

**Searching for the  
New Liberalism**

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**Canada's New Millenium:  
The Role of the Corporate  
Sector**

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Whether Canada's search for a brighter future is to proceed along the lines of a new liberalism or not, one condition must be satisfied and that is, Canada must have the ability to make its own choices.

The ability to make these choices is at the heart of the concept of national sovereignty and for these purposes I refer to sovereignty in the fullest sense of the word, that is economic, political and cultural. This is a challenge and indeed, in Canada's case, this particular challenge may be more pronounced than similar challenges facing any of the world's leading industrialized nations. Our geographic proximity to the United States, as well as our cultural similarity, and taking into account our much smaller population, makes our aspirations for full sovereignty somewhat more problematic than is the case for western European countries or even Australia. I am reminded of being in Melbourne just a few years ago and picking up the morning paper to read that Melbourne would be graced that evening by the arrival of two well known American entertainers, Bryan Adams and K.D. Laing. It is very easy to confuse Canadians for Americans.

In this quest for a brighter future, Canada's Corporate Sector will have a key role to play. Corporations will serve as the primary funding engines for our quality of life aspirations. The ability to create, on a sustained basis, a healthy economy is one of the foundations of Canada's ability to stay separate. This does not mean that the economies of the two countries will not continue to be closely linked. This does not mean that there will be significant acquisitions or mergers of Canadian companies by U.S. entities or indeed of U.S. companies by Canadian ones. Still, our ability to stay separate requires, for the most part, that the Corporate Sector itself retain sufficient independence to play a role in the promotion of sovereignty.

One further point needs to be emphasized and that is that our separateness, in every sense of the word, is a part of our overall quality of life. The world's economies and capital markets are integrating every day but this does not mean complete integration. Canada's quality of life will be enhanced by resisting complete economic or cultural integration.

All of this being said, what can we look to from the Corporate Sector in Canada to promote our aspirations? As we sit here in the second half of the year 2002, current events make it difficult to feel much confidence. The news, on a worldwide basis, at least insofar as the economy is concerned, has been unremittingly negative. It is hard to pick up a newspaper and find anything positive on the economic or corporate fronts. The world has witnessed, amongst other things, the following events:

- The implosion of valuations in the technology sector over the course of the last two years.
- An outright recession as defined by negative economic growth over at least two successive quarters.
- The terrorist events of September 11<sup>th</sup> in New York City and Washington, DC.
- A significant escalation in the risk of unleashing weapons of mass destruction, whether in Iraq or Kashmir.
- The bankruptcy of major companies such as Enron, WorldCom and Global Crossing.
- A high incidence of scandal, corporate theft and fraud in such cases as Enron, Tyco and Adelphia Communications.
- Questions regarding the quality and integrity of reported financial statements. Doubts were even expressed about such high quality and reputable names as IBM and General Electric.
- Auditors themselves being subjected to skeptical review, especially after Arthur Andersen was convicted of Obstruction of Justice by shredding Enron files.

- Instances of excessive executive compensation in companies such as Tyco, Hydro One in Canada, and even General Electric. These abuses are particularly unpalatable in the face of a recession and three years of falling stock prices.
- A daily litany of stories relating to conflicts of interest in the world of investment banking, including suggestions that equity research analysts distorted stock purchase recommendations in an effort to gain investment banking business. As well, press stories revealed that potential investment banking clients were given allocations of scarce initial public offerings of technology stocks in an effort to garner business. These stocks were sometimes resold within hours or days of being allocated.
- The Canada / U.S. trade relationship has been marred by a series of measures emanating from private quarters in the United States, designed to hinder trade between the two countries in such sectors as agriculture, steel and softwood lumber.

Taking all these factors together has resulted in the most precipitous drop in stock market values since the 1930s.

All of this is important, for without a recovery in the tone and confidence of the capital markets, there will be no recovery because there will be nothing available to fund it.

That being said, efforts are under way to bring about changes. Reforms are being implemented on both sides of the Canada - U.S. border which will promote auditor independence and provide greater confidence in the quality of accounting. Equity research is in the process of being separated from investment banking. Executive compensation will necessarily be modified to reflect public concern and cynicism.

These changes will serve to improve public and corporate confidence in capital markets. Much of this will be accomplished by a change of attitudes. Boards of directors will have to play a more diligent role in exercising an oversight function.

Government legislation and regulation will need to increase confidence and trust in the working of the economy generally, and in capital markets specifically. That being said, an overly stringent and detailed set of rules will not do the job. What is needed is a balance between careful

oversight and regulation and leaving enough room to allow the creative qualities of businesses to flourish.

Assuming that this recovery is to be accomplished over the course of the next couple of years or so, Canada must acknowledge that we still face challenges in being fully sovereign in the corporate and economic sphere. These challenges arise in ways that may appear to be excessively technical, but they have a profound affect on the day-to-day workings of Canada's economy.

All of this starts with the need to maintain a vibrant and separate financial services industry in Canada. This is easier said than done because the enormous size and liquidity of the U.S. capital markets serves as a significant magnet for Canadian companies seeking access to capital. Larger and more liquid markets are more efficient and yield better pricing for the issuers of stocks and bonds. The fact of integration in Canadian and U.S. capital markets, and considering relative sizes, means that there is a disproportionate influence of U.S. tax and accounting rules. It is hard for Canada to maintain separate and different rules for disclosure and accounting, in the case of those companies that seek access to both markets. This is a problem unique to Canada. Insofar as I know, American companies do not spend a lot of time worrying about other countries' accounting rules. They are fully occupied contending with their own. In the case of Canadian corporations, we have to worry about both. Similarly, in the case of tax, (and I do not mean levels of tax but rather rules of tax), the United States offers certain advantages for consolidating tax returns with subsidiaries, thereby making them more competitive internationally than Canadian corporations. Again, there are undoubtedly good reasons for separate Canadian tax rules, but it can be problematic when they are different than American ones.

As I stated earlier, these issues may appear to be technical and narrow, but they are important in the day-to-day workings of Canada's Corporate Sector. They are part of our struggle for sovereignty.

The upshot of all of this is that Canada must work hard to pursue a multilateral approach to tax and accounting issues. Post-September 11<sup>th</sup>, the United States does not seem much given to pursuing multilateral approaches in any sphere. Historically, U.S. financial regulation has served to provide exemptions for European and Canadian companies that follow their own domestic rules. Acceptance of these exemptions seems to be on the wane. Much of the U.S. regulatory thrust these days is to compel issuers seeking access to American markets to fully comply with

American rules. Again, this means that Canadian companies will have to comply with two sets of rules with the inevitable but perhaps slow push to standardize them in order to reduce complexity and compliance costs. In respect of all of this, we have much common ground to share with Western Europe. Western Europe may represent our best hope for a multilateral approach to these issues.

Finally, governments at all levels in Canada and the public generally will have to recognize that the benefits of our separateness come with a certain cost. Our society will need to arrive at a stronger consensus in an effort to pursue the advantages of this separateness. If it is simply a matter of the highest gain or highest value, our sovereignty will not have much long-term prospect of success. We have every reason to aspire to create world class competitive corporations but in the search for shareholder value, if that is the only goal, we will lose out to the much larger force to the South of us. Canada must arrive at a consensus where returns from companies and stock markets are exceedingly important but not the only consideration in determining economic decision-making.

Over the course of the last decade, as Canada's population has sought higher returns from equities in the face of extremely low interest rates and low returns from deposits or bonds, the pressures to pursue shareholder value have been growing enormously. This is not as a result of the forces of Bay Street or Wall Street or the banks of Zurich. This is about Canadians doing it to Canadians. We have demanded low-risk, high dividends and high returns, much in the same way that we want cheap airfares but extraordinarily well maintained aircraft with first-class meal service. Something has to give in all of this.

In our case, we must understand that some cost, perhaps slight, to maintain our separateness is well worth the price. Leadership in this respect should come from public sector fiduciary institutions, such as teachers and government civil service pension funds. They are the owners of much of the economy through their shareholdings and they should seek to make sure that non-financial goals are not completely eliminated. No one should think that placing financial goals on a secondary basis will lead to much success in the economy. That being said, non-financial goals such as sovereignty ought not to be excluded from consideration either.

By way of summary, therefore, two points should be made:

- The current economic and capital markets climate is as negative as anything seen in the last 70 years. Time will be required for a recovery in the Corporate Sector. Regulation and attitudes will need to be modified.
- Canada's proximity to, and cultural similarity with, the United States makes sovereignty a greater challenge for Canada than for other industrialized nations. For the Corporate Sector, this includes the difficulty in maintaining different tax and accounting rules than those facing U.S. companies. This does not mean falling in lockstep with U.S. rules. It does mean, however, that we need to be conscious of the cost of these differences and the advisability of pursuing multilateral approaches.