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## Post-Sarbanes-Oxley: International Responses

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<sup>56</sup> *Id.*

<sup>57</sup> *Vickers*, p. 1

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> Jost at 390.

<sup>61</sup> Ling, Thomas. *Smith v. City of Salem: Title VII Protects Contra-Gender Behavior*, 40 Harvard Civil Rights-Civil Liberties Law Review, October 2, 2006 at 1, at [http://www.law.harvard.edu/students/orgs/crcl/vol40\\_1/ling.php](http://www.law.harvard.edu/students/orgs/crcl/vol40_1/ling.php).

<sup>62</sup> Bazluke at.2.

<sup>63</sup> *Price Waterhouse* at 251.

<sup>64</sup> Sheehy, Catherine. *Transgender Issues in the Workplace 2004*, Human Rights Campaign Foundation at 4.

<sup>65</sup> *Id.*

<sup>66</sup> Vade at 315.

## POST-SARBANES-OXLEY: INTERNATIONAL RESPONSES

by  
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### INTRODUCTION

The Enron, WorldCom, Adelphia, and other corporate scandals gave rise to the passage of the Sarbanes-Oxley Act (SOX) in 2002.<sup>1</sup> This legislation seeks to change corporate culture and significantly improve the reliability of financial reporting by corporate CEOs and CFOs. The Act, however, created a number of problems including the enormous costs of compliance with the Act, particularly with companies whose incomes were borderline or below profitability. Significant conflicts with the laws and regulations of other advanced countries also exist. Section 404 of the Act, for example, requires that the company document every internal and external process that affects corporate earnings.<sup>2</sup> Estimated costs for compliance exceed \$4.6 million for companies with over \$5 billion in revenues and medium-size companies are expected to incur approximately \$2 million for compliance.<sup>3</sup> The EU adamantly stated that its regulations and the actions of member states protect shareholders and, therefore, SOX's extension of the Act to foreign companies is unwarranted.

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This article highlights US-European Union (EU) conflict and sets forth a possible resolution to the controversy.

#### SARBANES-OXLEY: KEY PROVISIONS AFFECTING NON-US PUBLIC ACCOUNTING FIRMS

Section 102(a) of SOX provides that: "...it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer." There is no exception for foreign audit firms. The statute requires foreign audit firms, whose reports are included in Securities and Exchange Commission (SEC) filings, to register with the newly created Public Company Accounting Oversight Board (PCAOB) by July 19, 2004. The application for registration with the PCAOB is quite extensive. The Board requires annual fees received for audit and non-audit services, quality control policy statements of the firm, a list of all accountants participating in audit reports, criminal or civil disciplinary proceedings against the firm or person associated with any audit, disputes between the audit firm and the issuer, and other information that the Board may determine is necessary.<sup>4</sup> A foreign firm registration does not relieve the auditor of responsibility for demonstrating its knowledge and experience in applying US GAAP, PCAOB standards, SEC financial reporting rules, and SEC independence requirements. A limited time grace period is allowed for the filing of quarterly reports by the foreign firm pending the review of its PCAOB registration application.<sup>5</sup>

Section 106(a) subjects "any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer" to the rules and regulations of SOX "in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or

any State." Even if the foreign firm does not itself prepare the audit, its substantial role in the preparation of reports may subject it to Act requirements. SOX, furthermore, requires the firm to monitor internal controls as well as external controls. The US government desires to uncover not only offshore investments but also to prevent the export of forbidden end products. SOX, therefore, requires the maintenance of accurate records to reflect such transactions and their authorizations.

Section 106(b) that concerns the production of audit workpapers has produced widespread controversy.<sup>6</sup> A foreign public accounting firm that issues an opinion or provides material services to a registered public accounting firm is deemed to have consented to the production of its audit workpapers to the PCAOB or to the SEC. The firm is subject to the jurisdiction of US courts with respect to the enforcement of the provision. Domestic registered public accounting firms that rely on opinions by foreign public accounting firms are also deemed to have consented to provide the audit workpapers of the particular foreign public accounting firm.

Section 301 concerns the makeup of public company audit committees. The Act prohibits national securities exchanges and associations from listing any security of an issuer not in compliance with the Section's provisions. It includes the requirement that the audit committee of an issuer, acting as a committee of the board of directors, shall be responsible for the appointment and supervision of any registered public accounting firm with respect to the preparation or issuance of an audit report or related work.<sup>7</sup> The registered firm is to report directly to the audit committee. Each member of the audit committee shall be a member of the board of directors and shall be independent therein. The member of the audit committee may not accept any consulting, advisory, or other

fee from the issuer or be an affiliated person of the issuer or a subsidiary thereof.<sup>8</sup>

Section 302 describes the corporate responsibility for financial reports. The Section mandates that the principal executive officer(s) and principal financial officer(s) certify in each submitted annual or quarterly report that each of the said officers have reviewed the report; that, based on each officer's knowledge, the report does not state any untrue statement or material fact or omission; that the said report, based on each officer's knowledge, fairly represents in all material respects the financial condition of the issuer; that the said officers are responsible for establishing and maintaining internal controls designed to ensure that material information is made known to them and have reviewed the issuer's internal control within the prior 90 days prior to the report; and that the signing officers have disclosed to the issuer's auditors and audit committee all significant deficiencies in the internal controls and any fraud involving management or other employees having a role in the internal controls.<sup>9</sup> Note that an issuer that reincorporates or transfers offices to a foreign state shall remain subject to the Act.<sup>10</sup>

Section 401 concerns the disclosure in periodic reports. Section 13 of the Securities Exchange Act of 1934 was amended to provide for accuracy of each financial report filed with the SEC. with respect to the problem of Enron's off-balance sheet transactions, the Section states that "each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons that may have a material affect or future effect on the financial condition,

results of operations, liquidity, capital resources, or significant components of revenues or expenses."

Section 402 provides for conflict of interest provisions. With minor exceptions, personal loans given by an issuer to executives are expressly prohibited after the Act's date of enactment, whether they be directly or indirectly made, or through a subsidiary, and includes the extension of credit.<sup>11</sup>

#### *PCAOB and SEC Standards*

In December, 2003 the PCAOB adopted the Auditing Standard AS 1. International auditors' reports must state that they are in compliance with the standards of the PCAOB. It is no longer appropriate or necessary to state that the auditors' reports are in compliance with Generally Accepted Auditing Standards (GAAS).<sup>12</sup> The SEC issued an interpretation of the requirement.<sup>13</sup> In it, the SEC makes it clear that AS 1 does not supersede any of the applicable rules or regulations of the Commission. Rather, the AS 1 requirement means that a report of an independent accountant must comply with both SEC and PCAOB rules and guidance. Registered public accounting firms must comply with the more restrictive of the rules and regulations of the SEC and the PCAOB.<sup>14</sup> The issue that has arisen was that the SEC, in the past, permitted some foreign issuers to file reports referring to compliance with both US GAAS and home country auditing standards. PCAOB rules now require that the entire audit must comply with PCAOB standards.<sup>15</sup>

Section 404 requires companies to include in their annual reports a statement analyzing and evaluating the effectiveness of their internal financial-reporting controls.<sup>16</sup> It appears that Section 404 not only applies to a firm's internal control structure but appears also to apply to export controls with

respect to end users and end uses; destinations (e.g., Cuba, Iran, North Korea); Commerce Control List determinations; screening of entities involved in the transaction; hardware, software, and technology controls; re-exports; and release of US-origin technology to foreign nationals.<sup>17</sup> There are significant criminal and civil penalties for the failure to comply with regulatory requirements.<sup>18</sup>

#### INTERNATIONAL RESPONSES

International responses have been rather mixed. Nearly one-half (44%) of executive management felt that SOX and the regulations issued by the Securities and Exchange Commission (SEC) would have little effect while 43% held the opposite view. The major complaints concerned the "noisy withdrawal statute" and the executive certification requirements. As a result of European complaints, a few of the regulations have been relaxed as to foreign companies and non-US lawyers practicing primarily abroad.<sup>19</sup> Nevertheless, European countries and, more particularly, the companies located therein, are rebelling against the US requirements. Specifically, there is increasing resentment at the pressure, costs, legal exposure, and possible violation of European law by attempting compliance with SOX. There is a consensus that European auditing standards, particularly, that of the major trading nations, are comparable to that of SOX.<sup>20</sup>

Companies, as a consequence, are considering de-listing or not listing their securities on US stock exchanges.<sup>21</sup> Inasmuch as there are some 470 non-US companies listed on US exchanges with a total capitalization of \$3.8 trillion, the costs of compliance in some cases exceed \$30-40 million as estimated by BASF, the German chemicals producer. Rank Entertainment Group and British Telecom are considering delisting even though SOX required statutory compliance

where there are 300 or more shareholders in the US<sup>22</sup> Fugro, a Netherlands-based engineering consulting firm, with a turnover of \$1.2 billion (one-third in the US) said that SOX ended any hopes that the company would list its securities in the US. The chairman of the International Corporate Governance Network and a senior adviser to Morgan Stanley said that SOX would cause Europe to become a haven for global public offerings. In addition, whereas a company had to be so listed in order to gain access to US capital markets, today, with the deregulation of global markets, the need to have a US exchange presence is less attractive.<sup>23</sup>

The EU lodged a series of complaints with respect to the promulgation and enforcement of SOX. The overall complaint concerned the extraterritoriality provisions of the statute. This concern was reminiscent of the bitterness caused by the extraterritorial enforcement of the US antitrust laws during the 1950s-1970s. Among the complaints by EU finance ministers were the US authorities' compulsion of access to the audit papers, including working papers; the SEC's grant of only a 30-day comment period for its impending regulations; and the subjecting of European audit firms to double oversight by both European member states and by the US<sup>24</sup> If there is a reference to another auditor's report by the principal auditor, then the said other auditor's report must also be included in the filing.<sup>25</sup>

The EU Finance Ministers' additional complaint, coupled with a threat, concerned the need for foreign firms to register with the PCAOB. The EU said that it already has established equivalent registration requirements for all member states and that compelling these firms to register with the PCAOB would be unnecessarily duplicative and expensive. Thus, it called for mutual recognition and equivalence of registration or else the EU may not be able to avoid reciprocity of member states which may require US firms to similarly register with the 25

member states wherein they may provide auditing services. Furthermore, the costs for registration by small EU auditing firms would be heavy and would exceed that of domestic US firms.<sup>26</sup>

The EU further noted that the PCAOB rules conflict directly with EU and national laws of member states. There were a number of examples given to illustrate the conflict of laws difficulty. In a Memorandum to the SEC Chairman,<sup>27</sup> the EU asked for an exemption under Section 106(c) of SOX<sup>28</sup> claiming that the PCAOB's proposal is "ineffective," "unnecessary," "disproportionate in that it involves significant costs of registration for EU audit firms with a relatively small number of US issuers," likely to cause distortions of the market for audit services..., and is "prejudicial to future EU policy making on audit issues."<sup>29</sup>

Some criticisms were more temperate. The UK banking industry, while recognizing the right and goal of the US to restore investor confidence by measures such as SOX, nevertheless, expressed its concern over regulations on companies which are already subject to equivalent or superior measures in their home states. The complaint is not only that of duplication but also may involve compliance with conflicting regulations. It also respected US regulations concerning raising capital in the US from domestic and foreign sources, but the US should not hold itself as being the sole determinant of such rules when other governmental authorities are equally competent to assure appropriate regulatory regulations. Specifically, the UK banking industry has suggested compromise concerning Sections 301, 302, 401 and 402 of SOX.<sup>30</sup>

With respect to Section 301, concerning the composition of audit committees, the EU published a report concerning the

Comparative Study of Corporate Governance Codes of member states and found the UK 's Combined Code to be widely adhered to and, though voluntary, compliance is a requirement under its Listing Rules of the Financial Services Authority. Among the standards discussed are the auditing standards and accounting issues. The UK, particularly after Enron and other debacles in the US and its own corporate scandals, have evolved standards that negate the need for enforcement of SOX standards. With respect to Section 302, certification of accounts, the concern is that of duplication, ambiguity and possible conflict with UK requirements. Under the UK Combined Code, the Board of Directors has specific responsibility to maintain a sound system of internal controls to safeguard shareholders' investments and company assets. At a minimum, an annual review by directors is mandated and a report to the shareholders is required. There are also additional proposals for further requirements of directors' duties and extension of obligations to auditors with possible criminal penalties for noncompliance.<sup>31</sup>

Concerning Section 401 rules concerning disclosures of off balance sheet transactions, the problem is that accounting and disclosure rules differ considerably between US and UK GAAP. Whereas US GAAP rules are detailed and require compliance to the letter of the rules, the UK GAAP looks to the principles and substance rather than to the legal form. The UK requires that in the examination of a transaction "all its aspects and implications should be identified and greater weight given to those more likely to have a commercial effect in practice. A group of series of transactions that achieves or is designed to achieve an overall commercial effect should be viewed as a whole." The substance of a quasi-subsiary's transactions of an entity should also be reported in consolidated financial statements.<sup>32</sup> Section 402 rules forbid loans to directors and employees with the exception of loans made or maintained by

depository institutions subject to Federal Reserve Board restrictions, which restriction is not extended to foreign entities. It is the view of the UK Bankers' Association that such failure is anticompetitive.<sup>33</sup>

Not all commentators abroad have written or espoused highly negative commentaries concerning SOX. One commentator suggested that SOX is compelling European governments, legislators, and regulators to modernize their long overdue overhauling of oversight structures of accountants and corporate governance. SOX has facilitated the efforts of EU Commissioners to modernize market supervision, accounting oversight, and corporate governance. Fritz Bolkenstein, the EU Commissioner for Internal Market & Taxation, stated that the EU was faced with the choice of either engaging in a major dispute with the US, as exemplified by the debate over the Iraq War, or to find a constructive way of moving forward to the benefit of both arenas while considering the different traditions and culture. The choice of the latter was exacerbated by the Parmalat fraud and its complicity by the several professions. The need for corporate governance reform is evidenced by the EU's new Corporate Governance Action Plan. Neither area can ignore the demands and needs of the other. 15 % of all capital raised by EU equity issuers was from US investors; purchases and sales of foreign securities by US investors rose from \$53 billion in 1980 to \$6.6 trillion in 2003 while foreign investors bought and sold \$30.9 trillion US securities (up from \$198 billion in 1980).<sup>34</sup>

Bolkestein noted the enormous task of the EU in created a single financial market among the now 25 member states each of which has its own internal laws and regulations. The problem has been exacerbated by the adoption of SOX with its sizeable complex rules. His suggested solution is the engaging in a constructive Financial Markets Dialogue with US

regulators to address EU concerns. He expressed his growing impatience with the US especially in the light that the EU-US conflict was not raised under the World Trade Organization's General Agreement on Trade in Services (GATS). Thus, there is a need for cooperation on three fronts: (1) Cooperation daily or weekly concerning financial services and markets regulatory issues; (2) Convergence on common principles and understandings rather than an identical approach but with the same goal of investor protection. The convergence on International Accounting Standards and US GAAP is an example of such cooperation; and (3) Regulatory equivalence rather than one standard as promulgated by the US whether it concerns auditing, disclosure standards, market stability, or other such issues. The need for cooperation is immense given the volume of transaction and peoples involved on both continents.<sup>35</sup>

#### *Advantages to SOX compliance*

Although there has been significant complaints concerning compliance by foreign companies with SOX, nevertheless, it appears that it is advantageous for these companies to conform to the stringent rules of the Act. The main advantage is the greater ease in seeking public financing. The full transparent disclosure appears to assuage any lingering doubts about a company's financial well-being. Compliant public and voluntarily compliant companies appear to have a competitive advantage over non-compliant companies that remain private so that SOX is not applicable. Some one-fourth of private companies, mainly larger companies, have voluntarily adopted SOX best practices in order to attract public financing and position themselves for the issuance of future IPOs or for possible mergers with publicly financed companies. The large majority of private companies, nevertheless, oppose SOX

mainly because of the cost of compliance and because of its alleged impediment to profitable growth.<sup>36</sup>

#### FOREIGN WHISTLEBLOWERS AND SOX

Sections 301(4) and 806 of SOX provide protection to whistleblowers. Specifically, Section 301(4) provides that each audit committee is to establish procedures for "(A) the receipt, retention, treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and (B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters." Section 806 is an extensive provision setting forth civil action and remedies for whistleblowers providing evidence of fraud.<sup>37</sup> The problem is that the information provided may concern data concerning other employees which, in turn, may violate the EU privacy laws. The SEC has refused to grant foreign companies exemption from this statutory requirement.<sup>38</sup> Item 8.1 of SOX's registration form provides that companies agree to provide information at any time in the future. Such agreement may violate the EU privacy regulation 95/46. Are foreign whistleblowers protected by SOX? The answer appears to be "No!" The laws, regulations, and court decisions of the country where the whistleblowing takes place would apply to the issues at hand.<sup>39</sup>

#### SOX AND THE INVASION OF PRIVACY

A major complaint of SOX is that Section 106(b) violates the mandates of the EU privacy legislation by requiring consent of foreign public accounting firms that issue an opinion or other material services upon which a public accounting firm relies with respect to the production of audit workpapers. The EU has the strictest privacy protection

restrictions in the world. Its Directive 95/46/EC, *On the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data*, sets forth a mandatory minimum of protection to be given by Member States to their inhabitants. Underlying the Directive was the Its predecessor was the Recommendation of the Council Concerning Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data that had been adopted by the Organization for Economic Cooperation and Development ("OECD"), as early as 1980.<sup>40</sup> The Recommendation became the basis for such protection in a number of Member States.<sup>41</sup>

Part Two of the Recommendation established limits with respect to the collection of personal data, requiring it be done lawfully and with knowledge and consent of the data subject where appropriate. The personal data had to be relevant for the purpose for which it is gathered and is accurate, complete and up-to-date. The data should not be disclosed other than for the essential purpose underlying its collection. The data should be protected by the use of reasonable security safeguards against unauthorized access or use. The individual, about whom the data is collected, should have the right to ascertain whether data has been collected about him/her; have the data communicated to the individual at a reasonable charge in a form that can be understood; be given reasons for denial of such information; and have the right to challenge inaccurate data and have it rectified.<sup>42</sup>

Part Three of the Recommendation requires Member States to consider the implications of domestic processing and re-export of personal data for other Member States. Transborder flows of such data should be uninterrupted and secure. With certain exceptions, a Member State should permit unrestricted transborder flows of personal data between it and another



Member State and avoid passing laws creating obstacles to such transmission. The OECD Principles concerning collection of data, data quality, use, openness, and safeguards became the basis for international goals, codes and statutes.<sup>43</sup>

The E.C. Directive sets basic requirements for data protection, allowing Member States to enact stricter standards. The effective date for implementation is October 25, 1998. A number of Member States had not yet enacted data protective laws when the Directive was issued. Moreover, the laws of Member States that did enact such measures differed substantially, thereby causing potential obstacles to the free flow of data and difficulties for the inhabitants therein. The Directive was enacted to remove such obstacles, harmonize the national provisions, and guarantee the right of privacy.<sup>44</sup>

Part of the basis for the Directive are the provisions of the Treaty on the European Union that provides in Title I, Article F, that the EU "shall respect fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms signed in Rome on November 4, 1950." Article 8 of the Convention provides:

1. Everyone has the right to respect for his private and family life, his home and his correspondence.
2. There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others.

The specific requirements are set forth in the endnote.<sup>45</sup>

Thus, according to the EU, in its correspondence with US SEC Chairman Donaldson, the data protection requirement prevents EU audit firms from providing information with respect to employees including their names or social security numbers, information concerning criminal, civil, or administrative actions or disciplinary proceedings that are pending; and information relating to non-SEC audit clients.<sup>46</sup> The EU member states, such as Denmark, Finland, Belgium, and Germany, all provide by law protections against revealing personal information of employees. In Germany, a court found Wal-Mart's voluntary and anonymous telephone hotline for the reporting of misconduct to be violative of the German Works Council Constitution Act that gives the Council codetermination rights concerning the conduct of employees. Wal-Mart's failure to consult with the Council negated its practice.

#### *Working Papers*

The provision of Article 106(b) requiring access to working papers flies in the face of contrary provisions and prohibitions with EU national professional secrecy laws. Many of the EU member states provide that working papers may only be given to a courts therein, which provision may not be waived. In France, Article L225-240 of the French Commercial Code requires secrecy by auditors which secrecy as to working papers may be granted access to French authorities. Finland has a similar provision. In Denmark and Belgium, the unauthorized handing over of working papers of a client is a criminal offense.<sup>47</sup>

There are strict limitations to the collection, use, and disclosure of personal information. In a French court decision

on November 21, 2005, Group McDonald's France was denied a request by the company to put into place a procedure for certain high-level employees to voluntarily and anonymously report on alleged wrongful behavior by co-workers. The La Commission nationale de l'informatique et des libertés (the French Data Protection Authority or CNIL) stated that, although the SOX requirement was not per se invalid, nevertheless, employers would have to comply with eleven guidelines or limitations.<sup>48</sup> The difficulty is that the SOX provision appears to conflict with the French Data Protection Act of January 6, 1978 as amended and the EU Directive on Data Protection.<sup>49</sup>

#### RECONCILING SOX AND EUROPEAN CONFLICTING STANDARDS

Although European companies and regulators have bitterly complained about the extraterritoriality of SOX's provisions, nevertheless, there are significant attempts to reconcile their differences. The need for reconciliation is evident by the degree of cross-border investments both to and from the US to Europe. Among the efforts at a not unfriendly reconciliation are the US-EU Financial Markets Regulatory Dialogue, which is an informal discussion of US and EU regulatory approaches, developments, and timetables. It brings together experts from the Federal Reserve and their counterparts of the European Commission particularly with respect to banking operations. It has been estimated that, as of September 30, 2003, there were 34 US banking organizations in the EU with third-party assets of over \$747 billion and much greater sums today. There were 68 EU banking organizations operating in the US with third-party banking assets of \$937 billion. The Dialogue has served to diffuse tensions concerning SOX between the two entities.<sup>50</sup>

A major effort that was well received in EU capitals is that of the former Chairman of the US SEC, William H. Donaldson, who expressed his and that of the SEC's commitment to engaging in a constructive dialogue to assure friendly cooperation in an endeavor to safeguard the integrity of corporate governance. He noted that, although SOX addressed corporate malfeasance that occurred among US enterprises, nevertheless, Europe has had its own series of major corporate scandals, which include Parmalat, Vivendi, Hoolinger, Ahold, Adecco, TV Azteca, Royal Dutch Shell, Seibu, China Aviation, and other scandals. Thus, it is in the best interests of both the US and the EU to restore shareholder confidence in the integrity of the marketplace. There is a need for global cooperation to raise standards in all of the many markets on a worldwide basis. Although acknowledging the complaints of the rise in cost of capital as a result of SOX, it should be noted that the costs come with major benefits. Inasmuch as nearly one-half of all of the world's equity shares, by market capitalization, are traded in the US, non-US investors have approximately \$4.5 trillion invested in US securities.<sup>51</sup>

Donaldson emphasized that the US, under SOX, enables a registered company to signal to others that it is committed to the highest audit reporting and governance standards. Nevertheless, he assured European regulators that the US is fully committed to working together to address the legitimate complaints of European regulators. Thus, the SEC has taken a number of steps to avoid have companies engaged in unnecessary and costly duplication of reporting standards. SOX requires that all members of audit committees be independent directors. The issue arose that German corporate governance have dual board systems that require corporate audit committees to include a labor representative. Inasmuch as SEC rules hold that employees of an issuer are not "independent," there was an inherent conflict between SOX and German

regulations. After a dialogue between the SEC and the EU, the former was given assurance that labor representatives in issuer audit committees are independent and, accordingly, the SEC provided an exception to its prior position.<sup>52</sup>

Two other examples of US and EU cooperation are the exemption for companies publishing financial information outside the US that were not in accord with US Generally Accepted Accounting Principles (GAAP) and the accommodation made to foreign issuers with respect to the information requested by the US Public Company Accounting Oversight Board (PCAOB) that may violate foreign privacy laws and blocking statutes. Thus, the PCAOB is engaging in a collaborative approach to reconcile its oversight role with the laws and regulations governing foreign issuers. Other accommodations include the extension of deadlines for filing requirements, reconciliation of reporting standards, and other efforts.<sup>53</sup>

A further effort of both reconciliation but also a potential retaliatory threat is the enactment of the 8<sup>th</sup> Directive<sup>54</sup> by the European Union.<sup>55</sup> The Directive aims at creating a high level harmonization of statutory audit requirement by Member States. It permits Member States to have more stringent requirements but the Directive serves as the minimum requirements for all of them.<sup>56</sup> Although the Directive places great emphasis on Member States to regulate statutory audits of accounts, the latter may not insist that a majority of the voting rights in an audit firm must be held by locally approved auditors or be the majority members of the administrative or management body of an audit firm.<sup>57</sup>

The closet threat is that the 8<sup>th</sup> Directive leaves it to Member States to determine whether to approve a non-EU Member State auditor as a statutory auditor. *Subject to*

*reciprocity*, such Member States may approve such person provided proof of compliance is furnished with the 8<sup>th</sup> Directive's mandates.<sup>58</sup> Compliance includes proof of good repute, educational qualifications, examination of competence, practical training, and continuing education.<sup>59</sup> Derogation from such compliance may be made on the basis of reciprocity provided that the foreign auditors and audit firms are subject to comparably systems of public oversight, quality assurance, and investigations and penalties. The EU Commission is to assess the alleged equivalence in cooperation with the Member States.<sup>60</sup> All such non-Member State auditors and audit firms which provide an audit report concerning the accounts of a company incorporated outside of the EU but whose securities are traded on an EU exchange. Exception is for companies' issues exclusively debt securities of EUR 50,000 or more traded on an EU exchange.<sup>61</sup>

All such foreign auditors and audit firms are to be subject to oversight, quality assurance systems, and systems of investigation. Exceptions may be made where the foreign entities can demonstrate equivalent third-country system of quality assurance within the past three years. Subject to proof and acceptance of equivalence by Member States in cooperation with the EU Commission, audit reports of accounts or consolidated accounts issued by non-EU Member State auditors or audit firms shall have no legal effect within the EU.<sup>62</sup>

#### EU CORPORATE GOVERNANCE INITIATIVES

Among the reasons for EU opposition to SOX is its own attempts to deal with European corporate scandals. In 2003, reacting to both US and comparable behavior by a number of European-based companies, the EU Commission communicated the following program: *Modernising Company*

*Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward.*<sup>63</sup> It proposed the enhancement of corporate governance structure. In a company's annual corporate governance statement, listed companies should state the key elements of their corporate governance structure which should include the operation of their shareholder meetings and key powers, the composition of the board and its committees, the shareholders possessing major holdings and voting rights, material transactions with other related parties and the existence and nature of a risk management system.<sup>64</sup> Shareholders' rights are to be strengthened by being granted access to information by electronic means, the right to vote in absentia and by electronic means, and the establishment of real shareholder democracy.<sup>65</sup>

The board of directors should be modernized by removal from voting, in favor of non-executive or supervisory directors, those board members with conflicts of interest, such as remuneration of directors and supervision of audit accounts; the creation of a one-tier board structure with executive and non-executive members or a two-tier structure with managing directors and supervisory directors; granting a special investigation right to shareholders to ask a court to investigate the affairs of a company; imposition of a directors' disqualification for misleading financial and other misconduct; and the development of a wrongful trading rule that would hold directors personally responsible for a company's failure and due to the conduct or lack of action.<sup>66</sup>

Groups and pyramids of companies would be compelled to provide complete and information and disclosure regarding their structure and intra-group relations as well as better financial and non financial information.<sup>67</sup> In the Annex to the EU Plan, it described the specific steps and timetables for member state actions and preferred types of initiatives. There

were Short-Term (2003-2005) steps, Medium-Term steps (2006-2008), and Long-Term (2009 and thereafter).<sup>68</sup>

## CONCLUSION

The impact of SOX on foreign registrants has been divided depending on the European commentator. The positive aspects noted by foreign registrants include the restoration of investor confidence in the light of the major corporate scandals both in the US and abroad; the need for effective internal controls; and the effect on corporate governance; improved vigilance by boards of directors who hitherto was to often passive; the requirement of financial experts on audit committees; the uniformity of standards for corporations and their subsidiaries; the active dialogue and engagement of advisers; the compelling of companies to re-examine their internal auditing and other financial practices; and the creation of a governmental board to oversee auditing by accounting firms. The negative aspects has been the need for alleged extraordinary effort and cost to comply with the statute; the compelling of restatement of earnings; the great increase in insurance costs for board insurance; and the failure to recognize the auditing standards of foreign companies that are equal to or were greater than that provided by SOX.<sup>69</sup>

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## ENDNOTES

<sup>1</sup> *The Public Company Accounting Reform and Investor Protection* (Sarbanes-Oxley) Act of 2002, Pub. L. No. 107-204, 2002.

<sup>2</sup> Section 404 requires each annual report required to be filed under the Act "to contain an internal control report, which shall:

(1) state the responsibility of management for establishing and maintaining an adequate internal

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- control structure and procedures for financial reporting; and
- (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.”

<sup>3</sup> Jill M. D’Aquila, *Tallying the Cost of the Sarbanes-Oxley Act*, THE CPA JOURNAL, [www.nysscpa.org/cpajournal/2004/1104/perspectives/p6.htm](http://www.nysscpa.org/cpajournal/2004/1104/perspectives/p6.htm). The medium-size firm costs have been calculated as follows: some 12,000 hours of internal work (from 1,150 to 35,000 hours); 3,000 hours of external work (from 846 to 6,197 hours), and additional audit fees of \$590,000 (from \$52,000 to \$1.5 million). CRA International in its *Sarbanes-Oxley Section 404 Costs and Implementation Issues: Spring 2006 Survey Update*, (April 17, 2006), found that the actual average costs for Section 404 issuer compliance by smaller companies were \$1,241,000 in the first year and \$860,000 in the second year while for larger companies, the costs were \$8,510,000 for year one and \$4,770,000 for year two. For a discussion of the need for a small business exemption, see Joseph A. Castelluccio III, *Sarbanes-Oxley and Small Business: Section 404 and the Case for a Small Business Exemption*, 71 Brooklyn L. Rev. 429 (Fall, 2005).

<sup>4</sup> Section 102(b)(2).

<sup>5</sup> For a lengthy discussion see US SEC, *International Reporting and Disclosure Issues in the Division of Corporation Finance* (Nov. 1, 2004), <http://www.sec.gov/divisions/corpfin/internal/cfirdissues1104.htm>. The discussion herein is at p. 18.

<sup>6</sup> Sec. 106(b), “Production of Audit Workpapers,” states as follows:

- (1) Consent by foreign firms.—If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that foreign public accounting firm shall be deemed to have consented—
- (A) To produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

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- (B) To be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers.
- (2) Consent by domestic firms.—A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1), shall be deemed—
- (A) To have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and
- (B) To have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

<sup>7</sup> Section 301(2) entitled “Responsibilities relating to registered public accounting firms” states:

The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.

<sup>8</sup> Section 301(3). Entitled “Independence,” it states:

- (A) In general.—Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer, and shall otherwise be independent.
- (B) Criteria.—In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee—
- (i) Accept any consulting, advisory, or other compensatory fee from the issuer; or

- (ii) Be an affiliated person of the issuer or any subsidiary thereof.

<sup>9</sup> Section 302(a).

<sup>10</sup> Section 302(b). It states that "Foreign Reincorporations Have No Effect.—Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302, by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.

<sup>11</sup> Section 402 (a) amends Section 13 of the Securities Exchange Act of 1934) It states:

(k) "Prohibition on Personal Loans to Executives."

(1) In general.—It shall be unlawful for any issuer...directly or indirectly including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer. An extension of credit maintained by the issuer on the date of enactment of this subsection shall not be subject to the provisions of this subsection, provided that there is no material modification to any term of any such extension of credit or any renewal of any such extension of credit on or after that date of enactment.

There are limited exceptions subsection (2) for certain home improvement loans, credit extensions under an open end credit plan, extension of credit by a broker or dealer made available by such issuer to the public, provided in the ordinary course of business, or made on market terms that are comparable to the general public.

<sup>12</sup> *Id.* at 10-11. The SEC approved AS 1 effective for auditors' reports issued or reissued on or after May 24, 2004.

<sup>13</sup> *Commission Guidance Regarding the Public Company Oversight Board's Auditing and Related Professional Practice Standard No. 1* (Securities Act Release 33-8422).

<sup>14</sup> *Supra*, Note 4. Also stated in a note to PCAOB Rule 3600T *Interim Independence Standards*.

<sup>15</sup> *Id.*

<sup>16</sup> Section 404 entitled "Management Assessment of Internal Controls," provides:

- (a) Rules Required.—The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934)... to contain an internal control report, which shall—
- (1) State the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
  - (2) Contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.
- (b) Internal Control Evaluation and Reporting.—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagement issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

<sup>17</sup> *Public and Private Firms Adopt SOX for Export Compliance as Penalties Grow*, MANAGING IMPORTS & EXPORTS, Issue 07-01 (Jan. 2007), [www.ioma.com/global](http://www.ioma.com/global).

<sup>18</sup> The civil and criminal penalties are scattered throughout SOX. Among the provisions are Section 802(a) amends Title 18, Chapter 73, to provide

imprisonment of up to 20 years for destruction, or falsification of records in federal investigations and bankruptcy as well as a possible fine. Any accountant who conducts an audit of an issuer of securities and fails to maintain all audit or review workpapers for a period of five years shall be subject to a fine and/or imprisonment of up to 10 years. Section 803 renders debts nondischargeable under the Bankruptcy Code if they are incurred in violation of securities fraud laws. Section 805 provides for the enhancement of federal sentencing guidelines for obstruction of justice and for significant criminal fraud. Section 807 provides for a fine and imprisonment of up to 25 years for defrauding shareholders of publicly held companies. Section 903 increases criminal penalties from 5 to 20 years for the commission of mail or wire fraud. Fines are increased from \$5,000 to \$100,000 against individuals and from \$100,000 to \$500,000 for corporate entities as well as increasing possible imprisonment from one year to 10 years for violation of the Employee Retirement Security Act of 1974. There are increased penalties for corporate fraud pertaining to the signing of corporate tax returns under Title X and increased fines for securities fraud under Section 1106 of up to \$5 million for individuals as well as imprisonment of up to 10 years and up to \$25 million for corporations. Whistleblowers who are wrongfully discharged under SOX shall be entitled under Section 806(c) to compensatory damages which shall include reinstatement with the same seniority status s/he previously possessed, back pay with interest, special damages resulting from the discrimination, litigations costs, expert witness fees, and reasonable attorney fees.

<sup>19</sup> Martindale-Hubbell's Counsel to Counsel, *International Reaction to Enron and Sarbanes-Oxley*, CONNECTIONS, Vol. 3, Issue 2 (Summer, 2003).

<sup>20</sup> For a discussion, see Jennifer G. Hill, *Regulatory Responses to Global Corporate Scandals*, 23 *Wis. Int'l L.J.* 367 (Summer, 2005) and Stefan W. Suchan, *Post-Enron: US and German Corporate Governance*, Cornell Law School L.L.M. Papers Series, Paper 4, (2004).

<sup>21</sup> Beth Carney, *Foreign Outfits Rue Sarbanes-Oxley*, Business Week, (Dec. 15, 2004), [http://www.businessweek.com/bwdaily/dnflash/dec2004/nf20041215\\_9306\\_db016.htm](http://www.businessweek.com/bwdaily/dnflash/dec2004/nf20041215_9306_db016.htm).

<sup>22</sup> Fran Howarth, *Anti Sarbanes-Oxley mood rises in Europe*, [http://www.the-register.co.uk/2005/01/11/Europeans\\_slam\\_sarbox/](http://www.the-register.co.uk/2005/01/11/Europeans_slam_sarbox/).

<sup>23</sup> <http://www.wcfcg.net/news1002.htm>.

<sup>24</sup> Klaus C. Engelin, *Preventing European "Enronitis,"* INTERNATIONAL ECONOMY, (Summer, 2004), 40-47.

<sup>25</sup> *Id.* at 24.

<sup>26</sup> Undated letter from the EU Finance Ministers to William H. Donaldson, Chairman of the SEC.

<sup>27</sup> Undated *Memorandum on Conflicts of European Union and National Law with Draft PCAOB Rules for Foreign Audit Firm Registration*. The said memorandum was annexed to the letter from the EU Council of Ministers to SEC Chairman, William H. Donaldson.

<sup>28</sup> Section 106(c) concerns exemption authority given to the SEC and the PCAOB with approval of the SEC. They "may, by rule, regulation, or order, and as the Commission (or Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act."

<sup>29</sup> *Supra*, note 20.

<sup>30</sup> British Bankers' Association, *Sarbanes-Oxley 2002: SEC Consultation on Certification of Disclosures* (Aug. 8, 2002), <http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=155&a=681>.

<sup>31</sup> *Id.*

<sup>32</sup> Financial Reporting Standard 5, *id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 45-46.

<sup>35</sup> Frits Bolkenstein, *EU-US Regulatory Cooperation on Financial Markets: A Matter of Necessity*, Speech before the European American Business

Council, Wash. D.C. (Feb. 24, 2003), <http://www.eurunion.org/news/speeches/2003/030224fb.htm>.

<sup>36</sup> PricewaterhouseCoopers, *Though Opposed to New Regulations, Fast-Growing Private Companies Voluntarily Adopt Sarbanes-Oxley Principles*, *PricewaterhouseCoopers Find*, TRENDSETTER BAROMETER, [www.barometersurveys.com/production/barsurv.nsf/89343582e94adb6185256b840...](http://www.barometersurveys.com/production/barsurv.nsf/89343582e94adb6185256b840...)

<sup>37</sup> Section 806 is an extensive provisions amending section 1514 of USC. Title 18 Chapter 73: that grants protection for employees of publicly traded companies who provide evidence of fraud. Specifically it states: No company ..., or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee---[who provides information which the employee reasonably believes constitutes a violation or any rule or regulation of the SEC relating to fraud against shareholders. Remedies include all relief to make the employee whole including compensatory damages consisting of reinstatement with the same seniority status the employee previously possessed, back pay with interest, litigation costs, expert witness fees, and reasonable attorney fees. For a discussion, see Karen L. Corman and Kristin Major, *Employee Whistleblower Rights Under the Sarbanes-Oxley Act*, [www.skadden.com/content/Publications/Publication1120\\_0pdf](http://www.skadden.com/content/Publications/Publication1120_0pdf).

<sup>38</sup> Hunton & Williams, *Conflict between Sarbanes-Oxley Whistleblower Provisions and EU Data Protection Law* (2005) and *Whistleblower Hotlines May Violate EU Data Protection Law* (2005). See also Fran Howarth, *Anti Sarbanes-Oxley mood rises in Europe*, THE REGISTER (Jan 11, 2005), [www.the-register.co.uk/2005/01/11/Europeans\\_slam\\_sarbox/print.html](http://www.the-register.co.uk/2005/01/11/Europeans_slam_sarbox/print.html), who cited a report by the United Kingdom's Institute of Chartered Accountants which stated that chartered accountants who complete item 8.1 of the registration form of SOX (agreement to provide information at any time in the future) are violating the EU's data protection rights.

<sup>39</sup> <http://www.sarbanes-oxley-forum.com/modules.php?name=Forum&file=viewtopic&p=5195>.

<sup>40</sup> The OECD is composed of almost all of the members of Western Europe together with the US, Canada, and Japan. Among the nations acting in

accordance with OECD Principles is Canada. Its provisions concerning privacy of electronic data may be found in the *Personal Information Protection and Electronic Documents Act*.<sup>40</sup> Canada sought to address three major concerns, namely, fear by consumers of tracking their usage on the Internet, consumers' lack of confidence concerning the security of Internet transactions, and the growing international concerns about data privacy. The statute repeats the principles set forth by the OECD and the UN. See Julia M. Fromholz, *The European Union Privacy Directive*, 15 BERKLEY TECH. L.J. 461 (2000)

<sup>41</sup> The United Nations thereafter adopted *Guidelines Concerning Computerized Personal Data Files* on December 14, 1990. While leaving to individual countries to issue and implement regulations concerning computerized personal data, it issued a series of principles that should guide each State's initiative. Included among the principles were those of: lawfulness and fairness, accuracy, legitimate purpose, access, and non-discrimination. The Council of Europe adopted the *Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data* on October 1, 1985. It also sets forth a series of principles very similar to those later outlined in the Privacy Directive of the European Union. In addition thereto, Article 14 of the Convention provides for assistance to data subjects residing abroad. It states that each party to the Convention shall give to such persons aiding in exercising the right to ascertain the existence of a personal file on him/her, its content, and to make corrections or erasures of data violating his/her privacy rights. Argentina enacted a statute in December 1996 giving data protection ("full protection of personal information") in conformance with another law giving its inhabitants the right to obtaining formation about data collected on them. In addition, a Bicameral Commission on Monitoring of Data Protection was established to enforce the statute. Australia and Belgium, as members of the OECD, enacted a statute in conformity with its principles. Hong Kong, prior to its takeover by the People's Republic of China, enacted a Personal Data (Privacy) Ordinance that is still in effect and is reflective of the EU Directive. The same types of protection may be found in the statutes and ordinances of many other countries. Japan, Taiwan, and Hong Kong have enacted measures to insure the some degree of protection concerning the accumulation and processing of personal data. Among the measures that have been enacted are: (1) In Japan: *The Act for Protection of Computer Processed Personal Data held by Administrative Organs* (December 1988); (2) In Taiwan: *Law Governing Protection of Personal Data Processed by*



*Computers* (July 1995); and (3) Hong Kong: *The Personal Data (Privacy) Ordinance* (September 1995).

<sup>42</sup> The Recommendation can be found at: [http://europa.eu.int/comm/internal\\_market/en/media/dataprot/inter/priv.htm](http://europa.eu.int/comm/internal_market/en/media/dataprot/inter/priv.htm).

<sup>43</sup> See, for example, William J. Clinton and Albert Gore, Jr., *A Framework for Global Electronic Commerce*, <http://www.ecommerce.gov/framewrk.htm>, ISSUES, No. 5.

<sup>44</sup> See European Commission, *Data Protection: Background Information*, [http://europa.eu.int/comm/internal\\_market/en/media/dataprot/backinfo/info.htm](http://europa.eu.int/comm/internal_market/en/media/dataprot/backinfo/info.htm).

<sup>45</sup> *Scope* (Article 3). The Directive concerns "any operation or set of operations which is performed upon personal data." Exceptions include data flowing outside of the European Union and data involving state and public security. "Personal data" is defined as "any information relating to an identified or identifiable natural person ('data subject')." The obligations are imposed upon the "controller" who is any person determining the purposes and means of processing data.

*Data Quality Principles* (Article 6). The Directive provides that Member States are to ensure that the personal data is: (1) processed fairly and lawfully; (2) that it is collected for specific and legitimate purposes; (3) relevant and not excessive for the intended purposes; (4) accurate and kept up to date when relevant; and (5) kept for no longer than necessary except when kept for historical, statistical or scientific use in which case appropriate safeguards are to be enacted.

*Criteria for Legitimacy* (Article 7). Personal data may be collected only if:

- The data subject has consented unambiguously (agreed freely after being adequately informed);
- It is necessary for contract performance involving the data subject (for example, data for job applicants or for billing purposes);
- It is necessary for compliance with a legal obligation of the controller;
- It is necessary to protect the vital interests of the data subject;

It is necessary to carry out a task in the public interest or for exercise of official authority involving the parties (for example, by police or tax authorities); or  
For legitimate interests of the controller or third party receiving the disclosure that outweigh the protection of the legitimate interests of the data subject.

*Prohibited Data* (Article 8). Member States may not collect personal data concerning racial or ethnic origin, political opinions, religious or philosophical beliefs, trade-union membership, and data concerning health or sex life. There are exceptions to such prohibitions including consent from the data subject and legitimate and lawful objectives and persons. For example, health professionals need health data for proper diagnosis, police authorities need data concerning prior convictions, and journalists may require background data.

*Information to be given to Data Subject* (Articles 10 and 11). The Directive provides different criteria of information to be given to the data subject depending on whether the data was obtained from the data subject or from some other source. If the data is derived from a third party, the data subject is entitled to know the identity of the controller and his/her representative; the purposes, thereof; and additional information such as categories of the data concerned, the recipients or groups of recipients of the data, and the right of access. If the data is from the data subject, s/he is entitled to the same type of information plus information as to corrections of errors. Exceptions are made for collection of data for historical or scientific research purposes.

*Right of Access to Data and Exemptions* (Articles 12 and 13). The data subject is entitled to know whether or not data about him or her is being collected, the purposes thereof, the categories of the data, and the recipients, as well as how to rectify, erase or block data. There are exemptions for national and public security, defense, prevention, detection, and prosecution of criminal offenses, and for economic or financial interest of a Member State.

*Miscellaneous Provisions: Right to Object* (Article 16). The data subject has the right to object on compelling legitimate grounds to processing of data about him or her. S/he also has a right to object on request and free of charge any data to be given to direct marketers.

*Confidentiality and Security* (Article 17). Member States are to ensure that agents of controllers not process data except on instructions from the controller. Measures are to be taken to protect the security of the data from accidental or unlawful destruction, alteration, unauthorized disclosure or access and all other unlawful uses.

*Remedies* (Articles 22-24). There are broad remedies available to the data subject for violation of his/her rights under the Directive, including judicial access and claim for damages.

*Notification and Exemptions* (Article 18). Controllers or representatives thereof are to notify Member States of automatic processing operations of their names, addresses, the purposes of data collection, and other such information. Exemptions are permitted where the data are unlikely to adversely affect the data subject. Among the exemptions is Article 3(2) that states the Directive does not apply to data falling outside the scope of EU law, to wit, in matters of public security, defense, state security, and matters pertaining to criminal activities. Article 13(2) also exempts member states from permitting access to data by the data subjects with respect to scientific research and for the collection of statistics. The third exemption provision is that of data transfer to non-member states.<sup>45</sup>

*Data Transfer to Non Member States* (Articles 25-26). Data is not to be transferred to countries outside of the European Union, unless those countries ensure "an adequate level of protection." What is "adequate" depends on all of the attending circumstances of the transfer, including the proposed processing operations, the level of security, its professional rules, and other such qualifications. Nevertheless data can be sent irrespective of such safeguards if the data subject consents; the transfer is necessary in connection with contract performance between parties of the respective countries; on public interest grounds; is necessary to protect the vital interests of the data subject; and where the controller assures protection of privacy concerning the data being sent abroad.

<sup>46</sup> *Letter from the EU Finance Ministers to Chairman William H. Donaldson, supra*, note 24.

<sup>47</sup> *Memorandum of EU Finance Ministers to SEC Chairman, William H. Donaldson, supra*, note 25.

<sup>48</sup> <http://www.cnil.fr>. See, also, commentary by Alan Berkowitz and Jacqueline Bronson, Bingham McCutchen Esqs., *Sarbanes-Oxley Act Whistle Blowing Measures Meet Resistance in the EU*, (Dec. 2005), <http://www.bingham.com>.

<sup>49</sup> Directive 95/46/EC (Oct. 24, 1995).

<sup>50</sup> Testimony of Federal Reserve Governor Susan Schmidt Bies before the US Committee on Financial Services, US House of Representatives (May 13, 2004).

<sup>51</sup> William H. Donaldson, *US Capital Markets in the Post-Sarbanes-Oxley World: Why Our Markets Should Matter to Foreign Issuers* (Jan 25, 2005), <http://www.sec.gov/news/speech/spch012505whd.htm>.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts*. The Directive replaced the Eighth Council Directive 84/253/EEC of 10 April 1984 that concerned the approval of persons responsible for carrying out the statutory audits of accounting documents.

<sup>55</sup> The European Union is composed of 27 member states as of 2007. They are as follows in the order of accession: the initial six states (Belgium, France, Italy, Luxembourg, Netherlands, and West Germany), followed by three added states (Denmark, Ireland, and the United Kingdom), Greece, Portugal, Spain, Austria, Finland, Sweden, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, and, as of 1 January 2007, Bulgaria and Romania. Other potential future member states who are in accession negotiations, candidate country, or potential candidate countries are Croatia, Turkey, Republic of Macedonia, Albania, Bosnia and Herzegovina, Montenegro, and Serbia. [http://en.wikipedia.org/wiki/List\\_of\\_European\\_Union\\_member\\_states\\_by\\_accession](http://en.wikipedia.org/wiki/List_of_European_Union_member_states_by_accession).

<sup>56</sup> Paragraph 5 of the 8<sup>th</sup> Directive.

<sup>57</sup> Paragraph 6 of 8<sup>th</sup> Directive.

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<sup>58</sup> Article 44 of the 8<sup>th</sup> Directive.

<sup>59</sup> Article 44 which incorporates Articles 4, and 6-14 of the 8<sup>th</sup> Directive.

<sup>60</sup> Article 46 of the 8<sup>th</sup> Directive.

<sup>61</sup> Article 45(1) of the 8<sup>th</sup> Directive.

<sup>62</sup> Article 45 (3)(4) with exception of equivalence as provided in Article 46 of the 8<sup>th</sup> Directive.

<sup>63</sup> EU Commission, *Communication from the Commission to the Council and the European Parliament*, COM (2003) 284 final (Brussels, May 5, 2003).

<sup>64</sup> *Id.* at 3.1.1.

<sup>65</sup> *Id.* at 3.1.2.

<sup>66</sup> *Id.* at 3.1.3.

<sup>67</sup> *Id.* at 3.3.

<sup>68</sup> *Id.* Annex.

<sup>69</sup> See, e.g., comments made by Jeffrey Marshall, *Sarbanes-Oxley: An International Perspective*, <http://accounting.smartpros.com/x42166.xml>.

## OF BASEBALLS CAUGHT AND KEPT

by  
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Christopher Companik\*\*

### INTRODUCTION

A baseball stadium seems an unlikely place to think about taxes. More likely than not, fans and players gathering for a baseball game consider recent team records, batting averages and fielding percentages, the likelihood of a perfect game, or maybe even the hotdog and beer to be consumed, as they prepare for the game to begin. However, on a regular basis, fans or players go home from a baseball game with something they did not have when the game began – a baseball that had been in play during the game. Those fans or players may also take home a tax liability when they go home with a baseball that had been in play during the game.

Several legal scholars have recently examined the theories by which a fan or a player could claim ownership of a baseball that had been in play.<sup>1</sup> These are not frivolous inquiries, as milestone or monumental home runs can have very significant economic value in the sports memorabilia marketplace. For example, the baseball Mark McGwire hit for his 70<sup>th</sup> home run in 1998 ultimately sold for \$3 million, and

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