Fordham International Law Journal

Volume 27, *Issue* 2 2003 *Article* 10

Regulation Without Borders: The Impact of Sarbanes-Oxley on European Companies

Maria Camilla Cardilli*

*

Regulation Without Borders: The Impact of Sarbanes-Oxley on European Companies

Maria Camilla Cardilli

Abstract

The purpose of this study is to: (i) outline the key provisions of Sarbanes-Oxley, highlighting the aspects of the Act which are most likely to impact European companies as well as their officers and directors; (ii) point out the provisions of the Act which conflict with EU national laws; and (iii) illustrate the key points of the proposed European reform of corporate governance, as formulated on November 4, 2002 by the High Level Group of Company Law Experts appointed by the European Commission.

REGULATION WITHOUT BORDERS: THE IMPACT OF SARBANES-OXLEY ON EUROPEAN COMPANIES

*Maria Camilla Cardilli**

* Current Associate in the Banking & Finance department of Allen & Overy in Milan; LL.M. in Corporate, Banking and Finance Law, Fordham University School of Law; former Associate in the Corporate and Banking departments of Gianni, Origoni, Grippo & Partners (Linklaters & Alliance); admitted to the Italian Bar (2001).

SCOPE OF ANALYSIS

"Today I sign into law the most far-reaching reform of American business practices since the time of Franklin Delano Roosevelt," declared President George W. Bush on July 30, 2002.[1] The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act"), approved in the House of Representatives by 422 votes to 3 and in the Senate by 99 to 0, attempts to restore investor confidence in U.S. capital markets after the corporate scandals of 2001.[2] Specifically, the Act is designed "to protect investors by

1. Julia Finch, *U.S. Clean-Up Angers Hewitt*, GUARDIAN, Oct. 8, 2002, *available at* http://www.guardian.co.uk/Print/0,3858,4517263,00.html. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 15, 28 U.S.C.) [hereinafter Sarbanes-Oxley Act].

2. The series of corruption scandals in the United States began in October 2001, with the revelation that Enron, America's biggest energy corporation, had fraudulently acted with its auditor Arthur Andersen to camouflage its losses. Shortly after,

improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes."[3]

The purpose of this study is to: (i) outline the key provisions of Sarbanes-Oxley, highlighting the aspects of the Act which are most likely to impact European companies as well as their officers and directors; (ii) point out the provisions of the Act which conflict with EU national laws; and (iii) illustrate the key points of the proposed European reform of corporate governance, as formulated on November 4, 2002 by the High Level Group of Company Law Experts appointed by the European Commission.

I. *A LAW DESIGNED TO PROTECT INVESTORS*

The Securities and Exchange Commission ("SEC") has always been recognized as the "statutory guardian" of the public's interest with regard to federal securities law.[4] Indeed, many of Sarbanes-Oxley's provisions involve remedies that trace their roots to the SEC's enforcement program of the 1970s, a period often referred to as the "*golden age* of SEC enforcement."[5] Stanley Sporkin, director of the SEC's Enforcement Division at the time, delivered a speech in 1976 entitled *Restoring Integrity to American Business*.[6] In it he suggested that companies appoint a business practice officer to be responsible for implementing codes of ethical conduct.[7]

In fact, very few statutory remedies were available to the SEC

WorldCom, the telecommunications giant, was in the news for huge unaccountable "holes" in its financial statements, which led to its filing for bankruptcy in July 2002. It was described by the New York Times as "the largest bankruptcy filing in the history of the United States." Simon Romero & Riva Atlas, *Bankruptcy at WorldCom is the Largest in U.S. History*, N.Y. TIMES, July 22, 2002, *available at* http://www.truthout.org/docs_02/07.23B.world.largest.htm. More corporate scandals, such as those that caused the fall of Tyco first and of Xerox later, were yet to come.

3. Sarbanes-Oxley Act, 116 Stat. at 745.

4. Theodore A. Levine & Daniel M. Hawke, *Sarbanes-Oxley: Back to the Future*, CHIEF LEGAL EXECUTIVE, Winter 2003, at 14, *available at* http://sechistorical.org/museum/Museum_Papers [hereinafter Levine & Hawke].

5. *Id.* at 14 (emphasis added). *See* Robert Reno, *Financial Watchdogs are Chihuahuas*, NEWSDAY, Oct. 23, 2003, *available at* http://www.hollandsentinel.com/stories/102302/opi_102302020.shtml.

6. *See* Levine & Hawke, *supra* note 4, at 17.

7. *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 360-63, 462-66 (1982). *See also* Levine & Hawke, *supra* note 4, at 17.

in the early 1970s. Its authority to seek injunctive relief[8] had proved insufficient to remedy the harm from violators or to deter them from committing violations in the future.[9] The SEC did not have the authority to impose fines or penalties on issuers or their management. Moreover, it could not enforce the disgorgement of management's ill-gotten profits, thus having to rely instead on the equitable discretion of the courts.[10] Generally, courts granted equitable relief to the extent necessary to achieve the purposes of the securities laws.[11]

The SEC also developed the so-called "access theory" of securities law enforcement.[12] Grounded on the belief that lawyers, accountants, and securities industry professionals held the keys to their clients' compliance with the law, the access theory put pressure on these professionals to monitor their clients' corporate transactions. Those who failed to do so faced SEC enforcement actions for their own participation, even acquiescence, in their clients' violations.[13]

In a 1976 speech to the Corporate Counsel Institute,[14] Stanley Sporkin explained the rationale underlying the access theory:

> We all recognize that a major securities fraud cannot be perpetrated by a corporation, its officers and directors without access to our financial markets. Such access can only be provided through the activities of broker-dealers, banks, insurance companies et al. In addition, systematized frauds frequently depend on the cooperation — intentional or otherwise — of professionals such as lawyers and public accountants. Many of the most egregious frauds of the past few years . . . have involved the full panoply of professional participation.[15]

Over the years, the SEC's statutory remedial powers were broad-

---

8. *See* Levine & Hawke, *supra* note 4, at 14.

9. *See id.*

10. *See id.*

11. *See id.*

12. *See* JOY A. SIGLER & JOSEPH E. MURPHY, INTERACTIVE CORPORATE COMPLIANCE: AN ALTERNATIVE TO REGULATORY COMPULSION 31, 48, 72, 130 (1988).

13. *See* Levine & Hawke, *supra* note 4, at 18.

14. Stanley Sporkin, SEC Enforcement Practices Against Corporations, Address Before the Corporate Counsel Institute in Chicago (Oct. 7, 1976).

15. Daniel M. Hawke, *Roundtable on Enforcement: A Brief History of the SEC's Enforcement Program 1934-1981*, SEC Historical Society, at 27 (Sept. 25, 2002), *available at* http://sechistorical.org/museum/museum_Oral_Histories.php.

ened after a series of Wall Street scandals, which highlighted the evident weaknesses of these enforcement powers.[16]

The mid-1980s witnessed a shift in the SEC's enforcement program. Controversies surfaced regarding the SEC's efforts to police the conduct of accountants, lawyers, and other professionals.[17] Enforcement programs encountered increasing resistance, however, as the courts progressively adopted narrower interpretations of the securities laws to prevent SEC attempts to broaden the scope of its authority.[18]

With the enactment of Sarbanes-Oxley, however, the circle has closed. The SEC today exercises broad powers, some of which are based on long-established principles. The code of ethics that Stanley Sporkin called for in 1976 is now mandated by statute,[19] particularly Section 307 of the Act ("Rules of Professional Responsibility for Attorneys") which is essentially a doctrinal extension of the access theory. The SEC's express authority to obtain the forfeiture of executives' bonuses and profits validates the SEC's previous efforts to obtain disgorgement of ill-earned profits.[20]

Following Sarbanes-Oxley, the SEC completed the most intense rule-making year in its history.[21] Never had it been afforded such authority to punish or deter wrongdoing.[22] Corporate governance rules and monitoring procedures have been made significantly stricter. Accounting regulations seek to achieve two primary goals:

(i) to prevent parasitic auditor/client relationships from taking root; and
(ii) to tighten up the standards used in financial reporting, standards which had previously been flexible enough to allow firms to get away with anything "from slightly exaggerated to fantastic projections" of companies' financial

16. See *id.* at 4.
17. See *id.*
18. *See id.*
19. *See* discussion *infra* Part III.A.3.
20. *See* discussion *infra* Part III.A.4.
21. Thomas G. Bost, *The Sarbanes-Oxley Act of 2002: A Summary*, 7 NAT'L LEGAL CENTER FOR THE PUB. INT., Apr. 2003, *available at* http://www.nlcpi.org/books/welcome.htm.
22. William R. Baker III & Christopher E. Campbell, *Sarbanes-Oxley Enhancements to the SEC's Enforcement Authority*, 7 WALL STREET LAWYER, No. 4, Sept. 2003, *available at* http://www.realcorporatelawyer.com/wsl/wsl0903.html.

situations.[23]

Companies' board members have been directed to become more inquisitive so that questions that might have seemed "hostile" to management two years ago would now be considered a natural extension of directors' functions.[24]

Sarbanes-Oxley is a complex piece of legislation that breaks ground in many areas of corporate governance and affects corporate America in numerous and substantial ways. It amends the Securities Act of 1933, the Securities Exchange Act of 1934, the Employee Retirement Income Security Act of 1974, the Investments Advisers Act of 1940, as well as a variety of statutes regulating federal fraud, criminal law, and bankruptcy.[25] It calls for U.S. government studies and reports on numerous business and accounting issues relating to public companies.[26] Moreover, the Act impacts public companies' officers, directors, employees, advisors (including attorneys appearing and practicing before the SEC), securities analysts, brokers and dealers, accountants, accounting firms, and accounting practices and principles. Most importantly for the purposes of this study, Sarbanes-Oxley's provisions are far-reaching and make virtually no distinction between U.S. and foreign companies with securities registered or listed in the United States.[27]

23. EU-US Project Group, *Special Supplement of Corporate Governance*, Institute of Europe Affairs, *available at* http://iiea.com/projs.html (n.d.).

24. SEC Commissioner Paul S. Atkins, *The Sarbanes-Oxley Act of 2002: Goals, Content and Status of Implementation*, INT'L FIN. L. REV., Mar. 25, 2003, *available at* http://www.sec.gov/news/speech/spch032503psa.htm.

25. Kaye Scholer LLP, *The Sarbanes-Oxley Act of 2002*, at 1, *available at* http://library.lp.findlaw.com/articles/00969/008687.pdf (Aug. 2002).

26. *See id.* Pursuant to the Sarbanes-Oxley Act, Title VII, the U.S. government was required to submit detailed reports on (i) the factors leading to, the impact on, and the problems created by the consolidation of public accounting firms, (ii) the role and function of credit rating agencies in the operation of the securities markets, (iii) the violations and violators of the federal securities laws from January 1, 1998 to December 31, 2001, (iv) the SEC enforcement actions during the five years subsequent to the enactment of Sarbanes-Oxley, (v) whether investment banks and financial advisers assisted public companies in manipulating their earnings and obfuscating their true financial condition.

27. For further discussion of the direct and indirect effects of the Sarbanes-Oxley Act on European companies, see Union of Industrial and Employers' Confederations of Europe ("UNICE"), *Sarbanes-Oxley Act: UNICE Comments*, Oct. 10, 2002 (on file with author) [hereinafter *UNICE Comments*].

II. *EUROPEAN CONCERNS EXPRESSED BY UNICE*

European businesses, while in favor of improved corporate governance standards, are not completely supportive of some of the changes underway in the United States. Concern was voiced by the Union of Industrial and Employers' Confederation of Europe ("UNICE"), one of the most authoritative representatives of business in Europe.[28] The corporate governance of companies, explains UNICE, is the product of a complex system having its roots in the country in which they are incorporated; a system that is the result of laws, regulations, self-regulation, accepted practices, and, more generally, of the legal and economic culture prevailing in each country.[29] The risk inherent in the application of Sarbanes-Oxley to non-U.S. issuers, particularly in corporate governance, is that some of the Act's individual provisions will conflict with those in force in the companies' country of incorporation.

UNICE argues that European companies with their main listings on European exchanges already meet tough audit standards and that the extra burdens imposed on them "go beyond what is needed to achieve the results that are sought."[30] Internal Market Commissioner Fritz Bolkestein agrees, arguing that "the implementation of some of the provisions of the Act might have undesirable extraterritorial consequences creating unnecessary difficulties for European companies. The European Commission's concern is that if its issuers and auditing firms are already subject to robust measures in their home markets, double regulation will impose unnecessary burdens and costs.[31]

---

28. *See* Friends of the Earth International, *The Citizens' Guide to Trade, Environment and Sustainability*, Trade Environment & Sustainability Programme, *available at* http://www.foei.org/trade/activistguide (Jan. 24, 2001). *See also* Batuk Gathani, *E.U. fine-tunes accession formalities*, THE HINDU, Oct. 24, 2002, *available at* http://www.hinduonnet.com/2002/10/24/stories/2002102401141500.htm.

29. *See UNICE Comments*, *supra* note 27.

30. Eamon Quinn, *Accountants Step up Bill Against U.S. Law*, THE POST.IE, Sept. 15, 2002, *available at* http://archives.tcm.ie/businesspost/2002/09/15/story327663.as. *See* Letter from Phillipe de Buck, Secretary of UNICE, to Frits Bolkestein, Internal Market Commissioner(n.d.) (on file with author). *See also* Letter from Frits Bolkestein, Internal Market Commissioner, to Harvey Pitt, Chairman of the SEC from 2001-2003 (Aug. 29, 2002) (on file with author); EU-US Project Group, *supra* note 23, at 4.

31. Letter from Alexander Schaub, Director General of the European Commission, to Jonathan Katz, Secretary of the SEC (Feb. 18, 2003), *available at* http://www.sec.gov/rules/proposed/s70203/aschaub1.htm. [hereinafter Letter from Schaub to Katz, 2/18/03]. The text reads as follows:

Indeed, Sarbanes-Oxley marks a radical change in the attitude of the United States towards foreign issuers. In the past, foreign companies benefited from a general exemption from the application of American corporate governance rules.[32] Non-U.S. companies listed in the United States were simply required to disclose their corporate governance arrangements; a solution that created no interference with the internal organization of most foreign issuers. Underlying this approach was the recognition that other national legal systems had the capacity to assure equivalent levels of investor protection.[33] This encouraged the listing of foreign companies on U.S. markets, without triggering the complications that adapting to a system different from their own would have caused.[34] The shift in the United States' approach toward imposing predetermined corporate governance requirements on foreign issuers and enhancing the responsibilities of issuers and their top management is rendered even more controversial by the difficulty foreign companies have in exiting U.S. markets. De-listed but registered issuers are nonetheless subject to the reporting requirements set forth in the securities laws.[35] This has caused several non-U.S. companies to approach

---

> We request full recognition of equivalence of EU corporate governance system. . . . [T]he SEC should be aware that EU companies and auditors are already subject to longstanding, well-developed member state corporate governance requirements. These are tailored to their specific legal environments and are in their different ways as effective and efficient at providing investor protection as U.S. rules. Additional requirements of the Sarbanes-Oxley Act applied to EU companies and auditors would place on them an unnecessary additional layer of requirements — taken from a completely different (U.S.) corporate governance environment. We fail to see why EU companies and auditors should be overburdened with such duplicative requirements compared to their U.S. counterparts. . . . Bearing this in mind, the SEC should recognize the equivalence of EU corporate governance systems and thus fully exempt not only EU lawyers but also EU companies and auditors from the provisions of Sarbanes-Oxley, also with regard to audit committee requirements.

Id.

32. *See id.*

33. Bowne & Co., Inc., *Sarbanes-Oxley Seems Hostile to Foreign Listings*, Bowne Securities Connect Newsletter, *available at* http://www.bowne.com/newsletters/newsletter.asp?storyID=578 (Jan. 2003).

34. *See id. See also* Jennifer Morris, *Foreigners Forced to Play By US Rules*, EUROMONEY, Oct. 2002, at 42.

35. Pursuant to Rule 12g3-2(a) of the Securities Exchange Act of 1934, an issuer with more than 300 shareholders in the United States — and most listed companies fall under this category — remains subject to the rules issued by the SEC and cannot avoid registration even when it decides to abandon the U.S. markets through a de-listing procedure. All it can do to avoid these reporting obligations is buy back all of the shares in

the SEC to obtain exemptions from the Act.[36] A handful of Germany's biggest firms, including DaimlerChrysler, Allianz AG, and Deutsche Telekom, have had their petitions rejected when trying to persuade the SEC that they should be exempt from the new rules.[37]

III. *REQUIREMENTS OF SARBANES-OXLEY*

The Act covers a very broad variety of issues. However, not all of its provisions became effective on the day of its enactment. A number of provisions only came into effect after the SEC promulgated the timetables set forth in the Act. The following outlines the most significant new requirements set forth in Sarbanes-Oxley and their relative impact on various European regulatory regimes.

A. *New Corporate Governance Rules for Directors and Executive Officers*

1. CEO/CFO Certification of Reports[38]

The Act requires that CEOs and CFOs personally certify the company's annual and quarterly reports under separate civil and criminal provisions.[39] Both provisions require the CEO and CFO to certify, individually, that they have reviewed all reports filed with the SEC and that, based on their knowledge, the reports do not contain any material misstatement or omission of any kind. In particular, the CEO and CFO must certify that (i) the financial statements and other financial information included in the reports are true and correct and fairly present — in all material aspects — the financial conditions and results of operations of the issuer, and that (ii) the company has implemented adequate and effective disclosure controls and procedures to assure transparency. Officers who knowingly provide false certifications are punished with fines and severe criminal

excess of the 300-shareholder threshold. This buy-back can be complex and extremely costly if, as is generally the case, the company's shareholders are not willing to sell.

36. *See* Peter Gumbel, *Tough Act To Follow: New U.S. Legislation to Combat Corporate Fraud Provokes a Backlash Among European Executives*, 160 TIME EUROPE, Sept. 23, 2002, *available at* http://www.time.com/time/europe/magazine/article/0,13005,901020923-351174,00.html.

37. *Id.*

38. Sarbanes-Oxley Act §§ 302, 906.

39. *Id.* §§ 302(a)1-3, 906(a).

penalties.[40] The only reports that, despite their filing with the SEC, are exempted from the described certification requirements are employee benefit plans and 8-K reports.[41]

Pursuant to Italian law, however, the annual accounts of a company must be prepared by the entire Board of Directors on a collegial basis.[42] Consequently, responsibility for the accuracy and truthfulness of the accounts in Italy is assigned collegially rather than individually to the Board of Directors. By requiring the CEO and CFO to certify the accounts individually, the Act transforms what was a purely internal responsibility (i.e., towards the company) into a responsibility towards all third parties. By the same token, the principle of *ne bis in idem* would be violated since the same offence by any corporate management would be punishable under two regimes: the Italian and the American.

In addition, French and German law provides for the collegial responsibility of CEOs and CFOs with respect to the truthfulness and accuracy of the company's financial statements.[43] Similarly, English corporate governance rules ignore the individual certification requirement.[44] English law recognizes that all directors are collegially responsible for the company's statutory accounts and does not provide for individual certification.[45]

2. Prohibition on Loans and Credit to Directors and Executives[46]

Under the new provisions of Sarbanes-Oxley, issuers are prohibited from directly or indirectly extending, maintaining or arranging for the extension of personal loans to their directors

---

40. *Id.* § 802(a).

41. *See* JAMES D. COX ET. AL., SECURITIES REGULATION: CASES AND MATERIALS 675 (3d ed. 2001) (defining 8-ks as reports which must be filed quarterly by public companies to give notice of any corporate changes or material events which haven't previously been disclosed in other forms). The decision to exempt 8-Ks and employee benefit plan reports from the new certification requirements was announced by the SEC in October 2003. *Id.*

42. *See* CODICE CIVILE [C.c.] arts. 2423, 2381 (It.).

43. *See* CODE DE COMMERCE [C.COM .] L225-251 (Fr.) (particularly Article L232-1 concerning the preparation of the corporate balance sheets by the board of directors). *See also* German Stock Corporation Act [Aktiengesetz] §93-II (recognizing the responsibility of the whole Vorstand and not only of certain executives).

44. *See* Companies Act of 1985 §233.

45. *See id.* at 49.

46. *See* Sarbanes-Oxley Act § 402(a).

and executive officers.[47] The few exemptions from this prohibition concern particular types of loans by limited types of issuers such as banks and brokerage firms.[48] Loans already in existence as of July 30, 2002 are also exempt, provided that there be no material modification of any term of the loan, and that it not be renewed or extended.[49]

In this area, we encounter only minor aspects of incompatibility with European rules. Amongst these, Italian law, which once prohibited directors, general managers, and members of the board of auditors of a company from obtaining loans from the company or its subsidiaries, has recently been amended, to allow an Italian company to grant such loans.[50] English and French law, on the contrary, forbid loans to directors and officers with provisions similar to those of Sarbanes-Oxley.[51]

UNICE representatives of Germany have not yet taken an official position with respect to the compatibility of German corporate governance rules and Section 402 of the Act. However, they have criticized the provision as being rather "unclear as to the persons concerned."[52]

3. Senior Management Code of Ethics[53]

With the enactment of Sarbanes-Oxley, management and

---

47. *See id.*

48. Due to the fact that U.S.-chartered banks are largely exempt from this prohibition, the SEC is considering the possibility of extending this exemption to non-U.S. financial institutions. *See* Freshfields Bruckhaus Deringer, *The Sarbanes-Oxley Act and U.S. Regulatory Developments*, Corporate Publications: Sarbanes-Oxley Material, 3 n.2, *available at* http://www.freshfields.com/practice/corporate/publications/sarbanes oxley (Jan. 2004).

49. *See* Sarbanes-Oxley Act § 402(a). Note that arrangements such as the cashless exercise of share options and loans in advance of indemnification are not addressed in Sarbanes-Oxley, nor have they yet been addressed by the SEC.

50. Article 2624 of the Italian Civil Code — which prohibited directors, general managers, and members of the board of auditors of a company from obtaining loans from the company itself or from any of its subsidiaries — has been abolished, thus making it legitimate for a corporation to grant such loans. *See* Luca Enriques, *The Changing Role of Directors in Corporate Governance — Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms*, 38 WAKE FOREST L. REV. 911, 922-23.

51. *See* Companies Act of 1985 § 330; *see also* C.COM . L225-243.

52. UNICE, *Compilation of Conflicts between the Sarbanes-Oxley Act and EU National Laws*, Part VIII: Germany, Oct. 2002, at 49 (on file with author) [hereinafter *Compilation of Conflicts*].

53. *See* Sarbanes-Oxley Act § 406. *See* Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002; Correction SEC Release No. 33-8177A, *available at*

directors are encouraged to emphasize ethics and integrity in business decisions.[54] In the reports they file with the SEC, issuers must disclose whether or not they have adopted a code of ethics applicable to their principal financial officer and comptroller or principal accounting officer, that meets the requirements set forth in the Act. If an issuer has failed to adopt an appropriate code of ethics, it must explain the reason for not doing so.[55]

The ethics principles set forth in the code may be used to ground operational requirements (things management must do) as well as operational prohibitions (things management must not do), and are generally illustrated with behavioral examples.[56] Management is expected to understand and apply the principles in situations the code does not specifically address.[57] Failure to do so triggers a corrective and/or disciplinary action which may range from reprimand to termination of employment. Furthermore, the company must report violations of the code of ethics that involve unlawful conduct to the appropriate authorities, thus possibly resulting in civil and criminal prosecution of the employee.

From the EU perspective, the code of ethics requirement does not represent a major area of concern because it offers a flexible approach to disclosure. This said, the added value of such a disclosure to investors is not clear, as due diligence requirements for directors should be sufficient to ensure ethical behavior. Moreover, "grass is green" disclosures are very costly

---

http://www.sec.gov/rules/final/33-8177.htm (last modified Mar. 27, 2003); Final Rule: Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002 SEC Release No. 33-8177, *available at* http://www.sec.gov/rules/final/33-8177.htm (last modified Mar. 27, 2003).

54. *See* Edward L. Pittman & Frank J. Navran, *Corporate Code of Ethics and Sarbanes-Oxley*, 7 WALL STREET LAWYER, No. 2, July 2003, *available at* http://www.realcorporatelawyer.com/wsl/wsl0703.html. The authors point out that the collapse of Enron was preceded by the decision of the company's directors to specifically waive provisions of the company's code of ethics. *Id.* This decision allowed Enron's chief financial officer to benefit from transactions involving the company. *Id.*

55. *See* Sarbanes-Oxley Act § 406(a). Companies must comply with the code of ethics disclosure requirements in their annual reports for fiscal years ending on or after July 15, 2003. A company may either file its code as an exhibit to the annual report, post the code on the company's website, or agree to provide a copy of the code upon request and without charge.

56. *See* Pittman & Navaran, *supra* note 54.

57. *See* Sarbanes-Oxley Act §406(c) (discussing reasonableness standard).

and diminish returns of scale for the companies who implement them.[58]

Italy, England, and Germany have not taken an official position regarding the adoption of a code of ethics. French law, on the other hand, does not require the implementation of such a code but encourages it on an exclusively voluntary basis.[59]

4. Forfeiture by CEOs and CFOs of Certain Bonuses and Profits[60]

If an issuer is required to prepare an accounting restatement due to a material non-compliance or misconduct, the company's CEO and CFO are required to reimburse the issuer for: (i) any bonuses or other incentive-based or equity-based compensation they received from the issuer during the twelve-month period following the first public issuance or filing with the SEC of the financial document that did not comply with such financial reporting requirement;[61] and (ii) any profits they may have earned from the sale of securities of the issuer during that same twelve-month period.[62]

This provision is significant because, read literally, the misconduct giving rise to forfeiture is not necessarily limited to the conduct of the CEO and CFO. In other words, the CEO and CFO could be required to reimburse their own bonuses and profits upon a finding that others in the company engaged in the misconduct leading to the issuer's violation.[63] This provision has no equivalent under most European jurisdictions and is thus likely to create problems of double regulation. Pursuant to the Italian corporate governance rules, the only possibility of bringing action to force directors to return part of their compensation exists when those directors have caused harm to the corpo-

58. *See* Letter from Alexander Schaub, Internal Market Director General of the European Commission, to Jonathan Katz, Secretary of the SEC (Nov. 29, 2002), *available at* http://www.sec.gov/rules/proposed/s70203/aschaubl.htm [hereinafter Letter from Schaub to Katz, 11/29/03].

59. *See Compilation of Conflicts*, *supra* note 52.

60. *See* Sarbanes-Oxley Act § 304.

61. *See id.* § 304(a)(1).

62. *See id.* § 304(a)(2).

63. *See* Sarbanes-Oxley Act § 304(a) (stating that forfeiture will occur "[i]f an issuer is required to prepare an accounting restatement due to the material non-compliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws").

ration by failing to perform their duties.[64] Under French law too, there is no equivalent of Sarbanes-Oxley's Section 304. Although France recognizes a possibility for criminal jurisdictions to fine directors by an amount up to ten times the gains earned by same directors as a result of their violations, such sanctions could only be provided in the context of an action for damages.[65]

5. Prohibition of Improper Influence on Audits[66]

The Act provides that no action may be taken by any director or officer of an issuer (or person acting under their direction) to fraudulently influence, coerce, manipulate, or mislead any independent auditor of the issuer's financial statements for the purpose of rendering the financial statements materially misleading.[67] The SEC rules implementing this provision of law supplement the pre-existing ones which addressed the falsification of books, records, and accounts. They are particularly useful in that, for the first time, they provide practical examples of the actions and behaviors that are considered improperly influential.

6. Trading Restrictions[68]

Except as permitted by the SEC rules, no director or executive officer of an issuer may buy, sell, or otherwise acquire or transfer any equity security of the issuer during the so-called "blackout period" if such security was acquired in connection with his or her service or employment as a director or executive officer.[69] Generally speaking, a "blackout period" is a period during which participants in the issuer's 401(k) plan,[70] or other

64. *See* C.c. arts. 2392-95.

65. *See Compilation of Conflicts, supra* note 52.

66. *See* Sarbanes-Oxley Act § 303.

67. *See id.* § 303(a). *See also* Final Rule: Improper Influence on Conduct of Audits, SEC Release No. 34,47890, *available at* http://www.sec.gov/rules/final/34-47890.htm (last modified Sept. 26, 2003) (containing the final text of the rule).

68. *See* Sarbanes-Oxley Act § 306.

69. *See id.* § 306(a)(1).

70. A 401(k) is a type of retirement plan that allows employees to save and invest for their retirement. Through a 401(k), an employee can authorize his/her employer to deduct a certain amount of money from his/her pay check before taxes are calculated, and to invest it in the 401(k) plan. This money is invested in stock options that are selected by the employee from the ones offered through his/her company's plan. The federal government established the 401(k) in 1981 with special tax advantages, to

individual account plan that allows participants to invest in their company's securities, are subject to specific restrictions on transactions in issuer securities held for their account in such plans.[71] Any profit earned by such prohibited trading may be recovered by the issuer, irrespective of the intention of the director or executive officer to engage in such transaction.[72] This remedy may also be pursued by a single shareholder if the issuer, upon request of the shareholder, does not start an action to recover the profits within sixty days of a request that it do so, or fails to diligently pursue the action.[73] The issuer is required to provide notice of each pension fund blackout period to each of its directors and executive officers as well as to the SEC.[74]

The area of insider trading during pension fund blackouts seems to be adequately addressed by most European countries. Their corporate governance rules in this area are quite similar in content to Section 306 of Sarbanes-Oxley. The SEC is therefore likely to recognize foreign companies' home state requirements. The only exception is Germany, which limits its insider trading sanctions to people residing in the United States.

7. Prohibition of Service as a Director or Officer[75]

Sarbanes-Oxley provides that an individual can, at the request of the SEC, be enjoined from serving as an officer or director of a public company if he or she is deemed "unfit" for violating the general anti-fraud provisions of the securities laws.[76] Although the SEC already had this authority under existing laws, the previous standard was "substantial unfitness"[77] rather than

---

encourage people to prepare for retirement. It gets its name from the section of the Internal Revenue Code which established it.

71. *See* Collected Wisdom on Blackout Periods, *available at* http://www.401khelpcenter.com/cw/cw_blackout.html (last visited Jan. 24, 2003).

72. *See* Sarbanes-Oxley Act § 306(a)(2)(A).

73. *See id.* § 306(a)(2)(B).

74. *See* Sarbanes-Oxley Act § 306(a)(6).

75. *See id.* § 305.

76. *See id.* § 305(a).

77. *See* Securities Exchange Act of 1934, 15 U.S.C. § 78u(d)(2) (1934) (amended 2002); Securities Exchange Act of 1933, 15 U.S.C. §§ 77(e) (1933) (amended 1954). Both Acts were amended by striking the "substantial unfitness" standard and replacing it with the "unfitness" standard. *Id. See also The New Disclosure & Corporate Governance Regime: What Every Corporate & Securities Lawyer Must Know Now — Sarbanes Oxley Act of 2002*, 1335 PLI/CORP 11, 49 (Oct. 8, 2002) (noting that Section 21(d)(2) of the Securities Exchange Act of 1934 (i.e., § 78u(d)(2)) is amended by striking "substantial unfit-

the simpler standard of "unfitness." Under the previous standard, the SEC had some difficulty demonstrating to the courts that the relevant conduct rendered someone "substantially unfit" to hold those positions.[78] The new "unfitness" standard, however, will likely make litigating officer and director injunctions easier for the SEC.

The Act also allows the SEC to seek the bar order if, after the notice and the hearing, it finds that the individual has wilfully or without reasonable justification violated the general anti-fraud provisions of the securities laws.[79]

B. *Requirements and Restrictions for Audit Committees and Audit Services*

The Enron and Worldcom experiences, together with other corporate scandals, made it clear that auditing firms operated in a way that was anything but independent. Pre-Sarbanes-Oxley, the laws allowed a considerable degree of overlap between audit and non-audit services, giving rise to conflicts of interest and facilitating complicity in covering malfeasance. As will be illustrated in the paragraphs that follow, Sarbanes-Oxley's primary goal is to enhance auditors' independence by imposing (i) restrictions on their compensatory fees and possible affiliations, (ii) stricter expertise requirements and, most importantly (iii) restrictions on the non-audit services that auditors may provide.

1. Audit Committee Provisions[80]

a. Auditors' Independence[81]

Section 301 of the Sarbanes-Oxley Act introduces provision 10A(m)(3) which sets forth the independence requirements for the members of the audit committee.[82] In order to be "independent," an audit committee must meet the "compensatory fees" and "affiliation" standards.

ness" and inserting "unfitness" and that Section 20(e) of the Securities Act of 1933 (i.e., § 77t(e)) is amended by striking "substantial unfitness" and inserting "unfitness").

78. *See* Louis Lavelle, *Enron Directors: Unfit to Serve Anywhere?* BUS. WK. ONLINE, Feb. 12, 2002, *available at* http://www.reclaimdemocracy.org/weekly_article/executive_dodge_taxes.html.

79. *See* Sarbanes-Oxley Act §§ 107(d)(3)(A)-(C).

80. *See* Sarbanes-Oxley Act § 301.

81. *See id.* §§ 201-09.

82. *See* Securities Exchange Act of 1934 § 301(10)(m)(3).

According to the compensatory fees standard, no member of an audit committee can accept any consulting, advisory or other compensatory fee from the issuer, other than in the member's capacity as member of the audit committee, the board of directors or any other board committee.[83] Prohibited payments include both those made directly or indirectly, such as to a spouse or an entity in which the member is a partner. On the other hand, compensatory fees do not include the receipt of fixed amounts under a retirement plan.[84]

Under the affiliation standard, a member cannot be an "affiliated person" of the issuer or a subsidiary of the issuer, other than in the member's capacity as a member of the audit committee or director.[85] An "affiliated person" is a person who directly or indirectly controls, or is controlled by, or is under common control with, the issuer, a term originally defined in the Securities Act of 1933.[86]

Section 301 makes the following exceptions to the independence requirement. First, for newly reporting companies such as those which are listing in connection with their initial public offering, only one member of the audit committee will have to be independent at the time of the listing; a majority of the members will have to be independent within ninety days, and all members will have to be independent within one year.[87] Secondly, an audit committee member will be allowed to serve on the board of directors of both the listed issuer and an affiliate of the issuer so long as the member otherwise meets the independence requirements for both entities.

In the first months of 2003, the EU began to express very strong concerns about the above audit committee requirements. "The criteria to determine the independence of audit committee members seem conceptually insufficient," remarked Alexander Schaub, Internal Market Director General at the European

83. *See id.* § 301(3)(B)(i).

84. *See* Standards Relating to Listed Company Audit Committees, SEC Release No. 33-8220, *available at* http://www.sec.gov/rules/final/33-8220.htm (last modified Apr. 10, 2003).

85. *See id.* § 301(3)(B)(ii).

86. *See* SEC General Rules and Regulations, 17 C.F.R. § 230.144 (2004).

87. *See* Womble, Carlyle, Sandridge & Rice, *SEC Adopts Standards Relating to Listed Company Audit Committees*, Apr. 28, 2003, *available at* http://www.commlaw.com/CM/Industry%20Groups/SEC%20Standards.pdf.

Commission.[88] According to Mr. Schaub, the independence standard must be defined practically, while specifically identifying the relationships that pose a threat to the audit committee's independence. For example, the definition of independence does not cover the relationships that audit committee members may have with the audit firm or its related entities. Nor does it address family relationships of audit committee members with the company's executive officers. "A more systematic principles-based approach to the independence of audit committee members would certainly provide better investor protection."[89]

Schaub also points out that the appointment of independent audit committee members should not be left to the entire board of directors, including management, but rather should be a task for the independent directors of the company alone. In the EU context, such an approach is also recommended by the report of the High Level Group of Company Law Experts.[90]

Section 301 is one of the most criticized provisions of the new law.[91] As the European Commission pointed out, Section 301 suggests that every issuer should have an audit committee "but does not make audit committees directly mandatory for registrants."[92] If the registrant does not have an audit committee, the independence requirements have to be fulfilled by all board members.[93] Undoubtedly, it is unclear how this solution would or could work in the single and dual board systems of EU Member States. In other words, the implementing rules will have to take into account the different EU corporate governance systems that exist in the various Member States. Moreover, these "different legal backgrounds should be considered in defining disclosure requirements for financial experts on audit committees."[94]

Numerous U.S.-EU roundtables were held to find an accord on the issues raised by Section 301. The SEC's final rule, which became effective on April 25, 2003,[95] marks the beginning of a

88. Letter from Schaub to Katz, 11/29/03, *supra* note 58.

89. *Id.*

90. On the European reform of corporate governance, see *infra.* Part V. *See also* Letter from Schaub to Katz, 11/29/03, *supra* note 58.

91. *See* Letter from Schaub to Katz, 11/29/03, *supra* note 58.

92. *Id.*

93. *Id.*

94. *Id.*

95. *See* Standards Relating to Listed Company Audit Committees, SEC Release No. 33-8220 (Apr. 25, 2003).

healthy and constructive dialogue between the parties. According to the final rule, all foreign issuers listed in the United States are exempted from the obligation to have an audit committee, provided that: (i) the foreign issuer has an alternative structure such as a board of auditors pursuant to its own national laws;[96] (ii) the same board of auditors is separate and distinct from the board of directors; (iii) no executive director of the company is a member of the board of auditors; (iv) the board of auditors is not appointed by the board of directors; (v) the foreign issuer's national laws provide standards that assure the independence of the board of auditors from management; and (vi) the foreign issuer's national laws or its by-laws provide that the board of auditors is responsible for appointing and monitoring the activities of the outside auditor, as well as solving all conflicts which may arise between the outside auditor and the board of directors.[97]

b. Auditors' Expertise[98]

The issuer's audit committee must include at least one "financial expert," meaning a person who through experience as a public accountant or auditor or as the principal financial officer, comptroller or principal accounting officer of a company has acquired: (i) a thorough understanding of the generally accepted accounting principles ("GAAP") and financial statements; (ii) expertise in preparing or auditing financial statements of companies comparable to the issuer; (iii) expertise with internal accounting controls; and (iv) an understanding of the functioning of audit committees.[99]

This definition of "financial expert" has caused controversy in Europe. In fact, although it is natural and completely understandable that the SEC is interested in requiring financial experts to have a deep understanding of the U.S. environment, the definition limits the choice for EU companies automatically ex-

96. The Italian *collegio sindacale* was cited in the SEC's final rule as an example of a board of auditors that satisfies Sarbanes-Oxley's requirements. In fact, although the *collegio sindacale* is not directly responsible for the outside auditor's activity, it still monitors the company internally. *See* D.LGS. 58/1998, art. 149(1)(c) (listing monitoring the company's internal controls among the duties of the *collegio*).

97. *See* Letter from Schaub to Katz, 11/29/03, *supra* note 58. *See also* Studio Santa Maria, Il Sarbanes-Oxley Act del 2002 e i suoi riflessi sulle Società Europee, *available at* http://www.santalex.com/news.htm (July 2, 2003).

98. *See* Sarbanes-Oxley Act § 407.

99. *See id.* § 407(b)1-4.

cluding all those experts who, though being highly qualified from a "local" point of view, lack direct U.S. experience.[100]

c. Auditors' Responsibilities and Functions

In general, audit committees are responsible for the appointment, compensation, retention, and oversight of the work of the issuer's independent auditor who is required to report directly to the audit committee.[101] The core functions of audit committees are to: (i) pre-approve the provision by the independent auditor of all audit and non-audit services;[102] (ii) analyze all reports by the auditor with respect to the issuer's accounting policies and practices;[103] (iii) resolve any possible disagreements between the auditor and management concerning the issuer's financial reporting;[104] (iv) be involved in analyzing internal control deficiencies and management or employee fraud, as identified in the CEO/CFO certifications;[105] (v) establish procedures for the receipt, retention and treatment of complaints addressed to the issuer regarding accounting, internal control procedures, or auditing matters; and (vi) for the confidential, anonymous submission by the employees of concerns regarding questionable accounting or auditing matters.[106]

It is problematic that in most European countries, the shareholders, and not the audit committees, appoint the outside auditors.[107] Moreover, Sarbanes-Oxley's requirement that the audit committee be composed only of independent directors is totally incompatible with laws in Germany and in the Netherlands that mandate employee representation on boards.

100. *See* Letter from Alexander Schaub, Director General of the European Commission, to Jonathan Katz, Secretary of the SEC, (Nov. 29, 2002) *available at* http://www.sec.gov/rules/proposed/s74002/aschaub1.htm (last visited Jan. 22, 2004).

101. *See* Charles Hecht, SEC Central: Audit Committee and Management Disclosure Requirements of the Sarbanes-Oxley Act, *available at* http://www.smartpros.com/x35187.xml (2002).

102. *See* Sarbanes-Oxley Act § 202(i)(A).

103. *See id.* § 204(k)(1).

104. *See id.* § 301(m)(2).

105. *See id.* § 302(a)(5)(A).

106. *See id.* § 301(m).

107. *See* Louis Lavelle & Mike McNamee, *Will Foreign Boards Play by US Rules?*, BUS. WK. ONLINE, Dec. 6, 2002, *available at* http://www.businessweek.com/bwdaily/dnflash/dec2002/nf2002126_4116.htm.

d. Adequate Funding

In order to enable the audit committee to carry out its functions in the most accurate and complete way possible, the Act requires issuers to authorize their audit committees to enlist independent counsel and any other advisers the audit committee determines necessary to carry out its duties.[108] Issuers are also required to provide appropriate funding to compensate the independent auditor and its advisors.[109]

Although the above-described rules apply to all SEC-reporting companies (both U.S. and non-U.S.), the final text of the Act has come to include a series of accommodations and amendments originally proposed to address specific concerns raised by non-U.S. issuers. Such exemptions for non-U.S. issuers allow:

(i) non–management employees of a non-U.S. issuer to serve as audit committee members;[110]

(ii) a representative of a non-U.S. government shareholder to serve on the audit committee;[111]

(iii) a more than 50% shareholder of a non-U.S. issuer or a representative of such a shareholder to serve on the audit committee, if the member has only an observer status and is not a voting member of the audit committee;[112]

(iv) alternative structures, such as boards of auditors or statutory auditors, to perform auditor oversight functions where those structures are provided for under local law;[113]

(v) the election, approval or ratification of the selection of the outside auditor by a non-U.S. issuer's shareholders.[114]

The European State that appears closest to the new U.S. audit committee requirements is, of course, England. England's Combined Code recommends all companies to have an audit committee and requires that it be composed of a majority of in-

108. *See* Sarbanes-Oxley Act § 301(m)(5).

109. *See id.* § 301(m)(6).

110. U.S. Department of State, International Information Programs, U.S. Regulators Propose Audit Exemptions for Non-U.S. Firms, *available at* http://usinfo.state.gov/topical/econ/mlc/03011002.htm (Jan. 10, 2003).

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

dependent members.[115] That said, a "recommendation" is very different from an "obligation".

All U.S. issuers will have to comply with the new listing requirements by the date of their first annual shareholders meeting after January 15, 2004, and in no event later than October 31, 2004 whilst non-U.S. issuers will be required to comply by July 31, 2005.

2. Regulation of Audit Services[116]

Sarbanes-Oxley imposes restrictions on an issuer's relationship with its auditor. More significantly, the Act prohibits accounting firms from providing any audit service to an issuer if the CEO, controller, CFO, or chief accounting officer of the issuer was employed by that accounting firm and participated in any capacity in the audit of that issuer during the one-year period preceding the date of the initiation of the audit.[117]

a. Restrictions on Non-Audit Services

The Act significantly restricts the non-audit services that audit firms may offer to issuers.[118] In general, an accounting firm that provides auditing services for an issuer cannot also provide non-audit services to that same issuer. That said, the Act takes a measured approach to the non-audit services issue. Not all non-audit services are in fact equal and, despite widespread misunderstanding, the SEC never intended to prohibit them generally.[119]

Section 201 makes it unlawful for the auditor to provide the following nine non-audit services: (i) book-keeping or other services related to the accounting records or financial statements of the audit client; (ii) financial information systems design and implementation; (iii) appraisal or valuation services, fairness opinions, or contribution-in-kind reports; (iv) actuarial services; (v)

---

115. *See* National Association of Corporate Directors ("NACD"), *Concerning Reforms in the Aftermath of the Enron Bankruptcy*, Recommendations from the NACD, *available at* http://www.nacdonline.org/nacd/enron_recommendations.asp (May 3, 2002).

116. *See* Sarbanes-Oxley Act § 206.

117. *Id.*

118. *See id.* § 201(a).

119. *See* Thomas L. Riesenberg, *The Non-Audit Service Restrictions of the Sarbanes-Oxley Act*, American Institute of Certified Public Accountants, *available at* http://www.aicpa.org/info/bna_020924.htm (Sept. 24, 2002).

internal audit outsourcing services; (vi) management functions or human resources; (vii) broker or dealer, investment adviser, or investment banking services; (viii) legal services and expert services unrelated to the audit; and (ix) any other service that the Public Company Accounting Oversight Board defines, by regulation, as impermissible.[120] Tax services, which belong to the category of non-audit services, may only be provided to the issuer if approved in advance by the issuer's audit committee.[121]

Most European countries see the difficult balance between auditing and non-audit services as an area in need of detailed consideration. In fact, Sarbanes-Oxley, by strictly prohibiting auditors from offering the above-mentioned non-audit services, is in contrast with the more flexible European approach that grants the relevant audit committees the authority to decide, on a case by case basis, whether or not a particular work can be done by an auditing firm without compromising its independence.[122]

b. Public Company Accounting Oversight Board[123]

To address the perceived deficiencies in the regulation of the accounting profession, the Act creates a Public Company Accounting Oversight Board (the "PCAOB") which is subject to the SEC's oversight authority.[124] Accounting firms, including non-U.S. firms, that prepare audit reports for issuers will be required to register with, and submit annual reports to, the PCAOB. By registering, accounting firms consent to comply with any request of the PCAOB or the SEC for testimony or production of documents.[125] The PCAOB's functions include: (i) establishing rules governing auditing, ethics, independence and other standards relating to the preparation of audit reports; (ii) conducting inspections on registered public accounting firms; and (iii) conducting investigations as well as disciplinary proceedings against

120. *See* Sarbanes-Oxley Act § 201.

121. Pursuant to Sarbanes-Oxley, Section 201, any such approvals by the audit committee must be publicly disclosed in the issuer's periodic reports as required also under the Exchange Act.

122. *See* Telefonaktiebolaget LM Ericsson, Standards Relating To Listed Company Audit Committees, SEC Release Nos. 33-8173; 34-47137; IC-25885 *available at* http://www.sec.gov/rules/proposed/s70203/ericsson1.htm (last visited Jan. 22, 2004).

123. *See* Sarbanes-Oxley Act, tit. I.

124. *See id.* § 101(a).

125. *See id.* § 102(b)(2)(C).

registered public accounting firms and persons associated with such firms.[126]

Most European countries greeted the institution of the PCAOB with strong hostility.[127] EU Commissioner Frits Bolkestein wrote to SEC chairman William Donaldson arguing that the "registration of EU audit firms [with the PCAOB] is unnecessary, burdensome and disproportionate because the EU has already equivalent systems in place that deal with registration, oversight and external quality assurance of auditors which are continuously being improved at EU and national level."[128] Moreover, the PCAOB's access to internal audit documents constitutes a breach of the professional secrecy laws existing in most European countries and, as such, raises concerns about confidentiality obligations.[129] In the conclusion of his letter, Commissioner Bolkestein demanded that European audit firms working for U.S.-listed companies be exempted from registering with the PCAOB. Bolkestein warned that "it would be difficult to avoid [a] call for reciprocity . . . whereby the U.S. [firms] would have to register with all our [M]ember [S]tates," he also added that "this could mean undergoing the process up to 25 times."[130]

Following Frits Bolkestein's letter to the SEC, the Finance Ministers of the European Union issued a declaration on June 3, 2003, opposed to the mandatory registration of European audit

126. *See generally* Public Company Accounting Oversight Board, *at* http://www.pcaobus.org (2003).

127. *See* Alexander Schaub, *Integrated European Financial Markets: The Stakes for U.S. Business*, European Union in the U.S.: Speeches, *available at* http://www.eurunion.org/news/speeches/2003/030703as.htm (July 3, 2003).

128. Commissioner Frits Bolkestein continues: "The European Commission fully shares the goal of having effective audit systems in place in order to prevent accounting irregularities and restore investor confidence in the securities market. However, this should be done on the basis of internationally acceptable solutions, including mutual recognition of equivalent systems of oversight." News Releases, *EU Concerned About US Audit Registration Step*, European Union in the U.S., No. 27/3, Apr. 24, 2003, *available at* http://www.eurunion.org/News/press/2003/2003027.htm.

129. In fact, the mandatory registration of European audit firms to the PCAOB would determine that (i) the personal data of tens of thousands of people working for the audit firms would be transferred to the United States; and (ii) the European audit firms would have to grant access to all audit confidential working papers as well as to any other audit client document. *See* Gumbel, *supra* note 36.

130. *See* Paul Grant, *EU Warns off SEC, at* http://www.AccountancyAge.com/News/1133274 (Apr. 23, 2003). *See also EU threatens reciprocal controls on US Firms, available at* http://www.AccountancyAge.com/News/1133211 (April 15, 2003).

firms with the PCAOB.[131] They requested the negotiation of a transatlantic mutual recognition agreement based on home country control. Subsequently, in October 2003, Commissioner Bolkestein introduced the idea of a particular form of registration for non-U.S. auditing firms: "Registration is something that can be done in different ways. We are trying to define what precisely registration means and how it should be done."[132] Bolkestein added that inspections and investigations would have to be carried out by EU officials in coordination with the PCAOB, rather than directly by U.S. officials. The reason is practical. The PCAOB admits that it does not have sufficient resources to conduct a detailed screening of audit firms in twenty-five Member States with twenty-one different languages. Thus, the PCAOB will *need* to cooperate with each and every State of the European Union if it wishes to carry out inspections or investigations.[133]

After countless comment letters, public roundtables, and bilateral and multilateral meetings, the SEC decided not to exempt foreign accounting firms from registration with the PCAOB. It did make, however, a series of significant preliminary accommodations for foreign firms: (i) foreign firms are not required to provide registration information to the PCAOB, where the provision of such information would violate home country laws; (ii) foreign audit firms are granted an additional six months to register with the PCAOB, in consideration of the fact that they will have to assess whether the new registration requirements pose a conflict with their local law; (iii) registration will be required only with respect to proprietors, partners and principals of foreign audit firms who provide over ten hours of service on a particular audit.[134]

---

131. *See* Alan Osborn, *EU Urges U.S. to Reconsider Rules*, *available at* http://www.accountancyage.com/News/1133834 (June 12, 2003). *See also* Burson-Marsteller, *Sarbanes-Oxley: One Year Later — The Jury is Still Out*, Summer 2003, Points of View, *available at* http://www.bm.com/newsroom/pov.html.

132. Lisa Jucca, *Bolkestein Sees EU-U.S. Audit Firm Deal by Year End*, Forbes.com, *available at* http://www.forbes.com/personalfinance/retirement/newswire/2003/10/09/rtr1103943.html (Oct. 9, 2003).

133. *See id.*

134. Ethiopis Tafara, Speech before the American Chamber of Commerce in Luxembourg (June 10, 2003), *available at* http://www.sec.gov/news/ speech/spch061003et.htm (addressing international concerns under the Sarbanes-Oxley Act).

C. *Expanded Company Disclosures*

The most salient characteristic of Sarbanes-Oxley is that it imposes much stricter disclosure requirements on virtually all activities of the issuing company. The following are the most significant new disclosure requirements set forth in the Act.

1. Accuracy of Financial Reports[135]

Each financial report filed by the issuer with the SEC must reflect all "material correcting adjustments" identified by the issuer's independent auditor in accordance with the GAAP and the SEC rules.[136] The SEC adopted the final rules regulating the use of non-GAAP financial measures in public disclosures.[137] The new rules, which implement Sections 401 and 409 of Sarbanes-Oxley, became effective on March 28, 2003.[138] The SEC amended the existing disclosure regulations and created stricter rules to information contained in a press release or similar public disclosure.[139]

Public companies, including foreign private issuers, that disclose or release non-GAAP financial measures are now required to include in such disclosures a presentation of the most directly comparable GAAP financial measure and a reconciliation of the two measures.[140] Furthermore, in the case of non-GAAP financial measures included in an SEC filing, a registrant must also state: (i) why it believes the non-GAAP financial measure would be useful to investors, and (ii) to the extent material, the additional purposes for which management uses the non-GAAP financial measure that are not otherwise disclosed.[141]

2. Real-Time Disclosure of Certain Information[142]

Issuers are required to disclose "on a rapid and current ba-

135. *See* Sarbanes-Oxley Act § 401.

136. *See id.* § 401(a)(i).

137. *See* Final Rule: Conditions for Use of Non-GAAP Financial Measures, SEC Release No. 33-8176 (Jan. 22, 2003), *available at* http://www.sec.gov/rules/final/33-8176.htm [hereinafter Release No. 33-8176].

138. *See id.*

139. *See id.*

140. *See* Sutherland, Asbill & Brennan LLP, *Legal Alert: Sarbanes-Oxley Act of 2002 Compliance Update*, News & Events, Apr. 2003, *available at* http://www.sablaw.com/news/alerts.asp.

141. *See* Release No. 33-8176, *supra* note 137.

142. *See* Sarbanes-Oxley Act § 409.

sis" all "information concerning material changes in [their] financial condition or operations" as the SEC may by rule require as "necessary or useful for the protection of investors and in the public interest."[143] This disclosure must be "in plain English."[144]

3. Restrictions on Use of Pro Forma Financial Information[145]

Companies may only present *pro forma* financial information, meaning statements that are not prepared in accordance with GAAP, in a manner that "does not contain an untrue statement of a material fact or omit to state a material fact" that would render the information misleading.[146] Such new rules apply to all *pro forma* information, regardless of whether the information is contained in an SEC filing or in any press release or other public disclosure.

4. Off-Balance-Sheet Transactions[147]

In every annual report filed with the SEC, the issuer is required to disclose "all material off-balance-sheet transactions, arrangements, obligations and other relationships with unconsolidated entities." Likewise, the statement must identify persons "that may have a material current or future effect" on the issuer's "financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses."[148]

5. Auditor Attestation[149]

The issuer's independent auditor is required to report on management's assessment of the issuer's internal control structure and procedures. Such report must be made in accordance with the standards adopted by the Oversight Board.[150]

143. *Id.*

144. *Id.*

145. *See id.* § 401.

146. *See id.* § 401(b)(1).

147. *See id.* at § 401. *See* Final Rule: Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, SEC Release No. 33-8182 (Jan. 27, 2003), *available at* http://www.sec.gov/rules/final/33-8182.htm.

148. *See* Sarbanes-Oxley Act § 401(a). This rule is effective for fiscal years ending on or after June 15, 2003.

149. *See id.* § 404.

150. *See id.* § 404(b).

6. Management and Independent Auditor Assessment of Internal Controls[151]

Every issuer's annual report must contain an "internal control report" stating that management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting. Said report must also assess, as of the end of the last fiscal year, the effectiveness of the internal control structure and procedures for financial reporting.[152]

"Currently, EU Member States do not require a specific certification of internal controls system by management and attestation by auditors."[153] Thus, European companies face significant additional burdens under the new U.S. requirements (e.g., hiring of new personnel, bureaucratic reporting systems, etc.). "The new concept of certification of internal control systems by executive management as well as by auditors has already been extensively considered in a number of Member States . . . but has not been adopted as a legal requirement."[154] The European Union generally supports internal control reporting as an effective means of improving the quality of financial reporting.[155] Nevertheless, the practical workability of the U.S. approach and whether its cost/benefit balance will be justifiable depends ultimately on the implementing rules that are adopted.[156] The European Union's position in this respect is that the SEC should grant European firms a full exemption from the attestation of the internal controls system.[157]

D. *Responsibilities of Counsel*

On January 23, 2003, the SEC adopted final rules implementing Sarbanes-Oxley's provisions prescribing "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers."[158] Attorneys representing issuers before the SEC

151. *See id.* § 404.
152. *See id.* § 404(a)(2).
153. *See id.*
154. *See* Letter from Schaub to Katz, 11/29/03, *supra* note 58.
155. *See id.*
156. *See id.*
157. *See id.*
158. *See* Sarbanes-Oxley Act § 307. *See also* Final Rule: Implementation of Standards of Professional Conduct for Attorneys, SEC Release No. 33-8185 (Jan. 29, 2003),

will be required to report violations of securities laws, breaches of fiduciary duty or other similar violations by the issuer to the issuer's chief legal officer and CEO.[159] If an appropriate response fails to be taken, the attorneys must report the evidence to the issuer's audit committee or to the board of directors.[160]

The European community expressed strong concern that it would be inequitable to apply these rules to foreign attorneys, who are bound by conflicting home country ethics requirements (such as the attorney-client privilege) or who lack the expertise necessary to assess violations of U.S. law.[161] Some commentators have argued that such rules constitute breaches of the attorney-client privilege.[162] These rules, ultimately, exclude most foreign attorneys, as the regulation only applies to those licensed to practice law in the United States. How a multi-jurisdictional practitioner fairs under these laws must be tested or resolved.

IV. *PENALTIES FOR NON-COMPLIANCE*

Sarbanes-Oxley imposes criminal penalties for specific categories of misconduct, some of which were not subject to criminal penalties before its passage. Particularly significant are the criminal penalties introduced by Sarbanes-Oxley that punish false certifications, fraud, and the destruction and/or alteration of corporate records.

A. *CEO/CFO False Certification*[163]

The Act requires the issuer to accompany their annual report with a written statement by the CEO or CFO containing the § 906 certification discussed above.[164] A CEO or CFO who pro-

---

available at http://www.sec.gov/rules/final/33-8185.htm [hereinafter Release No. 33-8185].

159. *See* Sarbanes-Oxley Act § 307(1). This obligation is referred to as "up-the-ladder reporting." *See* Fried, Frank, Harris, Shriver & Jacobson, *SEC "Up the Ladder" Reporting Requirement: Practical Suggestions for in House-Attorneys*, Firm Publications, *available at* http://www.ffhsj.com/firmpubs.htm (July 18, 2003).

160. *See* Sarbanes-Oxley Act § 307(2).

161. *See* Release No. 33-8176, *supra* note 158 (discussing scope and purpose of Section 205.1).

162. *See* Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, SEC Release No. 33-8186, *available at* http://www.sec.gov/rules/proposed/33-8186.htm#1167-42382 (last modified Sept. 26, 2003).

163. *See* Sarbanes-Oxley Act § 906.

164. *See supra* Part III.A.1.

vides such a certification with knowledge that the report does not comply with all of the described requirements is subject to a USD 1 million fine and/or imprisonment, for a maximum term of ten years. If the false certification was done "wilfully," the penalty is increased to a USD 5 million fine and/or imprisonment for a maximum term of twenty years.[165]

B. *Audit Records Destruction or Alteration*[166]

The Act requires auditors to maintain and preserve audit work-papers and other documents connected to an audit of an issuer for a period of five years.[167] The knowing and wilful alteration or destruction of any of these work-papers may result in a fine and/or imprisonment of up to ten years.[168] If done with the intent to impede, obstruct or influence a governmental investigation, the administration of any governmental function or a bankruptcy proceeding, the penalty is increased to a fine and/or imprisonment up to twenty years.

C. *Securities Fraud*[169]

The Act makes it illegal for any person to knowingly execute or attempt to execute a scheme to defraud any person in connection with any security of a public company. It also prohibits the procurement, by means of false or fraudulent representations or promises, of any money or property in connection with the purchase or sale of any security of a public company. The penalty for violation of this provision of law is a fine and/or imprisonment of up to twenty-five years.

D. *Increased Penalties*

The Act establishes new monetary sanctions and criminal penalties for securities fraud involving accounting irregularities and financial fraud. Some sanctions are specifically applicable to directors, officers, and professionals that have committed, conspired with, or "aided and abetted" the commission of viola-

---

165. *See* Sarbanes-Oxley Act § 906.
166. *See id.*
167. *See id.*
168. *See id.*
169. *See id.* § 803.

tions.[170] For those found guilty of committing securities fraud and financially responsible for their actions, those debts will not be dischargeable in any subsequent bankruptcy proceeding filed by the responsible party.[171] The Act also extends the applicable statute of limitations for securities fraud (i) from the existing one-year period to a term of two years after the discovery of the facts constituting the violation or (ii) five years, as opposed to the existing three-year period, after such violation.

E. *"Whistleblower" Protection*[172]

To protect persons who report suspect practices, Sarbanes-Oxley prohibits the discharge or discrimination against employees who lawfully report violations to authorities. These authorities include governmental agents or persons with supervisory power over the employee or those who are authorized by the issuer to investigate suspect conduct (e.g., the audit committee and auditors). Sarbanes-Oxley's protection applies only when the "whistleblower" reasonably believes that the conduct in question constitutes a violation of the securities laws or financial fraud statutes. The Act amends the U.S. federal criminal law to prohibit issuers and their employees (including contractors, subcontractors or other agents) from discriminating in the terms and conditions of employment against employees that provide information or cooperation with investigations carried out by U.S. federal regulatory or law investigating authorities.[173] A wronged damaged employee can seek relief under the provisions of the Act by filing a timely claim with the Department of Labor.[174]

As a further guarantee, the Act provides that if the Secretary of Labour does not render a decision within 180 days, the plaintiff may bring an action for de novo review before the U.S. federal district court with jurisdiction.[175] Once in federal court, potential relief can include not only reinstatement but also back-pay with interest and compensation for special damages such as

170. *See id.* § 703.
171. *See id.*
172. *See id.*§ 806.
173. *See id.*§ 806(a).
174. *See id.*§ 806.
175. *See id.*§ 806.

attorney's fees and other litigation costs.[176]

V. *THE EUROPEAN REFORM OF CORPORATE GOVERNANCE*

A. *Common Markets with Uncommon Practices*

Domestic laws often have international consequences. A growing and mutually beneficial economic integration that also creates confusion and controversy for businesses on both sides of the Atlantic. The passage of Sarbanes-Oxley by the U.S. Congress is only the most recent example of this phenomenon. Overnight, public companies with securities traded in the United States, as well as their officers, faced a wide range of new legal and regulatory requirements. With very few exceptions, Sarbanes-Oxley does differentiate between U.S. and non-U.S. companies in its application.[177] Considering that there are 469 non-U.S. companies listed on the New York Stock Exchange, the impact of Sarbanes-Oxley on companies based in the European Union has been considerable.

That said, U.S. laws are not unique in their impact on the international community. In the area of corporate governance, for instance, the European Union has advanced its own package of corporate reform initiatives that may have a far-reaching impact on European and U.S. companies alike.[178] Although these initiatives are at various stages of adoption and implementation, they all have the potential to create significant new regulatory obligations for both EU and non-EU companies.

The transformation of the more than forty existing corporate governance codes has long been a European political priority. One of the salient economic problems faced in this project,

---

176. *See id.* § 1314A(c)(2)(B), (C).

177. All foreign private issuers are subject to the new legislation. Pursuant to Rule 3b-4 of the Securities Exchange Act of 1934, as amended in 1999, a "foreign private issuer" is an entity — other than a foreign government — incorporated or organized under the laws of a country other than the United States, except an issuer meeting the following conditions: (i) more than 50% of the issuer's outstanding voting securities are directly or indirectly held by residents of the United States; and (ii) any of the following: (a) the majority of the executive officers and directors are U.S. citizens or residents; (b) more than 50% of the assets of the issuer are located in the United States; or (c) the business of the issuer is administered principally in the United States.

178. Important initiatives under the 1999 Financial Services Action Plan include the International Accounting Standards Regulation, the Prospectus Directive, the Transparency Obligations Directive, the Investment Services Directive and the Market Abuse Directive.

however, is the lack of a unified economy and established private voice for the region.[179] In spite of the single market of the European Union, Member States continue to differ greatly in their philosophical views of corporate entities and their relationships to shareholders.[180] The role of employees in corporate governance, the primacy of shareholder interests, the rights of minority shareholders, board structures, as well as the relationship between management and the supervisory body differ greatly across the continent. These differences cause the European Union considerable difficulty when promulgating common standards for corporate transactions and behavior.

B. *The Report of the High Level Group of Company Experts*

Despite the impasse, the European Union is just as determined as the United States to increase investor protection and prevent corporate scandals. This was the stated goal even before EU finance ministers called for urgent action in the wake of the American corporate and accounting scandals. After these market-shaking events, the focus on strong corporate governance only intensified. In November 2002, the European Commission received the report from the Group of Company Law Experts (hereinafter the "Group") who had been charged in September 2001 with making recommendations for a more effective regulatory framework for corporate law (hereinafter the "Report").[181] The Group's mandate was expanded, in reaction to Enron, to cover corporate governance and auditing issues, including the roles of non-executive and supervisory directors, the remuneration of management, the responsibility of management for financial statements, and auditing practices.[182]

---

179. *See* Holly J. Gregory, *The Globalisation of Corporate Governance,* Weil, Gotshall, & Manges LLP, (Sept.-Oct. 2000) *available at* http://rru.worldbank.org/documents/globalisation_of_corporate_governance.pdf.

180. *See Company Law: Commission creates High Level Group of Experts,* Financial Reporting & Company Law, *available at* http://europa.eu.int/comm/internal_market/en/company/company/news/01-1237.htm (Apr. 11, 2001).

181. *See A Modern Regulatory Framework for Company Law in Europe: A Consultative Document of the High Level Group of Company Law Experts,* Financial Reporting & Company Law (Nov. 4, 2002), *available at* http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/1_en.htm.

182. *See* Financial Services: Commission services publish analysis of repercussions of Enron collapse, *available at* www.lex.unict.it/cde/documenti/econ_finanza/2002/020418enron_en.htm (Apr. 18, 2002).

The Group also focused on various areas including disclosure, shareholder rights and minority protection, duties of the board, auditing practices, and concluded affirming the need for an EU-wide corporate governance code. The Report's key proposals included, but were not limited to, changes in corporate governance.[183]

Although the recommendations of the Group modify the principles of corporate governance in several European countries, its proposals did not yet result in a binding EU-wide set of rules along the lines of the Sarbanes-Oxley Act.

1. Annual Corporate Governance Statement

The Group recommended that the principles for the statement be set out in a "framework directive, leaving the detailed rules to be established by the [M]ember [S]tates."[184] A number of key issues that the annual corporate governance statement should address include the identification of the national code of corporate governance and/or company law rules with which it complies.

2. Shareholder Information and Communication

There should be greater shareholder involvement in company general meetings. For instance, listed companies should disclose to their shareholders the mechanics of asking questions, interpreting the company's answer and submitting proposals to the general meeting. Additionally, listed companies should facilitate shareholder voting by electronic means and through hard copy instructions or proxy forms.[185]

3. Institutional Investors

Institutional investors in all Member States should be required to disclose their policies on investment and on the exercise of voting rights in the companies in which they invest.[186]

183. *See* Corporate Finance Law Bulletin (Dec. 2002), *available at* http://www.sjberwin.com/media/pdf/publications/corpfinbulletin/1202.pdf (last visited Jan. 22, 2004).

184. *See id.* at 3.

185. *See id.*

186. *See id.*

4. Board Structures

Listed companies should (i) have the choice between one and two-tier boards[187] so as to adopt the system which best suits their corporate governance needs, and (ii) be required to ensure through their corporate governance procedures that the appointment and remuneration of directors as well as the supervision of the company's audit be decided upon only by non-executive or supervisory directors.

5. Wrongful Trading

A framework rule on wrongful trading should be implemented in Europe so as to hold company directors (including shadow directors)[188] liable, allowing the company to do business if and to the extent it cannot pay its debts.

6. Special Investigations

Give the shareholders the right, either in a general meeting or holding a minimum of 5% of the company's share capital, to apply to a court or other administrative body to order a special investigation. Such an order, however, should be conceived as an extreme measure and be granted only in the presence of serious suspicion of improper behavior. The Report further advises the European Union to coordinate the efforts of Member States to facilitate convergence with respect to enforcement, taking into account the developments in the United States.

VI. *INTERNATIONAL TREND AND FUTURE PROSPECTS*

The Sarbanes-Oxley Act has very important effects on U.S.-listed EU companies and auditors. European authorities have been given the opportunity to comment on each of Sarbanes Oxley's provisions as part of a constructive regulatory dialogue between the United States and the European Union.[189] Sarbanes-Oxley, however, remains a U.S. reaction to U.S. financial reporting scandals. The European Commission and its fif-

187. Scholars refer to the continental European two-tier board as a structure that clearly separates executive directors from non-executive directors. The strength of the two-tier board is its supposed independence.

188. Shadow directors are persons in accordance with whose instructions the directors are accustomed to act.

189. *See* Letter from Schaub to Katz, 11/29/03, *supra* note 58.

teen Member States share the same concerns as the United States with respect to the integrity of the markets and would in principle support many measures of the Act. The new rules, however, if applicable to foreign companies, must take into account the specific legal corporate governance environments of other parts of the world, including the European Union.

The impression of many in Europe is that the rules proposed by the SEC have been tailored to fit and accommodate only U.S. companies and U.S. auditors.[190] As such, they are largely unacceptable to European companies, who are now considering whether to leave the U.S. markets. The European Union and the United States most converge on common principles and understandings, which does not mean that they will have to adopt an identical approach. It would be sufficient that they agree to make their different approaches mutually consistent and effective in achieving the same goals. The converging of International Accounting Standards and U.S. GAAP is an excellent example of this approach.

At the core of U.S.-EU relations, whether they focus on auditing practices, disclosure standards, market stability or financial conglomerates, is a single concept: regulatory equivalence.[191] The success of all future relations will depend on whether they recognize each other's standards as equivalent. Far too often, the differences between countries' national laws and regulatory systems are used to deny equivalence. The competent authorities should take the time and make the effort to see whether, despite taking a different approach, the same level of investor protection could be achieved. The goal is not to ask

---

190. *See* Lawrence A. Cunningham, Sarbanes-Oxley and all that: Impact beyond America's Shores, Address before the FESE convention in London (June 12, 2003), *available at* http://www.fese.be/efmc/2003/report/efmc_cunningham.htm. Cunningham states:

> In the rush to do something, Congress neglected to recognize that it was for the first time both (a) regulating amid globalisation and (b) injecting itself into internal governance matters previously articulated by bodies other than Congress or the SEC — both inside and outside the U.S. . . . The greatest risk of exuberant exporting of U.S. corporate norms . . . is backlash against this process.

Id.

191. *See id.* "The U.S. instantly benefits from the expression of comity it extends. The U.S. may be the host of the party and can certainly invite who it wishes and lay down the etiquette. But part of being a good host is recognizing the right guest list and treating guests with respect." *Id.*

one side to accept lower standards, nor is it to set unreasonable requirements that do not protect investors, but rather to prevent them from accessing real opportunities. While conflicts of laws are inevitable given the variety of attitudes toward financial regulation and oversight that exist around the world, the financial markets dialogue has in the past been a successful forum for openly airing concerns on both sides. After all, Europe and the United States share the same objectives: sound financial market supervision and efficient capital markets that generate real benefits to firms and investors on both sides of the Atlantic.

WE HAVE TO SEIZE THIS CHANCE!

On May 21, 2003, the European Commission presented an action plan for "Modernising Company Law and Enhancing Corporate Governance in the EU" (the "Action Plan"),[192] a major part of the European response to Sarbanes-Oxley. The Action Plan is a comprehensive set of legislative and non-legislative proposals extending over three phases through 2009. The declared goal of the Action Plan is to improve the level of coordination between Member State initiatives (avoiding the adoption of a comprehensive EU corporate governance code).[193] It follows the Winter Group's recommendations to establish a broad framework at the EU level, that allows a certain degree of Member State flexibility.

Will Europe use Sarbanes-Oxley as a model? Although the new U.S. rules of corporate governance can certainly serve as a useful point of reference, it would be a mistake to follow them blindly. In fact, for many years, given the weight of the U.S. capital markets, the U.S. regulatory regime was considered a model for other countries. Yet, by the summer of 2002 it was clear that

192. *See* Latham & Watkins, The European Commission Publishes its Action Plan on Modernizing European Company Law & Enhancing Corporate Governance in Response to Enron, Ahold, and the Sarbanes-Oxley Act, *available at* http://www.lw.com/resource/Publications/_pdf/pub747.pdf (May 28, 2003).

193. *See id.* The main emphasis of the Action Plan is on corporate governance issues. For example, the Action Plan (i) introduces an "annual corporate governance statement" requiring all listed companies to explain their corporate governance structure (e.g., shareholder rights and how they may be exercised, mechanisms of operation of the boards, material transactions with related parties etc); (ii) facilitates the exercise of shareholder rights; (iii) reinforces the collective responsibility of board members for financial statements; (iv) recommends disclosure of the corporation's remuneration policy.

the U.S. regulatory scheme and its rules-based approach to accounting and corporate disclosure, was not invincible. Enron's sixty-four-page code of ethics, for example, did not prevent violations. Experience teaches us that the value of most corporate governance regulation lies in the deterrent effect of stringent enforcement. In other words, "there is nothing like jailing a few corporate leaders to get everyone's attention. Punishments must be more severe to act as meaningful deterrents to corporate criminals."[194]

Overall, the spate of new legislation and regulation on both sides of the Atlantic highlights the need for U.S. and European business communities to work together. Cooperation appears to be no longer a matter of courtesy among businesses and institutions but rather an obligation. As the European Commissioner for Internal Market and Taxation Frits Bolkestein said, "we are at a pivotal moment when legislation and rules on both sides of the Atlantic are being reconsidered: an ideal opportunity to converge, cooperate and compare. *We have to seize this chance.*"[195]

194. Markus U. Diethelm, *Corporate Governance on Command*, CHIEF LEGAL EXECUTIVE, Winter 2003, at 60, 63, *available at* http://www.chieflegalexecutive.com/sub_pages/publications/CLE/PDF/2003_winter/CLE_WinforeignFinal.pdf.

195. Frits Bolkestein, EU-US Regulatory Cooperation on Financial Markets: A Matter of Necessity?, Address before the European American Business Council in Washington D.C. (Feb. 24, 2003), *available at* http://www.eurunion.org/news/speeches/2003/030224fb.htm (emphasis added).