

# Scandals and Trends from Enron to Hollinger

*Happenings, Observations and Advice!*

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### *Happening, Observations and Advice<sup>1</sup>*

When and Where?	The "Bad" News Governance Scandals / Issues	The "Good" News Governance Initiatives / Responses
Nov.22, 2001 Canada		<b>TSE and CICA</b> release final Saucier Joint Committee Report recommending few minor changes to existing standards in Canada from '94 Dey Guidelines.
Dec.2001 US	<b>Enron</b> files for bankruptcy amid a flood of questionable accounting practices (including using SPE's or special purpose entities to hide liabilities; and bank loans to create artificial revenues.) This despite a blue ribbon board, apparently clean governance structure and code of ethics (which board voted to violate.)	
June 2002 US	<b>Tyco International</b> board criticized for failing to oversee former CEO Dennis Kozlowski's dealings with the firm. Major revelations during previous 3 months of hidden losses, frauds, inflating revenues, audit failures at: <b>Arthur Andersen, Adelpia Communications, ImClone Systems, Dynegy, Global Crossing, Qwest, Waste Management</b> and <b>Xerox</b> , among many others. An estimated 2/3 of <b>Fortune 500</b> have had a significant restatement of profits in 2001 or 2002.	
July 2002 US	<b>WorldCom</b> files for bankruptcy: largest bankruptcy in US history. WorldCom overstated profits by up to \$11 billion ("misclassifying" expenses as capital, booking reserves instead of writeoffs.)	
July 2002 US		<b>Sarbanes-Oxley Act (SOx)</b> adopted by US Congress & President, introducing sweeping new governance rules: <ul style="list-style-type: none"> <li>• CEO and CFO certifications and penalties</li> <li>• auditor restrictions, disclosures, oversight, rotation</li> <li>• board and committee independence, prescribed mandates, evaluation,</li> </ul>

		<p>disclosures</p> <ul style="list-style-type: none"> <li>• financial expert and literacy required on audit committees</li> <li>• "independence" redefined; cooling off periods</li> <li>• whistle blower protection</li> </ul>
July 2002 Canada		<b>Canadian Public Accountability Board</b> established to oversee auditors.
Sept.2002 Canada		<b>Canadian Council of Chief Executives</b> releases major report on corporate governance, calling for CEOs to take lead in ensuring ethics, disclosure, competent boards, etc.
Sept.2002 France		<b>Bouton Report</b> released [update to Vienot reports of '95 & '99]: best practices based on principles: <ul style="list-style-type: none"> <li>• board review of material changes</li> <li>• clear delineation of authority</li> <li>• ways directors can exercise right of access</li> <li>• independence redefined and should be reviewed by boards (2/3 of audit committee)</li> <li>• mandates, evaluations, disclosure tightened</li> <li>• independence of auditors strengthened</li> </ul>
Oct.2002 Canada	<b>Globe &amp; Mail</b> publish week long "Board Games" series: a large number of publicly traded Canadian companies fail to measure up to corporate governance standards.	
Nov.2002 Germany		<b>Cromme Committee</b> revises Kodex '01 corporate governance standards
Dec.2002 India		<b>Chandra Committee</b> recommends revision to corporate governance standards (similar to SOx): <ul style="list-style-type: none"> <li>• auditor relationship (independence)</li> <li>• independence of audit committees and boards</li> <li>• CEO certification</li> </ul>
Jan. 2003 UK		<b>Higgs Report</b> released [UK response to SOx]: <ul style="list-style-type: none"> <li>• majority of independent directors</li> <li>• CEO should not become Chair</li> <li>• firms must comply or explain departure from revised Combined Code [i.e. principle-based system like Canada not US]</li> <li>• disclose board selection &amp; evaluation processes, attendance</li> </ul>

		<ul style="list-style-type: none"> <li>• over 10 years tenure considered end of independence</li> </ul> <p><b>Smith Report</b> deals with audit process: independence, audit committees, external and internal auditors. Both adopted effective Nov.2003.</p>
Jan.2003 Canada		<p><b>OSFI</b> releases new Corporate Governance Guideline for Canadian financial institutions:</p> <ul style="list-style-type: none"> <li>• risk management central to control</li> <li>• independent outsiders on board</li> <li>• audit committee, audit regime standards</li> <li>• governance of subsidiaries (effective chain)</li> </ul>
Jan.2003 Netherlands		<p><b>Peters Report</b> - companies are failing to meet governance standards introduced in '97; new committee struck.</p>
Jan.2003 Spain		<p><b>Aldama Report</b> recommends revisions to Olivencia guidelines '97.</p>
Feb.2003 Italy		<p><b>Italian government</b> passes new law permitting threshold of (0.5%) shareholders to nominate directors.</p>
Feb.2003 Canada		<p><b>CPP Investment Board</b> issues tough new proxy voting guidelines, including a call for an effective end to stock options.</p>
Mar.2003 Australia		<p><b>ASX Council</b> introduces new corporate governance guidelines (similar to SOx)</p>
March 2003 Canada		<p><b>"Wise Persons" Committee</b> established by federal government to identify appropriate model for securities regulation in Canada.</p>
March 2003 Canada		<p><b>Conference Board and McMaster</b> announce launch of Directors College, Canada's first director certification program. ICD and Rotman follow suit.</p>
April 2003 US	<p><b>American Airlines</b> CEO Donald Carty forced to resign over secret bonuses to executives while unions agree to cuts as part of restructure to stave off bankruptcy.</p>	
May 2003 Canada	<p><b>Spencer Stuart/Rotman</b> Board Index released:</p> <ul style="list-style-type: none"> <li>• harder to recruit new directors</li> <li>• need to enhance performance measurement processes and training</li> <li>• pressure on level and structure of board compensation</li> </ul>	
July 2003 US	<p><b>Delaware courts</b> hand down major (and surprising) decisions against the boards of <b>Disney</b> and <b>Oracle</b> for failing to act</p>	

	diligently and independently in executive comp. transactions. Delaware, long a "safe zone" for incorporations, is seen to be moving power and sympathy to shareholders.	
July 2003 Europe		EU releases discussion paper on <b>EU corporate governance</b> : some common principles and benchmarks; "comply or explain" approach plus a "few essential rules"
July 2003 Canada		<b>Senate Banking Committee</b> releases report "The Perfect Storm" (recommendations for new Canadian corporate governance standards): <ul style="list-style-type: none"> <li>• need both rules and principles</li> <li>• split CEO and Chair</li> <li>• most of SOx regulations on independence, committees, audit, etc.</li> </ul>
July 2003 Canada		<b>OSC</b> and all but one (BC) provincial securities regulator introduce <b>new Canadian governance rules</b> (reflecting SOx): <ul style="list-style-type: none"> <li>• CEO certifications</li> <li>• independent audit committees (smaller firms exempt)</li> <li>• strong powers for auditor oversight</li> </ul>
Aug.2003 US		<b>Governance Metrics International</b> publishes research showing "well governed" companies outperform "poorly governed" on stock market in 3 year period
Sept.2003 Netherlands	<b>Royal Ahold</b> (huge Netherlands marketer) board chair forced to resign by investors: insider board, secrecy, accounting and control failures, yet high CEO pay package.	
Sept.2003 Canada	<b>Globe &amp; Mail</b> publish week long "Board Games" series (2nd year): <ul style="list-style-type: none"> <li>• significant improvements in scores for 2/3 companies in Canada (RBC and TransAlta tie for 1st)</li> <li>• room to go in compensation and nominating committees, directors owning shares, executive comp.-criteria, disclosure and stock option dilution, interlocking directorships, fully independent chairs (and directors), special share classes, disclosure of directors' qualifications, loans to officers, women on boards</li> <li>• TSE yielding responsibility for setting corporate governance standards to OSC</li> </ul>	

Sept.2003 Canada		<b>Canadian Coalition for Good Governance</b> publishes new Corporate Governance Guidelines that include both minimum standards and "best practices" in 12 areas of governance (covering almost every area) - notable: <ul style="list-style-type: none"> <li>• director share ownership</li> <li>• effective board/director evaluations</li> <li>• stronger board role in strategy, CEO evaluation, succession and comp.</li> </ul>
Sept.2003 Canada	Published reports that <b>major pension funds</b> are in serious deficit positions led by Air Canada, Bombardier, Nortel, Inco, Quebecor, Alcan each over \$500 million underfunding. 60 funds on OSFI watch list. Economic reality and governance failures combined.	
Sept.2003 US	<b>NYSE CEO Richard Grasso</b> resigns over \$140 million exec. comp. package approved by board then challenged by shareholders and the SEC. Board and Comp. committee members claim ignorance; SEC chief says "raises serious questions regarding the effectiveness of the NYSE's current governance structure."	
Sep/Oct.2003 Canada	<b>Ivey Business Journal</b> publishes research by Richard Leblanc and Jim Gillies (Schulich) that corporate performance bears no relationship to board structure - questions all new governance standards.	
Oct. 2003 US	US Treasury Secretary John Snow says that <b>executive compensation</b> is the next area that needs to be addressed: too many packages not linked to long term performance.	
Oct. 2003 France	<b>Rhodia</b> CEO J-P Tirouflet resigns in face of creditor demands and court investigations. A shareholder resolution to oust him in April gained 33% of votes, unheard of in France, but still lost.	
Oct.2003 Australia	Rare public criticism of dual/multiple listed companies like <b>Royal Dutch/Shell, Unilever, Rio Tinto</b> , and most multi nationals: "weaken the position of shareholders and entrench the position of board and management."	
Oct. 2003 US		<b>WorldCom</b> (now MCI) emerges from bankruptcy, after paying \$2.25 billion in civil settlements and adopting stringent new corporate governance standards

		beyond SOx: <ul style="list-style-type: none"> <li>• forcing director turnover,</li> <li>• splitting chair/CEO,</li> <li>• shareholder rights to propose resolutions and approve "governance constitution",</li> <li>• employee ethics training</li> </ul> based on Richard Breeden's ground-breaking Aug.2003 report <i>Restoring Trust</i>
Nov.2003 Canada	<b>Air Canada</b> agrees to pay \$21 million "retention bonuses" each to CEO Robert Milton and EVP, while unions agree to cuts in bankruptcy restructuring.	
Nov.2003 US	NY state and SEC launch investigations into illegal or improper trading at 12 large <b>mutual funds</b> .	
Nov.2003 US	<b>NYSE</b> fails to reach consensus among major owners on restructuring board and role in regulating corporate governance.	
Nov.2003 UK	<b>Rupert Murdoch</b> uses controlling share block (35%) to defeat shareholder resolutions at BSkyB on director elections, remuneration to CEO. Murdoch pays 10 million pounds to outgoing CEO after promising shareholders he won't.	
Nov.2003 US & Canada	<b>Hollinger International</b> fires Conrad Black as CEO: unauthorized and unreported payments to Black ("non compete fees") on transactions while company posted \$200 million loss. Blue ribbon board includes Henry Kissinger (missed 3/4 meetings), Richard Perle, Gov. James Thompson and Amb. Richard Burt. Special committee investigation instigated by investor Tweedy Browne and protected by SEC. Parent Hollinger Inc's 4 independent directors (audit committee) all resign, all 4 are prominent respected Canadians. Black fired as Chair and sued for \$200 million in Jan.2004.	
Nov.2003 US	<b>Disney</b> board splits on evaluating CEO Michael Eisner and costs of "foul ups" ["squandering shareholder value", including major shareholder suit for severance to Michael Ovitz tests director "independence"] - Roy Disney and Stanley Gold resign	
Nov.2003 Germany	<b>Deutsche Bank</b> CEO Josef Ackermann charged criminally for approving bonus for phone co. CEO	

Nov.2003 Sweden	<b>Skandia</b> - company famous for its CSR leadership - fires top executives and chair for unauthorized bonuses and perks	
Nov.2003 Canada	<b>CD Howe Institute</b> publishes report that shows "well governed" companies fail to outperform "poorly governed" ones. Propose "value creating" governance standards to replace orthodox "fiduciary" standards.	
Nov.2003 US		US SEC approves <b>new corporate governance rules for NYSE and Nasdaq listed</b> companies: [changes to drafts:] <ul style="list-style-type: none"> <li>• compliance dates moved up to 2004;</li> <li>• directors not considered independent if receive more than \$100k annual comp.;</li> <li>• "cooling off" periods reduced to 3 years for director independence tests.</li> </ul> [Major elements from SOx:] <ul style="list-style-type: none"> <li>• definition of director independence based on material relationship(s) with firm;</li> <li>• majority of board and all members of key committees must be independent;</li> <li>• disclosure of governance guidelines, code of conduct/ethics, compliance with rules</li> </ul>
Dec.2003 UK		UK Government introduces <b>new Companies Bill</b> [counterpart of SOx]: <ul style="list-style-type: none"> <li>• directors certifications to auditors</li> <li>• broader powers to auditors</li> <li>• new powers to anti-fraud bodies</li> <li>• whistle blower protection</li> </ul>
Dec.2003 US		<b>NACD</b> releases report advising boards and <b>compensation committees</b> on principles, charter and evaluation practices to deal with failures in executive comp.
Dec.2003 Canada	<b>CA Magazine</b> publishes special edition on corporate governance with new research/views: <ul style="list-style-type: none"> <li>• CEOs still have inordinate amounts of power: neither boards nor shareholders have experienced any real gains</li> <li>• investment community heavily conflicted</li> <li>• new governance regulations are needed (government)</li> </ul>	
Jan.2004 Europe	<b>Parmalat</b> CEO and other officers implicated in a fraud of breathtaking proportions. Probes begin in Italy and Europe - family dominated firm with	

	captured board a common occurrence.	
Jan.2004 OECD		<p><b>OECD</b> releases draft revised Corporate Governance Principles:</p> <ul style="list-style-type: none"> <li>• accounting and audit standards</li> <li>• independence of board members</li> <li>• duties of board</li> <li>• investors' rights: nominate directors, views on comp., question auditors</li> <li>• disclose voting policies of institutional investors</li> <li>• disclose conflicts of interest (investors, rating agencies, brokers), related party transactions</li> <li>• whistle blower protection by boards</li> </ul>
Jan.2004 Australia, Sweden and Hong Kong		National initiatives launched in all 3 countries to give shareholders votes on <b>executive compensation</b>
Jan.2004 Canada	Investors question "where in the heck is <b>the Canadian watchdog?</b> " after weeks of complete silence from the OSC, the regulator of Hollinger Inc. Doubts surface about Canadian resolve to police securities practices.	
Jan. and April 2004 Canada		<b>CSA securities regulators</b> issue 2 competing new draft corporate governance guidelines and disclosure requirements
Jan. 22, 2004 Canada	OSC discloses that it has launched an investigation in the <b>Hollinger</b> matter	
Mar. 2004 Europe	<b>Royal Dutch Shell</b> acknowledges overstating reserves and earnings: reduces energy reserves by 4.47 billion barrels of oil (23% of reserves) and reduces earnings by \$402 million for 2001-03. Chairman Philip Watts and Head of Exploration and Production Walter van de Vijver terminated.	
Mar. 2004 Canada	<b>Royal Group Technologies</b> under investigation by RCMP and OSC for alleged fraud and governance violations	
Mar. 30, 2004 Canada		<p><b>CSA (Canadian Securities Administrators)</b> sweeping corporate governance reforms take effect (announced in July 2003 as Canadian response to SOX), including:</p> <ul style="list-style-type: none"> <li>• auditor independence (52-108),</li> <li>• CEO/CFO annual &amp; interim certifications (52-109),</li> <li>• Audit Committee (52-110) and</li> <li>• continuous disclosure (51-102)</li> </ul>

		requirements B.C. opts out of certifications and Audit Committee requirements; exceptions are permitted for small cap and family firms
May 2004 Canada	OSC expands probe into potential market timing and late trading abuses by <b>mutual fund</b> managers. <ul style="list-style-type: none"> <li>• Late trading is illegal and occurs when purchase or redemption orders are received after the close of business, but are filled at that day's price rather than the next day's price.</li> <li>• Market timing involves short-term trading of mutual fund securities to take advantage of short-term discrepancies between the price of a mutual fund's securities and the stale values of the securities within the fund's portfolio.</li> </ul>	
May 17, 2004 Canada	Cease trading order issued against <b>Nortel</b> insiders as a result of new revelations of accounting misstatements, termination of senior financial officers, and delays in disclosing restated financial results	
May 18, 2004 Canada	Cease trading order issued against <b>Hollinger</b> insiders as OSC's first public enforcement action in the Hollinger matter	
June 2004 Canada	OSC initiates a quasi-criminal prosecution against four individuals, former members of senior management at <b>Atlas Cold Storage</b> , for offence of filing financial statements that were misleading by understating expenses by inappropriately capitalizing expenses thereby overstating net income and distributable cash.	
Aug. 2004 USA	<b>Hollinger International's</b> Special Board Committee releases its Investigation Report: <ul style="list-style-type: none"> <li>• "a corporate kleptocracy"</li> <li>• "systematic manipulation" by controlling shareholders that "violated every concept of fiduciary duty"</li> <li>• Controlling shareholders "transferred to themselves" more than \$400 million in 7 years, or 95% of entire net income during 1997-2003</li> <li>• "behind a constant stream of bombast" Black and Radler "lined their pockets almost every day, in almost every way"</li> <li>• "self-righteous, aggressive looting"</li> <li>• "liquidity needs from personal lifestyle"</li> <li>• "one scheme after another was devised"</li> </ul>	

	SEC and Illinois court now proceed with cases; Conrad Black finally forced from board chair position.	
Sept. 2004 China		<b>China Securities and Regulatory Commission</b> proposes major corporate governance reforms in China to protect minority shareholders. Draft rules would affect approval of related-party transactions, new stock issues, major strategic decisions and internet voting. Will be a tough fight to get rules approved, and if approved, enforced.
Oct. 2004 Europe		<b>Royal Dutch Shell</b> adopts a single, unified board, separate and single chair and CEO, single share structure and other governance reforms, from a dual-board and dual-share structure, in response to investor pressure due to ongoing governance and disclosure scandals. Stock price surges on the news.
Oct. 2004 Europe		<b>European Commission</b> announces first EU-wide corporate governance best practice standards, including: <ul style="list-style-type: none"> <li>• disclosing executive compensation</li> <li>• shareholder votes on comp policy</li> <li>• “sufficient” independent directors</li> <li>• Audit, Remuneration and Nomination Committees of the Board</li> </ul> Standards are voluntary but EU states are urged to implement them.
Oct. 2004 Korea	Chey Tae-Won resumes duties as Chairman of <b>SK Corp</b> , the world’s second largest oil refiner, despite being out on bail, jailed for accounting fraud and insider trading. Korea has long suffered from the power and abuses of <i>chaebols</i> , far-reaching family owned corporate conglomerates.	
Oct. 2004 USA	<b>Disney</b> case finally heard by Delaware Chancery Court: shareholders suing directors for rubber stamping \$140 million severance to Michael Ovitz.	
Nov. 2004 Russia	<b>Russia</b> fails 39 of 40 benchmark tests set for the nation in 2002, Standard & Poor’s reports in Moscow. Basic standards of disclosure, related party transactions and enforcement of investor rights all continue to fail to be met. Russia’s ongoing inability to deal effectively with the <b>Yukos</b> scandal is but one example.	
Nov. 2004 US/Australia	<b>News Corp’s</b> Rupert Murdoch took advantage of its recent reincorporation in	

	Delaware (from Australia) to adopt a poison pill defence against potential takeover rival Liberty Media, a defence that would not have been permitted in Australia	
Nov. 2004 Canada		CSA releases new corporate governance guidelines and disclosure requirements, a consensus and compromise solution among all provinces to earlier competing drafts; Canada will continue with a “comply or explain” (principles based) approach
Dec. 2004 Canada	OSC approves settlement agreements totalling <b>\$156.5 million</b> to be distributed to <b>mutual fund</b> unit holders who suffered harm from market timing activities in CI Mutual Funds Inc., AGF Funds Inc., I.G. Investment Management, Ltd. and AIC Limited.	
Dec. 2004 USA	<b>TIAA-CREF</b> pension fund trustees implicated in conflict of interest scandal with auditors to secretly set up new firm to value stock options, while TIAA-CREF led investor campaign to require stock option expensing. Two other leading global institutional investors, <b>CALPERS</b> (USA) and <b>Hermes</b> (UK) have also been hit with internal governance scandals and terminations since fall 2004.	

## So ... What Do We Know For Sure??

### *Some Observations and Advice*

1. the pace of corporate governance scandals has not slowed down:
2. part of this may be exposing malfeasance that has always existed, but has been hidden in the past - new regulations give shareholders and directors sweeping investigative powers backed up by government and court clout (e.g. Hollinger special board committee could never have happened before SOx)
3. part of this is inevitable after a sustained stock market and economic boom - most governance failures began as operational setbacks (margins shrinking, sales falling, etc.) and then escalated into malfeasance and failure of governance bodies to detect or stop losses
4. most countries are adopting generally the same new corporate governance standards as Sarbanes-Oxley ...
5. *however*, there is little research to demonstrate that these will improve firm performance or avoid failures ...
6. *however*, many experienced regulators and investors believe they will contribute to stemming failures and losses
7. most research indicates the key is to have the right people on the board, the right governance "culture" vs. structure / compliance ...
8. *however*, Hollinger, NYSE and Enron all had blue ribbon boards
9. clearly, there are more rules/regulations and failures to come, and more rigorous work on what lies behind corporate governance successes and failures, how to effectively promote the former and prevent the latter
10. **our best advice to you** is: adopt the gold standard; voluntarily embrace the highest bar of corporate governance, shareholder disclosure and accountability principles and practices: you will be rewarded by the market, the media, and your own managers and staff; and will be protecting your corporation's assets, interests, reputation and your own personal liability

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<sup>1</sup> Brown Governance Inc. acknowledges a number of news articles from *Global Proxy Watch* were used as sources.