SCANDALS AND THEIR AFTERMATH
WHY WE ARE DOOMED TO REPEAT OUR MISTAKES

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INTRODUCTION

When some of the largest corporations in the United States collapsed under the weight of fraudulent accounting and executive excess in the early years of this decade, US regulators, legislators and enforcement officials moved quickly to contain the damage and shore up confidence in the financial system. Stringent corporate governance legislation, known as the Sarbanes-Oxley Act, was rushed through the US Congress. The Securities and Exchange Commission was given an infusion of cash to beef up its regulatory activities. Enforcement officials began treating white-collar criminals the same as violent offenders, handcuffing them and parading them before the television cameras in high profile and humiliating perp walks. It seemed that the world had changed and corporate crime would now be treated seriously.

In Canada, the response was more muted. While corporate scandals were not unknown, Canada had not experienced one of comparable magnitude to Enron Corp. or WorldCom Inc. Canadian chief executive officers were quick to contend that they were more honest than their US counterparts.[1] The business community successfully characterized Enron, WorldCom and the like as uniquely US problems that required US solutions. Nevertheless, such was the impact of the US failures on the public imagination that Canadian legislative, regulatory and enforcement authorities were forced to respond in some way. Their efforts were much more modest than those made south of the border. Federal legislators made insider trading a criminal offence, increased maximum sentences for fraud offences, and provided protection to whistleblowers. Provincial securities regulators agreed to new disclosure requirements and auditor oversight. New national bodies were created to strengthen the independence of auditors and to push for better corporate governance. The Royal Canadian Mounted Police were given funds to set up new investigative teams to work with other federal and provincial authorities to root out and prosecute corporate criminals.[2] The days of lax enforcement were declared over.

When I first proposed this research project in the spring of 2004, authorities and companies on both sides of the border were taking steps to improve accountability at the corporate, regulatory and legislative levels. I wanted to know whether this momentum would be sustained. Had the shock of the corporate scandals launched a new era in which corporations would become increasingly transparent and accountable? Or, once the restless media spotlight moved on, would everyone—leaders, legislators, and regulators—go back to business as usual?

I decided to look at previous corporate scandals in Canada and see whether they produced changes in law, regulations, or attitudes that had lasting impact. In order to do that I had to define what the media deem scandalous behaviour. The media play a crucial role in exposing scandal and in determining what redress is required. The examples dealt with in this paper do not represent a complete history of corporate scandal in Canada. No such history exists, a testament to the near-total lack of interest among Canadian academics in business history. One notable exception is the two-volume history of securities regulation in Canada by Toronto historian Christopher Armstrong.[3] The scandals discussed here were drawn in part from Armstrong's work and in part from more recent examples. They were selected to span the last century, starting with the Pacific Scandal of 1873, involving contracts to build the Canadian Pacific Railway, and ending with the ongoing drama of Conrad Black and his Hollinger empire.

It became apparent that scandals follow a predictable pattern. This pattern will be examined in light of what it tells us about whether such incidents provoke lasting change. Finally, the Canadian system of corporate supervision and regulation is examined to see whether it too has an impact on what changes are made in the aftermath of scandal.

Circumstances have changed since I first proposed this research. Three years after the collapse of Enron, the momentum towards greater corporate accountability in the US has been checked. After initially acquiescing to new laws and regulations governing their behaviour, the US business community has begun to fight back, arguing that financial markets must be largely unfettered if they are to remain the driving force behind the US economy.[4] More specifically, prominent business leaders now complain that the Sarbanes-Oxley Act is too onerous. In Canada, there are also signs that the momentum, never quite as strong here, is ebbing. David Dodge, governor of the Bank of Canada, warned an elite Toronto business audience in December 2004, that Canada continues to be seen abroad as a "Wild West," where regulators are soft on fraud and illegal insider trading.[5] In the spring of 2005, the heads of Manulife Financial Corp. and Power Corp. of Canada both protested that corporate governance had gone too far.[6] Three years after Enron, the impact of the scandals on corporate attitudes north of the border has been limited.

This paper is in six parts:

Part One discusses what criteria the media use to decide whether an activity is a scandal.
Part Two is a detailed look at six Canadian scandals, media coverage of these events, and what changes were made in their aftermath.
Part Three uses the six Canadian examples and others to show that scandals follow a predictable pattern as they unfold.
Part Four deals with what has happened in the US post-Enron.
Part Five is a look at what has happened in Canada.
Part Six pulls this material together to explain why we are doomed to repeat our past mistakes.

PART ONE: HOW THE MEDIA DEFINE SCANDAL

What sort of behaviour constitutes a public scandal? The word itself is blunted by overuse. A search in February 2005 for articles containing the word scandal on Google News Canada (which archives news items from 4,500 sources for 30 days) produced no fewer than 24,900 items.[7] The stories describe a wide range of activities by varied actors: the use of steroids by a pro athlete, the abuse of prisoners in an Iraqi jail, a French politician using state funds to pay for a luxury apartment, gay hustlers in the White House, and Martha Stewart lying to investigators. All of these stories are labelled scandals.

I interviewed a number of senior figures in the Canadian print and broadcast media and asked them to define scandal. Giles Gherson, editor of The Toronto Star, said it was "malfeasance on a large scale." David Nayman, head of business news at CBC Newsworld, said it was a scandal when laws are broken. Ed Greenspon, editor of The Globe and Mail, said it was "an abuse of the public trust, in the public or private sector." And Prof. Christopher Waddell of Carleton University, a former print and broadcast journalist, said it was "fraud and misrepresentation that affects a large number of people."[8]

The definition given in the Oxford Canadian Dictionary covers all of the elements cited above. It says scandal is *"a person, thing, event or circumstance causing general public outrage or indignation*."[9] In order to cause public outrage or indignation, an action would have to be illegal or, at the very least, contravene public standards. The perpetrator would have to be someone who held the public trust, be that as a politician, sports star, or corporate leader. And their actions would have to have significant impact; otherwise there would be no cause for widespread reaction. To generate public outrage, the activity in question has to become public knowledge. That brings in the crucial role played by the media in exposing and publicizing scandal. Unless the media decide to publish or broadcast a story, behaviour that the ordinary person deems scandalous never actually becomes a public scandal. Without the warmth of the media spotlight, it withers and dies.

There are reasons why some scandalous behaviour is covered by the media and elevated to the level of scandal, while some other seemingly scandalous behaviour is ignored. Space in a newspaper, on a broadcast, or even on a website, is limited. To be allocated some of it, a scandalous story must also meet a media organization's criteria for news. This definition varies between organizations.

Generally speaking, a story is subjected to the following list of questions: Is it happening now? Will it have major impact? Are a lot of people interested? Is it novel or unusual behaviour? Is a celebrity involved? Some of these criteria are given more weight than others in determining whether a story constitutes news. For example, in the last 20 years, there has been a shift in the media towards tabloid-style celebrity news.[10] Thus celebrity involvement in a story is almost a guarantee that it will be allocated space, even if some of the other criteria are not satisfied.

In the last couple of decades, celebrities have come to include not just movie stars, musicians, and sports personalities, but also some corporate leaders. Because of her celebrity status, Martha Stewart garnered more news coverage than Kenneth Lay of Enron, even though their alleged crimes were not of the same magnitude.[11] When Bernie Ebbers, the Canadian born boss of WorldCom went to trial in New York in March 2005, The Globe and Mail sent an arts correspondent, someone who usually interviewed movie stars and musicians, to cover the trial.[12] It had become a celebrity event.

Once the first set of questions is answered, the story is subjected to a second set: Does it meet with the organization's editorial policy? Will the organization's readers or listeners care? For example, a story about gay hustlers at the White House might not be treated as a scandal on an Internet site whose target audience is gay hustlers. A television network that is solidly behind a particular party could be reluctant, at least initially, to broadcast a scandalous story about the party leader.

There are several other thresholds that a story must meet in order for the media to cover it as a public scandal. Prof. Waddell points to one of them when he says the media must be able to understand the story. He gives as an example the near collapse of Long-Term Capital Management, a US hedge fund that was rescued by the Federal Reserve Bank of New York in 1998 with a $3.5 billion US emergency package. The story met many of the criteria for news, but it never became a public scandal partly because the details of its operations were too complicated for any but financial experts to understand. Shawinigate, which involved questionable financing of a hotel property in the Shawinigan riding of former Prime Minister Jean Chrétien, was ignored by most of the media for months after The National Post first began carrying stories in 1999. That was due in part to the newspaper war being waged by The National Post and The Globe and Mail, in which each tried to belittle or dismiss stories highlighted by the other. But it was also because the story was too complicated to boil down to an understandable item, especially for television viewers. Frank Rich of The New York Times made this point eloquently when he wrote: "A scandal is like any other melodrama: It can't be a crowd pleaser unless the audience can follow the plot."[13]

Television has its own unique requirements for covering an emerging scandal. David Nayman of Newsworld and his senior producer Don Pittis explained that television needs victims, an accuser, good guys and bad guys, and an expert to explain the story. And they need to have as many of these people as possible agree to appear on camera. The print media, which in this case include the Internet, can publish stories without pictures, but this is not an option for television.[14] Prof. Waddell added that some people would readily talk to print reporters, but balk at appearing on camera, perhaps because they then lose the ability to claim they were misquoted.[15] This sets a high threshold that many scandalous stories, while legitimate scandals, never cross.

To summarize, a story that constitutes a public scandal to the ordinary person must still meet a number of conditions peculiar to the media before it is carried by newspapers, radio, television, or on the Internet. It must meet the test of news, agree with editorial policy, be simple enough to explain to readers, viewers and listeners, and, in the case of television, there must be pictures. If these conditions are not met, a scandalous story never becomes a public scandal.

PART TWO: SIX CANADIAN SCANDALS

This next section gives the broad details of six Canadian scandals. While each of these scandals emerged at a different point in our history and involve varying offences, they all fit a similar pattern in the way they unfolded. This pattern will be discussed in Part Three.

1. The Pacific Scandal: 1872-1873

While it may seem strange to start a discussion of business scandals with an example that is largely seen as political, it must be remembered that in 1872, the dividing line between business and politics was not as firmly drawn as it is today. It should also be noted that while this incident gained notoriety because of the involvement of Sir John A. Macdonald, Canada's first prime minister, there was also a businessman involved, railway promoter Sir Hugh Allan. A massive contract to build the Canadian Pacific Railway was at stake. The fiercely partisan nature of the press in those days also dictated that the affair was covered as a political scandal, rather than a business scandal, as this benefited prominent opposition Liberals, such as George Brown, who owned The Globe newspaper.

Sir Hugh, a director of the Bank of Montreal and founder of the Merchants Bank of Canada, headed one of two syndicates competing for the charter to build the railway.[16] His Montreal group was heavily backed by American money, a sensitive issue at a time when American domination of the Canadian economy was a concern.[17]

The railway promoter liberally distributed this money to politicians and journalists in an effort to secure the railway charter.[18] He gave an estimated $350,000 to the Conservatives during the 1872 campaign on the promise that his group would win the contract and he would be president of the new railway. Political corruption, particularly bribing voters, was widespread and was already the subject of critical comment in newspapers before the election began. Both Liberals and Conservatives accused each other of using identical methods.[19]

When Macdonald won a majority, the railway promoter was duly awarded the railway charter, which included one million acres of land.[20] But there was a condition attached. He had to reduce the level of American involvement. Sir Hugh agreed and cut his American partners out of the deal. They reacted angrily. It is not clear whether the angry Americans played a part, but somehow private correspondence between leading Conservatives and Allan was taken from the office of the railway promoter's lawyer and delivered to prominent Liberals, including newspaper editor George Brown.

The Globe, along with other newspapers, gave the story prominent play. While accepting donations from businessmen was common political practice, the large amounts given by Sir Hugh, their illegal use to bribe voters, the American involvement, and the direct connection between the political donations and the railway charter fuelled public indignation.

Macdonald tried to delay both the publication of the scandal and its examination by parliament.[21] Eventually, he was forced to give in to opposition demands to appoint a royal commission. However, he attempted to fix the outcome by including among the commission judges a man who had been his friend for 25 years. The prime minister attended every session of the commission, cross-examined some witnesses, and also testified.

In the end, the evidence against Macdonald was damning. He and his government were forced to resign in November 1873. His political career was thought to be over. Canadians elected the country's first Liberal government, led by Alexander Mackenzie. He personally took over the Public Works portfolio, a signal that he was committed to ending corruption in government contracting. His government also brought in secret ballots for general elections and declared the voting would all take place on the same day, both attempts to reduce electoral corruption.[22]

Mackenzie cancelled the railway contract negotiated under Macdonald. Sir Hugh lost the railway charter and the promised presidency of the new company. Far from being ruined, he continued running an industrial empire that included steamship lines, several smaller railways, cotton mills, real estate and banking interests.[23]

Yet in 1878, the Conservatives, with Macdonald as their leader, swept back to power. Memories of the Pacific Scandal and his central role in it had faded after only five years. Macdonald brought in the protectionist National Policy, which hugely benefited his business allies by reducing foreign competition.[24]

A new contract for construction of the Canadian Pacific was signed in 1880. The railway project was backed by American, French and British financiers.[25] Despite the change of leadership, the project was still dogged by scandal. There were rumours in 1891 that a diamond necklace, supposedly given to Macdonald's wife by the president of the Canadian Pacific, had smoothed the way for a government rescue when the railway teetered on the brink of bankruptcy.[26] Macdonald died that same year.

2. I.W.C. Solloway and the Crash of 1929

Ike Solloway was a mining prospector turned stock market broker. In 1929, he headed the largest brokerage firm in Canada—Solloway, Mills and Co. It had more than 1,000 employees and at least 30 offices spread across the country.[27]

While stocks had been traded in Canada since the 1820's, it was not until the 1890's that ordinary people joined the financial elite in buying and selling shares. Mining booms in British Columbia and Northern Ontario spawned a host of small companies, whose penny stocks were affordable and held the promise of great riches if a substantial ore body were found.[28]

By the 1920's, there were stock exchanges in Montreal, Toronto, Winnipeg, Calgary and Vancouver. They were rife with unscrupulous brokers cheating the investing public. Bucketing, where a broker accepted money to buy shares but did not process the order, was common. So was wash trading, where brokers sold shares back and forth among themselves to create the impression of a hot stock and attract money from the unsuspecting public.

Efforts to clean up these practices were stymied by two problems that still exist today. The federal and provincial governments fought over who had the right to regulate. And the exchanges resisted regulation on grounds that cracking down too hard on members would cause brokers to take their business to a competing exchange.[29]

The daily press generally ignored the abuses on the exchanges. The Financial Post, a weekly that began publishing in 1907, said in its first edition that "mining stock should be bought only by men who have made mining a business, or the rich individuals who can afford the hazard a mining proposition inevitably entails."[30] However, Saturday Night magazine campaigned strongly against questionable practices, calling repeatedly for a clean up.[31]

The government viewed the purchase of penny shares as gambling, but a necessary evil if the mining community were to raise funds. Securities regulation was laissez-faire.[32] Indeed, throughout Canadian history, politicians and those involved in the securities industry have repeatedly made the argument that there should be a loose regulatory rein on mining investment because it was key to the country's economic growth.[33]

Solloway, Mills was the first broker in Canada to actively solicit retail customers by opening offices on the ground floor of buildings, making them open and accessible to the general public. This gave it a client base of 70,000 by 1929.[34]

Then came the great crash of October 1929, which began in New York and quickly affected the exchanges in Canada.[35] In its wake, the public sought scapegoats. Governments in provinces where exchanges were located began investigating brokers. As head of the largest brokerage firm in Canada, Solloway was immediately in their cross hairs.[36]

In November 1929, The Financial Post newspaper began a 10-part series about price manipulation, insider trading and other chicanery by brokers. The focus of its criticism was the Standard Stock and Mining Exchange in Toronto, where Solloway held a seat. The newspaper urged authorities to do something and called for a royal commission.[37]

Alberta was the first government to act. Solloway was arrested there in January 1930 and charged with bucketing clients' orders, an offence under the Criminal Code.[38] He was shocked at being singled out because his firm was following what was then widespread industry practice. Nevertheless, he was tried, convicted, and sentenced to four months in jail, plus a fine of \$225,000. He was later tried in Ontario and fined an additional \$200,000. Other brokers were also arrested, tried and convicted. Solloway felt he had been unfairly targetted. On his release, he claimed he had been persecuted rather than prosecuted.[39]

In the wake of the crash, the provinces tightened some of their legislation governing stock trading and discussed other improvements designed to protect investors. But their actions were tempered by their continued belief that too much regulation would hinder the development of mining and other natural resources.[40]

The Ontario government did set up the Securities Fraud Prevention Board in 1931, changing its name to the more positive Ontario Securities Commission in 1932. While this was a step towards greater oversight, the attorney general at the time privately believed that the exchanges were best left to regulate themselves.[41]

Solloway, Mills and Company entered bankruptcy in 1932. Throughout the 1930's Solloway lost a number of civil lawsuits and in 1937 he was ordered to pay \$3.3 million in damages.[42]

3. The Windfall Oils and Mines Affair -- 1964

The announcement in April 1964 by American company Texas Gulf Sulphur that it had found a rich deposit of zinc, copper and silver near Timmins, Ontario, set off a rush by prospectors to stake properties in the area.[43] Among those first on the scene were Viola and George MacMillan, who jointly owned Windfall Oils and Mines. Mrs. MacMillan was a well-known figure in the mining industry. She had a track record of successful mine development and had been president of the industry's main group, the Prospectors and Developers Association, since 1944. As a woman in an industry dominated by men, she was a minor celebrity.[44]

At the time, the widely accepted belief about Canadian mining was that lone prospectors like the Macmillans were responsible for most of the great finds. The reality was that larger companies were behind most of these finds. But this did not destroy the myth, or the romantic image of lone prospectors.[45]

The MacMillans purchased a claim that bordered the Texas Gulf property and began drilling in June 1964. On the first Saturday in July, they suddenly stopped drilling and bundled four boxes of core samples into their car. The news spread quickly through the mining community that something was up on the MacMillan claim.[46] By Monday morning their shares were in hot demand on the Toronto Stock Exchange, opening at almost double their closing price of 56 cents.

Mrs. MacMillan fed the buying frenzy for the next month with heavy hints to journalists and others about the discovery. As the weeks passed with no assay results published, the exchange authorities and the Ontario Securities Commission grew increasingly nervous. Yet they allowed trading to continue. Favourable newspaper reports pushed the price of Windfall shares ever higher. By July 20, it had reached $4.75.[47]

Under pressure from the authorities, the Macmillans finally reported their assay results on July 30. In a press release, they admitted that there was nothing of value on the Windfall property.[48]

The Ontario Securities Commission launched an investigation that same day. The Ontario government appointed a royal commission to look into mining finance and the regulation of securities markets.[49] But the investigations ran into trouble when it emerged that a senior securities commission official had borrowed Windfall shares from Mrs. MacMillan as the stock was climbing. The official was forced to resign.

Evidence at the two inquiries indicated that the Macmillans had known within days that there was nothing on their property. During July, they sold 953,100 shares of the company, earning about $500,000 for the company and $1 million for themselves and other insiders.[50] They withheld information from their directors, who were weak and dependent on the Macmillans for employment.

The report by the royal commission criticized the Toronto Stock Exchange, pointing out that some brokers had profited by the Windfall Affair, both on the trades they made for outsiders and the ones they had made on their own account. The brokers, said the report, treated the exchange as a private gaming club maintained for their own benefit.[51] Lax listing requirements for speculative mining shares were also criticized, as was the exchange's hesitancy in demanding the Macmillans disclose their assay results sooner.

Mrs. MacMillan was convicted in 1968 of price manipulation, not related to Windfall but to another of the couple's companies, and sent to jail for eight months. She and her husband stood trial in 1969 for conspiring to affect the price of Windfall shares, but were acquitted on grounds that everything they had told the public was factual.[52] Mrs. MacMillan went back to mining and received the Order of Canada before she died in 1993 at the age of 90.[53]

A new director appointed to the Ontario Securities Commission following the affair blamed lack of staff for its poor enforcement record and promised to do better in future.

The revised Ontario Securities Act passed in 1966 prohibited insider trading. Another revision in 1978 tightened the rules for disclosure. Many of the speculative stocks moved to the Vancouver Stock Exchange (now defunct).[54] Prof. Armstrong notes in the second volume of his history of securities regulation, regulators still maintained that too much interference in the market place would have adverse consequences.[55]

4. Bre-X Minerals and the Busang gold hoax – 1997

The Busang property in Indonesia had been looked at and dismissed by a number of Australian companies before geologist John Felderhof marketed it to Canadian mining promoter David Walsh in 1993.[56] Felderhof had been working in the area for some time and had been asked by the British financier who owned the property to find a buyer. To help with that sale, Felderhof sent geologist Michael Antonio T. de Guzman to Busang to see if there was anything worth selling.[57]

de Guzman spent four days at the site and wrote a favourable report of its prospects, estimating it contained one million ounces of gold.[58] It was on the basis of this report that Walsh, through his company Bre-X Minerals, bought Busang. He hired Felderhof to head Bre-X's Indonesian operations.[59] The two then set out to raise money in Canada.

When exploratory drilling started in 1994, some of the cores were "salted" with gold from elsewhere, to make the potential mine look richer and more interesting to investors.[60] This salting was to continue throughout the life of the affair.

The discovery of diamonds in northern Canada and of nickel, copper and cobalt in Labrador in this period helped fuel a boom in mining stocks. Bre-X rode this boom.[61] In 1995, the company reported two more finds on its property and estimates for the amount of gold rose to 30 million ounces.[62] Although there was talk in the industry about unorthodox sampling methods by Bre-X at Busang and even the possibility that there was nothing there, the share price kept climbing as more and more investors jumped on the bandwagon.[63] Mining analysts and journalists happily promoted the stock, describing Busang as one of the largest gold deposits in the world, on par with Witwatersrand in South Africa.[64] In 1996, Walsh, his wife, and Felderhof sold shares in Bre-X, raising $30 million for Felderhof and the same amount for the Walsh's.

Bre-X reached its zenith in early 1997. Felderhof was now suggesting there could be 200 million ounces of gold at the site.[65] Walsh and Felderhof were given "Man of the Year" trophies by The Northern Miner, the bible of the Canadian mining industry.[66] Felderhof was named Prospector of the Year by the Prospectors and Developers Association.[67]

Things began to unravel in late March 1997. A company planning to bid for Bre-X did some exploratory drilling and found there was nothing there. The geologist de Guzman was dispatched to meet the now suspicious potential buyer. En route to the mine, de Guzman either fell, jumped, or was pushed from a helicopter, and was presumed dead.

Bre-X commissioned Strathcona Mineral Services Ltd., a firm known for giving reliable reports, to check the results at Busang.[68] Its investigation found there was no gold at Busang and that the core samples had been systematically salted. The share price plummeted. Investors lost an estimated $6 billion, making Bre-X the largest stocks swindle in Canadian history.[69]

The Toronto Star was the first major Canadian newspaper to call Bre-X a scandal in its April 1, 1997, edition.[70] The Financial Post followed on April 3, with a column suggesting that the scandal was all the fault of corrupt Indonesians.[71] Once further details filtered out, other papers joined suit.

Bre-X was far from the only salting scam to hit the Canadian mining industry. A handful of others occurred at about the same time. But because of the size of the hoax and the magnitude of losses, the authorities were forced into action.

The Toronto Stock Exchange and the Ontario Securities Commission set up a joint task force to discuss what the problems were and how to fix them. The result was something called National Instrument 43-101, which tightened standards of disclosure for the mining industry. Specifically, it set new guidelines on the technical and scientific information that mining companies release, orally or in writing. It also included standards on how this information is collected and by whom.

This has not put an end to core salting. In January 2004, another Canadian mining company with overseas properties was caught with salted core samples. The main difference was that the fraud was discovered earlier. Investors lost $14 million instead of $6 billion.[72]

David Walsh died at his home in the Bahamas in June 1998. Felderhof was charged with insider trading and has pleaded not guilty. His trial, which began in 2000 in Ontario Superior Court, is expected, with several interruptions, to last until late 2005. After the trial started, Felderhof returned to Toronto from his home in the Cayman Islands and has vowed to clear his name. There were reports in early 2005 that de Guzman had not died in the helicopter incident and was in hiding. They have not been confirmed.

5. David Peterson and YBM Magnex – 1998

YBM Magnex International Inc. was incorporated in Alberta in 1994 and within two years had secured a listing on the Toronto Stock Exchange. Its ostensible business was making industrial magnets. While it raised money from Canadian investors, it had no operations in Canada. Company headquarters were in the United States and its main operations were in Hungary. It had subsidiaries in Russia and the Cayman Islands. According to its official reports, it also traded in oil.[73]

The president and chief executive officer of YBM Magnex was Jacob Bogatin, who was born in Russia but had moved to the United States. Its chief operating officer was Igor Fisherman, born in the Ukraine.[74] David Peterson, former premier of Ontario, joined the YBM Magnex board in April 1996. His presence gave the company respectability and helped it raise money from Canadian investors.

This was a time when law enforcement officials were increasingly concerned that Russian organized crime groups were going global and infiltrating legitimate businesses around the world, including Canada.[75] Newspapers carried stories about this worrying possibility.

Not long after Peterson joined the company's board, Bogatin was informed that US authorities were investigating the company for suspected links to Russian criminals. The board of directors set up a special committee in the summer of 1996 to investigate what they were told were rumours circulating about the company in the US

In 1997, the company's Canadian lawyer told the Ontario Securities Commission that they were aware of the rumours and innuendo, but that these had not been independently verified. Yet when the company filed a preliminary prospectus with the commission, a necessary prelude to issuing shares and raising money from investors, the rumours were not mentioned.

Peterson signed several certificates on the board's behalf during this period saying there had been full disclosure in the company's prospectus. At the same time, he suggested to his fellow board members that they hire independent investigators in the US to ascertain whether there was any truth to the rumours.

The investigating firm, then known as The Fairfax Group, duly reported in March 1997 that there were quite a few things the company should investigate further: The original shareholders of YBM Magnex were members of the Russian mob; it looked as though the company's books had been falsified; and the company was possibly being used to launder money. None of this was disclosed to investors.[76]

Throughout 1997, various members of the board of directors discussed what should be done about the allegations. By early 1998, the company's auditors Deloitte & Touche decided they would no longer work for YBM Magnex, unless a forensic investigation was done of its accounts. When this did not happen, Deloitte & Touche stopped their work. When the auditor's departure was finally disclosed in a May 8, 1998 news release, the reasons given were general and misleading.[77]

The Ontario Securities Commission raised questions about the company's customers in July 1997 and the OSC enforcement director said the commission had concerns and urged reporters not to give up on the story.[78] But the company's Russian connections received little coverage in the media until after the FBI raided its offices a year later. One investment analyst lauded as a "super sleuth" by The Financial Post newspaper, recommended purchase of the company's shares in March 1997.[79] Meanwhile, Norman Inkster, a former RCMP commissioner who became president of KPMG Investigation and Security Inc., said the company's links to organized crime could have easily been discovered on the Internet.[80]

Matters came to a head May 13, 1998, when the Federal Bureau of Investigation raided the company's offices in Pennsylvania and seized documents and other evidence. In response, the Ontario Securities Commission ceased trading in the shares of the company, which were valued at almost $1 billion.[81] The company was placed into receivership in December 1998.

The US attorney's office charged Bogatin, Fisherman, and two others with 45 counts of racketeering, securities fraud, wire fraud, mail fraud and money laundering. Patrick Meehan, US attorney for the eastern district of Pennsylvania, said YBM's annual report "could rank among the great works of modern fiction."[82] The indictment claimed the men had systematically prepared bogus financial books and records, offered bribes to accountants, and lied to securities regulators, among other things. If found guilty, Bogatin would be subject to 425 years in jail and $16.5 million US in fines. Fisherman would be subject to 345 years in jail and $16 million US. in fines. As of March 1, 2005, Bogatin was free on bail, awaiting trial. Fisherman, along with two others named in the indictment, had fled and remained a fugitive.[83]

The Ontario Securities Commission launched an investigation after the FBI raid. It concluded in July 2003. Bogatin and Fisherman were banned by the OSC from acting as directors or executives of companies in Ontario for life. The two firms that acted as underwriters for the YBM Magnex stock—First Marathon Securities and Griffiths, McBurney & Partners—were each fined $400,000. Three other directors were given lesser fines. The total amount of all the fines was $1.2 million CDN. It is interesting to compare the penalties levied in Canada with the much harsher sanctions levied in the United States.

Peterson, the former Ontario premier, was not sanctioned. The commission merely said it was "disappointed" that he did not offer more insight and leadership.[84] "I'm delighted with the outcome," said Peterson, who had resigned from the board in August 1998. "But it has not been that much fun for 3 1/2 years."[85] The Ontario Securities Commission made plain in its report it was not concerned with organized crime, money laundering or whether YBM was a real company. "It is about disclosure of risk."[86]

The Financial Post was the first major publication in Canada to call the affair a scandal, affixing this label in a May 29, 1998 article.[87] The case provoked calls by the media for Canada to toughen enforcement and impose stiffer penalties.[88] In November 2004, the Ontario government announced plans to reform the Ontario Securities Commission so that it no longer acted as both prosecutor and adjudicator.

In a development that may be related to YBM Magnex, the RCMP set up specialized teams in November 2003 to investigate white-collar crime in Canada. The teams, known as Integrated Market Enforcement Teams, work closely with securities regulators and provincial attorneys general.[89]

6. Conrad Black and Hollinger – 2003

Conrad Black has been a controversial business figure in Canada since 1978. His first major business transaction, the takeover of the holding company Argus Corp. in 1978, was followed by complaints from the widows who had sold him key shares that they had been duped.[90] His bid to purchase the US firm Hanna Mining Co. in 1981 prompted a Securities and Exchange Commission investigation and a lawsuit against Black by Hanna Mining. The company accused him of fraud and racketeering. The suit was settled out of court and the SEC charges withdrawn after Black promised to refrain from future securities law infractions.[91] In 1986, employees of his company Dominion Stores sued him successfully over his withdrawal of $38 million from the company pension plan. The withdrawals had taken place while Dominion was closing stores and laying off employees.[92] His purchase of The Telegraph, Britain's largest circulation broadsheet newspaper in 1986, was followed by complaints from the previous owners about the tactics used.

Building on his purchase of The Telegraph, Mr. Black became a global media baron in the 1990's, buying interests in newspapers in Canada, Australia, Israel, and the United States, and creating a new newspaper in Canada, The National Post, in October 1998. These interests were held through a complicated set of interlocking companies controlled by Black and his close associates.[93]

Black was embroiled in a high-profile fight with former Prime Minister Jean Chrétien in 1999 over the latter's refusal to allow Black to accept a British peerage while remaining a Canadian citizen.[94] Black sued Chrétien but lost the case and his appeal in March 2001. He relinquished his Canadian citizenship and was given a peerage.[95]

The problems that were to result in his ouster as head of his main companies in both the US and Canada began in the fall of 2001 when Tweedy, Browne, a shareholder in Black's US operating company Hollinger International, queried the size of payments the company was making to Black's private holding company for management services.[96] The fight between Black and his disgruntled shareholders escalated, with suits and countersuits being filed. Each new twist in the story was given prominent treatment in the Canadian newspapers. The media have covered Black throughout his career. However, in much of the earlier coverage journalists have pulled their punches Black had a reputation for suing journalists.[97]

Black was forced to step down as chief executive officer of the US operating company Hollinger International in November 2003.[98] It was at this point that the Canadian media began describing events involving Black as a scandal. He remained chairman of the Canadian company Hollinger Inc. until he stepped down in November 2004. By that time the pressure on him was intense. A special committee of the Hollinger International board released a report in September 2004 detailing the personal spending of Black, accusing him of running a "corporate kleptocracy."[99]

Canadian newspapers gave prominent treatment to details of personal spending by Black and his wife Barbara Amiel, describing vacation costs, party expenses and even accessories that Amiel had purchased. The Globe and Mail used a picture of the Blacks, lavishly dressed for a costume ball, to illustrate its front-page story on their spending habits.[100]

In November 2004, the US Securities and Exchange Commission filed a lawsuit for civil fraud against Black in US federal court in Chicago. He is also the subject of a criminal investigation by the US attorney in Chicago.[101] Those cases were ongoing when this paper was written.

At least eight other lawsuits had been filed involving Black or his companies. They include one filed by him in Ontario Superior Court against the authors of the special committee report, claiming they have made him a "social leper" and "loathsome laughingstock."[102]

Under pressure to act, the Ontario Securities Commission launched an investigation into the Canadian company Hollinger in January 2004. That investigation is still ongoing.[103] The Ontario Superior Court appointed an inspector to look into related party transactions inside the Canadian company Hollinger Inc. That inspection is still in progress.

In early 2005, there were reports that Black, despite his disgrace, had been invited to join the board of directors of Blackpool Exploration Ltd., a western Canadian oil and gas company, and had accepted. However, he voluntarily stepped down after the TSX Venture Exchange, on which Blackpool shares were traded, told the company that Black should not be a director because he has been the subject of regulatory action by the Ontario Securities Commission.[104]

PART THREE: THE SEVEN STAGES OF SCANDAL

While these six scandals occurred at different times and involved vastly different personalities, a pattern can be discerned in how a scandal erupts, is publicized and played out. There are seven discrete stages: anxiety, focus, denial, validation, definition, punishment, and aftermath. Each is described in detail below. A scandal must transit through each of them in order to be considered complete, meaning that the behaviour that has caused public outrage is identified and investigated, the perpetrators punished, and steps taken by the relevant authorities to prevent reoccurrence. Skipping certain stages gives rise to public unease and the feeling that the scandal has not been dealt with properly. One example of skipping a stage would be punishing an individual without proper validation by authorities. Similarly, if the relevant authorities declare a wrong has been done and punishment is not meted out, the scandal remains incomplete.

It is important to note is that intervention at certain stages can change the course of the scandal and its eventual outcome. Intervention, for example, by parties interested in avoiding or affixing blame, or by the media, interested in targetting specific persons or institutions, while leaving others alone. While this paper focuses on business scandals, political scandals appear to fit the same pattern, although there are some important differences at the punishment and follow-up stages. Indeed, the Sponsorship Scandal involving misuse of public funds in advertising contracts in Canada, which is ongoing, has followed the cycle outlined below. Sex scandals were not included in this review.

Stage One: Anxiety

None of these scandals emerged out of the blue. There was always some pre-existing public anxiety about a situation or a particular individual before the scandal emerged. These existing public concerns are the bedrock on which a scandal is built. They increase public interest in the affair, encourage media coverage, and their existence exerts pressure on the authorities to act. We tend to view scandals as surprise events. Looked at in retrospect, they emerge from our existing anxieties and preoccupations. At their core, they involve some combination of the seven deadly sins, but each scandal is also firmly linked to its time in reflecting contemporary anxieties.

For example, there was widespread concern about political corruption as well as fears of American economic domination when the Pacific Scandal erupted. These fears were seized on by Macdonald's opponents, who used them to inflame public reaction and increase pressure on the Conservative government. With Solloway, there was disquiet about the tactics being used by brokers on the stock exchanges. At the time of the Windfall Affair, there had been many stories about unscrupulous mining promoters pushing speculative stocks. Bre-X occurred at a time when the Canadian mining community was increasingly seeking opportunities abroad. This created anxiety about the quality of information available from far-flung properties. As well, there had been several instances of core samples being salted. YBM Magnex emerged when the newspapers were carrying stories about the Russia mob expanding its activities to become global players. This concern had been mounting ever since the Soviet Union collapsed in the early 1990's. With Conrad Black, his entire career had been the subject of critical stories since his first major business venture in 1978. The media, and to a certain extent the public, were predisposed to viewing the media mogul as the central figure in a financial scandal. The US scandals, including Enron and WorldCom occurred against the backdrop of unease over growing corporate power and the exorbitant pay of corporate leaders.

Stage Two: Focus

Unfocussed public concern is not enough for a scandal to emerge. For that to happen, there has to be what Ed Greenspon, editor of The Globe and Mail, calls “a crystallizing event” that attracts the attention of the media. Media coverage gives the public a focus for existing anxieties and stokes public outrage and indignation. It is at this stage that the media apply their complicated criteria, mentioned in Part One, to determine whether the event heralds a potential scandal and whether this scandal merits news coverage.

For Sir John A. Macdonald, the crystallizing event was the release of private correspondence detailing his government’s financial involvement with railway promoter Sir Hugh Allan. Liberal opponents, who long held suspicions that the prime minister was corrupt, now had something they could show to the public through the media. For Solloway, it was the decision by the government of Alberta to lay charges. A lawsuit is often, but not always, the event that transforms unfocussed rumours into an understandable story line for the media. In the Windfall case, the crystallizing event was the company’s news release that admitted after weeks of frenzied trading in the company’s stock, that there was nothing of value discovered on their property in Northern Ontario. For Bre-X there were several events, close together. Rumours that a potential buyer could find no gold at Busang, followed by the suspicious disappearance of geologist de Guzman, and then the report from Strathcona Minerals confirming the lack of gold, turned the success story into a scandal. With YBM Magnex, it was the raid by the FBI on corporate headquarters in Pennsylvania. With Conrad Black, criticisms made over a period of years coalesced when a US shareholder complained publicly about misuse of funds.

It is interesting to note that the troubles plaguing Nortel Networks, whose shares plummeted when the tech bubble burst in 2001, are rarely described as a scandal, despite evidence of fraudulent accounting. There are a number of investigations ongoing by securities regulators and legal authorities in the US and Canada. As yet, the media has not found a person or event on which to blame Nortel’s problems. Without that crystallizing event, the behaviour of certain executives at the firm, while scandalous, is not yet deemed a scandal.

Stage Three: Denial and Evasion

In some of these cases, scandal could have been averted by an early admission of guilt on the part of the accused. One has only to think of Martha Stewart, convicted of obstructing the course of justice rather than the initial accusation of insider trading, to see that denial and evasion of responsibility serves to fan the flames of scandal. One of the tenets of corporate crisis management is that admitting responsibility immediately and announcing remedial action are necessary steps in limiting the damage to the company or individual. That advice was not followed in any of these cases. Had it been, some of these scandals might have been short-circuited or at least short-lived. Further research is needed to see if an admission of responsibility would end the more massive scandals, such as Enron or WorldCom. As it is, the main figures in these incidents denied responsibility, so that question was not answered. Sir John A. Macdonald used procedural tactics to delay examination of the political funds given by Sir Hugh Allan. Solloway still protested his innocence after serving his jail term. Viola Macmillan never admitted to wrongdoing in the Windfall Affair. Peterson claimed ignorance of what was happening at YBM Magnex. Felderhof, the only senior figure still alive from Bre-X, protested his innocence and fled the country. Conrad Black has launched a flurry of lawsuits that will take years to conclude. Many of the chief executives caught up in the US corporate scandals said in their own defence that they had no knowledge of the wrongdoing that took place on their watch. These denials were given prominent media coverage, along with the massive salaries the executives had earned for their work.

Stage Four: Validation

While pre-existing public anxiety, a crystallizing event and initial evasion or denial are all necessary to give a scandal momentum, at some point it will peter out unless the next two stages are reached—official validation and a further defining of the question to be investigated. In some cases, these two stages occur simultaneously. In others, attempts are made to narrow the question of what activity is being investigated and who the main actors are throughout several stages of the process.

Official validation occurs when the authorities step in, confirming to the media and through them to the broader public that there is some foundation for their suspicion of wrongdoing and that further investigation is required. This can take various forms: a royal commission, a judicial inquiry, a securities investigation, or a court case. But in two recent incidents, that of Hollinger and Nortel Networks in Canada (which has yet to become a full-blown scandal), it was a report of a special committee of the board of directors that validated criticisms against individuals or companies. Validating bodies such as courts or commissions are able to uncover information not available to the media. The investigations and subsequent reports also serve to keep the scandal alive by keeping it in the public eye and providing further details of the alleged wrongdoing. Put another way, lighting the initial spark does not guarantee that the flame of scandal will continue to burn. Greenspon of The Globe says that a story must have a constant supply of "oxygen," which he defined in part as new developments that can form the basis of new stories. Court appearances by the accused, reports issued by authorities, or new accusations by aggrieved victims, are all sources of this "oxygen." Without them, the flame peters out and the scandal dies as far as the media are concerned.

Stage Five: Definition

This is a crucial stage. It is necessary to define what activity is being examined and who is involved in order to determine who will be punished and what measures the authorities might take. Following the collapse of Enron and WorldCom, US President George Bush attempted to define the question by saying that "a few bad apples" were responsible. In putting the emphasis on individual actions, rather than on regulatory or systemic failure, he was attempting to steer public attention away from new regulations and laws and towards punishment of individuals. In this, he was not successful as Congress decided to pass the Sarbanes-Oxley Act. Prime Minister Paul Martin has also resorted to the bad apple defence in discussing the Sponsorship Scandal in Canada. In his case, it is important to focus attention on friends and colleagues of his predecessor, Jean Chrétien, and to divert attention away from the Liberal Party, which he still leads.

Scandals can be defined in many ways. Commissions are given specific mandates. Lawsuits are filed, naming the alleged offenders and their actions. Investigations inquire into specific actions. It is also at this stage, that people who may have been involved with the activity in question, struggle to remain outside the investigators' net. This is a key stage, fraught with politics and power, with much of the action going on behind closed doors. The outcome has a major influence on what actions are taken in the wake of a scandal.

The process of definition is often affected by what the authorities believe they can prove. For example, Felderhof of Bre-X is charged with insider trading, not with salting core samples at the Busang mine. YBM Magnex was investigated by the Ontario Securities Commission for improper disclosure of information to the public, not for having links to the Russian mob. The Securities and Exchange Commission suit against Conrad Black is about inaccuracies and omissions in his companies' public reports, not about how he spent the money.

In reporting these definitions, the media help to narrow the public focus. Many of those targetted claim they are being made scapegoats. While this is undoubtedly true in many instances, it does not alleviate their own guilt. Everyone else is doing it, is not considered an acceptable defence. For example, while political corruption was widespread during the time of Sir John A. Macdonald, not all politicians were being investigated by the royal commission. Solloway did not act any differently than most of the brokers active during the 1920's, but the Alberta government chose to lay charges against him. Mining promoters were widely known to be using unethical means to push speculative stocks in the 1960's, but it was Viola MacMillan who faced several lawsuits. With Conrad Black, the narrowing of the focus was a deliberate act of the special committee of the board. They needed the help of insiders to gather information on Black's activities and so made the deliberate decision not to pursue some of the directors with much enthusiasm.

Stage Six: Punishment

Two further stages are required for a scandal to run its course. The most important, from the public and thus the media perspective, is that punishment must be meted out. This is the climax of the cycle, the stage where the indignation that has been stoked by publicity can be appeased by a fitting punishment. It fits neatly into the familiar ritual of crime and punishment, described by US psychiatrist Karl Menninger, where once someone is fingered as a villain, crowds join in the cry for punishment.[105] Unfortunately, this is increasingly also the end of the cycle, with follow-up by the authorities treated as an afterthought or ignored by journalists. Punishment offers the media a spectacle to cover and offers the public a resolution of the affair.

Once this stage is passed, much of the media loses interest and the pressure on authorities to tighten laws and regulations is lessened. This is dealt with in more detail in the following section on follow up by authorities. However, one crucial reason is that if the media have bought the “bad apple” argument, they are satisfied that the matter has been dealt with once an individual has been punished.

Punishment can take various forms. Sir John A. Macdonald and his Conservative government were forced to resign. This appeared to satisfy the public appetite for justice because he was later re-elected. Solloway served time in prison and was forced to pay millions of dollars in legal settlements. Viola MacMillan went to jail, although not for manipulating the price of Windfall shares. Her return to respectability was crowned with the award of the Order of Canada before she died.

The Bre-X case is still unresolved, but one of its main actors, John Felderhof is on trial as this paper is being written. Black was forced to relinquish his positions as chief executive officer at Hollinger International and chairman of Hollinger Inc. His many court cases are still ongoing. In the spring and summer of 2005, many of the executives involved in the major corporate scandals had been convicted by the courts and were sentenced. These events received extensive coverage by the media. The Wall Street Journal continued to carry on its website a special section called Executives on Trial. Martha Stewart was released from prison early in 2005 and returned to the public stage with a television program.

Stage Seven: Aftermath

In this last stage, which is not always reached, authorities address the underlying causes of the scandal. As mentioned above, the punishment stage is often treated as the end of the cycle. Stories once featured on the front of a newspaper slip to the back. Journalists need new developments to continue covering a story. When these are not forthcoming, coverage drops off and dies. This is more true in business scandals, where a powerful business lobby puts forward the “bad apple” argument in order to avoid further regulation and legislation, than it is in political scandals, where the opposition can continue to press for action, even once the media lose interest, providing the government has not been toppled.

Anecdotal evidence suggests that in scandals where no central personality emerges to be prosecuted, convicted and punished, media attention then falls on institutional actors and governments. In these instances, for example, the tainted blood scandal of the 1980s in which thousands of Canadians contracted Hepatitis C from blood transfusions, the pressure remains on the authorities to act.[106]

But why does the media lose interest once the central figure in a scandal has been punished? Part of it is psychological. The punishment of an individual or a group of individuals draws a line under a scandal. It is a satisfying conclusion to the story. But part of it is connected with the mechanics of news coverage and recent developments in the media sector.

It is easier for assignment editors to send reporters to cover events, such as a trial or an inquiry, than to ask them to cover a process, such as drawing up new regulations or laws.[107] The latter often takes place behind closed doors, where participants are reluctant to speak, and where there are few, if any, concrete events to cover. It also requires more time and initiative from the journalist. Thus, once a scandal reaches this stage, it becomes more difficult for reporters to cover.

There is also the appeal of covering people, of personalizing a story. The personal element in a scandal ends at the punishment stage. In order for the story to go forward from that point, the media need to focus on the broader picture. In fact, for real change to result from a scandal, the eyes of the media should be trained on the broader picture from the very beginning. But the lure of personal drama is often too difficult for journalists to resist. Thus, scandals that contain important policy implications are reduced to personal narratives and declared over once that individual has been dealt with.

Prof. Waddell of Carleton University suggests a third reason: the abandonment by many of the media organizations in Canada of the beat system—where reporters specialize in coverage of a particular area. What this has meant, he says, is that more and more reporters know less and less about what they are covering. Even if a reporter knows little about a story or issue, they can focus on personality or conflict. Once those are gone, the reporter does not know what to do and stops covering the story.

Other recent developments in the Canadian media sector only add to the reluctance to delve deeper into the roots of any given scandal. Convergence, where newspapers have joined with television organizations and added Internet sites, have added considerably to the time pressure faced by journalists. Instead of just writing for a paper, or just putting together an item for television, some journalists are now expected to do both, and supply a quick item for the Internet. The result is superficial coverage, with the easiest stories being selected first. These points have emerged again and again in testimony before the Senate Transport and Communications Committee during its hearings into the state of the Canadian media.[108] Prof. Waddell suggests these industry trends have reduced coverage of public policy issues in Canada.[109]

What this means in terms of the lifecycle of scandal is that there is less interest in following up on regulatory or systemic failures that a scandal may have revealed. This translates into less pressure on the authorities to make significant changes in laws or regulations to address the underlying causes.

The rapid follow-up by authorities in the United States following the Enron and WorldCom scandals is the exception rather than the rule. The magnitude and timing of those failures—WorldCom was the largest bankruptcy in the history of the US, and it was one of a series of scandals that occurred in the crucial months before the 2002 congressional elections—forced worried legislators to take action. The first inclination of US President George Bush was to dismiss the scandals as the actions of “bad apples.” Congress did not buy this explanation. Share ownership by individuals in the US has grown significantly in the last couple of decades, ensuring that the impact of the scandals would be widely felt among their constituents. Had these scandals occurred in a year when an election was not looming, or had they had less financial impact, the outcome might have been very different in terms of regulatory and legislative change. It is unclear whether the public is satisfied with the follow-up in the United States. Investor confidence, defined as the public’s willingness to invest in shares and other securities, has not fully recovered in certain sectors following the corporate scandals of 2002.

In Canada, the record for follow up by the authorities in business scandals is mixed. In the wake of Solloway, the Ontario government set up the Securities Fraud Prevention Board in 1931. It is unclear whether this was a reaction to the specific case, or to the perception of widespread abuses in the industry. After Windfall, insider trading was prohibited in Ontario and disclosure rules tightened up. Following Bre-X, disclosure rules were further tightened. The RCMP were given new funds to investigate corporate crime after YBM Magnex, but the two might not be related. The RCMP attribute this new funding to the government’s concern about how much corporate crime was costing the government in lost taxes and other revenues. This is dealt with in further detail in the section on developments in Canada post-Enron. In the case of Black, the media coverage has focused on the “bad apple” argument. The question of whether regulatory or systemic failure played a part in his saga is rarely raised.

PART FOUR: THE US EXPERIENCE POST ENRON

When the financial scandals involving Enron, WorldCom, and a host of other US corporations first exploded three years ago, it seemed at first that a shocked and contrite business community would not stand in the way of new rules and reforms aimed at preventing similar malfeasance. Business leaders were more than usually quiescent in July 2002, when the US Congress passed legislation known as the Sarbanes-Oxley Act. It introduced new rules to make corporate leaders more accountable for their actions and their companies more transparent to investors. In normal times, such legislation would have prompted howls of protest and full-page newspaper ads expressing outrage at government intrusion. But the summer of 2002 was not a normal time. In the space of two months, the head of the Tyco International conglomerate was charged with tax evasion, accounting firm Arthur Anderson was found guilty of obstructing justice (a decision overturned in 2005 after the company had collapsed), cable television giant Adelphia Communications filed for bankruptcy amidst allegations of fraud, technology and services firm Xerox Corp. admitted it overstated sales by billions of dollars, telecom company Qwest confessed it had improperly accounted for more than one billion in sales, and WorldCom Inc. revealed one of the largest accounting frauds in history and then filed for bankruptcy.

In 2002, it was more important than ever before to maintain public confidence in the stock market. The number of US adults who owned shares, either directly or indirectly, had tripled since 1980 to about 60 per cent of the population. If the public deserted the stock markets en masse, it could lead to financial chaos.

Sensing the fragility of public confidence, President George Bush vowed to do everything in his administration's power to stop companies from "cooking the books, shading the truth and breaking our laws." These strong words from a president friendly to big business sent a signal to US boardrooms that it was not the time to speak up.

But the tide turned sooner than the public might have expected—first in the White House, and then in the business community. Within three months of his promise to clean up Wall Street, the president reduced an expected budget increase for the Securities and Exchange Commission, the government agency charged with policing corporate America. He did it again in 2003 and 2004. Even with these smaller increases, the agency's budget has grown significantly, just not as much as promised. The president's war on terror and the war in Iraq became higher priorities than reining in corporate wrongdoing.

Sensing this shift, some business leaders began to resist more strongly efforts by the Securities and Exchange Commission and New York State Attorney General Eliot Spitzer to police their activities. Spitzer had become the bane of the business community by exposing questionable and sometimes fraudulent practices by investment analysts, mutual fund managers, pharmaceutical companies and the insurance industry. His have been politically popular actions with the investing public. In October 2004, the US Chamber of Commerce sued the Securities and Exchange Commission, challenging its authority to tell them how boards should be structured in mutual fund companies. The agency had demanded that all such companies have independent chairmen and that 75% of their directors be independent. It is the first time in history the Chamber of Commerce has taken such a drastic step. The Managed Fund Association, which represents dealers in hedge funds and futures, has challenged a plan by the Securities and Exchange Commission requiring hedge fund advisors to register. Insurance brokers, under investigation by the New York attorney general for accepting commissions that resemble kickbacks from insurance companies, balked at the demand that they make their business more transparent by disclosing the fees upfront. There was also a chorus of complaints about Section 404 of the Sarbanes-Oxley Act, which requires auditors to verify a corporation's internal controls. Corporate executives said these verifications were costly and time-consuming.

Weighing in on the side of business leaders, US Treasury Secretary John Snow warned in December 2004 that regulators and prosecutors have to be balanced in the way they enforce new rules. He said he did not want what he called innocent bookkeeping mistakes treated as fraud. In July 2005, Leo Strine, the vice-chancellor of the Court of Chancery in Delaware, said the Sarbanes-Oxley Act was an infringement of state jurisdiction by the federal government. He accused federal legislators of hypocrisy, delaying public accounting reforms during the Clinton administration, and then switching sides in the wake of the scandals. Strine's comments have weight because more than 60 per cent of the largest US companies are incorporated in Delaware. The Court of Chancery is the court where business disputes are heard.[110]

William Donaldson, the former chairman of the Securities and Exchange Commission, acknowledged the growing opposition and accused some business groups of trying to derail much-needed improvements. The business response was a successful campaign to have Donaldson removed. In the summer of 2005, President Bush replaced him with Christopher Cox, a Republican congressman. The Wall Street Journal said the appointment of Cox, a free-market conservative who authored legislation that made it easier for companies to defend themselves against some types of lawsuits by shareholders, was a setback for the crackdown on white-collar crime.[111] Cox is not expected to take a tough line with companies.

Taken together, all these moves indicate that certain business leaders have decided that regulation post-Enron has gone too far and that the time has come to dig in their heels and resist further changes. This is not to say that they will succeed. Momentum has built in the US Justice Department, which formed a special task force in mid-2002 and has since charged more than 900 individuals in more than 400 cases of corporate fraud. As of mid-2005, 500 of those individuals have been convicted, including Dennis Kozlowski, former chief executive of Tyco International, Bernie Ebbers, former chief executive of WorldCom, and Andrew Fastow, former chief financial officer for Enron.

Nevertheless, the push for better corporate governance in the US has hit a rough patch compared with smoother sailing early on. This has implications for Canada because regulators here tend to lag their US counterparts. It is also an indication that the momentum for reform is felt most strongly in the immediate aftermath of a scandal and then begins to peter out. The time lapse between Enron and the corporate backlash against tightened regulation was about three years. Legislative and regulatory authorities had a three-year window in which to act. Further research would be required to determine whether this window for action is consistent with all scandals and whether it is shrinking.

PART FIVE: THE CANADIAN EXPERIENCE POST ENRON

Three years after Enron collapsed, Bank of Canada Governor David Dodge told a group of business luminaries in Toronto that the Canadian regulatory environment was seen abroad as a "Wild West."[112] It was not the first time that the central bank had issued such a warning. Sheryl Kennedy, deputy governor of the bank, had made several speeches touching on this same point in the previous year. The fact that the governor felt compelled to repeat this caution was evidence that the message was not getting through.

In contrast to the United States, where legislators moved rapidly to pass the Sarbanes-Oxley Act in 2002, tighten up corporate governance regulations, and arrest an array of suspected white-collar criminals, Canada moved slowly. This foot-dragging occurred despite the fact that Canadian companies listed on US stock markets have to comply with the Sarbanes-Oxley Act or lose their listing. There are some in the business community who argue that moving slowly is better for Canada in that regulators here can see what works and what doesn't in the United States before adopting similar measures.[113] There is also the argument, often made in Canada that while the United States relies on rules to control corporate behaviour, Canadian laws rely more on general principles.

Maintaining the public's confidence in the stock market was a priority for governments and regulators on both sides of the border. Share ownership in Canada doubled between 1989 and 2002, rising to 46 per cent of the adult population. Figures released by the Toronto Stock Exchange in early 2005 indicate share ownership has since reached 49 per cent. This meant that authorities had to do something in the face of widespread Canadian anxieties. Moves were made on a number of levels by the federal government, provincial securities regulators and by some of the large, institutional investors.

A change in the Canada Business Corporations Act in 2001, allowing shareholders to talk to each other for the first time, led to the establishment in 2002 of the Canadian Coalition for Good Governance, a group of institutional investors such as pension funds. They have outlined their own governance guidelines and have been working with major corporations behind the scenes on perceived lapses.[114] There is some evidence that other institutional investors have become activists in pushing for better corporate governance.[115] This development is so new that it is difficult to determine what effect the institutional investors will have. The emergence of institutional investors willing to take a stand on corporate governance will help the media cover this issue, provided the institutional investors are prepared to speak publicly. Journalists need real people to interview.

In 2004, provincial and territorial securities regulators adopted three rules that generally mirrored provisions in the Sarbanes-Oxley Act. The first requires the chief executive officer and chief financial officer to certify annual and quarterly reports from the company. The second says that the audit committees of major Canadian public companies should be fully independent and financially literate. (This second provision has not been accepted by all the provinces). A third rule established the Canadian Public Accountability Board and prohibited independent auditors from performing non-audit services for their audit clients.[116] Canada also moved in 2004 to require publicly traded companies to recognize expenses for all employee stock-based compensation. In this, Canada was ahead of the US, where the hidden cost of stock options remains a contentious issue.[117]

However, other efforts to update provincial guidelines on corporate governance dragged on for several years. The Toronto Stock Exchange set up a committee in 2000 to review and propose amendments to its 1995 corporate guidelines. When the committee reported in 2001, just as the Enron story was breaking, its recommendations were criticized as too tame. The Toronto Stock Exchange planned to implement them anyway. But then came the Sarbanes-Oxley Act in the US The Toronto Stock Exchange decided to take another look at its proposals. The Ontario Securities Commission then entered the picture and decided to draft some guidelines of its own. The Toronto Stock Exchange decided to bow out and leave the job to the OSC and other provincial securities commissions. New proposals were unveiled by the OSC in early 2004. Three months later, Alberta, Quebec and British Columbia published their own proposals. The provinces decided they should put these all together as one set of guidelines, which they published for comment in October 2004. They were due to be implemented sometime in 2005.[118]

One of the obstacles to speedier progress on improving corporate governance in Canada has been the stubborn refusal of some provinces to relinquish control over securities regulation in order to form a single national regulator. As Christopher Armstrong made clear in his two-volume history of securities regulation in Canada, this federal-provincial wrangling over jurisdiction is almost as old as Canada itself. It continues despite efforts by the Ontario government and the federal government to resolve the matter. In his most recent federal budget, delivered in February 2005, Finance Minister Ralph Goodale mentioned the need for more uniform regulation. But it remains unclear whether any progress will be made in this key area. This is a political problem, but it has serious implications for how the corporate sector functions.

There is anecdotal evidence that insurance companies have begun reviewing corporate practices in deciding the rates they will charge for liability insurance for directors and officers of corporations. Some bond rating agencies have started similar reviews. All of this puts pressure on companies to improve their governance.

Offsetting this pressure is the reluctance on the part of Canadian business leaders to criticize one another publicly. Canada is a small country and the people heading the major corporations tend to know each other, meet each other at social events, and join the same clubs. Often, their companies have business ties. The clubby nature of corporate Canada was cited by David Nayman of Newsworld as one of the reasons why television found it difficult to find qualified experts in Canada to talk on camera about a scandal. Television often had to go to the US to find an expert willing to appear.[119] Claude Lamoureux of the Ontario Teachers' Pension Plan, one of the emerging activist institutional investors, also mentioned the tight-knit nature of corporate Canada as a brake on more public discussion of corporate wrongdoing.[120]

Another offsetting pressure on governance reforms has been increased opposition from the business community, mirroring the growing resistance in the US. In early 2005, the heads of Power Corp. and Manulife Financial Corp., two of Canada's largest corporations, both went public with complaints that regulation had gone too far. Interestingly, the price of shares in both companies fell on the day the remarks were made.[121]

When Governor Dodge made his "Wild West" comments, he identified enforcement as the key area of concern. "There is a widely held perception that Canadian authorities aren't tough enough in punishing fraud and enforcing insider trading and other rules," he said. The governor acknowledged that some steps have been taken but said more needs to be done.[122]

A week after Mr. Dodge made his speech, the Ontario Securities Commission announced a number of settlements it had negotiated with four of Canada's largest mutual fund firms who had given preferential treatment to a handful of sophisticated investors at the expense of their long-term investors through what was called market timing. The four firms made total profits of $303 million and collected extra management fees of $17.3 million on these suspect trades. Yet the restitution they agreed to make under the settlement amounted to only $156.5 million.[123]

The Quebec Financial Markets Authority announced in May 2004 that it would end this practice of negotiated settlements with alleged securities violators. Instead of cutting deals, such as the one the Ontario Securities Commission cut with the mutual fund companies accused of market timing, it intends to investigate and prosecute. The authority decided that negotiated settlements, while they can speed up a resolution, are not the best way to restore investor confidence in the financial markets. It is not clear whether the other securities commission will follow Quebec's lead. Early comments from the Ontario Securities Commission indicate that it will not.[124]

Meanwhile, the federal government has stepped up its enforcement efforts. As mentioned previously, the RCMP set up teams to focus on white-collar crime. The federal government also amended the criminal code in March 2004 to make insider trading an offence. It increased the maximum sentences for fraud offences. It gave investigators new powers to obtain data and information from persons under investigation. And it provided protection to whistleblowers—employees who report unlawful conduct.[125]

One of the biggest obstacles to cracking down on corporate crime in Canada remains attitudes towards white-collar crime. In an interview for this research, Superintendent John Sliter, director of the Integrated Market Enforcement Branch, said that corporate criminals often appear to be pillars of society, not "slobbering sex offenders." Police find it tough to persuade judges that such criminals "who wheel and deal and socialize in the highest circles" should be sentenced to jail terms.

It is indicative of public attitudes towards corporate wrongdoing, that in the spring of 2005, the head of one of the mutual fund companies caught in the market timing scandal was invited to give a speech at the University of Toronto on corporate citizenship, despite the fact that his company had been caught short-changing its small investors.[126]

Supt. Sliter said that when the RCMP was trying to persuade the federal government to put more money into cracking down on corporate crime, it tried several arguments before it found one that worked. First, the RCMP tried to show the government that these crimes were not victimless. When that did not work, it drew links between corporate criminals and biker gangs and organized crime in Eastern Europe. After the attacks on the World Trade Center in New York in September 2001, the RCMP raised the possibility that terrorists had links with corporate crime. The approach that finally persuaded Ottawa to put more money into enforcement was when the RCMP showed the Department of Finance that corporate crime cost the Canadian economy an estimated $5 billion a year. Supt. Sliter's program was then given $30 million a year. He worries that, once the memory of Enron fades, there may be cuts.[127]While there is no doubt that effective enforcement is key to reducing corporate crime, there is a danger that a focus on enforcement alone reinforces the "bad apple" argument and saps efforts to identify and rectify problems with regulation and legislation.

What of Canadian media coverage post-Enron? The media write the first version of history, interpreting complicated events and reducing them to an understandable narrative. How did the media interpret the US scandals?

In an analysis of Canadian and American media coverage presented at the University of Alberta in May 2003, James Williams said several explanations of the scandals were offered, sometimes within the same publication. Williams wrote that the “bad apple” theory was advanced by some journalists, as was a natural cycle of capitalism argument, in which periods of excess are seen as inevitable. Some publications also mentioned problems with regulation and indeed with capitalism itself.[128] But Williams found there was underlying agreement in the articles that American capital markets are the most “efficient, effective and productive in the world.” There also appeared to be broad agreement that any increase in regulation would reduce market efficiency.

“The result is that the overall structure, logic, and tenor of the debate assumes an inherently conservative quality which is naturally conducive to the reproduction of the status quo, or some variant thereof,” wrote Williams.[129] It would appear from his analysis, that the media accepted the argument, also advanced by key business groups, that the solution to the scandals is not more regulation.

That said, Enron did provoke a heightened sensitivity in the media to wrongdoing by corporate leaders. This was more apparent in US publications, such as the Wall Street Journal, which in 2004 posted an interactive Scandal Scorecard on its website, and The New York Times, which in 2005 was still running critical commentary on companies who had not reformed their governance practices. In Canada, The Globe and Mail has run surveys of corporate boardroom practices on an annual basis, identifying companies that fall short of minimum standards. This has increased pressure on companies to change.

The most comprehensive coverage of a Canadian scandal post-Enron has been the corporate downfall of Conrad Black. This may be due to the fact that Black, as a former newspaper owner, was already a well-known figure to the media and was a colourful celebrity in his own right. The fact that the Black scandal first broke in the US and was covered by American media, thus validating it as an important story, may also have been factors.

The partial collapse of Nortel Networks, in which investors lost billions, not hundreds of millions, has not been treated as a scandal in Canada, even though questionable accounting was discovered. What is missing from Nortel, however, is a celebrity figure such as Black on which to focus blame. Without the personal story, the media have not sustained their interest.

To summarize, Canadian authorities tightened some laws and regulations post-Enron and there is a heightened sensitivity to corporate crime. However, public attitudes towards white-collar crime, the clubby nature of the corporate community, and the fact that Enron, WorldCom and the other scandals, occurred in the United States, have meant that the reaction in Canada appears anemic compared with the robust response south of the border.

6. PART SIX: WHY WE ARE DOOMED TO REPEAT OUR MISTAKES

No scandal has an impact that lasts forever. Memories fade with time and with them the pressure on the relevant authorities to pass new laws and regulations, or update existing ones, to prevent the same scandal from happening again. It was ever thus. Yet in looking at Canadian scandals over the span of a century, it seems that the half-life of a scandal, that period in which there is pressure for change, has shortened. And even when that pressure is at its strongest point, powerful countervailing forces resist disruption of the status quo.

Corporations lobbying against further regulation form one of those forces. There is also a connection to be made between corporate calls for lower taxes and less government and the underfunding of enforcement and regulatory bodies whose job it is to keep corporations in check. At some point, reducing government revenues also reduces its ability to regulate effectively.

However, corporate lobbying efforts would not be as effective as they are were it not for a number of other factors present in Canada, namely public tolerance of white-collar crime, the growing media fixation with celebrity and human interest stories, a fragmented system of securities regulation, and structural changes in the Canadian media that have reduced both the media's concentration span and its appetite to cover complicated regulatory and policy stories.

In analyzing the Canadian reaction to financial scandals, seven reasons emerge for why we are doomed to repeat our mistakes:

1. The lifecycle of a scandal strongly suggests that once the punishment stage is passed, media attention tapers off and the pressure on regulatory and legislative authorities to make difficult changes is reduced. This means that necessary changes are not made to prevent a repeat of the same behaviour.

2. Faced with enormous business disasters, albeit ones that occurred in the United States, regulators in Canada have dragged their feet in making changes to prevent an occurrence here. If they could not summon the energy to take on the business community in such an environment, when could they do it?

3. Federal-provincial wrangling over jurisdiction for securities regulation has been going on for over 70 years, leaving Canada with a mishmash of securities regulation. There is no indication that this political battle is anywhere near over.

4. The bad apple argument has strong appeal to both to the business community, which is adamantly against regulation, and to journalists, who prefer a human-interest story, featuring a colourful individual, or even a celebrity, over a complicated story about regulatory change and policy prescriptions.

5. There is greater emphasis on enforcement as a cure for scandals. While tougher sentences are to be welcomed, enforcement alone is not the answer. In a related development, there is no sign that securities regulators, other than the regulators of Quebec, are willing to abandon their practice of negotiating settlements with corporate wrongdoers, which frequently leads to lenient penalties and no admission of guilt on the part of the accused.

6. The clubby nature of corporate Canada makes it a potent countervailing force. Corporate leaders all know each other, are loath to expose each other's failings, can band together effectively to fight off the regulators and legislators, and appear to believe in the Canadian myth of our own goodness.

7. The under-funding of enforcement and regulation has meant that the risk-reward ratio remains high. As long this continues, people will be tempted to use illegal or unethical ways to make money.

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