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## WHY THE OSC SO RARELY GETS ITS MAN

More than 450 employees work at the Ontario Securities Commission. About 40% are paid more than \$100,000 a year. Their dismal track record begs the question: What on earth are they doing?

**TYLER HAMILTON**  
BUSINESS REPORTER

Bruce McLaughlin took millions of dollars from the company he led to pay off personal debts. That was the conclusion of a court-appointed accounting firm that looked into suspicious transactions at Mississauga property developer Mascan Corp.

The findings of the audit pressured the Ontario Securities Commission to take legal action on behalf of Mascan's minority shareholders.

That was 23 years ago. The case is still on the OSC's books, listed on the commission's website under "Current Proceedings." The OSC says it can't comment because it's a "live matter" before the courts. "Most of the former plaintiffs have died or lost interest," says Edward Waitzer, the lawyer who first pursued McLaughlin back in 1982 — at the time representing the Thomson family's Woodbridge Co. Ltd. — until a reluctant OSC waded into the case. The RCMP wanted no part of it, he says.

Waitzer eventually became OSC chair between 1993 and 1996 and even he couldn't get the case moving. "It's an example of how things get initiated and never get completed, and nobody holds the OSC to account," he says.

The OSC is Ontario's investment watchdog. It has ultimate authority over the Toronto Stock Exchange, pension funds, mutual funds and investment dealers. Across Canada, everyone from the tiniest investor to online day traders and retirees on a company pension is affected by transactions — right or wrong — under its jurisdiction.



### INSECURITIES INVESTOR PROTECTION

FIRST IN A SERIES ON  
MARKET REGULATION

It's accountable by definition. But academics, lawyers and forensic accountants interviewed for this story say accountability is sorely lacking when it comes to securities enforcement, whether it's regulatory matters overseen by the OSC or violations of criminal law overseen by police. They also cite a lack of focus, and the sense of urgency that makes enforcement an effective deterrent to breaching the rules.

The decades-old Mascan case, they say, illustrates much of what's wrong with the system. More recently, many believe the OSC and Canadian authorities dropped the ball on their investigation of Conrad Black, who will be sentenced later this month in Chicago after a speedy U.S. trial.

"For me, the hardest part about the Conrad Black trial has been explaining why it happened in Chicago and not in Toronto," former Ontario premier Bob Rae wrote recently in his blog.

SECURITIES continued on A10

### FROM DOCTOR TO PATIENT

Dr. Sheela Basur was widely hailed for her work on the front lines during Toronto's SARS crisis of 2003. Today, the city's former chief medical officer opens up about her own year-long fight against a deadly cancer. Story, A4



TARA WALTON/TORONTO STAR

### For Dion, a year of living dangerously

**SUSAN DELACOURT**  
OTTAWA BUREAU

OTTAWA—Is there any politician in Canada who has received more advice in the past year than Liberal Leader Stéphane Dion?

Perhaps not, though his critics might want to add: "... And ignored most of it?"

This weekend, Dion marks his first anniversary as Liberal leader where it all began — Montreal. Today, he's on the hot seat, where most would argue he's been almost constantly since the convention that installed him a year ago tomorrow as the official Opposition leader.

DION continued on A23

### STRONG AND FREE, BUT NOT CHEAP

How Canada can manage, and even capitalize on, climate change

IDEAS - ID 1



## Province puts focus on poorly rated hospitals

Revealing death rates 'revolutionary': Minister

**KERRY GILLESPIE, TANYA TALAGA, ROBERT CRIBB**  
STAFF REPORTERS

Calling the public release of Ontario hospital death rates "revolutionary," Health Minister George Smitherman said the province is contacting hospitals with poor scores to see what can be done to better protect patients.

"Those hospitals that have not been seen to perform well will feel under the most intense pressure to

take remedial action," Smitherman said. "The pressure will come from transparency."

For the first time, Ontarians can know death rates in their local acute care hospitals thanks to the release of a breakthrough study Thursday by the Canadian Institute for Health Information.

"It's not out there to be a consumer tool, it is more out there to help hospitals," said CIHI's Christina Lawand. "What are the factors making it higher or lower?"

It's easy to tell which Ontario hos-

HOSPITALS continued on A6

### TALK IT OUT

A new Middle East initiative and a time for — what? Cynicism? Pragmatism? Hope? Why the Middle East peace deals of 1978, 1991, 1993 and 2000 all failed... and why this one might, too. **A41**

### DAREDEVIL DEAD

Evel Knievel, who entertained a generation with his antics, has died. In 1974, he wowed crowds at the CNE. **A28**

### FULL INDEX PAGE A2

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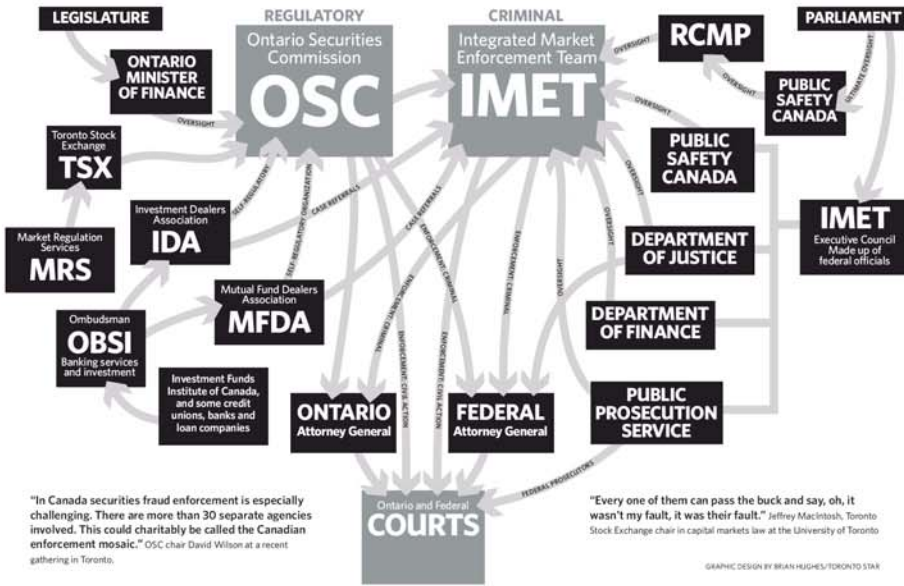
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**FINANCIAL REGULATORS** > AN INVESTIGATION

**Worried about stock fraud? Here's who's in charge**



"In Canada securities fraud enforcement is especially challenging. There are more than 30 separate agencies involved. This could charitably be called the Canadian enforcement mosaic." OSC chair David Wilson at a recent gathering in Toronto.

"Every one of them can pass the buck and say, oh, it wasn't my fault, it was their fault." Jeffrey MacKintosh, Toronto Stock Exchange chair in capital markets law at the University of Toronto

GRAPHIC DESIGN BY BRIAN HUGHES/TORONTO STAR

**Ontario enforcement 'third world'**

SECURITIES from A1

All this is no surprise to Utpal Bhattacharya, a finance professor at the Indiana University's Kelley School of Business and author of a report comparing the enforcement records of the OSC and the U.S. Securities and Exchange Commission (SEC).

"We found the enforcement in Ontario was pathetic," said Bhattacharya. "Canada is a first-world country with second-world capital markets and third-world enforcement."

Many high-profile cases of stock-market meltdown or corporate fraud in recent years have left investors fuming that authorities have either failed to hold people accountable or taken way too long to apply justice.

"I think delay is a big source of frustration for investors," said Poonam Puri, a law professor who teaches about white-collar crime at Osgoode Hall Law School.

This year, for example, many Canadians were frustrated that, after a decade of investigation and courtroom battles over Bre-X Minerals, nobody was held accountable for the world-infamous multi-billion-dollar gold fraud.

Many other cases have left Canadians scratching their heads, such as the 1990s meltdown of theatre-producer Livent Inc., the accounting fiasco of Nortel Networks, or the OSC's failure to pin stock-tipping charges on investment banker Andrew Rankin.

Critics say the OSC showed its light touch in the YBM Magnex stock-market scandal a few years ago. Despite FBI investigations linking YBM Magnex to the Russian Mob, the OSC in 2003 ruled "this case isn't about organized crime," and set light fines and penalties against a few company directors.

And investor advocates were shocked when in 2002 the holding company of Michael Cowpland, founder and then CEO of Corel Corp., was fined only \$1 million to settle allegations that he sold \$20.4

**BREACH OF PRIVACY COMPLAINT GOES NOWHERE**

TYLER HAMILTON

Industry whistleblower James MacDonald says he was betrayed. At a recent public forum in Toronto, MacDonald took the opportunity to tell David Wilson, chair of the Ontario Securities Commission, why the system let him down.

The former BMO Nesbitt Burns investment adviser discovered evidence of what he described as "alleged illegal activity" by a senior person within the industry. He said he dutifully reported his findings by phone — in a voicemail — to the Investment Dealers Association (IDA), a self-regulatory organization accountable to the OSC.

Within hours of that message being left, he said he received an email message from his branch manager at the bank asking MacDonald why he contacted the IDA. MacDonald was shocked to learn



James MacDonald

that his confidential message had been brought to his employer's attention. "As an employee, I was trying to do my part and I was betrayed," MacDonald, microphone in hand, told Wilson. MacDonald continued, explaining

he had written two letters to Wilson to complain about this breach of confidentiality. Both times he received a reply from someone else at the OSC who advised MacDonald to deal directly with the IDA, which was the subject of his complaint. "You've washed your hands totally of this," MacDonald said to Wilson.

Wilson advised MacDonald that if the IDA can't resolve his issue he should feel free to phone the OSC contact centre and file a complaint. "Or," added Wilson, "write me a letter." MacDonald later told the Star he has little confidence in the ability of Canadian enforcement agencies to adequately protect investors. "Canadians would be better off if we just disband everything and subcontract the work to Eliot Spitzer and the U.S. Securities and Exchange Commission."

million worth of Corel stock in advance of his earnings news, that caused the company's share price to drop 40 per cent.

The RCMP says the scope of fraudulent activity across Canada is unknown because there's no "systematic" collection of data.

But for certain crimes — such as insider trading — there's plenty of reason for worry.

According to a Bloomberg News study prepared by Port Hope-based Measuredmarkets Inc., 33 of 52 large Canadian mergers last year showed signs of aberrant trading just before the mergers were publicly announced. That's a rate of 63 per cent. A comparative study in the U.S. found a rate of 41 per cent.

"The findings don't prove illegal insider trading is widespread," says Measuredmarkets' Christopher Thomas, but "it raises a red flag."

And there are enough of these red flags to spark a growing call for change, increasingly from high-profile voices. Claude Lamoureux,

just-retired chief executive officer of Ontario Teachers' Pension Plan — one of the biggest in Canada — accused regulators last month of "pretending to oversee" securities rules and lambasted authorities for their light-handed treatment of white-collar crime.

Barbara Stymiest, chief operating officer at Royal Bank of Canada and former CEO of the Toronto Stock Exchange, called Canada's securities enforcement an "international embarrassment."

So what's the problem? Industry watchers point fingers everywhere:

- Law regulations and laws
- A leadership vacuum
- A defeatist culture
- A system short on accountability and focus
- Fragmentation among provincial and territorial regulators. More than 30 separate agencies — many of them self-regulating — are involved in Canadian securities regulation. "This could charitably be called the Canadian enforcement

ties Regulation in Canada.

Surprisingly, the SEC doesn't appear to have a leg up when it comes to resources, according to Howell Jackson, a professor who teaches securities regulation at Harvard Law School. In a recent comparison of Canadian and U.S. regulatory activity, he found a well-funded Canadian system.

"Adjusted for most measures of economic scale — population, GDP, or market capitalization — Canadian budgets and staffing may actually be somewhat more intensive than those in the United States," discovered Howell.

"Indeed, by international levels, total Canadian staffing and budgets seems to be on the high end."

Both the Ontario Securities Commission and the RCMP have seen their budgets increase in recent years.

The OSC staffing budget jumped 28 per cent in three years, to \$51.51 million in fiscal 2007 from \$40.15 million in fiscal 2004. About 40 per cent of the regulator's 464 employees make over \$100,000, including \$524,065 paid to the chair, Wilson.

Meanwhile, the RCMP launched its highly touted Integrated Market Enforcement Team in 2003, backed by \$120 million in new federal support. But so far it has been mostly tough talk and little action, a criticism IMET director John Slieter called "well founded" in an interview with the Star.

The OSC, however, is not so willing to accept the blame.

Commission vice-chair Lawrence Ritchie points out that regulatory enforcement ends once the evidence gathered by investigators is put before the court.

"What the court does with it, any regulator has absolutely no control over how a judge or jury will treat that," he says. "I'm not saying the focus or criticism should be laid elsewhere, but it should be seen within the proper context."

Others say the blame also lies with police. They emphasize the often forgotten distinction between

Continued on next page

**BRE-X**

**Issue:** The company's gold find was exposed as a fraud in 1997. Shares became worthless.

**Action:** The OSC charged Bre-X head geologist John Felderhof with insider trading.

**Outcome:** After a seven-year trial, an Ontario court judge in July acquitted Felderhof on all counts, saying there were no red

**LIVENT**

**Issue:** Theatre production company Livent Inc. collapses in 1998 and its shares become worthless.

**Action:** U.S. prosecutors file fraud charges against Livent co-founder Garth Drabinsky and others in 1998, but Drabinsky avoids the charges by staying in Canada. Four years later Canadian charges are filed.

**Outcome:** A trial is expected next

**ANDREW RANKIN**

**Issue:** Royal Bank in 2001 fires investment banker Andrew Rankin over suspicious trading.

**Action:** OSC charges Rankin in 2004 with providing inside information allowing millions in trading profits by friend Daniel Duic, who co-operated in exchange for immunity.

**Outcome:** Rankin is convicted in 2005 and sentenced to six months, but

**NORTEL**

**Issue:** An independent probe by a U.S. law firm concludes in 2005 that top Nortel officials

manipulated accounting to meet profit targets and trigger bonuses.

**Action:** Both the OSC and SEC investigate accounting issues. **Outcome:** Nortel agrees to pay the SEC \$35 million (U.S.) to settle fraud charges while the OSC

**HOLLINGER**

**Issue:** Investors in newspaper publisher Hollinger International Inc. complain that top executives, including Conrad Black, siphoned off millions through sham transactions.

**Action:** The SEC and OSC launch investigations into Hollinger, while U.S. prosecutors file criminal charges.



AN INVESTIGATION < FINANCIAL REGULATORS

**INVESTOR, JAMES MARKIS**

Bolton computer consultant says he lost \$104,000 in the Nortel collapse. He is expecting a settlement early next year after the company agreed to pay \$2.4 billion in cash and shares to settle a class-action lawsuit. Nortel also agreed to pay a \$1 million fine to the OSC and \$35 million to the SEC to settle allegations of wrongdoing.

Markis, 53, feels that, in both cases, Nortel paid only "minimum" fines. "Who's going to have faith in the equities markets when the regulators give them a slap on the wrist?" Markis asked. "I think the OSC should have set a precedent to say Canadian equities markets are safe and the watchdogs are doing their job."



**INVESTOR, CHRIS MORGIS**

The Toronto real estate developer lost \$2 million due to unauthorized trading by his now-defunct brokerage Thomson Kernaghan & Co. Morgis, 42, sued the adviser and Thomson Kernaghan. Morgis filed complaints with the Investment Dealers Association in March, 2001. The agency did not respond for more than a year. The brokerage went bankrupt in 2002. Its former chair, Mark Valentine, was later found guilty of securities fraud in the United States. Morgis tried to sue the IDA, but a court declared it has statutory immunity.

Dealing with Canadian regulators, Morgis said, "was such a disappointing process. There was smoke there, and there was a fire, but the IDA didn't go in."



**INVESTOR, OSAMU SHIMIZU**

The Etobicoke retiree, who lost \$7,800 when his shares of Bre-X collapsed, joined a class-action lawsuit against Bre-X, John Felderhof, and other former Bre-X executives. The lawsuit is pending, though it has been dealt a serious blow by an Ontario court ruling last summer that acquitted Felderhof, Bre-X's former chief geologist, of insider trading charges.

Shimizu, 80, feels regulators should have taken a closer look at the mining company's early claims that it had discovered the world's biggest gold deposit at its Busing property in Indonesia.

"The OSC is a toothless tiger," Shimizu said. "They make all kinds of noise — but no teeth."



**OSC'S MANDATE: PROTECT INVESTORS**

The Ontario Securities Commission's job is to protect investors from practices considered unfair, improper or fraudulent under the Securities Act.

It regulates investment advisers and companies that trade in securities. It has oversight over the Toronto Stock Exchange and a number of self-regulatory organizations composed of mutual fund and investment dealers.

**Why it matters**

Securities crimes affect most Canadians. If you've bought shares in a publicly traded company, either directly or indirectly through holdings in mutual funds and pension funds, any fraud hurting that company's performance or affecting its share value can leave the honest investor holding the bag.

Insider trading, stock manipulation, accounting fraud and the illegal sale of shares are among the crimes that regulators and law-enforcement agencies track. For certain crimes, white-collar crooks prey more often on seniors and other vulnerable members of society.

In one way or another, widespread securities fraud left un-

checked can lead to a breakdown in market confidence, discouraging investment in the Canadian economy that might otherwise lead to job creation.

Outside our borders, international investors are known to apply a "Canadian discount" on equities here to account for lax enforcement. Indeed, in many financial circles, Canada is considered an "enforcement-free zone" where people don't just get away with white-collar crime, they profit dearly from it.

**THE SERIES**

**TODAY:** How regulators have failed to crack down on stock-market miscreants while developing an international reputation for inaction and ineffectiveness.

**TOMORROW:** Why a big-budget police squad set up to take on corporate crime degenerated into a bureaucratic mess with few results.

**MONDAY:** An interview with the head of securities watchdog, Ontario Securities Commission chairman David Wilson.

**COMING UP:** What's needed to fix the mess?

**Fingers of blame pointing everywhere**

Continued from previous page

breaches of regulation and violations of the Criminal Code. Douglas Hyndman, chair of the I.C. Securities Commission, says regulators are criticized for weak enforcement of cases that criminal authorities should be pursuing, but don't.

"I just don't think our criminal investigation authorities strike fear into the hearts of crooks in the industry," Hyndman says.

They point out that most of the high-profile U.S. cases — WorldCom, Enron, Adelphia — were the result of criminal, not regulatory, enforcement.

Like in the U.S., regulators in Canada can refer serious cases of securities fraud to criminal authorities — the RCMP's commercial crimes unit or IMET — but there's no guarantee they'll be taken on.

The Investment Dealers Association and the Mutual Fund Dealers Association, self-regulatory bodies

accountable to the OSC in Ontario that can refer cases to IMET, have identified at least 84 cases of suspected fraud, forgery or misappropriation of funds to police, according to an association spokesperson.

It's unclear how many of these cases have been investigated, as IMET resists disclosing names of those being probed until charges have been formally laid. Cases not pursued by criminal authorities can easily slip through the cracks, though in some cases wrongdoers will get a regulatory wrist slap for criminal offences more deserving of jail time. Hyndman says regulators shouldn't be forced to use their own limited resources to prosecute allegations that are clearly criminal in nature. In the case of Bre-X's John Felderhof, accused of insider trading, many felt the RCMP should have laid fraud charges and pursued a federal conviction.

Instead, the OSC was forced to go after Felderhof with weaker quasi-



AP PHOTO/AMST Indiana University finance professor Utpal Bhattacharya compared records of the OSC and the U.S. Securities and Exchange Commission. "We found the enforcement in Ontario was pathetic," he says.

criminal charges of insider trading in an Ontario provincial court, a forum typically reserved for cases like drunk driving and breaking and entering. The case dragged on for years, arguably diverting the OSC's resources away from its core duties of enforcing regulation.

But investor advocates like Ken Kivenko argue nothing justifies the kind of delay both accused individuals and shareholders have faced

over the years, whether it's two decades in the case of Bruce McLaughlin, six years after signs of crooked accounting appeared at Nortel, or 10 years for the Bre-X case to conclude.

"The whole system is not set up to protect investors," says Kivenko, a former aerospace executive who wants to see major securities reforms.

"If you did a cost-benefit economic model, Canada would be the place to go for white-collar crime. Your chance of detection is small and the consequences for getting caught are not high."

Ontario's new attorney general, Chris Bentley, says a lot has been done over the past few years to improve enforcement of securities crimes, including a doubling of OSC enforcement staff and new offences in the Criminal Code, but he acknowledges more must be done.

"There's no stepping back. No taking a rest. We continue to push on this front, take it very seriously, and I'll continue to look for ways to strengthen investigation and prosecutorial capacity," says Bentley.

"The best way to protect those who use securities markets is by action, not words . . . By all means, judge me by my actions."

Waiter, benefiting from 30 years of hindsight, has little sympathy for any more excuses.

"The regulators are becoming like the people they're trying to regulate," he says.

"They're spending their time managing reputations instead of getting results. There's not a lot of accountability. They can talk a big game, and the fact is they don't deliver."

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