

**WHEN THE OSC COMES KNOCKING:  
ONTARIO SECURITIES COMMISSION  
ENFORCEMENT PROCEEDINGS**

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**Ontario Bar Association  
Everything You Always Wanted to Know About Securities Law  
But Were Afraid to Ask**

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**When the OSC Comes Knocking:  
Ontario Securities Commission Enforcement Proceedings**

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**Introduction**

Facing the potential pitfalls of dealing with a regulatory agency can be daunting. It need not be. This paper will provide a general guide for practitioners encountering the enforcement procedures of the Ontario Securities Commission (the “OSC”). We have attempted to cover a broad range of issues that might arise in the enforcement context. However, given the breadth of issues relevant to OSC proceedings, this paper should by no means be considered an exhaustive review. Nevertheless, we hope that it will provide a helpful guide and overview.

**Close Encounters of the First Kind: Advising a Client Pre- and Post-Contact with the OSC**

**(a) Pre-Contact**

Where a client comes to you with an issue they think the OSC might be interested in, but they have not yet been contacted by the OSC, there are a number of matters counsel ought to consider.

Firstly, counsel should advise their client to maintain documentary integrity. For a corporate client, this includes, but is not limited to, sending a document-retention memo to employees. It may also entail curtailing computer server programs which over-write tapes or destroy inactive documentation on a regular cycle. It may also

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be prudent to back-up all information on the server as well as individual employee's hard-drives. It is important to understand the mechanics of all computer and electronic communications in order to properly advise your client. Without this knowledge, one cannot ensure that all angles of document retention have been effectively accounted for and covered off.

Secondly, a client must always be informed that they should not attempt to 'stream-line' or manipulate any evidence. This includes attempting to streamline the evidence of individuals. A corporate client should not make efforts to get employees 'on the same page'. However, speaking to employees to determine their knowledge is most definitely a prudent course of action. It is important to note that employees caught up in this process should not assume that their individual interests will line up with corporate interests and they are well advised to obtain independent legal advice.

Internal investigations, whether formal or informal, are almost always viewed by regulators as proactive and may garner a corporate client favour with the OSC, particularly if the results of the internal investigation are shared. The Investment Dealers Association (the "IDA") requires that a member complete an internal investigation where it appears that the member (or a current or former employee of the member) has violated any legislation or law or any rule, etc. of the IDA, either inside or outside Canada.<sup>3</sup> The member is required to maintain detailed records of the investigation for a minimum of two years for the designated self-regulatory organization ("SRO") to examine. Where the client is a member of the IDA, counsel should bring this policy to their client's attention and ensure that such an investigation is undertaken in conformity with the IDA Policy.

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<sup>3</sup> IDA, Rule Book, online: <[http://www.ida.ca/Files/Regulation/RuleBook/RuleBook\\_en.pdf](http://www.ida.ca/Files/Regulation/RuleBook/RuleBook_en.pdf)>, Policy 8.

Where a client is not a member of the IDA, counsel should still consider the merits and potential scope of an internal investigation. In the context of such an investigation and follow-up, it is important for counsel to be aware of LSUC Rule 2.02 at sections 5, 5.1 and 5.2. It is also important to consider the OSC's allegations against Lawrence Wilder in YBM<sup>4</sup> and Sally Daub in ATI.<sup>5</sup> Discussion of LSUC Rule 2.02 and the Wilder and Daub matters are beyond the scope of this paper, but it is important that counsel be sensitive to their own professional and legal obligations when advising their clients. Any internal investigation also needs to be conducted in full consideration of the fact that any findings if not shared with or disclosed to the OSC, may be viewed as material non-disclosure and/or non-cooperation with the OSC.

YBM is an interesting case to consider in this context.<sup>6</sup> On June 27, 2003, the OSC found that YBM had failed to disclose material facts when it learned, through an internal investigation, that major shareholders and founders of the company were being investigated by U.S. law enforcement authorities for links with organized crime. The OSC also held a number of YBM's directors and officers liable for material non-disclosure.

In its reasons, the OSC found as follows. In January of 1996, the U.S. embassy in Budapest had refused a request to issue return visas to two YBM employees and YBM commenced informal inquiries into the reasons for the refusal. In August

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<sup>4</sup> OSC, Statement of Allegations Re. YBM Magnex International Inc. et al., online: <[http://www.osc.gov.on.ca/Enforcement/Proceedings/1999/soa\\_19991101\\_ybmmagnexinternationalinc.jsp](http://www.osc.gov.on.ca/Enforcement/Proceedings/1999/soa_19991101_ybmmagnexinternationalinc.jsp)> (1 November 1999).

<sup>5</sup> OSC, Statement of Allegations Re. ATI Technologies Inc. et al, online: <[http://www.osc.gov.on.ca/Enforcement/Proceedings/2003/soa\\_20030116\\_ati.jsp](http://www.osc.gov.on.ca/Enforcement/Proceedings/2003/soa_20030116_ati.jsp)> (16 January 2003).

<sup>6</sup> *Re. YBM Magnex International Inc. et al.* (2003), 26 O.S.C.B. 5272.

1996, YBM management learned through its U.S. counsel that the U.S. Attorney's Office was conducting an investigation into the business of the company. Management had also been informed of an article in a Russian newspaper alleging links between YBM and Russian organized crime. In December 1996, management learned of an FBI affidavit suggesting that one of the founding shareholders, as well as certain recipients of commission payments from an affiliated corporation, were founders and leaders of a Russian organized crime group, and that another affiliated corporation was being used to transmit large amounts of money from Moscow to Budapest.

On August 29, 1996, the board of directors of YBM formed a Committee of outside directors to investigate potential links between the company and organized crime. On November 8, 1996, the Committee retained the Fairfax Group, an independent international investigative and security firm, to assist the Committee in ascertaining the facts.

The OSC found that the conclusions of Fairfax, as reported to the Committee, were that, among other things, the founding shareholders of the company were linked to a Russian organized crime syndicate. The OSC also held that Fairfax considered that there were indications of money laundering in the company's Hungarian operations and that there were difficulties associated with tracing certain significant customers and vendors. According to the OSC, Fairfax was also concerned that there was a possible commingling of the business activities of Magnex RT, the offshore sales arm of YBM, and those of some of the founding shareholders.

None of this information was reported to shareholders in a preliminary or final prospectus issued at the material time and none of the company's continuous

disclosure documents contained such disclosure. The OSC found that by not disclosing the results of its internal investigation on a timely basis, YBM had breached its disclosure obligations under the *Ontario Securities Act* (the “OSA”)<sup>7</sup>.

Regardless of whether a corporate client undertakes a formal or informal internal investigation, there are important factual, legal and strategic consequences to be considered. As stated above, an internal investigation may be favourably looked upon by the OSC, but only if its results are shared. The consequences of not sharing the results of an internal investigation may include an OSC allegation of material non-disclosure. Counsel need to consider these issues when assessing how best to advise a corporate client to get to the bottom of a matter.

**(b) Post-Contact**

In situations where the OSC has already contacted your client, the same document-retention and other principles discussed above are equally important and need to be carefully considered.

In addition, one needs to decided how best to communicate with the OSC. Generally, once the OSC contacts an individual or a corporation, they want to talk. The question then becomes whether to have your client speak to the OSC on a voluntary or compelled basis. A voluntary discussion may be construed as cooperation by the OSC, which could be beneficial to your client. However, as there are certain important rights and protections which accompany compelled evidence, counsel should be extremely cautious before agreeing to have voluntary discussions with the OSC. In spite of any overarching desire to be cooperative, voluntary discussions with the OSC should not be

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<sup>7</sup> R.S.O. 1990, c. S-5.

taken lightly. Any statements and/or discussions with a securities regulator may become part of the evidentiary record and, as was the case with Martha Stewart and the U.S. Securities and Exchange Commission (the “SEC”), may in fact form the basis for a separate and distinct allegation if those communications are not truthful, accurate and fulsome. No discussion with the OSC should be undertaken without careful and thoughtful preparation by counsel and the client.

Compelled evidence, and the use thereof, is protected in Ontario under the *Charter of Rights and Freedoms*,<sup>8</sup> the *Ontario Evidence Act*<sup>9</sup> and the common law. Although a full discussion of these protections is beyond the scope of this paper,<sup>10</sup> it is important that counsel be aware of these safe-guards when weighing whether to allow a client to speak to the OSC on a voluntary basis.

The three protections available to compelled testimony are, broadly: (1) use immunity; (2) derivative use immunity; and (3) constitutional exemption. “Use immunity” is codified in both the *Charter*<sup>11</sup> and the *Ontario Evidence Act*<sup>12</sup> and provides that the testimony of a witness given at one proceeding may not be used to incriminate that witness at another proceeding, except in a prosecution for perjury or to impeach the witness. Under the *Charter*, this right is automatic while under the *Ontario Evidence Act* the witness must first object to the question in order to be afforded protections against incrimination. “Derivative use immunity” protects a witness from having incriminating

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<sup>8</sup> *Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c.11 [*Charter*].

<sup>9</sup> R.S.O. 1990, c. E-23.

<sup>10</sup> See Steve Tenai, “Cross-Border Securities Litigation: Coordinating Defences and Investigations” (Paper presented to the Canadian Institute Securities Litigation Conference, November 29 and 30, 2004) at 2 to 6 for a more fulsome discussion.

<sup>11</sup> *Supra* note 8 at section 13.

<sup>12</sup> *Supra* note 9 at section 9(2).

compelled evidence used as a stepping stone to obtain other incriminating evidence. Only where that evidence could have been obtained through other means will it be admissible. Finally, “constitutional exemption” provides that a witness need not testify at a proceeding where the predominant purpose or use of the proceeding is to obtain evidence for the prosecution of that witness. The Supreme Court of Canada applied these principles to the securities context in *British Columbia Securities Commission v. Branch* and held that all three protections operate in the regulatory context.<sup>13</sup> Accordingly, many counsel who deal with OSC enforcement matters on a regular basis advise those attending at the OSC for an interview or ‘discussion’ to do so only on a compelled basis.

It is important to note in this context that section 11 of the *OSA* gives the OSC the power to appoint an investigator who may order the production of any document or thing for examination in connection with the investigation. Pursuant to section 13 of the *OSA*, the investigator may compel the attendance of any person and may compel that person to testify under oath or otherwise. Section 16 provides the following:

- (1) Except in accordance with section 17, no person or company shall disclose at any time, except to his, her or its counsel,
  - (a) the nature or content of an order under section 11 or 12;
  - or
  - (b) the name of any person examined or sought to be examined under section 13, any testimony given under section 13, any information obtained under section 13, the nature or content of any questions asked under section 13, the nature or content of any demands for the production of any document or other thing under section 13, or the fact that any document or other thing was produced under section 13.

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<sup>13</sup> [1995] 2 S.C.R. 3.

Therefore, counsel must advise their client of these duties and obligations and ensure that the client understands the importance of full compliance.

### **Brownie Points: Credit for Cooperation**

Given the above analysis, it may seem that it would never be in a market participant's best interest to speak to or cooperate with the OSC on a voluntary basis. However, in order to encourage voluntary interactions, the OSC instituted Notice 15-702 *Credit for Cooperation*.<sup>14</sup> The Notice states that its purpose "is to clarify that it is part of the Commission's compliance policy that market participants should have an incentive to self-police, self-report, and self-correct matters that may involve breaches of Ontario securities law or activities that would be considered contrary to the public interest."<sup>15</sup> This includes, *inter alia*: reporting issues to the OSC; fully cooperating with the OSC, or any other regulator; volunteering documentation to the OSC, including any reports or analysis prepared by experts retained by the market participant or its counsel; making employees, directors and officers available for voluntary interviews; initiating an internal investigation; and making restitution.<sup>16</sup>

The Notice states that no credit for cooperation will be given where, *inter alia*, the market participant indicates they are prepared to cooperate fully but only on a compelled basis. It therefore appears on the face of it that certain aspects of the Notice suggest that in order to obtain credit for cooperation, a market participant may be required to forego various legal protections.

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<sup>14</sup> OSC, Notice 17-502 Credit for Cooperation, online: <[http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part1/sn\\_20020628\\_15-702.jsp](http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part1/sn_20020628_15-702.jsp)> (28 June 2002).

<sup>15</sup> *Ibid* at section 1.

<sup>16</sup> *Ibid* at sections 4 to 10.

According to the Notice, the types of ‘credit’ a market participant may obtain from Staff include:

- (i) Recommending that the matter not proceed by way of a prosecution under section 122 of the Act.
- (ii) Issuing a Notice of Hearing and Statement of Allegations and recognizing and giving credit for cooperation by narrowing the scope of the allegations and in the settlement process recommending reduced sanctions against cooperative respondents.
- (iii) Not issuing a Notice of Hearing and Statement of Allegations and propose that the issues be address [sic] by one or more of the following:
  - entering into an Executive Director settlement as contemplated in the Rules of Practice;
  - placing terms and conditions on a potential respondent's registration;
  - obtaining an undertaking from potential respondents that in the future they will not violate Ontario securities law;
  - issuing a warning letter.
- (iv) In appropriate circumstances, concluding the matter without taking any action against the potential respondent.<sup>17</sup>

The recent Court of Appeal decision in *Donnini v. Ontario (Securities Commission)*<sup>18</sup> considered whether it is appropriate for a ‘cooperative’ respondent to obtain a lesser sanction than an ‘uncooperative’ respondent. In *Donnini*, the respondent, Piergiorgio Donnini, was found by the OSC to have engaged in unlawful insider trading. Mr. Donnini “did not cooperate” with the OSC and maintained that he had not violated Ontario securities law. The OSC found that Donnini was “unrepentant and unwilling to acknowledge that his conduct was unbecoming a registrant and contrary to the public

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<sup>17</sup> *Ibid* at section 13.

<sup>18</sup> (2005), 194 O.A.C. 29 (C.A.) [*Donnini*].

interest.”<sup>19</sup> The OSC suspended Donnini for 15 years. In an appeal to the Divisional Court,<sup>20</sup> Donnini had his suspension reduced to 4 years. Donnini argued that his suspension was unwarranted given that Scott Paterson, who was also found to have violated securities law in the same matter, was only suspended for 2 years because of his cooperation and settlement with the OSC. The Divisional Court, in reducing Donnini’s suspension to 4 years, stated that “[a]n accused pleading guilty is not and should not be subject to increased penalties simply because he has chosen to defend himself.”<sup>21</sup> The Court of Appeal was very critical of the Divisional Court and restored the OSC’s sanction against Donnini on the basis that the OSC had not imposed a higher sanction on Donnini because of his failure to cooperate, but rather it had imposed a higher sanction on him because he had been more involved in the violation than his cooperating counterpart (Paterson) and had remained unrepentant in the sanctions portion of the OSC hearing.<sup>22</sup> We find it curious that the Court of Appeal chose not to defend the OSC’s Credit for Cooperation policy but rather determined that the OSC had imposed a lighter sanction on Paterson for a host of reasons other than his cooperation.<sup>23</sup>

In a recently released report,<sup>24</sup> the Fairness Committee to David Brown recommended that an adjudicative tribunal be established that would be separate from the OSC. During its discussion and analysis, the Fairness Committee referred to a “pervasive

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<sup>19</sup> (2002), 25 O.S.C.B. 4697, add’l reasons (2002), 25 O.S.C.B. 6225.

<sup>20</sup> [2003] O.J. No. 3541 (S.C.J.).

<sup>21</sup> *Ibid* at para. 29.

<sup>22</sup> *Supra* note 18 at paras. 64-65.

<sup>23</sup> Note that Notice 15-702 was released in June 2002.

<sup>24</sup> The Honourable Justice Coulter A. Osbourne, Q.C., Professor David J. Mullan and Bryan Finlay, Q.C. “Report of the Fairness Committee to David A. Brown, Q.C., Chair of the Ontario Securities Commission” (5 March 2004).

and widely held perception that a ‘fair hearing’ before the Commission cannot be obtained.”<sup>25</sup> The Committee stated that this perception was based on a number of factors, including a credit for cooperation policy, “the effect of which is to penalize defendants for exercising their rights.”<sup>26</sup>

Cooperation is a matter that should be carefully considered by counsel. It may (or may not) result in a more lenient sanction against your client, but it may also mean that a market participant is afforded fewer procedural protections than they are entitled to under the law. This careful balancing act is one that can only be performed in context.

### **Telling Tales Out of School: Disclosing OSC Investigations**

OSC Staff Notice 15-703,<sup>27</sup> released in October 2004, sets out the OSC’s policy on publicly disclosing its investigations. The Notice states that “[i]n the ordinary course, OSC Staff do not publicly disclose the existence of an investigation.” However, there are instances where disclosure may be warranted:

[P]ublic confirmation of the existence or nature of an investigation will provide investors with information that may be useful in assessing the risks of certain investments. Such confirmation may also serve to foster confidence in the capital market by affirming that enforcement action is being taken in relation to potential breaches of the *Securities Act* or conduct contrary to the public interest. Therefore, there are cases where the value in disclosing the existence of an investigation will outweigh any risks associated with disclosure.<sup>28</sup>

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<sup>25</sup> *Ibid* at 12.

<sup>26</sup> *Ibid* at 13.

<sup>27</sup> (2004), 27 O.S.C.B. 8520.

<sup>28</sup> *Ibid* at section 2.

The Notice then goes on to list illustrative exceptions where such disclosure is warranted. These exceptions include, *inter alia*: (1) where investor protection out-weighs factors favouring non-disclosure; (2) where the investigation relates to conduct or issues in the public domain and confidence in the capital markets may be harmed in the absence of disclosure; and (3) where the market participant has itself disclosed the investigation.<sup>29</sup> These so-called ‘exceptions’ could arguably apply to every OSC investigation.

Completely apart from any legal duty to make disclosure, a market participant ought to consider the strategic issues involved in making disclosure. For example, if the OSC discloses an investigation and the market participant has not already disclosed it, the market participant then may be left to react to the situation and possibly suffer investor fall-out for ‘concealing’ the investigation. On the other hand, if a market participant does disclose the investigation, the OSC has an opportunity to confirm the investigation and ‘correct’ any inaccuracies or deficiencies they consider exist in the disclosure.<sup>30</sup> Section 7 of OSC Staff Notice 15-703 states that the OSC will give the market participant the opportunity to make the announcement regarding the OSC’s investigation, absent exceptional circumstances. However, this was not the case in Biovail as discussed below. Further, given the OSC’s definition of ‘exceptional circumstances’ where disclosure is warranted, ‘exceptional’ may be the norm, rather than the exception.

The OSC’s recent disclosure of its investigations has generated some criticism. Ermanno Pascutto, a former OSC Executive Director, has stated that “[t]he

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<sup>29</sup> *Ibid* at section 6.

<sup>30</sup> *Ibid* at subsection 6(v).

general rule is that you try to keep investigations confidential.”<sup>31</sup> He listed three exceptions to this general rule: (1) when an investigation gets to the point where too many people are aware of it; (2) when unusual market action suggests that word of the investigation has leaked out; and (3) when it is clearly in the public interest to disclose the investigation, such as where it is obvious there is an issue and the Commission would be derelict in its responsibilities if it was not investigating.<sup>32</sup>

The three cases discussed below highlight some of the issues that arise in the context of the OSC’s disclosure of investigations.

**(a) Royal Group Technologies Ltd.**

On December 22, 2003, the enforcement branch of the OSC sent a letter to Royal Group Technologies Ltd. (“Royal”) informing it that an investigation had been commenced into insider trading allegations involving the company. The letter stated: “We are [...] putting you on notice that any trading by insiders of Royal will be subject to review. Staff are of the view that the investigation has reached a stage that it is a material fact.”<sup>33</sup> Royal responded to the letter by banning trading by insiders and establishing an independent special committee to conduct an internal review.<sup>34</sup> According to Royal, it was not specifically told by the OSC to disclose the investigation to shareholders.

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<sup>31</sup> John Saunders, “The OSC’s openness raises eyebrows among lawyers” *The Globe and Mail* (1 March 2004) B11.

<sup>32</sup> *Ibid.* Mr. Pascutto made these comments before the OSC issued Notice 15-703.

<sup>33</sup> Wojtek Dabrowski and Theresa Tedesco, “OSC letter warned of inside trades: Regulator’s December letter told Royal Group moves were being monitored” *National Post* (2 March 2004) FP01.

<sup>34</sup> *Ibid.*

Counsel for Royal had been told of the investigation three days earlier, on December 19, 2003. That same day, Market Regulation Services Inc. advised Royal that it should disclose the OSC's investigation. However, on December 24, the Toronto Stock Exchange (the "TSX") advised Royal that it did not have to disclose the investigation as a material change.<sup>35</sup>

In late February 2004, the OSC decided that the investigation should be disclosed to investors. On February 24, the OSC sent an e-mail to Royal advising that disclosure of the OSC's investigation had to be made the next day or the OSC would disclose the investigation to the public itself.<sup>36</sup> Royal agreed to issue a press release, which had been approved by the OSC, disclosing the investigation. However, before the press release could be issued, the OSC spoke to the media itself.<sup>37</sup> Michael Watson, the OSC's director of enforcement, revealed details of the December 22 letter sent to Royal and stated that despite the OSC's discussions with Royal about disclosing the investigation, the company chose not to do so.<sup>38</sup> Watson made this comment despite Royal's contention that it had prepared a press release, which the OSC approved, and which Royal says it was prepared to release later that day, following Board approval.<sup>39</sup> Watson said that the information garnered through the OSC's investigation since December had made it necessary for the OSC to publicly disclose the investigation. Watson also stated that the OSC had passed certain information regarding Royal to the RCMP.

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<sup>35</sup> *Ibid.*

<sup>36</sup> Terence Corcoran, "Where the Royal scandal is buried" *National Post* (4 March 2004) FP15.

<sup>37</sup> *Ibid.*

<sup>38</sup> "OSC letter warned of inside trades" *supra* note 33.

<sup>39</sup> "Where the Royal scandal is buried" *supra* note 36.

Some critics have said that the OSC should have forced Royal to disclose the investigation immediately.<sup>40</sup> Others disagree and believe that investigations in and of themselves should not be disclosed until charges are laid.<sup>41</sup> Royal Board member, Robert Lamoureux, explained Royal's decision not to reveal the investigation earlier:

I don't think the company wants to disclose when there's nothing to report other than there was an investigation. It's all a question of whether there is enough fact behind the allegations, I think, in all these things. That's a judgement call. If you call these things too early, you can hurt current shareholders at that time, right?<sup>42</sup>

The OSC went a step further when Royal issued a press release in March stating that it had been informed that Royal was not a target of RCMP or CCRA investigations.<sup>43</sup> Amid speculation about whether the OSC had also abandoned its investigation of Royal, the OSC issued a press release of its own confirming that its investigation of Royal was ongoing.<sup>44</sup>

**(b) Biovail Corporation**

On November 13, 2003, Biovail announced that it was the subject of a class action complaint in the United States brought on behalf of all purchasers of publicly

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<sup>40</sup> Derek DeCloet, "Royal Group bringing a smile to the short sellers" *The Globe and Mail* (26 February 2004) B12.

<sup>41</sup> Terence Corcoran, "Royal Group scandals sound big. But is it?" *National Post* (27 February 2004) FP11. Corcoran argues that investors were hurt by a plunge in stock prices after the investigation was disclosed. This might have been unnecessary if the investigations reveal no wrong-doing.

<sup>42</sup> Karen Howlett and Paul Waldie, "Royal Group chairman leads life of jet set" *The Globe and Mail* (27 February 2004) B1.

<sup>43</sup> Royal Group Technologies, Ltd., New Release, "Royal Group special committee understands Company is not a target of St. Kitts investigation" (16 March 2004).

<sup>44</sup> OSC, News Release, "OSC clarifies status of Royal Group investigation" (16 March 2004).

traded securities of Biovail between May 17, 2003 and October 30, 2003.<sup>45</sup> On November 20, 2003, the company announced that the SEC had begun an informal inquiry into Biovail's accounting and financial reporting practices for the fiscal year 2002 and the quarterly periods to date for 2003.<sup>46</sup> In a press release detailing the company's year end profits, there is mention of a routine inquiry by the OSC into the affairs of the corporation.<sup>47</sup> However, on February 20, 2004, the OSC released a statement indicating that it was investigating suspicious trading activity at Biovail, as well as conducting a full review of Biovail's disclosure records.<sup>48</sup>

Some have speculated that the public announcement of the OSC's investigation was prompted by an investigation in the United States and a fear that the OSC would look weak unless it revealed its own investigation.<sup>49</sup>

**(c) Mutual Funds Investigation**

On September 21, 2004, the OSC issued a press release stating that it had sent notices of potential enforcement proceedings to four unnamed mutual fund managers arising out of abuses in the industry.<sup>50</sup> The OSC delivered the notices after close of markets on September 20, 2004 and issued the press release the next day.

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<sup>45</sup> Biovail Corporation, New Release, "Biovail comments on class action complaint" (13 November 2003).

<sup>46</sup> Biovail Corporation, New Release, "Biovail confirms information inquiry by the SEC" (20 November 2003).

<sup>47</sup> Biovail Corporation, New Release, "Biovail announces 2003 fourth quarter and year end earnings" (17 February 2004).

<sup>48</sup> OSC, News Release, "OSC confirms Biovail investigation" (20 February 2004).

<sup>49</sup> John Saunders, "The OSC's openness raises eyebrows among lawyers" *The Globe and Mail* (1 March 2004) B11.

<sup>50</sup> OSC, News Release, "OSC Staff Warn Four Mutual Fund Managers of Potential Enforcement Proceedings" (21 September 2004).

David Brown, Chair of the OSC, stated: “We think it is important to give an update on the status of the probe at this point because we need to keep the investor and the whole of the capital markets in mind as we proceed with this very complex review.”<sup>51</sup> David Brown went on to say: “Today’s announcement indicates that we are prepared to take whatever regulatory action is necessary to reaffirm investor trust in the mutual fund industry. We never lost sight of that goal.”<sup>52</sup>

### **When to Hold ‘Em and When to Fold ‘Em: Settlement Options and Strategies**

The OSC Rules of Practice (Practice Guidelines - Settlement Procedures in Matters before the Ontario Securities Commission)<sup>53</sup> set out the procedure to be followed for settlement of an administrative proceeding.<sup>54</sup>

Settlement discussions are to be initiated by the market participant and will be carried out where OSC Staff is of the view that in the circumstances an appropriate result may be achieved.<sup>55</sup> Settlement discussions may be held at any time up until the final disposition of the matter.<sup>56</sup> If a settlement is reached before a Notice of Hearing is issued, the Executive Director may approve the settlement. If it is reached

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<sup>51</sup> *Ibid.*

<sup>52</sup> *Ibid.*

<sup>53</sup> OSC, Rules of Practice (Practice Guidelines - Settlement Procedures in Matters before the Ontario Securities Commission), online: <[http://www.osc.gov.on.ca/Enforcement/RulesPractice/rp\\_rules-of-practice.jsp](http://www.osc.gov.on.ca/Enforcement/RulesPractice/rp_rules-of-practice.jsp)> [Settlement Guidelines].

<sup>54</sup> *Ibid* at section 1.

<sup>55</sup> *Ibid* at subsection 2(1).

<sup>56</sup> *Ibid.*

after a Notice of Hearing is issued, the settlement must be submitted to the Commission, generally in the form of a Settlement Panel, for approval.<sup>57</sup>

Section 4(1) of the Settlement Guidelines sets out the form of the settlement agreement, which should contain, *inter alia*, a statement of the facts by the market participant, a joint recommendation of OSC Staff and the market participant on remedial matters, and the market participant's consent that the order will be based upon the facts in the agreement.

Deciding when and if to attempt to settle a matter before the OSC requires a detailed and case-specific analysis. However, given the Rules of Practice and the OSC's Policy on Credit for Cooperation, there are some general practice points to consider. Firstly, if you are going to settle, it may make sense in some circumstances to do so as early as possible. In that way, your client may get the benefit of being seen to be cooperating with the OSC and reap the benefits of OSC Policy 15-702, discussed above. Also, by settling early, the settlement can be approved by the Executive Director and need not go to a Settlement Panel. This may be advantageous given that Settlement Panels do not 'rubber-stamp' settlements put before them. For instance, in the matter of Wayne Umetsu, the Settlement Panel rejected the proposed settlement because they felt the settlement was not in the public interest.<sup>58</sup> The Panel stated:

In our opinion, the facts are insufficient for us to exercise our discretion under 127 of the Ontario Securities Act to approve the settlement agreement. Basically, there are too many unanswered questions.<sup>59</sup>

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<sup>57</sup> *Ibid* at subsections 5(1) to 5(3).

<sup>58</sup> *Re. Umetsu* (2001), 24 O.S.C.B. 5819.

<sup>59</sup> *Ibid.*

The Settlement Panel went on to comment as follows:

We do not know what is happening with respect to any proceedings outside of this matter. We do not know why staff of the Commission has not proceeded with a prosecution under the Provincial Offences Act R.S.O. 1990. We are dissatisfied that there is an admission of a misappropriation of money and we do not have a sufficient explanation as to how that misappropriation has been captured [...].<sup>60</sup>

The Settlement Panel then advised of the deficiencies it saw in the recommended sanctions for Mr. Umetsu:

[W]e are surprised that the settlement agreement does allow Mr. Umetsu to continue trading on his own account, particularly given the fact that he was holding himself out as being registered when he was not and misappropriating money.<sup>61</sup>

In the settlement approved approximately six months later, Mr. Umetsu agreed to almost twenty paragraphs of factual admissions and was permanently banned from trading, with the exception that after one year he would be allowed to trade on the account of his registered retirement savings plan.<sup>62</sup>

OSC Staff, in most cases, send potential respondents a Letter of Enforcement and ask for the respondent's position. This may provide an opening for settlement discussions. However, it must be remembered that the settlement process and corresponding strategy surrounding when to attempt to settle are highly contextual and depend on the specific facts of each case.

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<sup>60</sup> *Ibid.*

<sup>61</sup> *Ibid.*

<sup>62</sup> *Re. Umetsu* (2002), 25 O.S.C.B. 1608.

## **Navigating Judicial Waters: Admissibility of Regulatory Settlement Documents in Civil Actions**

Settlement agreements, as well as documentation and information used to reach those agreements, may not be as sacrosanct as they might appear at first blush. Two recent decisions of the Superior Court of Justice have taken differing approaches to the admissibility of OSC settlement agreements in subsequent related civil proceedings.

As discussed above, the Settlement Guidelines set out the procedure to be followed for settlement of an administrative proceeding. Section 4 of the Settlement Guidelines states that the settlement agreement should contain the respondent's consent to the order being based upon the facts set out in the settlement agreement and should set out an understanding between the OSC and the market participant concerning the confidentiality of the agreement. Further, the Settlement Guidelines state at section 7:

After a proposed settlement is approved by the Commission, the settlement agreement and any related order will be published in the OSC Bulletin. Where a respondent, including a non-settling respondent, has reason for not wanting a settlement agreement to be made public for a period of time, the respondent may apply to the Commission for an order to that effect. The policy of the Commission is to make approved settlement agreements public immediately, in the absence of exceptional circumstances.

Therefore, only in exceptional circumstances will a settlement agreement not be made public and thereby available to civil litigants.

Once public, the issue then becomes the admissibility of the settlement agreement in a subsequent civil proceeding. In *Hill v. Gordon-Daly Grenadier Securities et al.*,<sup>63</sup> the plaintiff sought to adduce a settlement agreement reached between the defendants and the OSC as evidence in a certification motion for a class proceeding.

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<sup>63</sup> (2001), 56 O.R. (3d) 379 (S.C.J.), aff'd (2001), 56 O.R. (3d) 388 (Div. Ct.) [*Hill*].

Justice Cumming held that the settlement agreement, as well as the decision and reasons of the OSC, were admissible.<sup>64</sup> Justice Cumming found that the settlement agreement formed the basis for an OSC order in the matter. He held that the settlement agreement could not be found to be privileged as the OSC order was a public document. Justice Cumming held that the limiting clause in the agreement, which stated that it “was for the purpose of this proceeding only”, did not exclude it as evidence in the class proceeding, but simply precluded it from being used in any other OSC proceeding.<sup>65</sup>

In *Moyes v. Fortune Financial Corp.*,<sup>66</sup> another class proceeding, the plaintiff, in the affidavit sworn in support of certification, referred to OSC proceedings brought against the defendants. The decision of the OSC was appended as an exhibit to the affidavit, along with the settlement agreement reached between the defendants and the OSC and the reasons for the OSC’s decision. The defendants brought a motion to strike out these portions of the affidavit. Justice Nordheimer allowed the defendants’ motion and struck out those portions of the plaintiff’s affidavit which referred to and appended the settlement agreement and the OSC’s reasons. Justice Nordheimer found that, based on the decision in *Hill*, an OSC settlement agreement would generally be admissible in a subsequent civil proceeding. However, he considered the privative clause in the settlement agreement which stated that “[f]or the purposes of this proceeding, and of any other proceeding commenced by a securities regulatory agency, [the respondent] agrees with the facts set out in Part III.”<sup>67</sup> Based on this language, Justice Nordheimer

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<sup>64</sup> *Ibid* at 387.

<sup>65</sup> *Ibid* at 383 to 385.

<sup>66</sup> (2002), 22 C.P.C. (5<sup>th</sup>) 154 (S.C.J.) [*Moyes*].

<sup>67</sup> *Ibid* at para. 4.

distinguished this privative clause from the limiting clause in *Hill* and found that since the class action was not an action commenced by a securities regulator, the settlement agreement and the OSC's reasons were inadmissible and reference thereto should be struck from the plaintiff's affidavit.

In *Fleming v. Yorkton Securities* and *Clarke v. Yorkton Securities*,<sup>68</sup> two related decisions of the Superior Court of Justice, Justice MacDougall agreed with both *Hill* and *Moyes*. Justice MacDougall held that settlement agreements with the OSC will generally be admissible where they form the basis of an OSC order, except where privative language in the agreement renders the agreement inadmissible.<sup>69</sup> Although the privative clauses in the *Fleming* and *Clarke* settlement agreements were almost identical to the privative clause in *Moyes*, Justice MacDougall ruled that the settlement agreements were admissible. Justice Nordheimer had held in *Moyes* that a privative clause in a settlement agreement may, if properly worded, make the settlement agreement inadmissible in a civil proceeding. Justice MacDougall held that Justice Nordheimer's ruling was not "applicable to the special circumstances [where] the admissions in the settlement agreement form the basis of an [OSC] order" and become part of an OSC order.<sup>70</sup> However, as we have seen from the Settlement Guidelines, settlement agreements almost always form the basis of an OSC order. Further, they are generally appended to an order approving the settlement unless exceptional circumstances exist. As a result, it is entirely possible that the *Fleming* and *Clarke* decisions may be read to mean that settlement agreements will generally be admitted as evidence in subsequent

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<sup>68</sup> [2003] O.J. No. 5004 (S.C.J.) [*Fleming*] and [2003] O.J. No. 4999 (S.C.J.) [*Clarke*].

<sup>69</sup> *Ibid* at paras. 24-32.

<sup>70</sup> *Ibid* at para. 31.

related civil proceedings even where there is privative language in the agreement which is designed to prevent its disclosure. Counsel must be cognizant of this when dealing with the OSC and agreeing to any settlement.

### **Hearings – Function Behind the Form**

The OSC Rules of Practice are the guide for hearings before the OSC. The Rules of Practice set out the procedures for such things as service and filing, representation, disclosure and motions.<sup>71</sup> Counsel for a respondent must ensure that the OSC provides adequate disclosure. After initial disclosure, it is often necessary to make additional requests for disclosure. Counsel need to be diligent to ensure nothing is missing. It may be a detailed and laborious task, but one must not underestimate the importance of full disclosure to your client's matter.

Although the Rules of Practice set out the procedure for a hearing before the OSC, Practice Guideline 1 states that the OSC may hold a hearing on an expedited basis, in which case the parties will agree on the procedure to be followed and the Commission will be prepared to waive or vary the requirements under the Rules.

Generally, the OSC has the power under the *Statutory Powers Procedure Act*<sup>72</sup> to govern its own procedure and will do so on a case-by-case basis. The standard for admissibility of evidence is low. The *Statutory Powers Procedure Act* at section 15 allows a tribunal to admit into evidence any oral testimony or document that it considers relevant, whether given or proven under oath or not. The Commission will generally allow parties to make submissions on the weight that should be accorded to any particular

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<sup>71</sup> OSC Rules of Practice, *supra* note 53 at Rules 1, 3 and 6.

<sup>72</sup> R.S.O. 1990, c. S-22.

piece of evidence, but the OSC is of the opinion that it is most beneficial for them to have as full a record in front of them as possible. The standard of proof applied in OSC hearings is a balance of probabilities.

The Commission has the power to award costs of the OSC's investigation and/or Commission hearing against the market participant.<sup>73</sup> The Commission has no power to award costs in favour of the market participant.<sup>74</sup>

### **Nosey Neighbours: Cross Border Issues and Talking to Canadian Regulators with the U.S. Listening In**

Part VI of the *OSA* governs the powers of the OSC to compel evidence and establishes protections against disclosure of that evidence to other persons, agencies and/or tribunals. However, section 153 of the *OSA* allows the OSC to exchange information with other bodies and agencies, subject to section 17 under Part VI. Section 152 of the *OSA* allows securities agencies or other bodies regulating securities law outside Ontario to compel evidence in Ontario.

Rule 8 of the OSC Rules of Practice allows the OSC, either at the request of a party to a proceeding or on the Commission's own initiative, to hold a hearing inside or outside Ontario with any other body empowered by statute to administer or regulate securities.

The OSC, along with the Commission de valeurs mobilières du Québec and the British Columbia Securities Commission, have entered into a Memorandum of

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<sup>73</sup> *OSA* at section 127.1

<sup>74</sup> *Ibid.*

Understanding<sup>75</sup> with the SEC to provide the “fullest mutual assistance” to each other by providing access to information in agency files, taking evidence of persons and obtaining documentary evidence. This language is reflected in the more recent IOSCO Multilateral Memorandum of Understanding.<sup>76</sup> The OSC and the SEC are among twenty-seven securities agencies from around the world who have signed the IOSCO MOU. Under these two agreements, a person is entitled to the protections granted to them by the jurisdiction of the requested authority.

It is important to be cognizant of these cross-border issues when dealing with the OSC and, depending on the case, it may be necessary to consult and/or retain foreign counsel to ensure that your client gets appropriate and comprehensive legal advice. This is so because when engaging in discussions with the OSC, you may in effect be ‘talking’ to any number of other agencies and/or organizations, both domestically and internationally.

The following two cases illustrate how some parties are managing the U.S.’s involvement in their dealings with Canadian regulators.

**(a) *Re. Gruson***

The Investment Dealers’ Associations (the “IDA”) launched an investigation into the conduct of Brian Gruson while he was a registered representative in Toronto with Yorkton Securities Inc. and First Associates Investments Inc. The conduct which was the subject of the IDA’s investigation related to trading involving an

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<sup>75</sup> Memorandum of understanding for mutual cooperation, the exchange of information and investigative assistance (1988), 11 O.S.C.B. 114.

<sup>76</sup> IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (2002), 25 O.C.B.B. 7157.

American company. The SEC had previously asked Mr. Gruson to provide information to them on a voluntary basis, a request which Mr. Gruson refused. As part of the IDA's investigation, the IDA ordered Mr. Gruson to attend an IDA interview or face a fine of \$50,000 plus costs and a permanent ban on his registration with the IDA. Mr. Gruson was informed that a representative of the SEC would be present at the interview and might ask him questions. Mr. Gruson refused to attend the IDA interview on the basis that an SEC representative would be present.

On May 6, 2004, Mr. Gruson failed to attend the IDA's interview and the IDA brought charges against him, alleging a violation of by-law 19.5 of the IDA Rule Book because of his failure to attend the interview. At the hearing into his non-attendance, the Panel held that Mr. Gruson did not violate by-law 19.5 and that the SEC should not be allowed to attend the IDA interview.<sup>77</sup>

**(b) Hollinger Inc.**

Justice Campbell of the Ontario Superior Court appointed an Inspector under s. 229 of the *Canada Business Corporation Act* (the "CBCA")<sup>78</sup> to review various matters related to Hollinger Inc.<sup>79</sup> The Inspector sought to interview Conrad Black and certain other principals of Hollinger Inc. pursuant to its powers under the *CBCA* and Justice Campbell's Order. Conrad Black and certain other principals brought a motion before Justice Campbell arguing that their rights against self-incrimination under the *Canadian Charter of Rights and Freedoms* and the Fifth Amendment to the Constitution

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<sup>77</sup> *Re. Gruson*, [2004] I.D.A.C. No. 61.

<sup>78</sup> R.S.C. 1985, c. C-44.

<sup>79</sup> *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*, [2004] O.J. No. 3644 (S.C.J.).

of the United States would be violated should they be compelled to answer the Inspector's questions. They argued that their answers could find their way into the hands of prosecutors in the United States and be used to incriminate them.

Black et al. argued that the Inspector's power to compel their examination under the *CBCA*, combined with the operation of the *Mutual Legal Assistance in Criminal Matters Act*,<sup>80</sup> meant that any answers compelled by the Inspector would almost certainly be provided to the SEC and the United States Attorney. The principals of Hollinger Inc. argued that there was no Canadian law which could protect their compelled answers to the Inspector's questions from being used against them in subsequent U.S. criminal proceedings. They argued that as a result they would in effect lose their *Charter* rights and their protection against self-incrimination under the Fifth Amendment.

The Court has yet to rule on Lord Black's motion.

## **Conclusion**

Having successfully read to the end of this paper, you will no doubt realize that even at a very general level there are a broad array of issues and procedures to be aware of when dealing with the OSC. An awareness and understanding of these issues are your best tools for serving a client who is involved with enforcement proceedings at the OSC, whether as a personal respondent, a corporate respondent or a witness.

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<sup>80</sup> R.S.C. 1985, c. 30 (4th Supplement).