



# A fine mess

In its handling of Nortel's alleged accounting frauds, the OSC is sending a dangerous message

**T**he U.S. Securities and Exchange Commission is thinking of fining Nortel Networks Corp. (TSX: NT) up to US\$100 million for the alleged accounting frauds that have taken place at the Canadian company over the past few years. In severe contrast, the Ontario Securities Commission has already decided to not fine the company at all. (Nortel is making a "contribution" of \$1 million toward the unknown costs of the investigation.)

Unless the intent of the OSC is to promote more securities fraud in Canada, its reasons for not issuing a very large fine to Nortel are baffling. The commission has been variously attributed as saying that a fine would not act as a deterrent in the market, and also that the current shareholders of Nortel should not pay for the acts of fired executives.

Either way, the OSC is dead wrong. At best, the commission has simply gone soft and second-guessed its way into violating its own mandate. At worst, it has acted as a conspirator after the fact to an accounting fraud.

Like it or not, it's essential to the integrity of our capital markets that the current shareholders of Nortel bear the brunt of a monetary fine as if they committed the fraud themselves. When you purchase a stock, you purchase the risks and rewards that have accrued to the company to that point in time. Any decision that throws this concept into question can wreak untold havoc on the market. Arbitrarily erasing a monetary risk to a stock is akin to playing fast and loose with the continuity of market values, and should not be left to the whims of the OSC brain trust.

As a simplified example, assume that before a company's fraud was uncovered, its stock was trading at \$10. Once the fraud was exposed, assume the stock dropped to \$5 for various reasons, including the financial overhang of the fines that the company was expected to pay. At that point, somebody sold the stock, and took the financial hit for the fine that was expected to come later. If the seller understood that no fine would be forthcoming, he would have sold the stock for more than \$5.

By not making current Nortel shareholders pay a fine, the OSC has unfairly disadvantaged past shareholders who were duped into



selling their shares for less than their fair value.

Still not with me? Consider the chaos that would be created if the OSC continued to randomly and capriciously obliterate large financial risks for some stocks, but not all stocks. It would essentially turn the market into a crapshoot for investors. You might get away with murder one day, and might be held accountable the next. But essentially, prior shareholders would still be getting screwed at least some of the time.

Alternatively, consider that this might be the new modus operandi of the OSC, and that the commission just isn't going to fine anyone anymore. While original shareholders would no longer be duped into selling their shares for less than fair value, the clear downside is that no deterrence to fraud will exist.

Now reverse the situation and assume that you bought a company because you thought it would win a substantial cash settlement in a lawsuit, and that this fact was not being reflected in the share price. Assume a year passes, and your company wins the lawsuit and decides to issue the cash to shareholders via a special dividend. You would expect a nice cheque because

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you own all risks and rewards attached to the company.

But what if the OSC came along and, in its deep wisdom, decreed that current shareholders should not receive the rewards because the lawsuit was originally filed by executives that are no longer with the company? Simply put, you'd be outraged by an act that carelessly turns hundreds of years of corporate law on its head, and you would be looking for someone to remedy the situation. Let's hope that someone is the more sensible U.S. Securities and Exchange Commission.



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