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'Broken Windows' and Corporate Corruption

The social science theory of 'broken windows' is generally associated with an analysis of criminology and underlying contextual circumstances that influence criminal and disorderly behaviour. An oft-cited work that is used to explain the 'broken windows' theory is an article by James Q. Wilson and George L. Kelling in *The Atlantic Monthly* in March 1982.[1] The basic theory is that a broken window in a building transmits the message that the community has a lack of control and is unwilling or unable to enforce or defend itself against criminal behaviour. Neighbourhoods that have a strong sense of cohesion will fix broken windows, assert social responsibility and effectively control their circumstances. In a city, relatively minor problems like public disorder, graffiti, panhandling and aggressive behaviour are the equivalent of 'broken windows'. Their theory links disorderly conduct. misdemeanors and incivility within a community to subsequent occurrences of serious crime. The Wilson-Kelling article contained the following analysis[2]:

> "Social psychologists and police officers tend to agree that if a window in a building is broken *and is left unrepaired*, all the rest of the windows will soon be broken. This is as true in nice neighborhoods as in run-down ones. …; one unrepaired broken window is a signal that no one cares, and so

[1] James Q. Wilson and George L. Kelling, "*Broken Windows: The Police and Neighborhood Safety*", (The Atlantic Monthly, March 1, 1982). James Wilson was a Professor of Government at Harvard University and George Kelling was then a research fellow at the John F. Kennedy School of Government, Harvard University. See also, George L. Kelling and Catherine M. Coles, "*Fixing Broken Windows: Restoring Order and Reducing Crime in Our Communities*", (Simon & Schuster, 1996).
[2] *Id.*, pp. 2-3.

> breaking more windows costs nothing." [emphasis in original]

Broken windows theory had an enormous impact on police policy and practice in the United States throughout the 1990s, particularly in New York City, and has remained influential, and controversial, into the 21st century. In 1985 Kelling was hired as a consultant to the New York City Transit Authority, which implemented his order maintenance policies in New York City's subways. William Bratton, who was the chief of the New York City Transit Police from 1990 to 1992, adopted Kelling's theory, calling Kelling his "intellectual mentor". Squads of plainclothes officers were assigned to catch turnstile jumpers, and, as arrests for misdemeanors increased, subway crimes of all kinds decreased dramatically. In addition, checks on those arrested for fare-beating found that one out of seven had an outstanding warrant for a previous crime and one out of twenty was carrying a weapon of some sort. Upon assuming office on January 1, 1994, New York City Republican Mayor Rudolph W. Guiliani[3] appointed William Bratton as his Police Commissioner. Bratton introduced his broken windows-based "quality of life initiative". This initiative cracked down on panhandling, disorderly behaviour, public drinking, street prostitution, and unsolicited windshield washing or other such attempts to obtain cash from drivers stopped in traffic. Bratton and others were convinced that the aggressive order-maintenance practices of the New York City Police Department were responsible for the dramatic decrease in crime rates within the city during the 1990s. When Bratton resigned in 1996, felonies were down almost 40 percent in New York and the homicide rate had been halved.[4]

Rudy Giuliani was a strong supporter of the 'broken windows' police enforcement theory while Mayor. He described his understanding of the policy in the following way:[5]

> " 'Sweat the small stuff' is the essence of the Broken Windows theory that I embraced to fight crime. The theory holds that a seemingly minor matter like broken windows in abandoned buildings leads directly to a more serious deterioration of neighbourhoods. Someone who wouldn't normally throw a rock at an intact building is less reluctant to break a second window in a building that already has one broken. And someone emboldened by all the second broken

[3] Rudolph W. Giuliani was Mayor of New York City for eight years (January 1, 1994 to December 31, 2001). His predecessor was Democrat David N. Dinkins (1990-1993) and Giuliani was succeeded by Republican Michael R. Bloomberg who held the position for 12 years (2002-2013). Bloomberg declared himself a Republican (2002-2007) and then an Independent (2007-2013).

[4] William Bratton was sworn in a second time as Police Commissioner of the New York City Police Department on January 2, 2014 following his appointment by the newly elected Democratic Mayor Bill de Blasio who succeeded Michael Bloomberg on January 1, 2014.

[5] Rudolph W. Giuliani with Ken Kurson, "*Leadership*", (Hyperion, New York, 2002), p. 47.

> windows may do even worse damage if he senses that no one is around to prevent lawlessness."

Mayor Michael Bloomberg applied that policy during his lengthy term through his Police Commissioner, Ray Kelly.

Current Mayor Bill de Blasio, the first liberal mayor in 20 years, stopped the 'stop and frisk' extension of the enforcement, which had been heavily employed during the Bloomberg administration. He considered that 'stop and frisk' resulted in racial unfairness, had been applied too aggressively in poor neighbourhoods and had become 'indirect racial profiling' in regard to young black and Hispanic men in poor neighbourhoods.[6] Mayor de Blasio, however, has stated that he believed "in the core notions of the broken windows policy".

Although subject to argument by some that there may be 'unethical manipulation of statistics', recent facts submitted by the New York Police Department reflect benefits to all New Yorkers from the 'broken windows' policy, despite some instances of injustice. "According to the NYPD, there were 333 murders in New York City last year [2013], a drop of more than 85 percent from 1990 when 2,262 New Yorkers fell victim to homicide. Armed robberies are down 81 percent from 1990, rape 55 percent, burglary 82 percent, auto theft 92 percent." As most murder victims in New York City are either Hispanic or black, the decline in homicides is felt most directly in impoverished neighbourhoods and therefore directly benefits those residents.[7]

There is challenging dissent to the 'conventional wisdom' that the aggressive enforcement of misdemeanor laws against disorderly conduct reduces the incidence of more serious crime. Professor Bernard Harcourt of the Columbia Law School appeared on msnbc's "Morning Joe" in December 2014 to re-express his researched opinion that "there is no reliable evidence" to substantiate the 'broken windows' policy. Harcourt's criminal and social science research findings led him to conclude that there is no empirical evidence that the causes of minor disorderly crimes were the same as the causes of serious crime, that one is not the mainspring of the other and that targeting minor offences does not reduce major crimes. "After reviewing the available social-scientific data, replicating a key study, and closely scrutinizing the empirical evidence in New York City, Chicago and other cities, I find that there is no good evidence to support the broken windows theory. In fact, the social science data reveal no statistically significant

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[6] In their original publication, footnote 1, Messrs. Wilson and Kelling worried about unfair or discriminatory application of the 'broken windows' policy: "The concern about equity is more serious. We might agree that certain behavior makes one person more undesirable than another, but how do we ensure that age or skin color or national origin or harmless mannerisms will not also become the basis for distinguishing the undesirable from the desirable? How do we ensure, in short, that the police do not become the agents of neighbourhood bigotry?"

[7] Michael Greenberg, " *'Broken Windows' and the New York Police*", (The New York Review of Books, Vol. LXL, No. 17, November 6, 2014), p. 23. As the author noted, it is hard to manipulate the number of murders.

relationship between disorder and crime in four out of five tests. The existing data, in the words of Robert Sampson and Stephen Raudenbush, do "not match the theoretical expectations set up by the main thesis of 'broken windows' ".[8]

Malcolm Gladwell has an insightful chapter in "*The Tipping Point*" that analyzed the relationship between the 'broken windows' theory with the significant reduction of crime in New York City in the 1990s. Gladwell emphasized what he called the effect of the 'Power of Context' on human conduct, namely, the influence that the environment has on behaviour. The 'broken windows' theory and the Power of Context are one and the same for Gladwell. Rather that explaining disorderly and criminal behaviour as caused primarily by personality traits, dysfunctional families, social and economic inequities, unemployment, lack of education, absence of role models or moral failure, 'broken windows' and the Power of Context both suggest that the individual who carries out disorderly or criminal behaviour is

> "actually someone acutely sensitive to his environment, who is alert to all kinds of clues, and who is prompted to commit crimes based on his perception of the world around him. That is an incredibly radical - and in some sense unbelievable - idea. There is an even more radical dimension here. The Power of Context is an environmental argument. It says that behavior is a function of social context. … The Power of Context says you don't have to solve the big problems to solve crime. You can prevent crimes just be scrubbing off graffiti and arresting fare-beaters: crime epidemics have Tipping Points every bit as simple and straightforward as syphilis in Baltimore or a fashion like Hush Puppies. This is what I mean when I called the Power of Context a radical theory. Giuliani and Bratton - far from being conservatives as they are commonly identified - actually represent on the question of crime the most extreme liberal position imaginable, a position so extreme that it is almost impossible to accept." [9]

What is the relevance of the 'broken windows' policy and New York City's experience in the decrease in serious crimes with the application of that policy to corporate corruption and unethical behaviour of senior officers and directors?

My personal experience in corporate governance as an independent director of more that 25 public, private, not-for-profit and Crown corporations amply supports my judgment that, notwithstanding the lack of a longterm empirical study of how much of

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[8] Bernard E. Harcourt, "*Illusion of Order: The False Promise of Broken Windows Policing*", (Harvard University Press, 2001), p. 7.

[9] Malcom Gladwell, "*The Tipping Point: How Little Things Can Make a Big Difference*", (Little, Brown and Company, 2000), pp. 150-151.

the decline of serious crime in New York City can be attributed to the 'broken windows' theory, the 'cultural and operational environment' of a corporation fundamentally affects the standard and quality of the conduct and behaviour of the individuals who comprise its board of directors, officers and employees. It seems to me that the burden of proof is on those who challenge the effectiveness of a 'broken windows' policy to show, in the context of corporate governance, that there is no link between the lack of adherence to principled standards of orderly behaviour and corrupt or unethical corporate conduct. In other words, that the failure of a corporation to adopt and enforce accepted and appropriate policies and codes of business practices does not influence the level of dishonest or fraudulent conduct within the corporation.

The responsibility to design, establish, apply and enforce a 'broken windows' policy to the conduct of corporate business and affairs rests clearly and squarely with the board of directors. It is the board of directors that has the overriding duty to supervise the management of the corporation. Under the diligent leadership of a non-management and truly independent Chairman of the Board, the board of directors has the obligation to adopt, bring into operation and enforce policies, procedures and processes that are directed to create a culture of ethical behaviour and compliance throughout the company. The application of a non-waiverable policy of exercising irreproachable values starts with the board and, under the board's supervision and oversight, with senior management. These principles of operation apply not only with respect to the performance of the company's business and affairs, but equally with respect to relationships with security holders, customers, suppliers, contractors, regulatory agencies, agents and other stakeholders.

There has to be a culture of and commitment to "zero tolerance" with respect to matters of integrity, ethical conduct and behaviour, and compliance with the code of business conduct. The board needs to make a choice and a decision in this regard, not simply to express a preference: "We will not do it. Period. No matter what the circumstances." If this is not the case, making a bribe or engaging in other forms of corrupt practice feels only half as bad after the fact as previously thought. Once the corporation has knowingly taken this step, it is easier to keep continuing 'sliding down the slippery slope'.

With respect to the important issues of creating confidence in the fairness and equity of applying and enforcing a 'broken windows' policy, it is essential that all directors, officers, managers, employees and company representatives and agents be required to observe and comply with the adopted policies completely. This entails obligations for the board and senior management clearly and periodically to communicate and reiterate the principles and the acceptable and required standards of conduct, and to provide education and training to all company employees and associates in order that they are aware of their responsibilities and of the conduct that is required of them, as well as what is not acceptable. This training is particularly required for all executive, senior and general management functions as well as all staff in business development, procurement, project management, and government relations. In addition to compliance in-person training and awareness, the board needs to ensure that compliance advice and

support services are established and available to officers and employees and others for consultation and guidance on an ongoing basis. In addition, the board has to assure itself that management has developed and integrated compliance operating plans into and as part of the regular business functions of each business unit. On top of these arrangements and functions, the board will require management to carry out compliance monitoring, oversight and reporting to the board or a committee of the board on a regular and periodic basis. There are many other policies and processes to reinforce and deepen an effective culture of compliance including integration in legal affairs, human resources, internal audit and supply chain and procurement.

In creating a culture of ethical behaviour and compliance, there cannot be subjective or varying interpretations of suitable or non-acceptable behaviour, management override or waivers of failure to conform, concepts that some persons are above the application of the adopted standards of behaviour and conduct, or that there are appropriate exceptions to the rules under certain circumstances. Equally important as the uniform and objective application of a culture of ethical behaviour to all is the understanding that there is not an implied or unexpressed notion of 'materiality' to non-compliance. Non-compliance is non-compliance. Judgment is not to be applied whether or not the non-compliance is 'material', and therefore appropriate consequences follow, or the non-compliance is 'not material', and therefore the non-compliant behaviour remains acceptable. The concept or practice of assessing the 'materiality' of a violation or breach cannot enter the discussion.

The OECD Working Group, which monitors compliance with the Convention on Combating Bribery in International Business Transactions for the Organization for Economic Co-operation and Development ("OECD Convention"), to which Canada is a signatory, has expressed concerns with Canada's enforcement efforts and with the leniency of one particular negotiated plea in another case. The federal Department of Foreign Affairs has expressed the opinion that interest in the problems of bribery and corruption on the part of companies doing business in foreign countries was considerably enhanced when more significant penalties and prosecutions of individuals were identified as the likely outcome of future prosecutions.

Griffiths Energy International Inc.

On January 25, 2013, Griffiths Energy International Inc., then a private company based in Calgary, Alberta, pleaded guilty to one charge under the *Corruption of Foreign Public Officials Act*[10] ("CFPOA") for bribery of a foreign public official to obtain a

[10] *Corruption of Foreign Public Officials Act*, S.C. 1998, c 34, in force February 1999. Subsection 3(1) provides: "Every person commits an offence who, in order to obtain or retain an advantage in the course of business, directly or indirectly gives, offers or agrees to give or offer a loan, reward, advantage or benefit of any kind to a foreign public official or to any person for the benefit of a foreign public official (a) as consideration for an act or omission by the official in connection with the performance of the official's duties or functions; or (b) to induce the official

production sharing agreement for oil exploration and development rights to two oil blocks in the Republic of Chad.[11] After the death of the company's co-founder, Chairman of the Board and largest shareholder, Brad Griffiths[12], new management of Griffiths Energy formed a special committee of the board to investigate the legality of certain consulting agreements the company had entered into. Following its internal investigation, Griffiths Energy voluntarily self-reported its findings on November 15, 2011 to the RCMP and other law enforcement agencies in Alberta and the United States. Griffiths Energy cooperated with the enforcement agencies and admitted in court in 2013 that it had unlawfully agreed to provide a benefit to Mahamould Adam Bechir, the Ambassador of the Republic of Chad to the United States and Canada. Griffiths Energy confirmed it paid Bechir U.S.$2 million and four million company Griffiths Energy founders' shares in order to induce him, a foreign government official, to exercise his influence over the award of oil development rights in Chad to Griffiths Energy. (The four million common shares were part of the "founders' seed round" of forty million shares and were allotted at $0.001 per share. The Ambassador's wife was granted 1.6 million shares and 2.4 million shares were granted to two individuals nominated by the wife, including the wife of the then Deputy Chief of the Chadian Embassy in Washington, D.C. It was this Deputy Chief that gave the deposit instructions to Macleod Dixon LLP, Griffiths Energy's lawyers, for the U.S.$2 million cash payment in February 2011.)

Griffiths Energy paid the U.S.$2 million cash bribe and the other valuable consideration by entering into a series of 'consulting contracts' with Bechir and also with a shell company owned by his wife. The bribery period was from August 30, 2009 to February 8, 2011. On August 30, 2009, Naeem Tyab signed an agreement on behalf of Griffiths Energy with Ambassade du Tchad LLC, a U.S. registered entity owned by the Ambassador. In early September 2009, on legal advice from its lawyers, Heenan Blaikie,

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to use his or her position to influence any acts or decisions of the foreign state or public international organization for which the official performs duties or functions."

Completed prosecutions under Canada's *Corruption of Foreign Public Officials Act*, are few and include: *R. v. Watts and Hydro-Kleen Systems Inc*., [2005] A.J. No. 568 (Alta. Q.B.); *R. v. Niko Resources Ltd.*, 101 W.C.B. (2d) 118 (Alta. Q.B, 2011); *R. v. Griffiths Energy International Inc.*, [2013] A.J. No. 412 (Alta. Q.B.); and *R. v. Karigar*, [2013 O.J. 366 (ONSC) [conviction] and 2014 ONSC 3093 (CanLII) [sentence].

[11] Griffiths Energy International signed an Agreed Statement of Facts with the Crown dated January 14, 2013 that was submitted to the Alberta Court of Queen's Bench on January 22, 2013, days before the court appearance and guilty plea.

[12] Brad Griffiths died in a boating accident on Lake Joseph, Muskoka, on July 18, 2011. The other co-founders of Griffiths Energy in 2008 were brothers Naeem and Parvez Tyab. In 1996, the Tyab brothers formed and operated Foresight Capital Corp. which was registered as a securities dealer with the British Columbia Securities Commission. As a result of enforcement actions undertaken by the securities commission, the registration was terminated in December 2002. Naeem Tyab signed the three 'consulting agreements' on behalf of Griffiths International that were to benefit Chad's foreign pubic officials. He left Griffiths International in July 2011 and has not been charged. David Baines, "*Vancouver promoter implicated in international bribery scandal*", The Vancouver Sun, February 1, 2013.

that the agreement constituted an unlawful benefit to a public foreign official, that agreement was terminated. A virtually identical second agreement, drafted by lawyers at Heenan Blaikie, was signed by Naeem Tyab on September 15, 2009 with Chad Oil Consulting LLC, a newly incorporated Nevada entity owned by the Ambassador's wife. On September 24, 2009, Brad Griffiths, Naeem Tyab, former Prime Minister Jean Chretien, counsel to Heenan Blaikie, met with President Idriss Deby of the Republic of Chad, the oil minister of Chad and the Ambassador at the Ritz-Carlton Hotel in Washington, D.C.[13] A memorandum of understanding was signed with the Republic of Chad in October 2009. Naeem Tyab signed a third renewal 'consulting agreement' for Griffiths Energy effective January 1, 2011. The agreements provided for payment if Griffiths Energy secured the oil rights. Griffiths Energy obtained two production sharing agreements with the Republic of Chad on January 19, 2011. On February 10, 2011, Macleod Dixon LLP, new lawyers for Griffiths Energy who replaced Heenan Blaikie in early 2011, followed wire instructions provided by the then Deputy Chief of the Chadian Embassy in Washington, D.C., and transferred U.S.$2 million to an account held in the name of the Ambassador's wife's shell company, Chad Oil Consultants, LLC[14]. After commingling the payment with other funds and laundering these funds through U.S. bank accounts and real property transactions, Bechir transferred U.S.$1.5 million to his account in South Africa, where he had been posted as Chad's ambassador.

In January 2013 the Alberta court accepted Griffiths Energy's agreement to pay a penalty of $10.35 million (a $9 million fine plus a 15 per cent victim fine surcharge). Griffiths Energy subsequently changed its name to Caracal Energy Inc. and was later acquired by Glencore PLC 18 months later. The shareholders of Caracal Energy approved the sale of the company to Glencore on June 6, 2014. Glencore paid £5.50 cash for each share (the then equivalent of about C$10.04 per share) for a total of approximately C$1.7 billion. If the four million shares granted to the Ambassador's wife and nominees were validly issued, such shares would then have had value of about C$40 million. In September 2013, The Bradley Griffiths BDG Trust held 12,651,000 common shares of Caracal Energy. On the Glencore acquisition, such shares would have been worth about C$127 million. Quite profitable outcomes for the Griffiths Energy shareholders from a U.S.$2 million cash bribe in 2011.

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[13] The Republic of Chad embassy for both the United States and Canada was located in Washington, D.C. Bechir, later became Chad's Ambassador to South Africa. Brian Hutchinson, "*Griffiths Energy hired notorious international lobbyist to intervene with president of* Chad", National Post, February 24, 2013. The lobbyist referred to in the article was Ari Ben-Menashe whose business dealings with Dr. Arthur Porter forced his resignations as Chairman of the Security Intelligence Review Committee and as Director General and CEO of McGill University Health Centre in November and December 2011. Arthur Porter is one of nine persons who has been criminally charged in connection with alleged fraud of $22.5 million involving the $1.3 billion contract awarded to SNC-Lavalin Group Inc. for the McGill University Health Centre.

[14] Macleod Dixon LLP later merged into Norton Rose Fulbright Canada LLP. Norman Steinberg, global chairman of Norton Rose, is reported to have explained that the lawyers thought they were paying a long-standing consultant. "We had no knowledge that there were foreign public officials involved in the payment", Sternberg said. Jacquie McNish, Carrie Tait and Kelly Cryderman, "*Bay Street law firms advised Griffiths on Chad deal*", The Globe and Mail, January 26, 2013.

In November 2014, the United States Department of Justice filed a civil forfeiture complaint against the Bechirs to recover the balance of the funds in their South African bank account and to seek other assets from them. The complaint alleged, among other things, that in 2008 Canadian financier and company founder Brad Griffiths and his business partner Naeem Tyab contacted Bechir and the Embassy of Chad in Washington, D.C. to express their interest in acquiring the development rights to certain oil blocks in Chad. The complaint also stated: "In or about 2009, upon information and belief, Griffiths and Tyab paid a personal visit to Bechir's residence in the D.C. metropolitan area, offering Bechir $2 million in U.S. currency and an opportunity to buy shares in their new Canadian energy company, Griffiths Energy, in exchange for his unlawful assistance in securing the development rights to oil blocks in Chad."

Nazir Karigar

In the *R. v Karigar* case, the individual accused was convicted under CFPOA of one count of conspiring to offer a bribe to a foreign public official. The accused Nazir Karigar, a Canadian businessman resident in Toronto, was a paid agent of Cryptometrics Canada of Ottawa. He was convicted of conspiring, in a sophisticated and carefully planned scheme, to offer bribes to officials of Air India, an Indian government enterprise, and to an Indian Cabinet Minister to win a multi-million dollar contract to sell facial recognition software and related products to Air India to be supplied principally by Cryptometrics Canada. Karigar also participated in the entry of false bids to create the illusion of an auction and received and used confidential information in the bid preparation. The bribery scheme was not successful and bribes were not paid. Karigar was convicted and sentenced to three years in prison for the offence of 'conspiring' to bribe a foreign public official. The accused, age 67, was sentenced to three years in penitentiary.[15]

Nortel Networks Corporation

In late October 2003 the Audit Committee of Nortel Networks Corporation ("Nortel") initiated an independent review of the events that caused the first restatement of its previously filed financial statements which was reported in December 2003 ("Nortel Independent Review"). The Nortel audit committee, chaired by director John E. Cleghorn, former Chairman and CEO of RBC Financial Group, then also Chairman of SNC-Lavalin Group Inc., and a director and later Chairman of Canadian Pacific Railway Company, reported the findings of the Nortel Independent Review to the Nortel board in January 2005.

The first restatement covered Nortel's consolidated financial statements for the years ended December 31, 2002, 2001 and 2000 and the quarters ended March 31, 2003 and June 30, 2003. Among the adjustments made in the first restatement, approximately

[15] *R. v. Karigar*, [2013] O.J. 3661 (ONSC, August 15, 2013) [conviction]; *R. v. Karigar*, 2014 ONSC 3093 (CanLII, May 23, 2014), [sentence].

US$935 million and US$514 million of certain liabilities (primarily accruals and provisions) carried on previously reported consolidated balance sheets were released to income in prior periods, reducing accumulated deficits by US$706 million. Deloitte & Touche LLP[16], Nortel's auditors, informed the audit committee that there were two "material weaknesses" in Nortel's internal control over financial reporting applicable to 2003. In the Settlement Agreement between the staff of the Ontario Securities Commission and Nortel, Nortel admitted:[17]

> "…the emphasis by former members of Nortel's senior corporate finance team on meeting revenue and/or earnings targets led to a culture within the finance organization of Nortel that condoned two types of inappropriate accounting practices …[revenue recognition and provisioning], which did not comply with applicable GAAP and were contrary to the public interest.
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> "During the 2000 fiscal year, former Nortel senior corporate finance management inappropriately changed Nortel's accounting policies several times either to recognize revenue prematurely or to defer the recognition of revenue to a subsequent period. … This conduct was driven by the need to close the gap between actual and targeted revenue and earnings.
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> "During the third and fourth quarters of 2002 and the first and second quarters of 2003, former Nortel corporate and finance management (who have since been terminated for cause) endorsed, and finance employees carried out, accounting practices relating to the recording and release of certain accrued liabilities and provisions that were not in accordance with U.S. GAAP or Canadian GAAP. In three of those four quarters, these practices were undertaken to meet internally imposed pro forma earnings before taxes targets. … The pro forma calculation was used by the Company to make its determination on whether to award various bonuses under bonus plans that provided for payments tied to a pro forma profitability metric.
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> "Nortel admits that these inappropriate accounting practices and the absence of effective internal control over financial

[16] Deloitte and Touche LLP charged Nortel fees that aggregated US$199.9 million for the three fiscal years 2003-2005.

[17] *Re Nortel Networks Corporation and Nortel Networks Limited*, Settlement Agreement between the Staff of the Ontario Securities Commission and Nortel, May 16, 2007, approved by order of the OSC on May 22, 2007, III Statement of Facts, paras. 11, 13, 14 and 15.

> reporting contributed to the issuance of financial statements by the Company … that were not in compliance with U.S. GAAP and/or Canadian GAAP."

The audit committee adopted the findings and recommendations of the Nortel Independent Review in their entirety. The investigation identified what it considered to be inappropriate accounting practices and inaccuracies in Nortel's financial statements. Based on periodic reports on the progress of the Nortel Independent Review, the Nortel audit committee recommended and the board, under the chairmanship of Lytton R. ('Red') Wilson, approved the termination 'for cause' in April 2004 of Frank Dunn, the President and CEO, Douglas Beatty, the CFO, and Michael Gollogly, the Controller. In August 2004, seven additional senior finance employees of the company were terminated[18]. The background and facts relating to the alleged inappropriate accounting practices at Nortel need not be repeated in detail and are disclosed and discussed in the report of the independent law firm and expert accountants retained by the audit committee[19] and in the Settlement Agreement between Staff of the Ontario Securities Commission and Nortel[20]. In summary, it concluded that former corporate management (terminated for cause) and former finance management (terminated for cause) endorsed, and employees carried out, accounting practices relating to the recording and release of provisions that were not in compliance with U.S. generally accepted accounting principles nor Canadian GAAP. In certain of the financial quarters in question – when Nortel was at, or close to break even - the practice of releasing provisions were undertaken to meet internally imposed pro-forma earnings before taxes ("EBT") targets. The achievement of the EBT targets entitled the payment of bonuses to Nortel employees and significant bonuses to senior management under bonus plans tied to a pro-forma profitability metric. The allegations asserted that Nortel senior management treated identified excess provisions as a pool from which releases could be made to income to 'close the gap' between actual EBT and EBT targets in subsequent quarters.

The audit committee then directed new Nortel corporate management to examine the concerns identified by the Nortel Independent Review. This resulted in the second restatement of Nortel's financial statements for the years 2002 and 2001 and the quarters ended March 31, 2003 and 2002, June 30, 2003 and 2002 and September 30, 2003 and

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[18] Message from Chairman of the Board Lynton R. ('Red') Wilson, Nortel 2004 Annual Report.

[19] Wilmer Cutler Pickering Hale and Dorr LLP and Huron Consulting Services LLC, "*Summary of Findings and of Recommended Remedial Measures of the Independent Review submitted to the Audit Committee of the Boards of Directors of Nortel Networks Corporation and Nortel Networks Limited*", (January 2005). The review was led by Washington, D.C. based law firm Wilmer Cutler partner William McLucas, who was a former director of investigations for the U.S. Securities and Exchange Commission and who worked under Richard C. Breeden when he was Chairman of the SEC.

[20] Under the terms of the OSC Settlement Agreement, Nortel was ordered to make only a nominal payment of $1 million "as a contribution towards the costs of the investigation." The OSC staff also agreed not to initiate any other proceedings against Nortel for violations of the *Securities Act* (Ontario).

2002. As a result Nortel increased revenues by an aggregate of US$1.492 billion in 2001, US$439 million in 2002 and US$386 million in 2003. This had the effect of reducing previously reported revenues in 1998, 1999 and 2000 by approximately US$158 million, US$355 million and US$2.866 billion, respectively. With respect to the second restatement, Deloitte and Touche found six additional "material weaknesses" in Nortel's internal controls over financial reporting as at December 31, 2003.

The Nortel Independent Review concluded that one of the characteristics that allowed for the allegedly inappropriate accounting conduct at Nortel included a management "tone at the top" that " conveyed the strong leadership message that earnings targets could be met through application of accounting practices that finance managers knew or ought to have known were not in compliance with U.S. GAAP and that questioning these practices was not acceptable." With respect to the importance of the "tone at the top", the Nortel Independent Review noted:[21]

> "An effective "tone at the top" requires effective policies and procedures, but those alone are not sufficient. Those who manage and lead the Company, and are its officers, must exercise the highest fiduciary duties to the Company and shareholders and must be accountable, both to corporate management and the Board, for accurately reporting financial results. …
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> "The Board of Directors must make clear that it has not tolerated, and will not in the future tolerate, accounting conduct that involves the misapplication of U.S. GAAP. It must further communicate its expectation that every Nortel employee will adhere to the highest ethical standards; will have training and experience commensurate with his or her job responsibilities; and will be held accountable for his or her actions and decisions. The Board of Directors and management should continue to address the issues associated with the inappropriate use of provisions."
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> "Employees must be convinced of the Company's commitment to an ethical climate, and of the central role that they play in ensuring that the Company's code is followed. They must view compliance with the Company's code of conduct, standards, and control systems as a central priority, and understand that they will be rewarded for ethical behaviour, even if it uncovers some problem that others might prefer to remain undisclosed."

[21] At pp. 7-8.

A number of class action lawsuits in the United States and Canada were commenced against Nortel, several former and senior officers, including former CEOs John Roth and Frank Dunn, several directors including John Cleghorn, Robert Brown and Guylaine Saucier, and Nortel auditor's, Deloitte and Touche LLP. The plaintiffs in the two main Canadian class actions were the Ontario Teachers Pension Plan and the Ontario Public Service Employees Union. A global resolution of the multiple-jurisdictional class actions were approved by courts in the Southern District of New York, Ontario, Quebec and British Columbia. The Nortel defendants did not object to the settlements, in which the courts awarded damages of approximately US$2.3 billion in favour of Nortel's shareholders, consisting of approximately 629 million Nortel common shares (comprising 14.5 per cent of Nortel's then current equity and valued at approximately US$1.4 billion, based on Nortel's market price at June 30, 2006), and US$575 million in cash.[22] Nortel's insurers also contributed US$228.5 million to the global settlement fund. The class action settlement became effective on March 20, 2007.

On January 14, 2009, after acknowledging it was insolvent, Nortel filed for and was granted creditor protection in Canada under the *Companies' Creditors Arrangement Act*.[23] It also sought creditor protection in the United States, the United Kingdom, Israel and France.

Fraud charges under the *Criminal Code* were laid against Frank Dunn, the dismissed CEO, former CFO, a certified management accountant and long-time senior financial officer of Nortel; against Douglas Beatty, a chartered accountant and Nortel's CFO; and against Michael Gollogly, a chartered accountant and Nortel's Controller. After a lengthy trial before a judge sitting alone, all three defendants were found not guilty. "I am not satisfied beyond a reasonable doubt that Frank A. Dunn, Douglas C. Beatty and Michael J. Gollogly deliberately misrepresented the financial results of Nortel Networks Corporation and, therefore, I find each of them not guilty of counts one and two in this indictment", the court concluded.[24] The Crown decided that it would not appeal the not guilty verdicts.

While the conduct of the dismissed senior executives in question was held not to be criminal, it clearly was inappropriate and had damaging consequences on the future of Nortel, leading ultimately to the bankruptcy of the company and disintegration and demise of its global telecommunications business. The conduct of the board of directors of Nortel has not been without criticism by serious commentators. "All the available evidence regarding the Nortel board's latest disaster points to the conclusion that

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[22] *Leslie Frohlinger v. Nortel Networks Corp., John Roth, Frank Dunn, et al*., Ontario Superior Court, Court File No. 02-CL-4605; *Peter Gallardi v. Nortel Networks Corp., Frank Dunn, Douglas Beatty, Michael Gollogly, John Cleghorn, et al*., Ontario Superior Court, Court File No. 05-CV-285606CP; *In Re Nortel Networks Corp. Securities Litigation*, Consolidated Civil Action No. 2001-CV-1855, United States District Court for the Southern District of New York; *Frohlinger v. Nortel Networks Corp*., 2007 CanLII 696 (ON SC, January 18, 2007).

[23] *Re Nortel Networks Corp*., 2009 CanLII 726 (ON SC, January 14, 2009).

[24] *R. v. Dunn*, 2013 ONSC 137 (CanLII) (January 14, 2013).

individually and collectively, directors failed almost completely to perform these duties and prevent the scandal that resulted. …The Nortel story is also one of failed leadership. The chair's job was to make his 'all-star' group into an effective team that worked well with management to identify, focus on, diagnose and fix Nortel's basic problems. This he failed to do. As well as running an effective board, it was also a critical part of his job to make the chair/CEO relationship work well. This also seems to be lacking."[25]

Five of the Nortel directors did not stand for re-election at the AGM held in June 2005: Lynton R. ('Red') Wilson, the Chairman (non-executive) and a director since 1991; The Hon. James J. Blanchard, a director since 1997; L. Yves Fortier, director since 1992; Guylaine Saucier, a director since 1997; and Sherwood H. Smith, Jr., a director since 1994. The Nortel board considered that Messrs. Blanchard and Fortier were "related" directors because their respective law firms provided legal services to Nortel. The following year, another three of the pre-financial restatement incumbent Nortel directors did not stand for re-election at the AGM held in June 2006: Robert ('Bob') E. Brown, a director since 2000; John E. Cleghorn, a director since 2001; and Robert E. Ingram, a director since 1999. Messrs. Cleghorn (Chairman), Brown, Ingram, Smith and Ms.. Saucier were members of the Nortel audit committee. Messrs. Brown (Chairman), Wilson and Smith were members of the Nortel joint leadership resources (compensation) committee. The audit committee for 2000 was comprised of Sherwood H. Smith, Jr. (Chairman), Robert E. Brown, L. Yves Fortier, Robert A. Ingram and Guylaine Saucier.

SNC-Lavalin Group Inc.

> "Over the past three years, we have made significant changes in the company and remained focused on continuous improvements in ethics and compliance. *The tone from the top is clear and unequivocal; there is zero tolerance for ethics violations*". [26] [emphasis added]

SNC-Lavalin Group Inc. ("SNC-Lavalin") has now embraced the 'broken windows' policy.

On March 26, 2012, SNC-Lavalin released its results of its internal review of information with respect to questionable payments aggregating US$56.1 million made to presumed agents which were allegedly documented to construction projects to which they did not relate. These disclosures evidently came to the attention of the board in January 2012. Since that initial exposure of corruption at SNC-Lavalin, the scope and extent of that company's improper business practices in the conduct of its operations, both within Canada and internationally, has enlarged and broadened significantly to other projects and activities. It is beyond the subject matter of this commentary to review the broad scale of the alleged defalcations, improper payments and questionable business

[25] Donald H. Thain, "*Reflections of a veteran director: The unsatisfactory performance of Nortel's 'distinguished' board*", Ivey Business Journal (May/June 2004), at p.4.
[26] SNC-Lavalin press release, February 19, 2015.

behaviours, none of which have to date been proven in court, and too soon to analyze past and subsequent events at the company, which are still coming to light and developing.

In 2012 and 2013, new senior leadership at SNC-Lavalin, recruited from outside the company, replaced those in authority during the period investigated. There is a new President and CEO, new members of the Office of the President, a new Chairman of the Board of Directors, and six new directors to replace those directors who departed. Under its new senior management and refreshed board of directors, SNC-Lavalin created the position of Chief Compliance Officer reporting to the board of directors, hired an experienced Compliance Officer on March 1, 2013, developed a control compliance framework and in 2013 undertook its initial implementation.[27] SNC-Lavalin appointed compliance officers in all of the company's business units and regional offices worldwide. As a result of the actions of the World Bank in blacklisting SNC-Lavalin, the company appointed an Independent Monitor recommended by and who reports to the World Bank. Under new command, SNC-Lavalin has publicly stated that it is committed to conducting its business with integrity and to ethics excellence.

Several charges have been laid against former officers and employees of SNC-Lavalin under CFPOA in relation to the awarding of a contract for the supervision and consultancy services for the construction of the PADMA multipurpose Bridge project in Bangladesh. Kevin Wallace, a resident of Oakville, Ontario, and the former Vice-President, Energy and Industrial executive of SNC-Lavalin, has been charged with bribing a foreign official. Two other former employees of SNC-Lavalin, who reported to Wallace, Ramesh Shah, Vice-President of the International Division, and Mohammed Ismail, Director, International Projects who reported to Shah, have also been charged. In addition, a Bangladeshi lobbyist, Abul Hasan Chowdhury, has been charged.[28] A fifth person, Zulfiquar Ali Bhuijan, a Bangladeshi businessman who holds citizenship in Canada and Bangladesh and is not an SNC-Lavalin employee, has also been charged under the CFPOA. These allegations have not been proven in court.

Nine individuals have been charged in connection with allegations of bribery relating to the award of a $1.3 billion contract to SNC-Lavalin to build the McGill University 'superhospital'. Among those former SNC-Lavalin senior executives facing criminal fraud and conspiracy charges in connection with the McGill University Health

[27] With a new Chief Compliance Officer function established on March 1, 2013, new management held an Ethics and Compliance Awareness Session in April 2013 with its Management Committee; the new compliance organization was formed; the company conducted an Amnesty Program from June 3 until August 31, 2013; management held its first Compliance Officer Meeting on July 16, 2013; an Anti-Corruption Manual was issued with guidance information on relevant Compliance topics; a new Policy on Business Partner Compliance Due Diligence was prepared and became effective on August 1, 2013; its Global Compliance in-person training program commenced on September 30, 2013; and the company sought external validation and monitoring of its rejuvenation efforts.

[28] *Chowdhury v. H.M.Q.*, 2014 ONSC 2635 (CanLII).

Centre contract are former CEO Pierre Duhaime and former senior executives Riadh Ben Aïssa and Stéphane Roy.

On February 19, 2015, the RCMP National Division announced that it had laid two criminal charges against SNC-Lavalin and two other SNC-Lavalin affiliates for corruption under the CFPOA and fraud under Canada's *Criminal Code* in connection with SNC-Lavalin's operations in Libya. The time period for the alleged criminal acts is from August 2001 to September 2011. The corruption charge alleges bribes of $47.6 million to Libyan public officials and the fraud charge alleges SNC-Lavalin defrauded the Libyan government and state entities of $129.8 million.[29] The RCMP commenced its investigation in 2011 and three former officers and employees were previously charged in relation to the same investigation: Stéphane Roy, Constantine Andreas Kyres and Abdellah Sami Bebawi.

SNC-Lavalin issued its own press release the same day, stating that "the charges are without merit" and it will vigorously defend itself and plead not guilty. SNC-Lavalin also argued that criminal charges should be brought against the individuals involved, and not against the company. However, it appears from the information available to date that the defalcations were not simply the actions of a few rogue officers and employees. The allegations have not been proven in court and an assessment of the corruption tragedy and its causes at SNC-Lavalin will need to await further disclosures and developments.

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[29] Royal Canadian Mounted Police press release, "*RCMP Charges SNC-Lavalin*", February 19, 2015.