

Business ethics comprises two sets of concerns:

Ethical / moral issues

A - For individuals - as employers, employees, consumers - business ethics in its **basic** sense
EX Enron - if employee know books are "being cooked", false accounting, blow the whistle or not?

Hiring, firing - what are rights, duties, etc?

Advertising, marketing - what is effective and fair? What is misrepresentation? etc

B - For business vis-a-vis government/society: this is business ethics in a **broad** sense

EX Causes of recession, what to do: more regulation? Less?

Should government bail out failing companies? As it did, USA Canada etc

Taxing corporations: reasons, levels, effects?

CEO pay: too high or no reason to limit?

Materials, kinds of readings

1. Principles and theories about
 - a. Ethics/Morality - for evaluating what is decisions as employee/employer
 - b. Nature of business and government - for evaluating social political policies
2. Business situations / legal cases

Two Initial General Ideas

1. Corporate Social Responsibility (CSR), not just for profits
Valid idea? Misleading idea?
2. Stakeholders, not just shareholders/stock owner?
Who are stakeholders? Should their views define corporate aims? Why/why not?

For CSR origins

1960s Ralph Nader - consumers movement versus General Motors regarding safety

Ralph Nader, book (1965)

Unsafe at any speed: The designed-In Dangers of the American Automobile

Regarding Corvair GM

Reaction by General Motors Corp

Nader sues GM for invasion of privacy

GM fights case then settles, paying Nader \$425 000

Nader and others use shareholder status to try to promote CSR concerns in GM and elsewhere

Against CSR

Milton Friedman "*The Social Responsibility is to Increase its Profits*" (1970)

Friedman, economist, University of Chicago, advisor to governments.

Nobel Prize economics 1976, died 2006

Two General Ideas

1. Corporate Social Responsibility (CSR), not just profits
Valid idea? Misleading idea?
2. Stakeholders' interests matter, not just the shareholder/stock owner
Who are stakeholders? Should their views define corporate aims? Why/why not?

Against CSR and stakeholders' interests

Milton Friedman. The social responsibility of business is to increase its profits (1970)
Economist, U of Chicago, advisor to governments. Nobel prize economics 1976, died 2006
Carr, "Is Business Bluffing Ethical?"

For CSR and stakeholders' interests

Bowie, Stone, Frankel

Stakeholders: Groups involved in or affected by corporation

Who = employees, customers, suppliers, community/citizens generally, foreign host countries
Why? And self-interest in broad sense
Why not? "Affected" = vague. Anyway, ranking different stakeholders priorities?

Friedman vs CSR

- Owners/shareholders basic rights and concerns
- Social responsibility - and ethics - not defined, not definable
- Business follows rules, government makes them
- Responsibility is individual not corporate
- Private interest not contrary to public interest. Free market resolves problem (laissez-faire capitalism)

A basic idea similar to Friedman's, not in our readings:

Adam Smith, *The Wealth of Nations* (1776)

"The invisible hand" (Book IV, Chapter II)

In system of free markets competition:

"... [the individual] intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest [the individual] frequently promotes that of the society more effectually than when he really intends to promote it."

Reply to Friedman (and Smith)

- Issue not mainly need to do good, but avoid harm: "moral minimum"
- Corporations can be responsible through roles and policies, collective decisions
- Market externalities
- Prisoner's Dilemma

The Prisoner's Dilemma / P.D.

Hypothetical situation, "thought experiment" in economics, game theory, political analysis.
Purpose: analyse rational strategies based on self-interest, in situations of competition or potential cooperation.

Suppose two suspects arrested as jointly responsible for, say, armed bank robbery.
Police have evidence to convict each lesser crime, EX possessing stolen money.
To convict for armed robbery, confession needed from at least one suspect.
Suspects separately questioned, each offered same deal.

Assume outcomes as in following table.

What is rational choice for seeking best personal outcome: confess or refuse to confess.

POSSIBILITIES

1. A and B refuse to confess
2. A confesses, B refuses
3. B confesses, A refuse
4. A and B confess

OUTCOMES

- A and B receive 2-year sentences
A free, B 20-year sentence
B free, A 20-year sentence
A and B receive 10-year sentence

(The precise outcomes can be varied; rough proportions are what matters.)

The answer: what the prisoners are lead to choose.

B reasons:

Suppose A confesses ... I should confess (10-year sentence, not 20; line 4 vs 2)

Suppose A refuses ... I should confess (free, not 2-year sentence; line 3 vs 1)

Interchange B and A, for parallel results.

Thus, each confesses, that is, rationally should.

But, then, both end up worse off (10 year) than if neither confessed (2 year)

Conclusion & Application

Unhindered self-interest by each person leads to opposite of self-interest for all.

Furthering self-interest can require accepting laws/rules with some rules on self-interest.

EX. Can we rely on purely voluntary commitments for mutual benefits?

It would *seem* that best self-interested option is be a "**free-rider**", try to gain benefit without carrying through on commitment - *however*, by thinking thus, everyone loses.

Albert Z. Carr

Normal and valid to bluff/deceive, as in a game/poker.

Not wrong, expected, necessity to win

More on **milton friedman** - critic of corporate social responsibility, died 2006; prof U Chicago, advisor to governments: nobel prize economics 1976

Capitalism and freedom (1962)

- On discrimination in employment
- On government licensing occupations
- On monopolies: natural and other

Text: Arrow, "*Social Responsibility and Economic Efficiency*", pp.269-273

Kenneth Arrow (1921-) Nobel Prize economics 1972

Profit maximization in ways promotes efficiency, choice, etc... but:

Initial points: assumes vigorous competition; accepts significant income inequality

And basic reasons for CSR

- Market externalities vs friedman's views
- Consumer protection: asymmetry of info

Text: Dowie, "*Pinto Madness*", pp.384-387

1972, woman (Grimshaw) driving Ford Pinto, with young boy in car:

Car stalls, rear-ended by vehicle driving 28 mph

Pinto gas tank explodes in fire, killing woman and boy

Ford: rushed production, knew gas tank concerns, had corrective device \$11/car, did cost benefit analysis calculating cost of altered production, number of expected incidents, "value" of life lost (from government study) and for burn injuries.

1977 Ford alters Pinto Design

1978 Grimshaw trial: Ford must pay \$128 million then reduced to \$3.5 million

In next article:

1978 incident: three young women in Pinto rear-ended by van, gas tank explosion; killed

Jury: Ford not guilty: 2 months prior to Pinto Recall; van driver alcohol, driving fast

Text: Werhane, "*The Pinto Case and the Rashomon Effect*", pp.387-391

The "Rashomon metaphor"

Article compares different "narratives of whole Pinto affair"

Rush production?

Placement of gas tank: alterable?

Yes, Cost benefit analysis - but number of expected and actual incidents?

Point: perspective, claim of fact, can differ

McDonalds, too hot coffee? 1992 (not in readings)

79 year old woman sues for spillage in lap at McDonalds drive through Car (driven by grandson) was stopped; serious burns, skin grafts.
Jury awards \$160k compensation + \$2.3 million punitive damages
Coffee approx. 30 degree hotter than normal for coffee
Previously, complaints to McDonalds
She had sought \$20k, mcd refused
Court reduced amount to \$480k
Settled for undisclosed amount before appeal

Text: French, “*Corporate Moral Agency*”, pp.258-263

Can a corporation, a collective entity, be responsible for harms, not just individuals?
Friedman and others: no. Article: yes ... and why it matters

(258) “... corporations should be treated as full-fledged moral persons...”
= be responsible, held accountable, for harm
(Context: Oil corporation joining a cartel)

Reasoning: corporation action and responsibility if action based on CID (Corporate Internal Decision Structure) + corporate aims/success
Article misses (?): individual responsible for wrongdoing IF against corporate policy

General matters: origins/evolution of corporations

What is the nature of a corporation? 2 key characteristics
Is an entity created for the purpose for limiting the liability of individuals that invest money
Where public shares are available on the market (ownership available to everyone)
Owners and managers are different. Separation of ownership and control to some extent
Decision making by managers not owners - shares widely owned but firm controlled by senior management who in theory answer to board of directors.

Text: Freeman, “*A Stakeholder Theory of the Modern Corporation*”, pp.263-69

(pp.163-4) “... managers have a fiduciary relationship to stakeholders. Stakeholders are those groups who have a stake in or claim on the firm. Specifically I include suppliers, consumers, employees, stockholders, and the local community, as well as management as the agent for these groups. (...) each of the stakeholder groups has a right to not be treated as a means to some end, and therefore must participate in determining the future direction of the firm in which they have a stake.”

(p.268) “... the stakeholder theory does not give primacy to one stakeholder over another, though there will surely be times when one group benefits at the expense of others. In general, however, management must keep the relationships among stakeholders in balance. When these relationships become imbalanced, the survival of the firm is in jeopardy.

Text: Bok, *“Defining Secrecy - Some Crucial Distinctions”*, pp.50-53

Lies - wrong (includes misrepresentation by withholding the whole truth)

Secrecy & privacy - wrong if purpose is

Text: Battin and Mower, *“The Columbia Shuttle Disaster: Should We Have Told the Astronauts the Truth?”*, pp.82-83

2003 explosion of space shuttle, kills 7 astronauts

Explodes at return, 16 day mission

Cause: damage to wing at launch

What mission control knew, did, didn't do, etc

Issues (a) responsible action about risk?

(b) obligation to inform astronauts?

Not in readings:

1986 US Space Shuttle “Challenger” explosion

Explodes moments after take-off

All astronauts killed - including one teacher on board

(some astronauts conscious for brief time?)

Cause?

The Rogers Commission investigates

Rubber o-rings fail in cold temperature (hot gasses leak in fuel tanks)

Some engineers in company manufacturing the shuttle had concerns, warned: ignored/silenced

Rush to launch?

BASIS FOR DECIDING RIGHT & WRONG

Non-Philosophical Sources .. Inadequate

Laws: Yes, but...

Common practices: Maybe, but...

Religion: Which? What implied? Persuasive to others?

Relativism: no such thing as right?

PHILOSOPHICAL SOURCES: ETHICAL THEORIES

Text: Audi, *“Some Approaches to Determining Ethical Obligations”*, XXV-XXX and *“What is Ethics?”*, pp.23-38, in Ronald Duska, *Contemporary Reflections on Business Ethics*. EBook at Library (2007)

PHILOSOPHICAL THEORIES OF ETHICS:

Summary of two main theories:

Utilitarianism: choose option with best overall consequences for all concerned
Absolute Rules: act only on what can be universalized; others never as mere “means”
(Kantian ethics)

Combined? Utilitarianism but some things absolutely forbidden

Utilitarianism

(source: John Stuart Mill, 1860s)

- Compare alternative actions for consequences
- Consider consequences for all persons affected (self and others)
Negative & positive consequences, harms & benefits; degree/extent
- Choose option that overall maximizes benefits, minimizes harms
- Goal: greatest happiness for the greatest number
= the general / aggregate welfare

A kind of cost-benefit thinking but ... not just money, and for all affected

Advantages:

- Empirical: factual and measurable
- Flexible: not fixed rules
- Realistic: moral trade-offs & balance unavoidable

Disadvantages:

- Intentions don't matter? Only results?
- Sacrifice individual or minority for majority
- Anything/Everything acceptable in some circumstances?
End justices means?
- Neglects rights/justice
- Neglects special obligations - to family, friends, co-workers?
- Harms and benefits: what to include and exclude? How far into future?
Distribution problem, doesn't state what fair is
- Is everything comparable? Does everything have a price?

Absolute Rules / Deontology / Kantian Ethics

(source: Immanuel Kant, 1780s)

The “*categorical imperative*”

Formulate what you intend to do

Imagine everyone intending that, ie try to “universalize”

Moral actions can be universalised. Immoral actions cannot be.
Whatever you intend must apply to everyone/be universalised

Is it moral to intend to break a promise if it suits you?
No, then promising becomes meaningless, even for/by you

Is it moral to help someone in trouble if feasible?
Yes, you would want that if you are in trouble

Underlying rationale:

Must not treat self as exception to rules

Must not treat people merely as “a means”, they have rights, are “ends-in-themselves”

Advantages:

- rules/duties/rights can't be compromised
- Emphasis on responsibility/moral agency

Disadvantage

- Too strict/absolute? Can't rules have exception, be flexible?
- Which duties/right, to what extent?
- What of conflicting duties, conflicting rights?
- Test of universalizing: Not clear? Tricks with formulating?

Virtue Ethics

- Morality can't be specified by general principles; (either utility nor universalizability)
- Morality requires becoming a person with certain qualities
Honesty, generosity, respectfulness + good judgement in applying
- Persons as models for others

Advantages

- Rules require judgement/interpretation: the essential thing here
- Life in business not separate from life outside it: unity of the person

Disadvantages

- Employees are adults: characters already formed
- Unclear how to train for virtues, cultivate character
- Approach risks being intrusive and controlling

Text: Loomis, “*Lies, Damned Lies, and Managed Earnings*”, pp.132-139

Livet: plays, musicals on stage in Toronto and New York, Broadway
Expensive productions, needs more money, falsifies info to get investors

NOT IN TEXT

“Livent went bankrupt in 1998 and, according to the RCMP, cost investors nearly \$500 million

1999: Garth Drabinsky and partner Gottlieb charged with fraud

2011: sentenced to 5 years (originally 7), paroled in 2014

2014: auditor for Livent (Deloitte & Touche) trial for negligence

Decision: must pay \$118 million; that being appealed to Supreme Court

At trial, judge: auditors “seemed to turn a blind eye to warning signs”

Harboring improper reserves “to cover up excessive expenses”

Text: Frederick & Hoffman, “The Individual Investor in Securities Markets...”, pp.141-5

(142) “Since we feel justified in prohibiting consumers from buying(...) highly dangerous drugs or other consumer products, shouldn’t we, by analogy, be justified in prohibiting certain investors from buying highly risky financial instruments?”

1 Concern: paternalism: preventing adults from making free choices (that are bad for them)
-- again do that in ways, already

But here, better; (p. 144) “providing information to at-risk investors”

Even...? “[...] as with prescription drugs, at risk investors be required by law to engage the services of an expert”

Pro? Con?

NOT IN TEXT:

Bernard Madoff, “Ponzi Scheme”

Madoff: prominent on Wall street, former chair of NASDAQ (Stock exchange)

Apparently exceptional investor; fund much in demand

Consistent, higher than normal annual returns to investors

Billions in fund

2007-08 economic crisis: investors need money, seek to cash out

Dec 2008 fund revealed not actually investing ... ponzi scheme

Investors money wiped out: wealthy and not; charities, universities

\$60 billion losses

Madoff arrested, charged, convicted: March 2009 sentenced 150yrs..

Some associates also

Trustees, via government, claim back some billions from big “winners”, return to losers

Failure of the SEC (US Securities Exchange Commission) to detect, though warned

Text: Cohen, *“Arthur Andersen Refugees Reflect on What Went Wrong?”*, pp.139-140
Was auditor/accounting

MSSING INFO PROFF

NOT IN TEXT:

2002 “the 89 year old firm was convicted ... of obstructing justice by shredding tons of documents and destroying emails related to its clients, Enron, just before the energy trading giant abruptly went bankrupt.

Arthur Andersen collapses, goes bankrupt

2005 US Supreme Court overturns conviction, “technical (?) grounds”

Text: Kuttner, *“Everything for Sale”*, pp.675-678

Economics system / capitalism, esp. In U.S., after Great Depressions 1930s,
Adopted significant government regulation, social safety nets, etc.

MISSIN INFO

Text: Shaw and Barry, *“Blood for Sale”*, pp.679-680

Voluntary blood system? Or ... for pay?

What about plasma?

US, Britain, Canada

Plasma International in US practises

Purpose: (1) for transfusions, for (2) making drugs (pharmaceuticals)

NOT IN TEXT

Canadian plasma services: private company

2013 O.K. from Health Canada (federal Ministry)

2014 Ontario Law against, also in Quebec

But in Sask., and in N.B?

“Those who cannot remember the past are condemned to repeat it.”

Philosopher George Santayana (*The Life of Reason*, vol. 1, p.190) (see text, p.148)

The S&L / Savings Loan Scandal In the United States 1980's

(see pp.173-74 in text, part of article, *“Wall Street Lays Another Egg”*)

S&Ls: Bank-like institutions; originally highly regulated,

Limited to deposits, with ceiling on interests; and loans for mortgages.

Late 1970s: Rise of general interest rates to double digits

Oil prices doubled

Interest rate ceiling for S&Ls; competitive disadvantages:
Depositors turn elsewhere

1970s-80s deregulation (Presidents Carter, 1981-1989; Reagan, 1989-93)
S&Ls allowed more speculative ventures, commercial real estate, etc
Reduced net worth requirement
Relaxed accounting practices
Federal insurance increased for deposits
Number and responsibility of gov't regulator / overseers reduced

Criminal Activities
"Land flips"; special loans to S&L managers

Combination of risky investments, accounting practices, lack of oversight, etc
Bankruptcies of over 1000s S&Ls
Cost and bailout: \$153 billion; gov't/ U.S. taxpayers cover \$123.8 billion

Global Economic & Recession, 2007-20012
" **Finance ethics** " , pp.146-52.; " **F.I.A.S.C.O.** " ; " **Derivatives, the new 'Ticking bomb'** " ;
" **The Running of the Hedgehogs** " ; **Wall Street Lays Another Egg** " , pp.160-177..
" **The Untold Story of How Canada Survived the Financial Crisis** " ,
The Globe and Mail, Report on Business, Sep. 13, 2013 (updated Jun 19, 2005)

Some key facts/ideas

General **shift of economy**: manufacturing sector to financial services sector

Deregulation of financial services in 1999
Ex: commercial and investment banks

Securitization (see pp. 174-5):
Debts/loans with collateral based on equipment/homes/equity, etc
By 2006: trillions

Derivatives: esp: "credit default swaps";
Forms of insurance above
Can be treated separately without owning underlying mortgages

Hedge Funds: linked to subprime mortgages

Private Equity Firms: mergers, leveraged buyouts (ex. KKR, Blackstone)

Credit Crunch: because financial institutions have bad debt, toxic assets worth less or worthless

Global Economic crisis/recession.2007-2012...:Phases (Details below)

- 1) Housing Sector: subprime mortgages collapse of housing market
2004-2006 US interest rates rise; 2007 Housing market collapses: prices tumble
People can't pay mortgages; millions lose homes
- 2) Financial Sector: Securitization of mortgages (derivatives, etc)
Bankruptcies,bailouts,takeovers of financial institutions:
Credit crunch/freeze: financial institutions with bad debt: toxic assets
Understanding Derivatives
Robert Rubin, former Treasury Secretary, and chair Citigroup:
"I had no familiarity at all with CDO's
Warren Buffet on derivatives in 2003: "We view them as time bombs, both for the parties that deal in them and the economic system." (Forbes.com dated 05.09.03)
- 3) Manufacturing sector (from Wall st to Main st) GM, Chrysler... bankruptcies bailouts
- 4) Governments/Countries at risk: especially Europe, the sovereign debt crisis:
Countries bailed out by IMF, ECB: Ireland, Greece, etc

US Stock Market, DJIA:

Jul 2007: 14 000
Mar 2009: 7 000 +/-
Sep 2012: 13 500 +/-

Unemployment

U.S. Summer 2008:<6% Summer 2009 - Summer 2010 almost 10%
Canada Summer 2007: 6% , Summer 2009: 8.7%

Some Developments in the Extended Crisis (select details from above)

-Feb 2007: The US Federal Home Loan Mortgage Corporation (Freddie Mac) stops buying "risky subprime mortgages and mortgage-related securities".
-April 2007: "New Century Financial Corporation, a leading subprime mortgage lender" bankrupt
-Aug 2007: "BNP Paribas, France's largest bank" stops "redemptions on investment funds."
-Sep 2007: "Bank of England, \$ supports "Northern Rock, the United Kingdom's fifth-largest mortgage lender."
-Oct 2007: Swiss bank UBS loses \$3.4 billion from subprime mortgages; later \$37 billion
-Oct 2007: Citigroup writes down, \$3.1 billion, then \$5.9 billion
Later: \$45 billion bailout from US government
-Mar 2008: Bear Stearns taken over by rival JP Morgan Chase (pushed by US government)
-Jun 2008: Bank of America takeover of Countrywide Financial Corporation
-Sep 2008: Bank of America purchases Merrill Lynch & Co.
-Sep 2008: Lehman Brothers investment bank bankruptcy, lost billions
-Nov 2008: Bank of America Corp acquire Merrill Lynch and Company
-Sep 2008: AIG massive insurance company, US loan initial loans to, in all \$180 billion bailout, in exchange for ownership stake, restrictions on CEO pay, etc

-Sep 2008: Goldman Sachs, investment banking firm \$5 billion investment from Warren Buffet, urged by US government; (2011 Buffet sells stock profits billions)
-June-2009 General Motors bankruptcy; July 2009: GM out of bankruptcy, government becomes partowner; Aug 2010: New GM: IPO
Chrysler: Apr 2009 bankruptcy; Jun 2009 takeover by Fiat
-May 2010: IMF approves [...] 30 billion Euro Stand-By Arrangement for Greece
-Nov 2010: EU/IMF: three year financial assistance for Ireland
-2010: Goldman Sachs Fined \$550 million. (G's profits that year \$13.4 billion) misleading clients in selling mortgage-backed securities 2007

North American Government Action

1. Oct 2008: **TARP** by US government/Troubled Assets Relief Program
President George W. Bush, Congress: Bailouts, loans to banks, investment firms
Originally **\$780 billion** authorised, then cut to \$414 billion paid out. Much repaid.
Net cost to taxpayers \$60 billion
2. Feb 2009 **US Government Stimulus** package under president Obama: \$800 billion
"American Recovery and Reinvestment Act of 2009"
3. 2009 **Canada**: government "Economic Action Plan" (**Stimulus**) **\$40 billion**
4. July 2010: US new regulations; Dodd-Frank Wall Street Reform and Consumer Protection Act

And the aftereffects continue:

June 2016

"The Securities Exchange Commission [...] reached a \$415 million settlement with Bank of America. The SEC found the bank's Merrill Lynch to have misused billions of dollars of client money to finance its own trades [...] the second-largest against Wall Street

Jan 2017

The US Justice Department completed a deal with Deutsche Bank on Tuesday that will require the bank to pay \$7.2 billion for its sale of toxic mortgage securities in the run up to the 2008 financial crisis [...] [...] to pay a civil penalty of \$3.1 billion and provide \$4.1 billion in consumer relief to homeowners, borrowers and communities harmed by its practises. The total is the largest amount ever paid to resolve charges against a single entity for misleading investors in residential mortgage backed securities, the department said in a statement.

Ethical Questions (also: political-economic)

About the Role of Government vis a vis Economy

Regulation: More? Less?

Bailouts: Yes? No?

National debt/deficit ... Stimulus? Austerity?

About Businesses and Individuals

What is the responsibility of sellers or buyers: for mortgages, financial instruments
Reckless, overly risky transactions - with consequences for others
Others - employees, buyers of homes or investments, taxpayers
In housing and financial transactions: deception, fraud
Companies in trouble buy bonuses to execs
Securitization instruments, too abstract, incalculable worth
Insufficient government regulation in housing sector
Some enterprises too big fail ... so too big to exist?

NOT IN TEXT:

Georges Soros, *"The Crisis & What to do About It,"* The New York Review of Books (Dec 4, 2008)

"The crisis was caused by the system itself. This fact -- that the defect was inherent in the system -- contradicts the prevailing theory, which holds that financial markets tend toward equilibrium and that deviations from the equilibrium either occur in a random manner or as caused by some sudden external event to which markets have difficulty adjusting. The severity and amplitude of the crisis provides convincing evidence that there is something fundamentally wrong with this prevailing theory and with the approach to market regulation that has gone with it. To understand what has happened, and what should be done to avoid such a catastrophic crisis in the future, will require a new way of thinking about how markets work."

Insider Trading

Text: Glynn and Dowd, *"Martha Stewart Focuses on her Salad"*, pp.571-574

Text: Burton and Kishon, *"How Raj Rajaratnam Gave Galleon Group Its Edge"*, pp.577-579

Stewart

1982-1999 Martha Stewart, great success with magazine, television program, etc, company goes public becomes billionaire
2001 sells stock in pharmaceutical company just before drops significantly
Just after failed test on promising drug; company owned by friend
2004 what is your convicted of insider trading and sentenced to 5 months
2005 after jail resumes successful business

Rajaratnam

Hugely successful hedge fund; Galleon Group
By 2008 \$5billion assets
Accused of insider trading with info from various companies, including Moody's Investors Service

Reference Re Securities Act, [2011]

Issue

Constitutionality of setting up federal regulatory agency for stock markets;

Key: question of federal vis-a-vis provincial jurisdiction.

Decision

Law and agency unconstitutional, oversteps provincial jurisdiction

Reasons

Although:

- Studies recommended federal regulatory agency
- New concerns about stock markets; regarding fairness, protection for investors: especially “domino effect” of default affecting entire system: systematic risk
- BUT: Constitution Act of 1867
 - Federal government authority for interprovincial & international commerce
 - Remaining matters to provincial authority - property ownership, etc.
- “Cooperative and flexible federalism” essential
 - Regulation of competition is federal matter, IF affects “trade as a whole”
 - But here, issue is just securities industry
- Previous Conservative government & PM Harper wanted federal agency
- Current Liberal government & PM Justin Trudeau also wants, will pursue
- Some provinces, especially Alberta and Quebec still oppose

See syllabus: “Finance Minister Says Ottawa Supports National Securities Regulator”,
The Globe and Mail, Report on Business, Jan 11, 2016

See syllabus: “Why Quebec Must oppose a National Securities Regulator”,
The Globe and Mail, Report on Business, Jan 26, 2016

“It’s difficult to understand the motivation for reforming the current system, which, in addition to working well, is flexible and allows the provinces to have laws and approaches that enable them to adjust and coordinate with one another...”

Text: “*What is Really Unethical About Insider Trading?*”, pp.152-159

- Considers arguments why insider trading might not be wrong, shouldn't be illegal
- Partly persuasive but miss the real issue
 - Not always unfair to profit by knowledge others lack: smart buy at auction;
 - expertise of doctor or engineer
- Allow managers/employers to trade on insider info an incentive to innovation?
- But... REAL ISSUE
 - Insiders/managers have *fiduciary* duty to shareholders (actual & potential ones)
 - In other words, fairness of equal info to those entitled to it

CORPORATE GOVERNANCE

Text: *"Who Rules the Corporation?"*, pp.582-587

Text: *"Power and Accountability: The Changing Role of the Corporate Board"*, pp.588-594

Criticism of role of boards of directors (as representatives of shareholders)

Board of Directors ... in control? Should be, but ...

(p.582) "In nearly every large American corporation, there exists a management autocracy"

Like "a political state in which all powers are held by a single clique"

Passive role, occasional meetings, managers control perks, etc

Changes need:

Board members approve all major decisions

Board members as full time professionals in relevant areas

Knowledge about laws and monitor corporation

Importance of independent directors ... (directors who are not shareholders)

Members elected by different shareholder groups

Defense of role of board of directors:

Managerial role controlled by basic government regulations and market competition

Government regulations increased 1930-1980; effective; critics wrong

In fact, excessive now and intrusive

General oversight by responsible board members sufficient: flexibility to managers

Maybe independent "audit committees" from outside directors, but no fixed formulas

(p.594) In all: no good reason for radical changes

ENRON: Rise and Fall 2001 (more than in text)

Text: Lawrence and Beauchamp, "Enron and Employee Investment Risk", pp.183-184

Enron Corp: energy company, Houston TX, started 1958

Before fall, multi billion dollar corporation - 7th in Fortune 500 Magazine

Originally natural gas exploration, producer

Then middleman: "future contracts" for gas, electricity

(and communications divisions, etc)

CEO Ken Lay, then J. Skilling, then Lay again: Andrew Fastow CFO

"Skilling who had made revenues grow from \$4 billion to more than \$60 billion"

(text: the once successful business model, page 443 - article not required)

Dec 2001, stock almost 0: bankruptcy \$62 billion

Over 5000 employees lose jobs

Investors: individual and institutions lose

Executives found guilty

What it Did

Benefited from deregulation in energy sector, and:

“Using the lawful practice of “mark-to-market” accounting, Enron’s financial analysts and advisors were able to record potential, future profits as immediate gains. To boost these apparent profits even more, Enron also created businesses and partnerships to hide its debt. These practises inflated stock prices while falsely establishing the company’s financial position and stability.” (Text, “Enron and Employee Investment Risk”, p.183) -- “future contracts”

“Special purpose entities (SPEs), off balance sheets
Execs: loan to selves; on eve of bankruptcy, huge bonuses, sell much stock
Warnings, attempted whistleblowing, but stonewalling

2006 “” Lay & Skilling; guilty of fraud and conspiracy; Lay dies, before sentencing

Skilling: 24 year, appealed but ...; Fastow 6 year

2008 US Court: shareholders some compensation from \$ of financial institutions benefited/aided

A twin to ENRON,; WORLDCOM

Text: Moberg and Romar, “The Good Old Boys at WorldCom” , pp. 625-629.

- Worldcom created 1983; telecom business
- Rapid acquisitions and mergers: (p.626) “65 acquisitions between 1991 and 1997”
- 1999 stock at \$99: down 90% by 2002: bankrupt (p.628)
- CEO Bernie Ebbers, for a time billionaire - personal loans from company: \$341 Million
- Systematic false accounting by company
- Accountants: Arthur Andersen company (same as for Enron): later collapsed
- Ebbers convicted of various forms of fraud

New Regulation in wake Of Enron and Worldcom:

Sarbanes-Oxley Act (SOX), United states, 2002

Response to scandals at Enron, etc. Especially regarding accounting

New government body: oversee, investigate, discipline, accountings, firms, public companies

This in addition to SEC

CEO/CFO must certify finance statement

New standards/rules for accounting

Audit committees must be independent

Accountants can’t also be consultants

Major changes to finance situation must be promptly public

Heavier penalties for fraud, etc

Protection for whistleblowers

Canada

2002 Ontario Bill 198 parallel to SOX (so: C-SOX)

Similar in other provinces, etc.

Critique

Too much too fast?

Too costly?

I feel nothing..... Except this beat that never ends.... Some girls talking.... Sounds like fucking white noise in my head... everything is bending... your the only focus in my lens.... I dont get it... im not drunk... a million people in the place but your the one... that gets me like.... HI MY NAME IS.... WHAT EVER U CALL ME..... SO LETS GET UNDRESSED.... CAUSE YOU LOOK A LITTLE LONELY... ill make you scream yea, make you laugh,,,,, cover your body with my autograph..

And Later: after 2008 crisis

July 2010 US government / President Obama passes

Dodd-Frank Wall Street Reform and consumer protection act

New government regulations controlling US banking resulting from 2008 crisis

Controls derivatives, creates Bureau of Consumer Financial protection,

“Transparency requirements, such as details of executive compensation and how [...] linked company performance” and “Pay ratio of CEO compensation to average employee”

Rules against speculative investing involving customers’ deposits

Increases requirements for bank capitalization

Affects Canadian companies doing business on U.S. stock exchange

President Trump seeking to undo regulations

“US President Donald Trump on Friday (Feb 3, 2017) ordered reviews of major banking rules that were put in place after the 2008 financial crisis, drawing fire from democrats who said his order lacked substance and squarely aligned him with Wall Street bankers.”

“The 2010 Dodd-Frank Wall Street reform law that raised capital requirements for banks, restricted their trading by means of the “Volcker Rule”, and created the Consumer Financial Protection Bureau

-Trump meets w CEO of Morgan Chase and others

Why not self-regulation by industry or profession?

Consider doctors, lawyers, engineers...

The problem of self-interest/free riders

Effects on third parties

Text: "occupy wall street", pp. 221-222.

"The anti-economist: the fall and rise of occupy wall street", by Jeff Madrick, Harper's Magazine, Mar 2013:9-11:

- 2011 group protesting economic inequality (the 99% i.e. vs the top 1% (p. 221) in 2007: top 1% in U.S. = $\frac{1}{3}$ wealth; other 99% = $\frac{2}{3}$)
- takeover of public park in NYC; confrontations with police left alone at first then evicted
- a movement, aims? | deliberate lack of structure and definite policies.
- Dissipated: but echoes w. B. Sanders as U.S. Pres. candidate, anti-Trump

PRODUCT LIABILITY; ADVERTISING

Text: Goldman, "The Justification of Advertising in a Market Economy", pp. 337-341

Purposes of Advertising

Provide information, allow consumer choice

Promote sales

Compatible?

(p. 338) "principal among the [...] benefits claimed to result from advertising is [...] consumers having relevant knowledge of the existence, quality, and price of the products."

(p. 339) "the central function of much advertising is to persuade people to buy products."

Ethical (and effective) advertising

(p. 340) "persuasion by rational means respects the right [...] of informed choice."

Clear, accurate, adequate, information; consumer choice

Basis:

Utilitarianism: if not thus, harmful effects

Deontology/Absolute Rules: if not thus, manipulates people, treats as means

Commercial vis-a-vis other forms of free speech: see below

Text: Galbraith, "The Dependence Effect", pp.329-333

Text: Hayek, "The NonSequitur of the Dependence Effect", pp.334-336

Assumption about markets, supply-demand, etc

- markets are efficient ways of responding to wants, promoting consumer choice, etc
- wants/people's desires for goods are unlimited; consumer demand results in production/supply

Galbraith: natural wants / desires not really unlimited

- Expanding production/profits requires creating consumer desires by advertising
IF so, then
 1. Consumers not sovereign/autonomous; people are puppets
 2. No neutral standard/baseline to judge markets as efficient;
 3. Social needs -- public transportation, health, etc -- sacrificed to (minor) private wants

Hayek: alleged "dependence effect" false, misrepresentation

True:

(p.334) "we would not desire any of the amenities of civilization [...] if we did not live in a society [...] that provides them"

False:

(p.335) the resulting desires and amenities/products are not really valuable, important, etc
Logic of the "dependence effect" would imply that refined art, music, etc would be worthless

Unethical/illegal advertising - an interesting example

F.T.C vs Colgate-Palmolive Co. 380 US 347 (1965)

Supreme Court of the United States on advertising (website on syllabus)

Seeing is Believing?

Sandpapered could only be shaved after prolonged soaking

What was shown as sandpaper was actually plexiglass

In Canada, advertising regulated by "Competition Act" enforced by Competition Bureau

Text: Reich, "Corporate Governance and Democracy", pp.629-630

Text: Reich, " Supercapitalism", pp.665-673

Pros and cons of advanced capitalist economies US and elsewhere

Pros: more products & services, often cheaper, necessities and luxuries, consumer choice, etc

Cons: widening economic inequality, loss of jobs to technology and foreign labour, environmental issues, democratic concern: government more subject to influence of corporations, lobbyists

In Canada: pay for access to government officials, pipelines, loan to Bombardier

(p.669) “corporate income tax is inefficient and inequitable”

“Interest payments made by corporations on their debts are deductible from their corporate income tax

INFO SKIPPED MOFO

Back to “commercial speech” vis-a-vis other forms

Reich: reduce effect of corp money on politics; increase for individual citizens

(p.669) “corporations are not people. They are legal fictions ...

Should not have rights of free speech, due process, political representation”

NOT IN TEXT OR ON SYLLABUS; NOT required: Supreme Court of the US 2010

Citizens United vs Federal Election Commission 558 US 08-205 (2010)

NOT required for test

Issue:

Limits on financing of political campaigns?

Decision:

Corporations, also unions: no limit to spending to support political parties, campaigns

Rationale:

Such spending counts as a form of political speech: so freedom of expression/First Amendment

- This much beyond prior recognition of corporations as “legal persons” in limited ways
- Overturns (as unconstitutional) federal law that banned/limited direct corporate financing of political campaigns (US McCain-Feingold legislation 2002)
- Decision overturns some prior Supreme Court precedents