text has been prepared for the purpose of publication in the Ontario Securities Commission Bulletin and is based on excerpts of the transcript of the hearing. The excerpts have been edited and supplemented and the text has been approved by the Chair of the Panel for the purpose of providing a public record of the decision.

Chair:

[1] This was a hearing under sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended, (the "Act") for the Ontario Securities Commission (the "Commission") to consider whether it is in the public interest to approve a proposed Settlement Agreement between Staff of the Commission ("Staff") and the respondent Biovail Corporation ("Biovail"). Biovail is a reporting issuer in the province of Ontario and is Canada's largest publicly traded pharmaceutical company. The common shares of Biovail are listed and posted for trading on the Toronto Stock Exchange and the New York Stock Exchange.

[2] We, as a panel, have decided to approve the Settlement Agreement as being in the public interest. These are our oral reasons in this matter which will be published in the Bulletin.

[3] The facts and circumstances agreed to by Staff and Biovail are set out in the Settlement Agreement. These facts are not findings of fact by this Panel, rather, they are facts agreed to by Staff and Biovail for purposes of this settlement. In approving the Settlement Agreement, we relied solely on the facts set out in that agreement and those facts represented to us at today's hearing (see: *Re Rankin* (2008), 31 O.S.C.B. 3303 at para. 5).

[4] The conduct at issue involves inaccurate and false public disclosure that had a material impact on Biovail's financial statements for the relevant periods.

[5] As a reporting issuer in Ontario, Biovail has continuous disclosure obligations pursuant to Part XVIII of the Act. Sections 77 and 78 of the Act and related provisions in the Regulations direct that all financial statements filed with the Commission must be prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). Moreover, all financial statements and other material filed with the Commission must not be misleading or untrue or omit a fact which would render them misleading.

[6] Specifically, this settlement hearing is concerned with conduct relating to Biovail's annual financial statements for the fiscal year ended December 31, 2001, interim financial statements for Q3 of 2001, Q1, Q2 and Q3 of 2002, and Q1, Q2 and Q3

of 2003, as well as the conduct concerning Biovail's disclosure during that time and the provision of misleading information to Staff.

[7] As set out in the Settlement Agreement at paragraph 13:

> Biovail filed with the Commission during the Material Time financial statements that, while represented to be prepared in accordance with Canadian GAAP, were, to the extent described herein, not prepared in accordance with Canadian GAAP and therefore such filings were contrary to sections 77 and 78 of the Act. Further, Biovail's representations that the financial statements had been prepared in accordance with Canadian GAAP were, to the extent described below, materially inaccurate, contrary to Ontario securities law and the public interest.

[8] The conduct of Biovail in the Settlement Agreement falls into five general categories, the following is a brief description of these categories.

[9] The first category relates to Biovail's failure to disclose the establishment of and arrangements with Pharmaceutical Technologies Corporation ("PTC"), a research and development vehicle, and this failure was in public disclosure documents filed with the Commission, including Annual Information Forms and an annual and interim Management Discussion & Analysis, Shelf Prospectus and two Prospectus Supplements.

[10] To summarize, as discussed in paragraphs 15 to 27 of the Settlement Agreement, the transfer of the development of some products and the related development expenses from Biovail to PTC was an event that was reasonably expected to have a material effect on Biovail's business, financial condition and/or results of operations and was therefore a material fact.

[11] Biovail failed to disclose in its public disclosure during the relevant period the existence of PTC and the nature and substance of Biovail's arrangements with PTC. In so doing, Biovail violated the requirements of Ontario securities law and acted in a manner contrary to the public interest.

[12] The second category of conduct relates to the Biovail's improper recognition in its interim financial statements for Q2 of 2003 of revenue relating to a sale of a drug called Wellbutrin XL (see paragraphs 30 to 53 of the Settlement Agreement).

[13] Biovail did not meet its required reporting obligations. For example, the Q2 2003 Press Release, Q2 2003 Analyst Call and the Q2 2003 Financial Statements included in Biovail's revenue for the quarter approximately U.S. $8 million relating to a sale of Wellbutrin XL tablets to GlaxoSmithKline that was purportedly carried out on a "bill and hold" basis. Inclusion of this amount in the revenue for the quarter increased Biovail's operating income by approximately U.S. $4.4 million.

[14] The transaction did not meet all of the revenue recognition requirements under Canadian GAAP for a "bill and hold" arrangement. Accordingly, the inclusion of the revenue in Q2 2003 was improper.

[15] Also, when Biovail was questioned by its auditors about the sale of the Wellbutrin tablets, Biovail did not inform its auditors at the time that the sale was conducted on a "bill and hold" basis. However, such information should have been disclosed because "bill and hold" transactions must meet very specific accounting requirements.

[16] Canadian GAAP provides that in most cases, revenue should not be recognized until delivery has occurred. Delivery is generally not considered to have occurred unless the product has been delivered to the customer's place of business or to another site specified by the customer.

[17] Accordingly, Biovail should not have recognized revenue in its Q2 2003 Financial Statements from the sale of Wellbutrin XL pills pursuant to the purported "bill and hold" arrangement. Further, in its Q2 2003 Press Release and Q2 2003 Analyst Call, Biovail disseminated the financial results, which incorporated this improperly recognized revenue. Both of these activities on the part of Biovail's conduct were a violation of securities law and were contrary to the public interest.

[18] The third category of conduct relates to Biovail's failure to correct and disclose, on a timely basis, a material error in its 2003 financial statement (see paragraphs 54 to 60 of the Settlement Agreement). Biovail failed to account properly for an obligation denominated in Canadian dollars in its Q1, Q2 and Q3 2003 Financial Statements.

[19] Canadian GAAP requires that any outstanding balance of a foreign currency denominated obligation that is a monetary item be revalued using the current exchange rates at each balance sheet date. However, Biovail used the December 31, 2002 exchange rate for its 2003 Q1, Q2 and Q3 interim financial statements, and therefore the statements for these three quarters did not accurately reflect any unrealized exchange losses or gains and the outstanding balance of its obligations. This resulted in a material effect on the reported income. Biovail's net income was overstated by U.S. $5.4 million for Q1 2003, $3.9 million for Q2 2003, and it was understated by $3.1 million for Q3 2003.

[20] In early July 2003, the error in the exchange rates was raised with Biovail by its subsidiary BLI. Biovail represents that no immediate steps were taken to analyze the issue and confirm whether the appropriate accounting treatment was being used. Biovail's conduct in this regard was contrary to Ontario securities law and the public interest.

[21] The fourth category of conduct relates to Biovail's dissemination of incorrect statements in four press releases issued in October 2003 and March 2004, as well as in an analyst conference call held on October 3, 2003, and also in a series of investor meetings held in October 2003. Biovail made statements that, in a material respect, inaccurately disclosed the implications, for Biovail, of a truck accident that occurred on October 1, 2003 (see paragraphs 61 to 82 of the Settlement Agreement).

[22] These press releases concerned Biovail's disclosure that its preliminary financial results for its third quarter of 2003 would be below previously issued guidance.

[23] In the October 3, 2003 Press Release, Biovail made the claim that a truck accident was one of the reasons for Biovail's failure to meet previously issued revenue guidance for the quarter. Also, as mentioned earlier, Biovail disseminated information in its statement that the revenue associated with the Wellbutrin XL shipment was in the range of U.S. $10 million to U.S. $20 million. Biovail repeated, or implicitly reinforced these claims during the October 3, 2003 Analyst Call, and in statements made in the October 8, 2003 Press Release, the October 30, 2003 Press Release, the March 3, 2004 Press Release and the various investor meetings.

[24] Regardless of the truck accident, Biovail, under Canadian GAAP, would not have been able to recognize the associated revenue until its fourth quarter. Further, Biovail's statement that the value of the Wellbutrin XL shipment was U.S. $10 million to U.S. $20 million was materially in error. Biovail later stated in a March 3, 2004 press release that the "actual revenue loss" from the shipment on the truck was U.S. $5 million.

[25] The October 8 and October 30, 2003 Press Releases, and the March 3, 2004 Press Release continued to disseminate the prior information provided by Biovail in its original October 3, 2003 Press Release and Biovail failed to correct the incorrect information previously provided to the investing public.

[26] Biovail should have taken greater care, from the outset, to accurately assess the revenue associated with the product on the truck, and to accurately assess whether, but for the accident, it would have been able to recognize revenue from the sale of the product on the truck in Q3. Upon learning the true state of affairs, Biovail should have clearly disclosed, at the earliest opportunity, that the truck accident was a Q4 issue.

[27] Biovail should have clearly disclosed, at the earliest opportunity, that the statements suggesting the truck accident was one of the reasons for the Q3 earnings missing the guidance and that the revenue associated with the product in the truck was $10 to $20 million, were incorrect. By failing to do so, Biovail violated Ontario securities law and engaged in conduct contrary to the public interest.

[28] The final category of conduct relates to Biovail's provision of materially inaccurate information to Staff during a continuous disclosure review conducted in 2003 and 2004 with respect to several issues, including the formation of PTC.

[29] A letter to Staff from Biovail dated January 28, 2003 contained the following statement: "[n]one of Biovail, nor any of its affiliates, directors or officers were involved in the formation of [PTC]". This statement was materially inaccurate. By making this statement, Biovail violated Ontario securities law and engaged in conduct contrary to the public interest.

[30] These five categories of conduct just discussed form the crux of the facts agreed to between Staff and Biovail and form the basis of Biovail's Settlement Agreement with Staff.

[31] By entering into the Settlement Agreement, Biovail has recognized that its conduct was contrary to the public interest, and we find that it is appropriate to impose sanctions including a reprimand, a substantial administrative penalty, a substantial payment of costs and the retention of a consultant by Biovail to report on Biovail's training of its personnel concerning compliance with the financial and other reporting requirements of Ontario securities law.

[32] The Commission's mandate in upholding the purposes of the Act, as set of in section 1.1 of the Act, is:

(a) to provide protection to investors from unfair, improper or fraudulent practices; and

(b) to foster fair and efficient capital markets and confidence in the capital markets.

[33] In pursuing the purposes of the Act, section 2.1 provides that the Commission shall have regard to certain fundamental principles. Relevant to this case, paragraph 2 states that the primary means for achieving the purposes of the 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.

[34] These requirements articulated in section 2.1 dealing with the timely, accurate and efficient disclosure of information form the cornerstone principle of securities regulation (*Re Phillip Services Corp.* (2006), 29 O.S.C.B. 3971). Sections 77 and 78 of the Act reflect this. The Act's focus on public disclosure of information is meaningless without a requirement that such disclosure be accurate and complete and accessible to investors. Pursuant to these important disclosure requirements under the Act, Biovail was required to disclose, among other things, any event occurring during the reporting period that was reasonably expected to have material effect on Biovail's business, financial condition or results of its operations.

[35] It is clear from the facts in the Settlement Agreement that Biovail's filings during the material period were problematic and contained falsehoods. Biovail acknowledged in the Settlement Agreement that it failed to disclose in its public disclosures the establishment of and nature of its arrangements with PTC and disseminated incorrect statements in certain press releases in October 2003 and March 2004, in an analyst conference call held on October 3, 2003 and investor meetings held in October 2003 relating to a truck accident.

[36] Biovail also admits in the Settlement Agreement that it provided certain misleading information to Staff during a continuous disclosure review conducted in 2003 and 2004.

[37] By entering into the Settlement Agreement, Biovail has recognized the seriousness of this misconduct relating to disclosure practices. It is a recognition that this is a serious violation of securities law, and it undermines the primary goals of the Commission to achieve investor protection and fostering of fair and efficient capital markets. Disclosing false information into the marketplace sends the wrong signal to investors and misleads the market as a whole and this endangers the efficiency of the capital markets and damages investor confidence.

[38] Before stating our order, we would first like to briefly refer to the law as it applies to the consideration of settlement agreements before the Commission.

[39] With respect to sanctions, we are guided by the sanctioning factors listed in *Re M.C.J.C. Holding and Michael Cowpland* (2002), 25 O.S.C.B. 1133 and *Re Belteco Holdings Inc.* (1998), 21 O.S.C.B. 7743, which were referred to us by Staff in their submissions. In doing this, the Commission takes into account circumstances that are appropriate to the particular respondents. This requires us to be satisfied that the proposed sanctions are proportionately appropriate with respect to the circumstances facing the particular respondent. (*Re M.C.J.C. Holdings and Michael Cowpland* (2002), O.S.C.B. 1133 at 1134.)

[40] With respect to reviewing the Settlement Agreement, as established in *Re Sohan Singh Koonar et al.* (2002), 25 O.S.C.B. 2691, the role of the Commission Panel in reviewing a settlement agreement is not to substitute its own sanctions for what is proposed in the settlement agreement. The Commission should ensure that the agreed sanctions in the settlement agreement are within acceptable parameters. Specifically, the Commission's role is to decide whether to approve the Settlement Agreement, as a whole, on the terms presented to us (see: *Re Melnyk* (2007), 30 O.S.C.B. 5232 at para. 15).

[41] In addition, consideration should be given to the agreement reached between adversarial parties, as a balancing of factors and interests, which would have taken place between Staff and Biovail in reaching this Settlement Agreement.

[42] This is what we as a Panel have done in approving this Settlement Agreement. Considering the respondent's position as stated in the Settlement Agreement, we are of the view that the sanctions set out in the Settlement Agreement are within the acceptable parameters.

[43] We also took into account the following mitigating factors:

1. the avoidance of additional costs and expenses associated with proceeding with a contested hearing in respect of Biovail;

2. Biovail's agreement to retain a consultant to report on Biovail's training of its personnel concerning compliance with the financial and other reporting requirements of Ontario securities law; and

3. Biovail's cooperation with respect to the ongoing proceeding.

[44] By entering into the Settlement Agreement, Biovail has recognized and concedes that errors were made that its conduct was contrary to the public interest.

[45] In moving forward, Biovail has recognized it must deal fairly with the past. We also take comfort in the submissions this morning that Biovail has new executive and senior management and specifically hired appropriately qualified senior management staff. We also were informed that Biovail has substantially strengthened and renewed its corporate governance

oversight. In this regard in the past year, it almost totally reviewed and renewed its board and audit committee memberships. The company has affirmed it has and will continue to develop and maintain an appropriate and robust reporting and compliance infrastructure.

[46] We therefore find it appropriate to order that:

1. the Settlement Agreement is approved;

2. Biovail is reprimanded;

3. Biovail shall pay an administrative penalty of CAN$5,000,000.00 to be paid to or for the benefit of third parties designated by the Commission, pursuant to section 3.4(2) of the Act;

4. Biovail shall pay CAN$1,500,000.00 in respect of a portion of the costs of the investigation and hearing in relation to his matter;

5. Pursuant to a Consent Final Judgment entered in the United States District Court for the Southern District of New York in *Securities and Exchange Commissions v. Biovail Corporation, et al.*, dated March 18, 2008, Biovail has retained a consultant (the "Consultant") to conduct a comprehensive examination and review of Biovail's internal accounting controls, policies and procedures, training, ethics and compliance policies and procedures and other matters (the "Review"). The terms of reference for the Consultant are attached to the Settlement Agreement as Schedule "C". The Consultant is required to provide reports from time to time to Biovail's board of directors, audit committee and the United States Securities and Exchange Commission. Biovail will provide Staff with copies of any such reports;

6. Biovail shall retain a further consultant acceptable to Staff (the "Ontario Consultant") to examine and report on Biovail's training of its personnel concerning compliance with the financial and other reporting requirements of Ontario securities law (the "Ontario Review"). In conducting the Ontario Review, the Ontario Consultant shall consider the investigations carried out by, and the reports prepared by, the Consultant pursuant to the Review, and may conduct such further investigations as are reasonably necessary. The terms of reference for the Ontario Review are attached to the Settlement Agreement as Schedule "D"; and

7. Biovail shall use its best efforts to ensure that individuals who are current or former Biovail employees, and whom Staff wishes to interview, or call to testify at the hearing in this proceeding, are made available as Staff may reasonably require. Biovail shall use its best efforts to provide such additional documentation as Staff may reasonably require for the purposes of this proceeding.

[47] In conclusion, we find that together, all the sanctions imposed in this matter provide adequate specific and general deterrence, which the Supreme Court has established is an important regulatory objective for securities commissions (*Re Cartaway Resources Corp.*, [2004] 1 S.C.R. 672).

[48] Biovail is a prominent and widely-held reporting issuer and is Canada's largest publicly traded pharmaceutical company, and in our view, the administrative penalty, combined with the scope of the remediation undertaking engaged in at Biovail has an impact on Biovail, both reputational and financial, and sends a message of deterrence to both Biovail and the marketplace.

[49] The public reprimand provides strong censure of Biovail's past conduct.

[50] In our view, the imposition of an administrative penalty in the amount of CAN$5,000,000.00 is appropriate. We note that the administrative penalty is a relatively new power of the Commission that came into force in 2003, and we do not have many precedents. In this matter of Biovail there are multiple breaches of the Act, including misrepresentations made to Staff. The imposition of an administrative penalty of this magnitude sends a message that:

> [t]he purpose of an administrative penalty is to deter the particular respondents from engaging in the same or similar conduct in the future and [sends] a clear deterrent message to other market participants that the conduct in question will not be tolerated in Ontario capital markets. (*Re Limelight Entertainment Inc.* (2008), 31 OSCB 12030 at para. 67)

[51] The substantial amount of CAN$1,500,000.00 ordered in costs will also enable the Commission to recover a substantial portion of its costs conducting the investigation and the hearing in this matter, and as a result ensures that the costs will not be borne by other participants in the marketplace.

[52] Further, the sanctions require Biovail to hire a consultant to assist with the company's continued remediation efforts. Therefore, it takes into account Biovail's commitment to identify and remedy its previous wrongdoings. This will also ensure that Biovail will have in place the appropriate policies and procedures to meet its continuing disclosure obligations and best practices.

[53] Therefore, we approve the Settlement Agreement as being in the public interest.

Approved by the Chair of the Panel on January 26, 2009.

"Suresh Thakrar"