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The Equivalence Test and Sarbanes-Oxley: Accommodating Foreign Private Issuers and Maintaining the Vitality of U.S. Markets

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TABLE OF CONTENTS

I. INTRODUCTION

On the eve of 2001, Enron[1] CEO Kenneth Lay announced to his executives that Enron would become the world's greatest company.[2] While Mr. Lay was publicly declaring Enron's triumphs, unbeknownst to most Enron employees, accountants at the Houston headquarters were desperately trying to contain a

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1. *See* Kurt Eichenwald, *Enron's Many Strands: The Company Unravels; Enron Buffed Image to Shine Even as It Rotted from Within*, N.Y. TIMES, Feb. 10, 2002, at 1 (reporting on the accounting irregularities that forced the Texas corporation to reconcile over $600 million previously stated as profits).

2. *Id.*

financial disaster that would eventually consume the company.[3] Just months before Enron declared bankruptcy in December 2001, the company was widely regarded as one of the most innovative, fastest growing, and best managed businesses in the United States.[4] Formed in 1985, Enron owned the first nationwide natural gas and pipeline network, but eventually shifted its focus away from natural gas to the unregulated energy trading markets.[5] This change in focus, widely regarded on Wall Street as a success, propelled Enron towards annual revenues of $101 billion in 2000.[6] However, everything began to crumble by August 2001.[7]

Since mid-1999, Enron had been establishing a vast web of partnerships, eventually allowing the company to reduce its financial risk by moving various holdings into these partnerships.[8] Establishing partnerships is a common financing technique used by large companies because it allows companies to sell the holdings deposited into the partnerships to outside investors who are more willing to assume the financial risks.[9] However, it was later discovered that the partnerships Enron established were improperly used as a means for making the company seem far more profitable than it actually was.[10] These improper accounting practices forced Enron to eliminate $600 million in previously reported profits.[11] Enron's stock plummeted as a result, forcing the company to file for Chapter 11 Bankruptcy on December 2, 2001.[12]

Not long after the fall of Enron, WorldCom, the nation's second largest long distance telecommunications company, announced on June 25, 2002 that it had overstated its earnings by more than $3.8 billion.[13] The fundamental problem that

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3. *Id.*

4. *See* MARK JICKLING, THE ENRON COLLAPSE: AN OVERVIEW OF FINANCIAL ISSUES, C.R.S. REP. RS21135 (Feb. 4, 2002) (providing a general overview of various financial issues that need to be addressed in order to avoid another disaster like the one Enron experienced).

5. *See id.* (reporting that Enron believed there was more money to be made in buying and selling financial contracts linked to the value of energy than in actual ownership of physical assets).

6. *See id.* (pointing out that Enron's annual revenues only a decade earlier were $10 billion).

7. *Id.*

8. *See* Eichenwald, *supra* note 1 (discussing some of the partnerships set up by Enron that later caused serious problems).

9. *See id.* (reporting that Enron had sold its stake in a Brazilian power project to one of its partnerships, which it later bought back). Enron later sold to the same partnership a stake in future gains in one of its technology investments. *Id.* This complex arrangement allowed Enron to report a "paper profit" on the deal. *Id.*

10. *See id.* (noting that many of the Enron partnerships had been formed for the sole purpose of erasing the risk of future losses from the company's financial statements). However, Enron could only keep those losses off the books if the partnerships remained financially healthy. *Id.* Most of the partnerships had been financed with Enron stock, and because Enron's stock was reducing in value, it decreased the partnerships' ability to cover the losses. *Id.*

11. *Id.*

12. *See* JICKLING, *supra* note 4, at 2 (postulating that even if Congressional investigations had found no wrongdoing by Enron, the quick and unanticipated collapse of a large corporation suggests a basic problem with the U.S. system of securities regulation).

13. *See* BOB LYKE & MARK JICKLING, WORLDCOM: THE ACCOUNTING SCANDAL, 1 C.R.S. REP. RS21253 (Oct. 11, 2002) (providing a summary of the events surrounding WorldCom's collapse). In WorldCom's June 25th statement, the company admitted that it classified $3.8 billion in payments for line costs

WorldCom faced was the vast oversupply in telecommunications capacity due to overly optimistic projections of Internet growth.[14] WorldCom continued to expand despite the end of the dot-com era and an economic recession. This combination of factors increased the company's debt at a time when revenues were steadily declining,[15] thus, creating an incredible incentive to hide losses through bad accounting practices.[16] Yet, WorldCom's troubles continued and the company filed for bankruptcy on July 21, 2002.[17]

The collapse of WorldCom illustrated that Enron was not simply an anomaly[18] and that America needed corporate reform. The sudden and immediate collapse of two corporate giants forced the U.S. Congress and President to respond. On July 30, 2002, U.S. President George W. Bush signed the Sarbanes-Oxley Act[19] ("Sarbanes-Oxley") into law. President Bush declared the piece of legislation the "most far reaching overhaul of the nation's business practices since the Great Depression."[20] The Act restricts accounting firms from performing a number of services for the companies they audit.[21] The Act also requires new disclosures for public companies as well as the officers and directors of those companies.[22] For example, a company's executives must sign off on the accuracy of the company's financial statements and certify that they have designed procedures to ensure the accuracy of the reports.[23] Other issues affected by the new legislation include securities fraud, criminal and civil penalties for violating the securities laws, blackouts for insider trading of pension fund shares, and protections for corporate whistleblowers.[24]

International reaction to Sarbanes-Oxley has been less than favorable. Many foreign companies and government officials have publicly voiced their opposition.[25]

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as capital expenditures rather than current expenses. *Id.* at 2. Line costs are what WorldCom pays other companies for using their communications networks. *Id.*

14. *Id.* at 1.

15. *Id.* at 4 (noting that WorldCom stock had fallen from $64.50 a share in mid-1999 to less than $2 a share just prior to the June 25th announcement). After the announcement, the price per share dropped to just pennies. *Id.*

16. *Id.*

17. *Id.*

18. *See* Mike Allen, *Bush Signs Corporate Reforms into Law; President Says Era of 'False Profits' Is Over*, WASH. POST, July 31, 2002, at A4 (reporting that Congress quickly and easily passed Sarbanes-Oxley after the fall of WorldCom, responding to fears that the measure would not be passed after the collapse of Enron).

19. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

20. *See* Allen, *supra* note 18 (reporting the President's concern that corporate fraud has undermined investor confidence).

21. *See* LYKE & JICKLING, *supra* note 13, at 7 (summarizing the purposes of Sarbanes-Oxley).

22. *Id.*

23. *See generally infra* Part II.B.1-2 (discussing the requirements of § 302 and the SEC rules).

24. LYKE & JICKLING, *supra* note 13, at 7.

25. *See* Julia Finch, *U.S. Clean-Up Angers Hewitt: Law Designed to Prevent Another Enron Is Seen as Threat to British Business*, GUARDIAN (London), Oct. 8, 2002, at 21 (interviewing UK Trade Secretary Patricia Hewitt, who accepts the basic premise behind Sarbanes-Oxley and its necessity for restoring confidence in investors). However, Ms. Hewitt argues that "little thought" was given to the international repercussions and that "a number of general and partial exemptions are justified because of the stricter regulatory environment in Britain." *Id.*

Foreign companies are opposed to Sarbanes-Oxley because the Act imposes increased disclosure requirements and criminal liability[26] that may be at odds with their country's regulations.[27] Over the past few months, Europe has channeled its anger into a concentrated lobbying effort against the implementation of various provisions of the Act's rules regarding foreign companies.[28] In response, former Securities Exchange Commission (SEC) Chairman Harvey Pitt told Europe's business community that the United States would consider granting exemptions in special circumstances where Sarbanes-Oxley conflicts with a foreign country's laws or where there are comparable regulations in place.[29] However, Pitt did not issue the broad exemptions that Europe had hoped for.[30] Pitt recently resigned as SEC chairman, leaving Europe guessing whether its lobbying efforts had been in vain.[31] It remains to be seen whether the new head of the SEC, William Donaldson,[32] will engage in a dialogue with the international business community and consider granting exemptions.

Obtaining exemptions for foreign companies will most likely prove to be an uphill battle. Following the collapse of Enron, the U.S. Congress resolved not to allow corporate executives to escape liability for wrongdoing with the "I don't know" excuse.[33] Public and investor outrage fueled the drive towards the development of very specific certifications imposed on CEOs and CFOs.[34] However, the United States failed to address several key issues through legislation and agency rulemaking. For example, what happens when a foreign issuer's home jurisdiction's corporate governance rules and laws conflict or overlap with U.S. rules? What would happen if a company or executive could be

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26. *Id.*

27. *See* Mark Landler, *Porsche Is Balking at U.S. Auditing Rule*, N.Y. TIMES, Aug. 21, 2002, at W1 (reporting that German companies are especially upset with the law because they feel that they are "quite far away from the U.S. system"). In addition, differences in the way European and American companies operate contribute to Europe's dissatisfaction. *Id.* For example, many German companies utilize a two-tiered managerial system, as opposed to a single executive. *Id.*

28. *See* Suzanne Kapner, *S.E.C. Chief Promises to Cooperate with Europe*, N.Y. TIMES, Oct. 11, 2002, at W1 (describing the pressure the European community is putting on the SEC to accommodate its companies).

29. *Id.* (explaining that Harvey Pitt won praise among European policymakers when he promised to cooperate with Europe on issues of new accounting measures and regulatory policies); *see also* Stephen Castle, *Pitt Reassures Europe on New Accounting Law*, INDEPENDENT (London), Oct. 11, 2002, at 25 (reporting Chairman Pitt's comment that a comprehensive approach by the European Union "would have enormous bearing on whether and the extent" to which U.S. regulations would apply).

30. *See* Kapner, *supra* note 28 (mentioning that Chairman Pitt is prepared to implement Sarbanes-Oxley to all companies consistent with its purpose).

31. *See* Gary Duncan, *Europe Seeks Exemption on US Act*, TIMES (London), Nov. 18, 2002, at 6 (noting the uncertainty of promises for exemptions or compromise after the departure of Harvey Pitt from the SEC and the transition to Republican control of Congress).

32. *See* Andrew Countryman, *Donaldson Takes Reins at an SEC in Turmoil*, CHI. TRIB., Feb. 19, 2003, at 1 (reporting that Donaldson is replacing Harvey Pitt after his resignation as SEC Chairman amid widespread criticism for poor judgment).

33. *See* BRUCE C. BENNETT & GRAHAM ROBINSON, EXECUTIVE CERTIFICATIONS 9, *available at* www.cov.com/publications/311.pdf (last visited Mar. 4, 2003) (copy on file with *The Transnational Lawyer*) (noting that former Enron CEO Jeff Skilling testified before a congressional committee that he was "not aware of any inappropriate financial arrangements").

34. *See id.* at 10 (noting the SEC's general policy that it is the senior corporate official's duty to securities holders to be involved in determining disclosure).

criminally liable in both the United States and its own jurisdiction? From the drafting of Sarbanes-Oxley to the SEC's rules, the United States has failed to make concessions to foreign companies who must comply with their own country's laws and rules regarding corporate governance. In the absence of a global securities regulator, the United States should now consider granting exemptions.

This Comment is designed to achieve three goals: first, to provide a basic background of disclosure requirements for foreign private issuers; second, to discuss the certification and compliance requirements found in section 302 of Sarbanes-Oxley; and finally, to propose a new approach for granting exemptions from certification. Specifically, this new approach will explore the potential development of an Equivalence Test for granting exemptions from section 302 to foreign private issuers. Part II of this Comment discusses the history of foreign issuer disclosure and examines section 302 of Sarbanes-Oxley. Furthermore, Part III explains the problems that the United Kingdom and Germany have with section 302. Part IV advocates a method the SEC should adopt for granting exemptions to foreign issuers. Finally, this Comment concludes that adopting an Equivalence Test to place the burden on the foreign private issuer to demonstrate the need for an exemption would best comport with U.S. goals of protecting investors and encouraging foreign offerings on the national stock exchanges.

II. FOREIGN PRIVATE ISSUERS AND DISCLOSURE: A BACKGROUND

Securities reform first appeared in the United States in the years immediately following the stock market crash of 1929.[35] The United States was somewhat of a latecomer in regulating securities, as many European countries already had securities laws on the books.[36] Surprisingly, it took an unprecedented stock market crash and incredible investment losses to push the U.S. Congress toward regulation.[37] Congress responded by enacting the Securities Acts of 1933 and 1934.[38] The Acts codified principles of broad disclosure by mandating that companies disclose to investors all material facts regarding the financial condition of the company.[39] In the years following the passage of the Securities Acts, critics questioned the need for mandated broad corporate disclosure when it was already in a company's best interest to disclose all relevant documents.[40]

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35. 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 166-67 (3d ed. 1989).

36. *Id.*

37. *See id.* at 167 (recognizing that one of the motivations for reform was to push the economy towards recovery).

38. *Id.* at 172-77 (explaining that the securities acts are a combination of the post-war English "Companies Act" and the "New York Martin Act").

39. Peter L. Cholakis, *Company Disclosure of Earnings Projections: Should Individual Investors Be Allowed into "The Ball Park?,"* 39 SANTA CLARA L. REV. 819, 825 (1999) (explaining that material facts are those matters which an average prudent investor ought to reasonably be informed).

40. *See* 1 LOSS & SELIGMAN, *supra* note 35, at 187-91 (arguing that some theorists believe mandatory disclosure is unnecessary because of developments in financial theory and competition for investors). However,

However, mounting evidence of corporate misconduct and concern for the continued stability of the markets prompted the further development of disclosure rules.[41]

A. The Development of SEC Disclosure Requirements for Foreign Private Issuers

As foreign private issuers[42] began to make offerings into the United States, the SEC slowly recognized the need to provide them with a special disclosure form. For several decades following the enactment of the Securities Acts, the SEC did not provide a separate disclosure form taking into account any differences between U.S. and foreign issuers' business practices because there simply had not been enough foreign offerings into the U.S. markets to warrant it.[43] By the 1970s, however, offerings into the United States by foreign companies had increased enough to necessitate a response by the SEC.[44] The result was the development of the Foreign Integrated Disclosure System whereby foreign issuers would be subjected to slightly different disclosure requirements.[45] In providing this alternative, the Commission performed a difficult balancing act. On one hand, it had to balance the strong interest in allowing U.S. investors full access to consistent and comprehensible information. On the other hand, there was the equally important interest of encouraging offerings by foreign companies into the United States.[46]

As a result of its difficult balancing task, the SEC developed Form 20-F.[47] Use of this form allowed foreign issuers to prepare their financial statements in accordance with the currency of the country where the company was organized or

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these theorists have ignored the evidence of fraud or excessive compensation that prompted Congress to act in 1933, 1934, and 1964. *Id.*

41. *See generally id.* at 193-218 (explaining that evidence of misconduct by both large and small companies required the SEC to expand disclosure requirements).

42. Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,276 n.41 (Sept. 9, 2002) (to be codified at 17 C.F.R. pts. 228, 229, 232, 240, 249, 270, 274).

> A "foreign private issuer" is any foreign issuer (other than a foreign government) except an issuer meeting the following conditions:
>
> (1) More than 50% of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the U.S.; and
>
> (2) [T]he majority of the executive officers or directors are U.S. citizens or residents; or more than 50% of the assets of the issuer are located in the U.S.; or the business of the issuer is administered principally in the U.S.

Id.

43. 2 LOSS & SELIGMAN, *supra* note 35, at 802.

44. *Id.* at 802.

45. *Id.* at 802-03.

46. *See id.* at 803 n.47 (explaining these interests in further detail). Most foreign issuers maintained different methods of accounting, auditing, and traditional business practices. *Id.* The SEC understood that considerations would have to be made to foreign issuers because of these differences. *Id.* In many cases, the SEC accepted foreign issuers' registrations despite these variations. *Id.*

47. *See id.* at 805 (explaining that this form is available to any foreign private issuer registering under § 12 of the 1933 Act or filing an annual report under § 13(a) or § 15(d) of the 1934 Act). Those filing reports on Form 20-F were required to furnish information provided in their home jurisdiction. *Id.* at 805 n.49.

incorporated.[48] In addition, foreign companies could prepare their financial statements according to either generally accepted accounting principals ("GAAP")[49] in the United States or alternative bodies of accounting principles, provided a discussion of material variations was included.[50] Furthermore, Form 20-F did not require any specific corporate officer to verify its contents. Instead, the form only required a signature on behalf of the company.[51] These specific instances of treating foreign issuers differently illustrate that the SEC has historically recognized a disparity between U.S. and foreign corporate practices and has attempted to accommodate these differences while still providing for strong investor protection. However, the deference to foreign practice was undermined when the SEC published its final rules concerning the scope and interpretation of section 302.

B. Sarbanes-Oxley Section 302 and Enhanced Disclosure: SEC Interpretation

Anticipating the political fallout from the Enron and WorldCom scandals, the SEC quickly formulated a set of proposed rules reflecting the President's goal to hold corporate executives accountable.[52] The proposed rules, which have come to be known as the "June Proposals," contain many of the same ideas and policy statements as those found in section 302 of Sarbanes-Oxley.[53] For example, the proposals state that the SEC wants executives to certify the accuracy of annual reports, maintain a system of internal controls and procedures, and undertake a review of the effectiveness of the procedures.[54] These substantive requirements were based on the principle that full and fair disclosure of all material aspects of a corporation's business is the most effective means to assure investor protection and accurate reporting.[55]

In addition, the proposals were used as a tool to improve investor confidence in the marketplace.[56] The SEC expressed concern that the real or perceived absence of executive participation in the formulation and oversight of internal controls was

48. *Id.* at 806.

49. *See* BOB LYKE, AUDITING AND ITS REGULATORS: PROPOSALS FOR REFORM AFTER ENRON 2, C.R.S. REP. RS21120 (July 11, 2002) (describing GAAP as "the conventions, rules, and procedures that define accepted financial accounting principles at a particular time"). These include "both broad guidelines as well as detailed procedures." *Id.* GAAP standards are generally set by the Financial Accounting Standards Board (FASB); however, the SEC has the authority to establish accounting principles for the public companies. *Id.*

50. 2 LOSS & SELIGMAN, *supra* note 35, at 807.

51. Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 41,877, 41,882 (proposed June 20, 2002) (to be codified at 17 C.F.R. pts. 232, 240, 249).

52. *See id.* at 41,877 (explaining that the rules were drawn in accordance with the President's remarks requiring that corporate executives certify their reports).

53. *See id.* (explaining that the SEC wants executives to certify their reports and internal control procedures).

54. *See id.* at 41,878-41,882 (laying out the proposed requirements of each certification).

55. *Id.* at 41,877.

56. *Id.*

shattering investor confidence.[57] Investors expect a company's management to ensure all reports present a clear and accurate picture of the financial condition of the business.[58] However, the SEC questioned whether investors truly expect accurate reports if corporate executives do not spend an adequate amount of time reviewing and analyzing the internal procedures that generate the data they present in their annual reports.[59] In an effort to respond to these concerns, the SEC proposed the certification and internal control provisions.[60]

Despite announcing broad policy statements and new disclosure requirements, the SEC specifically exempted foreign private issuers from the June Proposals.[61] The SEC articulated several reasons for the exemptions. First, Form 20-F does not require the signature of the CEO or CFO.[62] However, the form must be signed on behalf of the company, which generally results in the signature of the principle executive officer.[63] Second, unlike domestic companies, foreign private issuers are not required to file a quarterly report.[64] However, they must file copies of all information required under the laws of the jurisdiction of incorporation.[65] Most importantly, the SEC recognized that "mandatory requirements regarding internal procedures raise several issues, since those requirements may be inconsistent with the laws or practices of the foreign private issuer's home jurisdiction and stock exchange requirements."[66] For these reasons, the SEC explained that requiring foreign private issuers to comply with the new proposals would raise issues that do not exist for domestic issuers.[67] The specific exemption of foreign issuers from the proposed rules implies that the Commission recognizes that investor protection may be accomplished even with some accommodations for foreign issuers.[68]

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57. *See id.* (explaining that investor confidence is important, but executive participation may provide additional assurance that any reporting is accurate).

58. *See id.* (noting some basic principles that maintain investor confidence in the markets).

59. *See id.* (questioning whether the traditional anti-fraud and disclosure rules are enough to ensure full disclosure).

60. *Id.*

61. *Id.* at 41,882.

62. *Id.*

63. *Id.*

64. *See id.* (noting that domestic issuers are required to file quarterly reports on form 10-Q).

65. *See id.* at 41,882 n.67 (explaining that foreign issuers file the information on Form 6-K).

66. *See id.* at 41,882 (illustrating that the SEC was interested in soliciting comments from the public to determine whether foreign private issuers should be subject to the disclosure requirements).

67. *See id.* (adding that the SEC would solicit comments on the issue of whether foreign private issuers should be subjected to the new proposals).

68. *See* Letter from Todd M. Malan, Executive Director, Organization for International Investment (OFII), to Jonathan G. Katz, Secretary, Securities Exchange Commission (Aug. 19, 2002), *at* http://www.sec.gov/rules/proposed/s72102/tmmalan1.htm (copy on file with *The Transnational Lawyer*) (explaining that the SEC has exempted foreign issuers from the quarterly reports, the proxy rules, and the insider reporting and short swing profit recovery provisions of § 16 of the 1934 Securities Act). In addition, foreign issuers are not required to disclose individual executive compensation. *Id.* The SEC has accepted some international accounting standards and allowed U.S. exchanges to tailor special rules for foreign issuers. *Id.*

However, with the passage of Sarbanes-Oxley, the SEC proceeded to require foreign issuers to comply with section 302.[69] According to the Commission, the section, "by its terms," clearly applies to foreign issuers.[70] On its face, section 302(a) appears to cover foreign issuers because it applies to companies filing reports under sections 13(a) and 15(d) of the Exchange Act.[71] However, when read in light of section 302(b), section 302(a) appears to be designed to apply

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69. *See* Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C. § 7241 (2003) (listing the specific statutory requirements for compliance). Section 302 provides:

> (a) The Commission shall, by rule, require for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934, that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of the Act that—
>
> (1) the signing officer has reviewed the report;
>
> (2) based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;
>
> (3) based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods in the report;
>
> (4) the signing officers—
>
> (A) are responsible for establishing and maintaining internal controls;
>
> (B) have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared;
>
> (C) have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report; and
>
> (D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;
>
> (5) the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function)—
>
> (A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
>
> (B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
>
> (6) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.
>
> (b) FOREIGN REINCORPORATIONS HAVE NO EFFECT.--Nothing in this section 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 officers of the issuer from inside the United States to outside of the United States.
>
> (c) DEADLINE.--The rules required by subsection (a) of this section shall be effective not later than 30 days after [July 30, 2002].

Id.

70. Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,278 (Sept. 9, 2002) (to be codified at 17 C.F.R. pts. 228, 229, 232, 240, 249, 270, 274).

71. *Id.*

only to American companies.[72] Section 302(b) states that re-incorporation or moving of the corporate domicile from within the United States to another jurisdiction would not preclude the operation of section 302(a).[73] If section 302 applies to every issuer, both foreign and domestic, then it would have been unnecessary for Congress to add section 302(b).[74] Foreign issuers are already incorporated and domiciled outside the United States, and the section 302(b) re-incorporation provision has no practical affect on foreign issuers. However, the Commission's new approach is a clear reversal of its position stated in the June Proposals. Regardless of any ambiguity in the language of section 302, foreign issuers must comply with the Commission's final rules implementing section 302.

1. Providing Guidance: The SEC Publishes Final Rules

Pursuant to its rulemaking authority, the SEC recently adopted Exchange Act rules 13a-14 and 15d-14[75] to clarify what the term "fairly presents" means in section 302(a)(3). The SEC also adopted rules 13a-15 and 15d-15[76] which introduced the concept of "disclosure controls and procedures" that modifies the term "internal controls" in section 302(a)(4)(A). With the adoption of these rules, the SEC was finally able to clarify section 302.

Viewed collectively, the rules clarify the meaning of fairly presents found in section 302(a)(3).[77] The executive must make a certification regarding the fair presentation of "financial statements and other financial information."[78] The commentary in the rule interprets financial statement and other financial information to comprise all elements of a company's financial disclosure, including financial statements, selected financial data, management discussion and analysis, and any other financial information in the report.[79] The SEC has determined that fair presentation is not limited to a representation that the financial statements and other financial information have been presented in

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72. *See id.* (mandating in § 302(b) that re-incorporating in another jurisdiction would not allow a company from circumventing the requirements of this section).

73. *Id.*

74. *See* Letter from Dr. Arnold Knechtle, Director, INDUSTRIE - HOLDING, to Jonathan G. Katz, Secretary, Securities Exchange Commission (Aug. 19, 2002), *at* http://www.sec.gov/rules/proposed/s72102/aknechtle1.htm [hereinafter Knechtle Letter] (copy on file with *The Transnational Lawyer*) (arguing that if § 302(a) is read to apply equally to both foreign and domestic private issuers, there would be no reason for Congress to include § 302(b) to prevent domestic issuers from circumventing the rules).

75. *See* Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. at 57,277 (stating that these are the rules requiring an issuer's CEO and CFO to certify the quarterly or annual reports submitted under § 13(a) or § 15(d) of the Exchange Act). These rules embody § 302 of Sarbanes-Oxley. *Id.*

76. *Id.* at 57,279.

77. Sarbanes-Oxley Act of 2002 § 302(a)(3), 15 U.S.C. § 7241 (2003).

78. *See* Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. at 57,279 (noting that a discussion of fair presentation was not included in the June Proposals).

79. *Id.*

accordance with GAAP.[80] Instead, the SEC concluded fairly presents is a concept of material accuracy and reporting broader than what is required under GAAP.[81] The move beyond GAAP was a victory for the SEC because the Commission has previously indicated that a statement can be misleading despite being in strict accordance with GAAP principles.[82] Accordingly, a fair presentation of the information encompasses judgments about the issuer's selection, proper application of appropriate accounting polices, and disclosure of all financial information.[83] An issuer must also include any additional information that is necessary to provide investors with a materially accurate and complete picture of the issuer's financial condition.[84]

Foreign issuers argue that the term fairly presents, as defined, could prove problematic because the term reflects audit procedures and practices employed in the United States and the certifying officer may be unsure whether the information provided satisfies the section 302 certification requirement.[85] However, the Commission makes it clear in the rule that the International Accounting Standard speaks to the essential elements that must be considered within the framework of GAAP in evaluating whether an issuer's financial statements fairly present its financial condition.[86] In addition, it is unlikely that compliance would be difficult in practice for foreign issuers because the term fairly presents only requires, for example, additional statements of why certain accounting principles were chosen and disclosure of certain financial information to explain transactions or events. In this context, fairly presents takes on less meaning than the interpretation the SEC has given it.

Equally important, the new rules interpret the requirement that the CEO and CFO certify that they are responsible for maintaining disclosure controls and procedures.[87] Rules 13a-15 and 15d-15 call for an issuer to maintain

80. *See id.* at 57,279 (indicating that it was Congress' intent to include both income or loss and cash flows within the concept of "fair presentation" of an issuer's results of operation).

81. *See id.* at 57,279 n.5 (explaining that presenting information in conformity with GAAP may not necessarily satisfy the anti-fraud provisions of the federal securities laws).

82. *See* BENNETT & ROBINSON, *supra* note 33, at 25-26, *available at* www.cov.com/publications/311.pdf (citing *In re* Edison Schools, Inc., SEC Release No. 34-45925 (May 14, 2002) and U.S. v. Simon, 425 F.2d 796 (2d Cir. 1969), where the financial statements were misleading despite being in accordance with GAAP principles).

83. Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. at 57,279.

84. *Id.*

85. *See* Letter from Linklaters, to Jonathan G. Katz, Secretary, Securities Exchange Commission (Aug. 19, 2002), *at* http://www.sec.gov/rules/proposed/s72102/linklaters1.htm (last visited Mar. 4, 2003) (copy on file with *The Transnational Lawyer*) (arguing that the certification cannot be meaningfully applied to a company that prepares its accounts in accordance with principles other than U.S. GAAP). According to the argument, the only way to ensure that the statements satisfy § 302 is to require foreign issuers to comply with U.S. GAAP. *Id.* But requiring foreign issuers to do so would be contrary to a long standing policy of allowing foreign issuers to supply information according to local GAAP. *Id.*

86. Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,278 (Sept. 9, 2002) (to be codified at 17 C.F.R. pts. 228, 229, 232, 240, 249, 270, 274).

87. *Id.* at 57,277-57,278 (defining "disclosure controls and procedures" as "controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms").

commensurate procedures for gathering, analyzing, and disclosing all required information.[88] Disclosure controls and procedures apply only to the certification required by section 302(a)(4) and were designed by the Commission to be distinguishable from the concept of internal controls.[89] The SEC adopted the broader concept of disclosure controls and procedures to ensure compliance with disclosure requirements generally because the concept is intended to address the quality and timeliness of disclosure.[90] By contrast, internal controls pertain only to an issuer's financial information.[91] Specifically, internal controls make up a process designed to achieve reliability in financial reporting, the effectiveness and efficiency of operations, and compliance with applicable laws and regulations.[92] Foreign issuers must immediately take the appropriate steps in order to effectively respond to these new rules. Failure to do so could subject the issuer and its officers to potential civil liability even where the failure to respond to the new rules does not lead to a flawed disclosure.[93]

2. *Maintaining Effective Disclosure Controls and Procedures*

Despite announcing the intended scope of disclosure controls and procedures, the SEC did not mandate a formal structure for maintaining these procedures. Rather, each issuer is expected to "develop a process that is consistent with its business and internal management and supervisory practices."[94] While each issuer will have to develop a means for implementing and complying with these new rules, such procedures and controls should incorporate the general principles of verification, analysis, organization, education, and communication.[95] However,

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88. *See id.* at 57,281 (stating that these rules are intended to complement the existing requirements for reporting companies to establish and maintain internal controls).

89. *See id.* at 57,279-57,280 (explaining that internal controls pertain to an issuer's financial reporting and is addressed in § 302(a)(5)-(6) and § 404 of the Act).

90. *Id.* at 57,279.

91. *Id.* at 57,280.

92. *Id.*

93. *See* Mayer Brown Rowe & Maw, *Securities Update: Suggested Disclosure Controls and Procedures*, Sept. 25, 2002, at 1, *available at* www.mayerbrownrowe.com/publications/article.asp?id=260&nid =6 (copy on file with *The Transnational Lawyer*) (noting that even if an issuer's disclosures are appropriate, failure to maintain adequate disclosure controls and procedures could expose the certifying officers to liability for making a false certification). This could subject the company to SEC sanctions for failure to observe the company's obligations under § 13(a) of the Exchange Act. *Id.*

94. Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. at 57,280 (suggesting that "an issuer create a committee with responsibility for considering the materiality of information and determining disclosure obligations on a timely basis").

95. *See* Michael L. Zuppone, *Section 302 of the Sarbanes-Oxley Act of 2002: Disclosure Controls and Procedures and the Related CEO and CFO Certification-Analysis and Recommendations* (Paul, Hastings, Janofsky & Walker LLP ed., Oct. 2002), *at* http://www.paulhastings.com/ClientAlerts/Content/10-2%20Section %20302%20of%20Sarbanes%20Oxley.pdf (last visited Mar. 4, 2003) (copy on file with *The Transnational Lawyer*) (suggesting several principles that should be adhered to when developing the disclosure controls and procedures). The disclosure controls and procedures should be formally organized so that the persons responsible are identified and their responsibilities are clear. *Id.* Participants must have knowledge of the SEC's reporting requirements. *Id.* The information in the reports must be carefully reviewed and substantiated to ensure that it reflects a reasonable interpretation of the facts. *Id.* In addition, there should be clear lines of

the SEC does suggest that an issuer establish a disclosure committee that reports directly to the certifying officer on the maintenance of these procedures.[96] Such a committee should be formed for the purpose of designing and implementing the issuer's disclosure controls and procedures.[97] In addition, the committee would oversee the issuer's compliance with its disclosure obligations.[98] The disclosure committee must have a written compliance procedure detailing the company's disclosure policies, each individual's specific responsibilities, and the disciplinary procedures for participants who fail to perform their duties.[99] This procedure will assist in guaranteeing that information to be disclosed is recorded and summarized on a timely basis.[100]

Certifying officers need to make an effort to take an active role in the disclosure process because they are the ones ultimately held accountable for flawed disclosures and false certifications.[101] To protect themselves, officers should consistently inquire into the progress of their company's disclosure controls and procedures and should meet with senior management to discuss the content of the procedures employed.[102] Furthermore, one cannot underscore the importance of some basic principles such as starting early,[103] preparing to adhere to a realistic time schedule,[104] documenting the process,[105] and remaining aware of SEC precedent.[106] The implementation of these suggestions and principles should assist an issuer in complying with the requirements of section 302. However, a foreign private issuer may find it difficult or burdensome to comply with the

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communication to assure that only the information necessary for compliance is identified and there is clear access to the information. *Id.*

96. *See* Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. at 57,280 (describing that the committee would be effective if it included the controller, general counsel, risk management officer or other officers as members).

97. Zuppone, *supra* note 95, *at* http://www.paulhastings.com/ClientAlerts/Content/102%20Section%20302%20of%20Sarbanes%20Oxley.pdf.

98. *See id.* (explaining that the committee's members must have a collective understanding of the issuer's business and strategic plan, financial results and condition, and operational, competitive and financial risk profile). A subcommittee should also be established to address problems requiring immediate attention or sensitive developments not otherwise known throughout the company. *Id.*

99. *See id.* (noting that a written compliance procedure would only underscore the importance of the disclosure controls and procedures).

100. *See id.* (suggesting that a disciplinary procedure will help ensure individuals are responsible for their portions in the process).

101. *See id.* (discussing, generally, the suggested procedures for executive review of disclosure).

102. *See id.* (emphasizing that the certifying officers should make inquiries and ask a lot of questions). A sample list of questions follows: who was involved in the drafting; how was the information recorded and processed; are the participants comfortable with the procedures employed; what significant issuers arose; are the statements consistent with the GAAP; were there any disagreements with outside auditors; are the participants aware of any material misstatement or omission contained in the reports. *Id.*

103. *See* Mayer Brown Rowe & Maw, *supra* note 93, *at* www.mayerbrownrowe.com/publications/article.asp?id=260&nid=6 (suggesting that companies should begin to gather information before the end of the fiscal year and constantly prepare narrative descriptions to be included in the final draft).

104. *See id.* (noting that the importance of establishing deadlines increases as the amount of people involved in the process grows).

105. *See id.* (suggesting that records of meetings and procedures should be consistently kept).

106. *See id.* (stating that a company should be aware of its own prior disclosures and competitors' disclosures to further enhance its own understanding of how their industry handles disclosure).

enhanced disclosure requirements of section 302 if the issuer's laws and practices are different from the type of procedures that are necessary to comply with section 302 despite the recommendations.

Foreign issuers must also be aware that rules 13a-15 and 15d-15 require companies to conduct an evaluation of the effectiveness of the design and the operation of their disclosure controls and procedures within ninety days prior to filing a report with the SEC.[107] The scope of the evaluation will vary, but at the least, it should confirm that each individual's job was completed and that the certifying officers consulted with outside advisors regarding any concerns or suggestions.[108]

C. Potential Consequences of Non-Compliance: Section 906 and Criminal Liability

Despite the difficulties foreign issuers might face in complying with section 302, foreign issuers should take the required steps because the potential consequences for failing to follow section 302 are serious. In an effort to encourage compliance, Congress added section 906 as an amendment to the federal criminal code.[109] Under section 906, a signing officer may be fined not more than $1,000,000, imprisoned not more than ten years, or both if the officer certifies a report "knowing" it is false.[110] If the officer "willfully" certifies a report knowing that the certification is false, the signing officer may be fined not more than $5,000,000, imprisoned not more than twenty years, or both.[111] Section 906 creates harsh criminal penalties where previous liability was limited to civil damages.[112]

Similar to section 302, section 906 creates patent ambiguity because of apparent drafting flaws. On its face, section 906 imposes a separate certification requirement from section 302. Section 906 certifications apply to periodic reports,[113] while section 302 certifications apply to annual or quarterly reports.[114]

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107. *See* Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,281 (Sept. 9, 2002) (to be codified at 17 C.F.R. pts. 228, 229, 232, 240, 249, 270, 274) (noting that the evaluation must be carried out in a manner that would form the basis for the certifications required to be made by §. 302).

108. *See* Mayer Brown Rowe & Maw, *supra* note 93, *at* www.mayerbrownrowe.com/publications/article.asp?id=260&nid=6 (suggesting that the certifying officers should confirm the agreed upon steps for preparation). In addition, the officers should verify that each portion of the project was competently completed and inquire whether any matter has come up after the last filed report. *Id.* Finally, they should ensure all information was checked against the financial information. *Id.*

109. Sarbanes-Oxley Act of 2002 § 906, 18 U.S.C. § 1350 (2002) (indicating that § 906 requires the CEO and CFO to provide written statements which shall state that the periodic report fully complies with the requirements of § 13(a) or § 15(d) of the Exchange Act; and the information fairly presents, in all material respects, the *financial* condition and results of operation of the issuer).

110. *Id.*

111. *Id.*

112. *See* BENNETT & ROBINSON, *supra* note 33, at 39, *available at* www.cov.com/publications/311.pdf (noting that SEC filings have always been subject to potential criminal liability under the False Statements Act, 18 U.S.C. §§ 1001-1036 (2003)). However, prosecutions under this Act have been uncommon and the maximum imprisonment is far greater under § 906. *Id.*

113. *See* Sarbanes-Oxley Act of 2002 § 906, 18 U.S.C. § 1350 (2002) (referring only to periodic reports).

Sarbanes-Oxley and the Securities Acts do not define a periodic report, but securities practitioners generally refer to annual and quarterly reports as periodic reports.[115] The SEC has failed to provide any guidance on this issue because section 906 falls within the jurisdiction of the Department of Justice.[116] However, statements from members of Congress make it clear that their intent was to create only one certification under section 302 and enforce its provisions with the harsh criminal penalties provided under section 906.[117] Because Congress did not intend to create two separate requirements, it is unclear whether a person may be criminally liable for failing to comply with the non-financial reporting requirements contained in section 302.

The plain language of both sections 302 and 906 provides guidance on the issue. For example, section 906 requires the signing officer to certify that the report fairly presents the financial condition and results of the issuer's operations.[118] Section 302(a)(3) also requires the signing officer to certify that the financial statements fairly present the financial condition and results of the issuer's operations.[119] The parallel language suggests criminal liability will only attach to the certification of financial information, not to non-financial information found in the remaining portions of section 302.[120] In addition, it appears unlikely Congress intended criminal liability to attach for false certifications of non-financial information when various civil remedies are already available.[121] However, it will remain unclear whether criminal liability attaches to the certification of non-financial statements under section 302 until there is a definitive statement determining the scope of section 906.[122] Ultimately,

114. *See* Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C. § 7241 (2003) (noting that § 302(a) mentions only quarterly and annual reports).

115. *See* BENNETT & ROBINSON, *supra* note 33, at 21-22, *available at* www.cov.com/publications/311.pdf (arguing that the distinction in language makes little difference because annual and quarterly reports contain financial statements and, thus, come under the ambit of § 906).

116. *See id.* at 20 (noting that the SEC has taken the position that it does not have jurisdiction over § 906). However, the SEC and the Department of Justice determine whether the two sections can be harmonized. *Id.*

117. *See id.* at 20-21 (stating that Senator Enzi made a statement on the Senate floor where he pointed out that there is cause for confusion because the penalties under § 906 are effective upon the President's signature, whereas the SEC has 30 days to promulgate rules under § 302). Senator Enzi expressed his view that the penalties under § 906 should not take effect until the final § 302 rulemaking process had been completed. *Id.*; *see also* Karen L. Werner, *Technical Correction on Sarbanes-Oxley Needed on Certification Conflict, Oxley Says*, BANKING DAILY, Nov. 8, 2002 (reporting Representative Michael Oxley as stating he believes Congress did not intend to create two separate certification requirements). Representative Oxley remarked that he hoped this flaw could be corrected through an amendment to Sarbanes-Oxley or by cooperation between the SEC and the Justice Department in administration of §§ 302 and 906. *Id.*

118. Sarbanes-Oxley Act of 2002 § 906.

119. Sarbanes-Oxley Act of 2002 § 302.

120. *See generally* Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,276 (Sept. 9, 2002) (to be codified at 17 C.F.R. pts. 228, 229, 232, 240, 249, 270, 274) (affirming the information to be certified under § 302(a)(4)-(6) is not a financial statement, but rather information relating to internal operations and management).

121. *See id.* at 57,280 (explaining various liability provisions for false statements found in the Exchange Act).

122. *See* BENNETT & ROBINSON, *supra* note 33, at 21-22, *available at* www.cov.com/publications/

uncertainty in the application of and the integration between sections 302 and 906 may present problems for all issuers. Uncertainty will ultimately provide foreign issuers with an incentive to be cautious and reflective concerning their decision to enter or remain in U.S. markets.

III. THE PROBLEM IN CONTEXT: SARBANES-OXLEY AND THE FOREIGN PRIVATE ISSUER

The United Kingdom and Germany are examples of two jurisdictions where companies organized under and subject to their domestic laws may find compliance with section 302 problematic. An examination of these countries' securities laws illustrates how foreign laws overlap or conflict with a foreign private issuer's obligations under section 302, forcing foreign issuers to re-evaluate their business practices and responsibilities under the new rules. The potential cost of compliance with Sarbanes-Oxley could prove quite burdensome for foreign issuers because of the time and capital necessary to restructure procedures and policies to reflect these new requirements. The United Kingdom and Germany present two distinct scenarios to help understand the difficulty in applying inconsistent securities laws and provide a context for advocating in favor of an exemption policy.

A. *United Kingdom: Corporate Governance and Section 302*

The United Kingdom is a prime example of a jurisdiction where the laws and the corporate governance codes virtually overlap with section 302. The corporate governance codes in the United Kingdom place heavy emphasis on financial reporting obligations.[123] The United Kingdom drafted both the Combined Code[124]

311.pdf (noting that securities practitioners refer to quarterly and annual reports as periodic reports). The term "periodic report" is not defined in Sarbanes-Oxley. *Id.* However, because the annual and quarterly reports contain financial statements, they will most likely be subject to § 906. *Id.* It should be noted that the doubt surrounding the application of § 906 does not relieve one of civil liability under § 302. *Id.* at 38. A § 302 certification is a "statement," and any materially false or misleading information may lead to liability under Rule 10b-5 or under § 18 of the Exchange Act. *Id.* at 38.

123. Holly J. Gregory & Robert T. Simmelkjaer, *Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States* (Jan. 2002), at 68-69, *available at* http://europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm (last visited Mar. 4, 2003) (copy on file with *The Transnational Lawyer*).

124. *See generally* COMMITTEE ON CORPORATE GOVERNANCE, THE COMBINED CODE (May 2000), *available at* www.ecgi.de/codes.country-documents/uk/combined_code.pdf (last visited Mar. 4, 2003) (copy on file with *The Transnational Lawyer*) (noting this corporate governace code brings together the recommendations from the earlier Cadbury Report and Greenbury Reports).

and the Turnbull Report[125] out of concern for maintaining integrity in financial reporting and boosting investor confidence.[126]

The United Kingdom, like many other European jurisdictions, enforces mandatory disclosure requirements by linking its corporate governance codes to the stock exchange listing rules.[127] For example, companies listed on the London Stock Exchange are required to take into consideration provisions of the Combined Code.[128] The Code is composed of a list of corporate governance principles and best practices.[129] The London Stock Exchange rules require each company to include in its annual report a narrative statement of how it applies the principles set out in section 1 of the Combined Code with sufficient explanation to enable shareholders to evaluate the extent to which those principles have been applied.[130] However, the London Stock Exchange operates under a "comply or explain" basis.[131] Thus, in accordance with London Stock Exchange rule 12.43.A(b), the company must state:

> whether or not it has complied throughout the accounting period with the Code provisions set out in Section 1 of the Combined Code. A company that has not complied with the Code provisions, or complied with only some of the Code provisions or complied for only part of an accounting period, must specify the Code provisions with which it has not complied, and where relevant, for what part of the period such non-compliance continued and give reasons for any non-compliance.[132]

125. *See* INTERNAL CONTROL: GUIDANCE FOR DIRECTORS ON THE COMBINED CODE (Inst. of Chartered Accountants in England & Wales ed., 1999), *at* www.ecgi.de/codes/countrydocuments/uk/turn bull.pdf [hereinafter INTERNAL CONTROL] (copy on file with *The Transnational Lawyer*) (providing general guidelines of how to comply with the Combined Code).

126. Gregory & Simmelkjaer, *supra* note 123, at 68-69, *available at* http://europa.eu.int/comm/internal _market/en/company/company/news/corp-gov-codes-rpt_en.htm.

127. *See id.* at 69 (explaining that the stock exchanges have listing rules, which are requirements within specific exchanges in order for a company to list its securities). Many of these exchanges require compliance with codes of corporate governance as a means to enforce mandatory disclosure. *Id.*

128. *Id.*

129. *See* COMMITTEE ON CORPORATE GOVERNANCE, *supra* note 124, *available at* www.ecgi.de/codes. country-documents/uk/combined_code.pdf (establishing basic principles of corporate governance).

130. Gregory & Simmelkjaer, *supra* note 123, at 69, *available at* http://europa.eu.int/comm/internal_ market/en/company/company/news/corp-gov-codes-rpt_en.htm; *see also* COMMITTEE ON CORPORATE GOVERNANCE, *supra* note 124, *available at* www.ecgi.de/codes.country-documents/ uk/combined_code.pdf (explaining that § 1 lists the obligations of companies under the code). Section 2 reflects the responsibilities of Institutional Shareholders. *Id.*

131. *See* Brian R. Cheffins, *Current Trends in Corporate Governance: Going from London to Milan via Toronto*, 10 DUKE J. COMP. & INT'L L. 5, 26 (1999) (stating that although the Combined Code does not have a statutory backing, the rules are enforced as a continuing obligation of listing on the London Stock Exchange). The United Kingdom made a decision not to rush into statutory requirements in the absence corporate scandals. *Id.* at 27-28.

132. Gregory & Simmelkjaer, *supra* note 123, at 69-70, *available at* http://europa.eu.int/comm./internal_ market/en/company/company/news/corp-gov-codes-rpt_en.htm.

The comply or explain principle was adopted as a means to encourage specific corporate governance practices without mandating actual practices.[133] However, most companies simply comply with the Combined Code's provisions in order to avoid having to explain the variance.[134]

The Combined Code requires a company to maintain a system of internal controls. Principle D.2 of the Combined Code declares that "the board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets."[135] The Turnbull Report, which provides guidance on how to comply with the Combined Code, suggests several key reasons for maintaining an effective internal control system.[136] The report explains that internal controls play a key role in managing business risks and safeguarding shareholders investments.[137] A sound system helps ensure reliable and timely compliance with laws and regulations as well as proper maintenance of accounting records.[138]

However, the SEC made a distinction between internal controls and disclosure controls and procedures.[139] The SEC explained internal controls as relating only to financial reporting, whereas disclosure controls and procedures addresses quality and timeliness of disclosure.[140] The Turnbull Report implicitly combines the aspects of disclosure controls and internal controls into its concept of internal controls.[141] The report characterizes the elements necessary for a sound system of internal controls as ones that enhance the quality, timeliness, and accuracy of financial reporting.[142] For example, the Combined Code provides such elements should include procedures for enhancing the maintenance of records to facilitate timely reporting with applicable laws and improving communication and information processes.[143] Thus, it appears that compliance with the Combined Code's internal control suggestions achieves the same basic goal of quality and timeliness of disclosure as the SEC's interpretation of disclosure controls and procedures.

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133. *See id.* at 69 (explaining that many companies also comply with the Code's provisions because investors may not agree with the justifications for deviating from the Code's provisions).

134. *Id.*

135. *See* COMMITTEE ON CORPORATE GOVERNANCE, *supra* note 124, § D.2, *available at* www.ecgi.de/codes.country-documents/uk/combined_code.pdf (establishing basic principles of corporate governance). The review should cover all controls, including financial, operational and compliance controls, and risk management. *Id.*

136. INTERNAL CONTROL, *supra* note 125, at 4, *available at* www.ecgi.de/codes/countrydocuments/uk/turnbull.pdf (providing general guidelines of how to comply with the Combined Code).

137. *Id.*

138. *Id.*

139. *See* discussion *supra* Part II.B.1 (explaining the difference between internal controls and disclosure controls and procedures).

140. *Id.*

141. *See* INTERNAL CONTROL, *supra* note 125, at 4, *available at* www.ecgi.de/codes/countrydocuments/uk/turnbull.pdf (explaining in paragraphs 10 through 12 the elements of internal controls). Those elements include timeliness, quality, and financial aspects of reporting. *Id.*

142. *See id.* at paras. 20-24 (listing the essential elements of a sound internal control system). Paragraphs 25 to 34 detail the procedures that should be utilized when performing a review of the effectiveness of these controls. *Id.*

143. *See id.* at 7 (citing financial considerations that should be included as well).

Sections of the Combined Code also address SEC concerns about an executive's duty to participate in the disclosure procedure. Sections 16 through 18 of the report explain that it is the role of the company's directors to design, maintain, review, and implement a system of internal controls.[144] For example, the report provides that the board of directors should formulate the internal controls policies while management implements and maintains the policies in whatever form the company chooses.[145] This practice parallels the SEC's discussion of executive certification of disclosure controls and procedures.[146] The SEC only imposed the certification requirement because it wants executives to participate in the design and implementation of disclosure procedures.[147] That goal is accomplished under the Combined Code because the Code requires the board of directors and management to design and maintain such procedures.[148]

In addition to the Combined Code, the United Kingdom maintains certain statutory requirements. The Companies Act of 1985 is the main source of corporate law, and it applies to all companies incorporated in England and Wales whether listed on the London Stock Exchange or not.[149] The Combined Code is relevant because several provisions parallel portions of section 302. For example, this Act requires that a company's annual accounts give a true and fair view of the state of affairs of the company at the end of each financial year.[150] This section is not unlike the financial reporting requirements of section 302 dealing with fair presentation.[151] Furthermore, the Act provides that the board of directors must approve the company's accounts and that the name of each person signing the accounts must be listed.[152] If the board approves annual accounts that do not comply with the requirements of the Act, every director of the company who is a party to the approval and knows that the accounts do not comply or is reckless as to whether the account complies may be guilty of an offense[153] and liable for a

144. *See id.* at paras. 16-18 (suggesting the board take into account appropriate policies to assure that the system is functioning correctly in order to reduce the company's risk).

145. *Id.*

146. *See* discussion *supra* Part II.B (discussing SEC concerns that the certification requirement was being imposed to force executives to participate in the process and boost investor confidence in management).

147. *Id.*

148. *See* INTERNAL CONTROL, *supra* note 125, at 6, *available at* www.ecgi.de/codes/countrydocuments/uk/turnbull.pdf (emphasizing that the board is responsible for establishing appropriate policies and seeking regular assurance that the system functions effectively).

149. *See* Letter from Peter Maynard, Group Legal Services Director, Prudential plc. to Jonathan Katz, Secretary, Securities Exchange Commission 2 (Aug. 19, 2002), *at* http://www.sec.gov/rules/proposed/s72102/pmaynard1.htm [hereinafter Maynard Letter] (copy on file with *The Transnational Lawyer*) (explaining briefly what is required under the Companies Act).

150. *Id.*

151. *See* discussion *supra* Part II.B.1 (discussing reporting requirements under the fair presentation clause of § 302). The discussion also addresses the SEC's view that foreign companies using International Accounting Standards should still be able to address fair presentation adequately because of the interpretation attached to the term. *Id.*

152. Companies Act, 1985, c. 6, § 234 (Eng.).

153. *Id.*

fine.[154] There is an exhaustive list of over two hundred offenses and penalties if the company fails to comply with any portion of the directors' report.[155]

In addition to the Companies Act, other penalties are available and may be imposed under U.K. law. The Financial Services and Markets Act of 2000 provides that the U.K. Listing Authority may fine or publicly censure any director who was knowingly involved in any breach of the London Stock Exchange's listing rules.[156] Specifically, U.K. listing rule 16.2 requires a company to ensure that its directors take full responsibility, collectively and individually, for the company's compliance with the listing rules.[157] The censure provisions of this Act supplement the penalties that may be imposed under the Companies Act if directors fail to act responsibly. These provisions, like section 906 of Sarbanes-Oxley, are designed to pressure executives to be truthful and disclose all material information to investors.

British companies listed on the London Stock Exchange are bound to comply not only with the statutory requirements of the Companies Act, but also with those of the Combined Code. The Turnbull Report's analysis of the Combined Code illustrates that its provisions overlap, if not parallel, section 302 requirements as interpreted by the SEC. Imposing the requirements of section 302 on British companies would require those issuers to comply with two systems of disclosure that are essentially the same. If the U.K. system achieves the same policy goals of heightening disclosure and enhancing investor protection, forcing those issuers to shoulder the expense of modifying its procedures to effectively comply with both systems is a heavy burden.[158]

B. Germany: Corporate Governance and Section 302

For German companies, where the laws of its jurisdiction do not closely parallel the U.S. system, compliance may impose an even heavier burden than those companies in systems like the United Kingdom. For this reason, German companies have been some of the most vocal opponents to the SEC rules.[159] The argument from German companies has focused on differences in corporate structure.[160] German companies maintain a two-tiered board structure comprised

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154. *See generally id.* (providing for over 200 offenses and their corresponding punishments).

155. *Id.*

156. *See* Financial Services and Markets Act 2000, (2001) SI 2957, § 11 (Eng.) (providing examples of the many censure sections contained in the Act).

157. *See* Maynard Letter, *supra* note 149, at 2, *at* http://www.sec.gov/rules/proposed/s72102/pmaynard1.htm (reiterating that under the listing rules a company must take all reasonable care to ensure that none of the information provided is misleading, false or deceptive, making it subject to various penalties).

158. *See* Michael Hughes, *Some Devil in the Detail: Businesses Could Be Underestimating Their Responsibilities on the Need for Internal Controls Under the Sarbanes-Oxley Act*, FIN. TIMES, Feb. 27, 2003, at 2 (reporting that the review of internal control procedures is actually quite burdensome for U.K companies).

159. *See* Landler, *supra* note 27 (reporting that German companies are reconsidering whether to list in New York).

160. *See* Letter from Cleary, Gottlieb, Steen & Hamilton to Jonathan Katz, Secretary, Securities Exchange Commission (Aug. 19, 2002), *at* www.sec.gov/rules/proposed/s72102/cleary1.htm [hereinafter

of a management board and a supervisory board.[161] This is very different from the U.S. system where the CEO is perceived as being the head of the corporation.[162]

Under German law, the management board is responsible for managing the business and its members are jointly accountable.[163] It is the Board's role to lead the company and perform the day-to-day decision-making.[164] The supervisory board appoints, supervises and advises the members of the management board.[165] The supervisory board has no managerial function, however, it performs the important role of serving as a check on the power of the management board.[166] According to opponents of the SEC rules, the differences in management structure make compliance difficult. Opponents argue that the management board more closely resembles a U.S. company's board of directors and there are no members that fit the U.S. model of a CEO and CFO.[167] However, there are indications that German companies are willing to comply with section 302 despite potential differences in the corporate structure. Siemens, a U.S. listed German corporation, recently filed its Form 20-F and had it signed on behalf of the company's chief executive and financial director.[168] Theodor Baums, a leading German Scholar, suggested that the initial concern surrounding section 302 was that it would contradict the German principle of collective responsibility.[169] According to Mr. Baums, in practice there does not appear to be as much conflict as Siemens recently demonstrated.[170] Thus, it appears that the two-tiered board system is not a major obstacle to compliance with section 302.

Cleary Letter] (copy on file with *Transnational Lawyer*) (arguing that the United States should defer to German law because some of Sarbanes-Oxley is inconsistent with German law).

161. *Id.*

162. *See id.* at 2 (arguing that the focus of the rules is on the CEO and CFO as the ultimate stewards of disclosure procedures). According to opponents, this particular methodology is not how German corporations function. *Id*

163. *See* GERMAN CORPORATE GOVERNANCE CODE, Feb. 26, 2002, at 1, *available at* www.ecgi.de/codes.country_documents/germany/corgov_endfassung_e.pdf [hereinafter CROMME CODE] (copy on file with *The Transnational Lawyer*).

164. *See* Gregory & Simmelkjaer, *supra* note 123, at 45, *available at* http://europa.eu.int/comm./internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm (citing the Berlin Initiative Code Thesis 6). The report also explains the differences in two-tiered systems across Europe. *Id.*

165. *Id.*

166. *Id.*

167. *See* Cleary Letter, *supra* note 160, at 2, *at* www.sec.gov/rules/proposed/s72102/cleary1.htm (arguing that the German Stock Corporation Act imposes duties on all the members of the management board, and it would be inappropriate to require specific members of the management board to shoulder the responsibility of potential criminal liability).

168. Bertrand Benoit, *German Companies Upbeat on U.S. Rules*, FIN. TIMES (London), Dec. 27, 2002, at 27 (reporting that Siemens' position is contrary to the position taken by Germany's main industrial federation). According to Siemens, both de-listing and breaking German law are out of the question. *Id.* Siemens is confident that a compromise can eventually be reached. *Id.*

169. *Id.*

170. *Id.* (noting that Siemens' decision to file Form 20-F set a precedent that would make it difficult for other German companies to argue against Sarbanes-Oxley in coming years).

The real difficulty between U.S. and German law is that section 302(a)(5) requires the executive to report on internal controls to an audit committee that is independent according to U.S. standards.[171] However, German management boards do not have independent members.[172] The role independent members of the audit committee perform in the U.S. system is instead within the functions of the German supervisory board.[173] Accordingly, without some concessions, it appears that it would be impossible for an executive to certify that all the necessary disclosures have been made to the issuers audit committee because compliance with section 302 would require a company to violate German law. German companies should not be expected to violate their own law to comply with the requirements of section 302, and the SEC must take this conflict into consideration in adopting an exemption policy.

IV. STRUGGLE FOR EXEMPTIONS: THE EQUIVALENCE TEST

International concerns about the application of section 302 to foreign private issuers should be addressed by the SEC through the adoption of an exemption policy that parallels the Commission's tradition of deference to foreign laws and regulations in the area of internal domestic corporate law.[174] If the SEC fails to grant provision specific exemptions to foreign issuers, it could result in companies deciding not to list their stock on the U.S. national exchanges.[175] This could prove disastrous for the United States. In 2001, the total worldwide market capitalization of non-U.S. companies listed on the New York Stock Exchange was $4.9 trillion.[176] European stocks accounted for over thirty-eight percent of all non-U.S. trading.[177]

In recent months, the London Stock Exchange has been aggressively exploiting international concerns surrounding Sarbanes-Oxley by highlighting troublesome areas and encouraging companies to list in London rather than in

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171. *See* Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C. § 7241 (2003) (indicating that § 302(a)(5) requires that the certifying officer disclose information to the issuer's auditors and the audit committee); *see also* Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1 (2002) (mandating that audit committee members are supposed to be independent as defined by § 301). To be considered independent, a member of the audit committee cannot be a member of any other board or committee. *Id.* In addition, the members cannot be paid for any other work done for the issuer. *Id.*

172. Cleary Letter, *supra* note 160, *at* www.sec.gov/rules/proposed/s72102/cleary1.htm.

173. *Id.*

174. *See* Maynard Letter, *supra* note 149, at 1, *at* http://www.sec.gov/rules/proposed/s72102/pmaynard1.htm (last visited Mar. 4, 2003) (copy on file with *The Transnational Lawyer*) (noting the SEC's traditional deferential policy toward foreign laws).

175. *See* Andrew Jack & Andrei Postelnicu, *Russian Group to Switch to U.K. Listing*, FIN. TIMES, Mar. 3, 2003, at 28 (noting that Uralsvyazinform, a Russian telecommunications company, is likely to switch its international listing from New York to London). The company cites the rising cost of listing in New York because of Sarbanes-Oxley as its reason for considering London. *Id.*

176. *See* New York Stock Exchange, International Information, *available at* www.nyse.com/pdfs/2001_factbook_07.pdf (last visited Mar. 4, 2003) (copy on file with *Transnational Lawyer*) (noting that 174 European companies combined for a market capitalization of $3.4 trillion).

177. *Id.* at 65.

New York.[178] Asian multinationals and European Technology firms are among the first to consider a London-only listing and are prepared to forego a New York listing.[179] Further aggravating the situation, the recent SEC proposal of a listing ban of companies failing to meet the audit committee requirements is likely to increase frustration for those foreign issuers that cannot meet the audit committee requirements.[180] The New York Stock Exchange is so alarmed about the impact Sarbanes-Oxley will have on foreign listings that its chairman has been pressing for exemptions.[181] The concern is that the recent trend toward moving away from U.S. markets will not be temporary and companies will continue to choose other stock exchanges over New York.[182] The chairman of the London Stock Exchange, Mr. Cruickshank, believes that many companies find the U.S. capital markets to be too domestic and unwilling to work with foreign issuers.[183] A recent example is the Benfield Group, a U.K. corporation, who announced that it is listing on the London Exchange for its initial public offering rather than the New York Exchange because of the uncertain environment created by the passage of Sarbanes-Oxley.[184] The heightened disclosure requirements and tough criminal penalties created by the Act place a burden on many foreign private issuers, prompting them to seek alternative markets for their shares. It is in the United States' best interests to explore alternatives to requiring compliance with section 302.

A. The Equivalence Test: A Balancing of Factors

One approach to granting exemptions is the adoption of the Equivalence Test. This test is a balancing approach that gives the SEC discretion in granting exemptions based on three major considerations: overlapping requirements, the nature and character of conflicting requirements, and the extent of the burden on the issuer. This balancing approach will allow the SEC to consider whether a foreign issuer is providing acceptable levels of disclosure and maintaining adequate internal control procedures. Once the SEC has determined that an issuer

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178. Lenore Taylor London, *Sarbanes-Oxley Gives UK an Edge*, AUSTL. FIN. REV., Dec. 24, 2002, at 13 (stating that the London Stock Exchange is encouraging Australian companies to list in London rather than in New York).

179. Vincent Boland & Andrei Postelnicu, *NYSE Fears Loss of Foreign Listings*, FIN. TIMES (London), Dec. 5, 2002, at 16.

180. Vincent Boland, *SEC to Ponder Listing Ban Idea*, FIN. TIMES (London), Jan. 2, 2003, at 13 (reporting that such a move would have a massive impact on the ability of foreign companies to list their securities on the U.S. exchanges).

181. Boland & Postelnicu, *supra* note 179, at 16 (stating that Sarbanes-Oxley has created an unattractive environment in the United States).

182. Vincent Boland & Andrei Postelnicu, *LSE Hopes to Take Business from New York*, FIN. TIMES (London), Dec. 5, 2002, at 21 (reiterating that the NYSE is concerned that if the SEC does not grant exemptions, the London Stock Exchange will pull business from New York).

183. *Id.*

184. Andrew Bolger, *Benfield Chooses London for IPO*, FIN. TIMES (London), Nov. 29, 2002, at 24 (stating that Benfield Group is a U.K.-based reinsurance broker). Benfield's choice to list in London rather than in New York was motivated by the cost and uncertainty caused by regulatory changes in the United States. *Id.*

provides adequate levels of disclosure when balanced with these three considerations, an issuer should expect the SEC to grant an exemption from strict compliance with section 302.

The first consideration is the extent the issuer's domestic laws overlap with the requirements of section 302. To satisfy this prong, an issuer must be able to demonstrate that its country's domestic laws and codes either mirror or are substantially similar to the requirements or policies of section 302. An issuer can demonstrate similarities in substantive law by proving that its jurisdiction requires, for example, procedures for maintaining internal controls and executive accountability. An example of a jurisdiction that has overlapping requirements is the United Kingdom.[185] However, merely stating that a country's corporate governance code requires the maintenance of internal controls may not be sufficient,[186] especially in those countries where the corporate governance codes and laws provide for only minimal disclosure.[187] For the Commission to fully consider an exemption request, a company should provide a statement of how its internal control procedures function. Evaluation of this statement will allow the SEC to consider whether the company's internal controls are sufficiently similar to what section 302 contemplates.

Second, the SEC should consider whether certain provisions of section 302 materially conflict with a jurisdiction's laws or practices. Section 302 is predicated on an American management structure that may be inapposite in other countries.[188] However, the provisions must materially conflict, making compliance impossible or extremely difficult. For example, it would be impossible for German companies to certify that it has reported on its internal controls to an independent audit committee as required by section 302 because it would violate German law.[189] Situations such as this create real issues for foreign issuers and are sufficiently material.

Criminal liability for any false certification raises concerns as well. There exists the potential for criminal liability in both the United States and an issuer's

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185. *See* discussion *supra* Part III.A (discussing the overlapping requirements of U.K. companies). This is a good example of the type of information that an issuer should demonstrate to the SEC. *Id.*

186. *See* Gregory & Simmelkjaer, *supra* note 123, at 68, *available at* http://europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm (noting that general principles of corporate governance is not a "one size fits all" situation). Companies apply principles of corporate governance according to the company's size, culture, organization, and many other factors. *Id.* Many of these principles are not mandatory, but are merely a supplement to various jurisdictions' company and securities laws and stock exchange listing rules. *Id.* Many of the laws require only minimum levels of disclosure and rely on the issuer to provide additional information. *Id.*

187. *Id.*

188. *See* Cleary Letter, *supra* note 160, *at* www.sec.gov/rules/proposed/s72102/cleary1.htm (noting that the certification requirement focuses on the CEO and CFO as the persons ultimately responsible for internal controls, whereas for companies that maintain a two-tier system the counterpart to those U.S. roles may not exist).

189. *See* discussion *supra* Part III.B (discussing the role of the German supervisory board for auditing duties and German conflicts with § 302); *see also* Gregory & Simmelkjaer, *supra* note 123, at 44, *available at* http://www.europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm (noting those countries that maintain a two-tiered system).

jurisdiction.[190] However, strong penalties for corporate irresponsibility was an important addition to Sarbanes-Oxley.[191] Thus, an issuer should be able to demonstrate that its country has strong penalties for false statements and that the issuer would be liable in both jurisdictions for the same offence.

Finally, the SEC should consider the burdens that compliance with section 302 places on an issuer. The most common burden is the cost of complying with Sarbanes-Oxley. The uncertainty surrounding the application and compliance with new corporate governance and accountancy standards has the potential to send legal fees through the ceiling.[192] Other costs may be associated with the restructuring of a company's reporting process.[193] Management will have to engage in a rigorous evaluation of existing procedures, and then move on to implementing new procedures.[194] This will most likely entail a complete overhaul of the financial controls, which then must be communicated throughout the business and properly documented.[195] The cost implications for large multinationals are boundless and may force an issuer to reconsider its New York listing.[196] In order to accommodate foreign issuers without sacrificing investor protection, the SEC must seriously consider granting exemptions or run the risk of forcing foreign issuers to forego a New York listing.

B. Policy Rationale

The Equivalence Test is based upon the rationale that exemptions would only be granted if the laws of a foreign jurisdiction when combined with the issuer's own actions advance similar public policy goals to those in section 302.[197] The

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190. *See* Knechtle Letter, *supra* note 74, *at* http://www.sec.gov/rules/proposed/s72102/aknechtle1.htm (noting that it is possible that one could be liable under both U.S. and Swiss law for the same behavior). Arguing that holding a person liable twice for the same offense violates settled principles of international law. *Id.*

191. *See* BENNETT & ROBINSON, *supra* note 33, at 9-10, *available at* www.cov.com/publications/311.pdf (noting that after the collapse of Enron, investor outrage prompted a renewed effort to try executive certification with appropriate penalties as a means to ensure that companies do not make false statements). Former SEC Chairman Pitt stated that he was outraged after WorldCom made a $4 billion restatement and was determined to ensure that investors' financial statements are reliable. *Id.* at 11-12.

192. *See* Bolger, *supra* note 184, at 24 (citing the Benfield Group's concerns that the new regulatory environment would have inevitable cost implications); *see also* discussion *supra* Part II.B-C (discussing the requirements of the new rules and the uncertainty surrounding the application of § 906). *See generally* Richard A. Rosen & Daniel J. Kramer, *Litigation Implications of the Sarbanes-Oxley Act: An Analysis of the Key Issues*, SH097 ALI-ABA 115 (Dec. 5, 2002) (discussing the Act's impact on litigation).

193. *See* Hughes, *supra* note 158, at 2 (reporting that the review of internal control procedures is actually quite burdensome for U.K companies).

194. *Id.*

195. *Id.*; *see also* Jonathan Peterson, *Companies Blazing a Paper Trail to Comply with New SEC Rules; Mandate to Certify Financial Data Shakes up Longtime Business Practices at Many Firms*, L.A. TIMES, Feb. 24, 2003, at B1 (emphasizing that firms do not agree with the SEC's estimate that the increased disclosure requirements would add five hours of company time each quarter). Firms estimate that the time required is at least one hundred times larger than the SEC's estimated time. *Id.*

196. *See* Hughes, *supra* note 158, at 2 (explaining that auditors for these large businesses will want to meticulously review all the company's procedures, translating into increased costs).

197. *See* Maynard Letter, *supra* note 149, *at* http://www.sec.gov/rules/proposed/s72102/ pmaynard1.htm

ultimate goal in using an Equivalence Test would be to avoid imposing the requirements of section 302 when doing so would clearly require a foreign issuer to comply with unnecessarily overlapping or conflicting and burdensome requirements.[198]

Exemptions based on an Equivalence Test should be issuer specific. Exemptions should not be granted to all companies in a specific foreign jurisdiction because companies within a jurisdiction may have different levels of disclosure if the codes provide for minimal disclosure and rely on the issuer to volunteer any additional information.[199] For example, the London Stock Exchange operates on a comply or explain basis with regard to the corporate governance provisions of the Combined Code.[200]

Furthermore, the burden should be placed on the issuer to demonstrate that it should be granted an exemption. Despite a seventy-seven percent spending increase for the SEC, the Commission is struggling to maintain an adequate staff in its enforcement and compliance divisions and the Commission could not reasonably be expected to seek out candidates for exemptions or perform extensive research.[201] Placing the burden on a foreign entity to demonstrate that it meets any requirements for special treatment has been applied in other areas of the law and is not a new concept.[202] Thus, the commission should take into consideration the Equivalence Test and its policy rtionale to immediately grant relief to foreign issuers before they choose to separate themselves from the U.S. markets.

V. CONCLUSION

Requiring foreign issuers to comply with the new regulations may cause problems because these regulations are either overlapping or conflicting and may place a heavy financial burden on the issuer to adopt new procedures to ensure compliance. The SEC has throughout its history traditionally accommodated foreign issuers within the area of internal corporate governance. After the

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(establishing the basic proposition that if a finding can be made that a foreign private issuer's home jurisdiction has safeguards that are sufficiently similar from a public policy perspective to those advanced in § 302, the home country's safeguards should be considered sufficient for purposes of § 302). Additionally, the United States should provide similar relief from criminal liability under § 906. *Id.*

198. *See id.* (arguing that it would not prove useful to compel U.S.-listed British companies to satisfy differently worded but overlapping tests). To do so would only foster confusion and place an additional burden on the issuer. *Id.*

199. *See* Gregory & Simmelkjaer, *supra* note 123, at 68-69, *available at* http://europa.eu.int/comm./internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm (noting that the jurisdictions relying on additional voluntary disclosure do so because it is believed that the marketplace will encourage disclosure). The argument is that a company will appear less attractive to investors if it fails to provide additional disclosure. *Id.*

200. *See id.* at 69-70 (explaining that the companies listed on the London Stock Exchange must comply with the Combined Code or explain which provisions have not been complied with and why).

201. *See* Stephen Labaton, *In Stormy Time, SEC Is Facing Deeper Trouble*, N.Y. TIMES, Dec. 1, 2002, at 1 (explaining that budget and staffing difficulties threaten to undermine the effectiveness of the SEC).

202. *See* 12 U.S.C. § 1842(c)(3)(a) (2001) (requiring bank holding companies to provide all of the necessary information for special treatment).

collapse of Enron and WorldCom, the political and social fallout from massive corporate irresponsibility may have forced the SEC to abandon its traditional deference to foreign laws. The SEC is now realizing that abandonment of its deferential policies has led the international business community to reconsider listing their securities on the New York Stock Exchange. Foreign securities constitute a large portion of the stocks traded in the United States, and the SEC should consider granting foreign issuers exemptions to maintain the continued vitality of foreign trading in the United States. The United Kingdom and Germany are just two examples of jurisdictions where foreign issuers find compliance with section 302 problematic. Thus, the SEC should adopt an Equivalence Test that takes into consideration the level of investor protection provided by a foreign jurisdiction's laws. This can be achieved by examining any overlapping or conflicting requirements with section 302 and the extent of the compliance burden on the foreign issuer. This balancing approach should provide the SEC with a reasonable and principled approach to granting exemptions to foreign issuers.

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