

COMING HOME TO ROOST: OFFSHORE OPERATIONS FROM AN IN-HOUSE PERSPECTIVE

Gwendolyn Yvonne Alexis
Monmouth University, United States

Abstract

Greatly aided by an information age in which protesting laborers in a remote offshore outpost can capture front page headlines around the globe, the Sarbanes-Oxley Act of 2002 (SARBOX) has made corporate transparency the linchpin for good corporate governance. Under a SARBOX-enhanced regulatory framework, publicly traded corporations are required to rapidly disclose material changes in their financial conditions or operations—changes such as impairments to goodwill, a trademark, or some other intangible corporate asset. Especially challenging for multinational corporations (MNCs) with far-flung corporate empires is the need to stay abreast of the ebb and flow of goodwill, at a time when transnational human rights groups are aggressively mobilizing world opinion against the sweatshop labor conditions that abound at the offshore production sites favored by MNCs. The author explains why the convergence of a digital age of free-flowing information and the advent of SARBOX, a legislative enactment of paraenetic design, is causing the boards of MNCs to more critically evaluate the long-term costs of their offshore operations.

Introduction: New Standards for Monitoring Goodwill

Previous standards provided little guidance about how to determine and measure goodwill impairment. . . . This Statement [SFAS 142] provides specific guidance for testing goodwill for impairment. Goodwill will be tested for impairment at least annually using a two-step process that begins with an estimation of the fair value of a reporting unit. The first step is a screen for potential impairment, and the second step measures the amount of impairment, if any.¹

Since SFAS 142 took effect in the United States at the beginning of 2002, multinational corporations (MNCs) with far-flung corporate empires have found it to be a more exacting task to produce consolidated financial statements that portray the full impact of subsidiary operations on the corporation's overall financial picture. Before SFAS 142, companies followed a practice of simply amortizing the portion of a unit's purchase price that was designated as attributable to goodwill at

the time of acquisition. Most companies used a forty-year period to write off the goodwill investment as that was the maximum allowable amortization period under the pre-SFAS 142 standard. However, with SFAS 142, the Financial Accounting Standards Board (FASB) effectively discredited the notion that goodwill declines at a steady and predictable pace.

Goodwill is now presumed to have an indefinite lifespan, which means annual tests must be conducted to determine whether or not a subsidiary's goodwill has declined since the last reporting period. Moreover, an MNC with publicly traded stock may find itself in a situation where it cannot wait until its next scheduled (quarterly or annual) report to disclose the impairment of a subsidiary's goodwill. The U.S. Sarbanes-Oxley Act of 2002²—an Act aimed at increasing corporate transparency—calls for real-time disclosure of significant corporate events deemed relevant to making informed investment decisions (decisions about whether to purchase or continue to hold a company's stock). Section 409 of SARBOX amended the Securities Exchange Act of 1934 ("Exchange Act") to add the following provision:

(1) REAL TIME ISSUER DISCLOSURES. [Each publicly traded company] shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission [SEC] determines, by rule is necessary or useful for the protection of investors and in the public interest.³

In compliance with this SARBOX mandate, the U.S. Securities and Exchange Commission (SEC) expanded the number of events that must be immediately disclosed to the investing public on the Form 8-K—the "current report" that must be filed with the SEC *within four days* of the occurrence of an event likely to have a material impact upon a company's financial condition.⁴ All of the new Form 8-K items dealt with "material impairments," and impairment of goodwill was specifically named as an example of a material impairment that would trigger the need to file a Form 8-K with the SEC. Thus, like SFAS 142, SARBOX requires parent companies to actively monitor the goodwill of their subsidiary units. And, in the case of MNCs with offshore facilities, this entails keeping a close watch on whether these plants are being operated in a socially responsible manner—both with respect to the indigenous labor force and in terms of shepherding the natural environment of the host country.

The SEC Release issued in connection with the amendment of Form 8-K left no doubt that it is the board of directors who bears the brunt of responsibility for ascertaining that consolidated financial statements disclose material impairment of company assets, both tangible and intangible assets, such as goodwill.⁵ Thus, corporate boards are charged with overseeing a reporting process that SARBOX has made more rigorous by requiring greater corporate transparency. The fact that the board will be held accountable for financial statements that fail to adequately disclose the risk to long-term profitability of business strategies that reap short-

term profits will likely embolden boards to become involved at an early point in the managerial decision-making process for certain types of corporate ventures.

As an example, establishment of an offshore production facility is the type of risky venture that the board of an MNC might want to be brought in on relatively early in the exploration stage, before any corporate resources have been committed. Indeed, the fact that non-governmental organizations (NGOs) can now utilize U.S. federal courts to mount class action lawsuits against MNCs by alleging human rights abuses in their offshore plants makes it incumbent upon the prudent board to become involved from the outset when outsourcing is being considered.⁶

With these introductory remarks out of the way, it is time to turn to the body of evidence that supports the central thesis of this paper; namely, that SARBOX is forcing corporate boards, especially the boards of MNCs, to assume a more activist stance vis-à-vis management. SARBOX offers strong motivation for corporate boards to overcome their demonstrated reluctance to second-guess management. And, in light of the recent spate of corporate scandals, there is reason to believe that a board actively engaged in the managerial decision-making process is in a better position to fulfill its fiduciary obligations to the shareholders of the company.

From Lapdog to Watchdog: The Post-SARBOX Corporate Board

The Effects of Globalization

Keeping tabs on the ebb and flow of corporate goodwill is no easy task today. Yet, this daunting responsibility is squarely on the shoulders of the post-SARBOX corporate board, although many of its members will be outside directors without the benefit of day-to-day exposure to the business operations of the company. Goodwill is a highly volatile asset in this digital age when with the click of a mouse, news of protesting laborers in a small Asian outpost can be simultaneously transmitted around the globe. MNCs with high-name recognition are most vulnerable to the ephemeral nature of a favorable public image. Their subsidiary operations can have a devastating effect on overall brand image and, consequently, wreck havoc on the bottom line. As an example, in its 2005 Annual Report, Coca-Cola took note of the fact that continued impairments to goodwill on the order of those that it experienced during 2004 and 2005 could result in a reduction of the future earnings:

We assess our goodwill, trademarks and other intangible assets and our long-lived assets as and when required by generally accepted accounting principles in the United States to determine whether they are impaired. In 2005, we recorded impairment charges of approximately \$89 million related to our operations and investments in the Philippines, while in 2004 we recorded impairment charges of approximately \$374 million. . . . Additional impairment charges would reduce our reported earnings for the periods in which they are recorded.⁷

Unnerving current shareholders and scaring off potential investors by issuing financial statements that warn of a possible drop in future earnings due to impairment of goodwill is not something that a corporation does eagerly. However, SARBOX

has made the stakes too high for a company to do otherwise than to issue financial statements that accurately portray its financial standing and clearly set forth the palpable risks to which its investors will be exposed.

SARBOX-Enhanced Criminal Sanctions

Section 807 of SARBOX amends the United States Code to make “securities fraud” a federal crime that is punishable by fine and/or imprisonment for up to 25 years.⁸ Although in the past, few top-level executives “signing off” on corporate financial statements paused to consider whether they were putting themselves at risk for charges of securities fraud, SARBOX makes it prudent for anyone in the position of vouching for the accuracy of a financial report to consider the possibility of being held criminally liable if the reports are subsequently found to contain inaccurate or misleading information. Alas, *securities fraud* does not require *scienter*. It is committed when one endorses company financial statements that contain material misstatements or omissions of fact that induce members of the public to purchase a company’s stock or—as was the case with Enron—convinces current stockholders to continue holding a company’s stock. It is the Office of the U.S. Attorney that institutes a criminal action in federal court to prosecute violators of the criminal laws set forth in the U.S. Code. By contrast, the SEC enforcement actions do not take place in a court, but are administrative proceedings—civil regulatory matters.

SARBOX contains two additional provisions that enhance the criminal sanctions that can be brought against directors and officers of a corporation. Section 1104 instructs the U.S. Sentencing Commission to, “expeditiously consider the promulgation of new sentencing guidelines or amendments to provide an enhancement for *officers or directors* of publicly traded corporations who commit fraud and related offenses” (emphasis added). Section 905 of SARBOX, which is subtitled the, “White-Collar Crime Penalty Enhancement Act of 2002,” directs the U.S. Sentencing Commission to review and amend, where appropriate, the sentencing guidelines for white-collar crimes.

Responding to the mandates in sections 905 and 1104, the U.S. Sentencing Commission significantly increased the penalties applicable to corporate officers and directors, in particular, and to white-collar offenders in general. The jubilant news release issued by the U.S. Sentencing Commission in this regard leaves no doubt that members of the board of directors are vulnerable to the enhanced sanctions:

I am happy that the Commission was able to respond so promptly to the concerns of Congress, said Judge Diana E. Murphy, the Commission’s Chair. The U.S. Sentencing Commission is doing its part in the fight against corporate fraud. The penalty increases that we approved today send a message to those who would commit securities, accounting, and pension frauds that our country will not tolerate this behavior. Officers and directors of public corporations are also on notice.⁹

Checks and Balances under SARBOX

Fueled by the outrage of a public that demanded a corporate bloodletting, the 107th Congress convened in January 2002 determined to breathe new life into the Exchange Act—a statute enacted after the Stock Market Crash of 1929 and revealing its age by its inability to stem the wave of corporate scandals that were making headlines on a daily basis as Congress set about its work. Although the Act produced by the 107th Congress provides for criminal sanctions, criminalizing acts that more often than not are a result of negligence rather than criminal mischief is not the primary purpose of this historic piece of legislation. Indeed, the preamble to SARBOX identifies it as an Act to “protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.”¹⁰ In keeping with this objective, SARBOX ensures that the maximum number of individuals in the upper echelons of the corporate hierarchy have some part in reviewing corporate financial reports before they are released into the public domain.

This system of checks and balances is accomplished by way of the SEC rule-making power.¹¹ As an example, section 302 of SARBOX directs the SEC to enact rules requiring the principal executive officer(s) and the principal financial officer(s) to attest to the truth of their company’s quarterly and annual reports, and further to certify that the contents of the financial reports have been disclosed to the *audit committee* of the board of directors. In keeping with the central role of the top echelon of the corporate hierarchy in the checks and balances schema of SARBOX, section 1105 of the Statute gives the SEC authority to prevent persons of questionable ethics from serving as officers or directors of publicly traded corporations. Mores specifically, the section amends the Exchange Act to grant authority to the SEC to prohibit persons who have violated the securities laws from serving as an officer or director of a listed company with publicly traded stock.

Finally, section 305 of SARBOX tightened up the provision of the Exchange Act that gives the courts authority to prohibit certain securities laws offenders from serving on corporate boards. Prior to the amendment, the Exchange Act provided that where a court determined that an individual had violated the securities laws, it could prohibit that person from serving as an officer or director of a listed company where the individual’s conduct demonstrated “*substantial* unfitness to serve as an officer or director.”¹² This forgiving standard for fitness is changed by section 305, which amends the Exchange Act to replace “substantial unfitness” with “unfitness,” thereby assuring that any degree of unfitness, whether substantial or not, renders a person unqualified to serve as an officer or director of a publicly traded corporation.

The Board Audit Committee

The term “audit committee” means . . . a committee (or equivalent body) established by and amongst the board of directors of an issuer [of publicly traded stock] for the purpose of overseeing the accounting and financial reporting processes of the issuer. (SARBOX, section 2, Definitions)

Incorporated into the foregoing definition of *audit committee* is a presumption that each corporate board will appoint an audit committee to serve as an internal corporate watchdog that oversees a company's financial reporting process. Leaving no doubt that the board's oversight function is obligatory, SARBOX provides that the entire board shall constitute the audit committee where a board fails to form such a committee.¹³ Nonetheless, when a board forms an audit committee, only outside directors may serve on the committee. The advantage of this requirement in terms of maintaining a system of checks and balances is evident.

Further, in respect to the makeup of the audit committee, section 407 of SARBOX requires a company to disclose in its periodic financial reports whether or not there is a financial expert on the audit committee. If there is no such financial expert on the audit committee, then a company must disclose the reasons why one has not been appointed. Section 407 defines a "financial expert" as someone with "an understanding of generally accepted accounting principles and financial statements." With this *de facto* requirement that the audit committee have a financial expert among its members, it is clear that where there are found to be material misrepresentations or omissions in a company's financial statements, the board of directors will be held accountable. However, there is strong indication that the board is not just another link in the system of checks and balances, but the ultimate "fall guy" if the system of checks and balances fails to root out misleading or downright fraudulent financial statements.

The Board as Governing Authority

1. Definitions—For purposes of this guideline: . . . "Governing authority" means the (A) the Board of Directors; or (B) if the organization does not have a Board of Directors, the highest-level governing body of the organization.¹⁴

This Federal Sentencing Guideline was added in response to section 805 of SARBOX which directs the U.S. Sentencing Commission to review the sentencing guidelines for organizations (corporate entities) for the purpose of making any amendments deemed necessary to increase their deterrent effect.¹⁵ Titled "Effective Compliance and Ethics Program," guideline §8B.2.1 contains a model ethics program that, if adopted, provides a safe harbor from the imposition of vicarious liability on a corporation based upon the criminal misconduct of its individual employees.¹⁶

Given that the shareholders of a company that does not have an equivalent ethics program in place would have a sound basis for suing the board of directors if the company is held vicariously liable for the wrongdoing of its employees, the prudent board will adopt the §8B.2.1 Model Ethics Program or an ethics program that is substantially similar. However, for the matter at hand, the importance of the guideline is that it leaves no doubt that where an organization has a board of directors, that board is deemed to be the organization's "governing authority." This means that the Board is the ultimate check in the system of checks and balances put in place by SARBOX.

Establishment of a whistle-blowing system is Integral to the Model Ethics Program set forth in guideline §8B.2.1.¹⁷ Here again, the corporate boardroom emerges as the place where the buck stops. The guideline presumes that the board of directors (where one exists) is the final rung on the internal whistleblowing ladder, the place where an employee can turn to report corporate wrongdoing when adequate remedial action is not taken at a lower level in response to an employee's complaint about corporate wrongdoing.

The board of directors is also placed at the top of the whistle-blowing ladder for internal and external attorneys. Section 307 of SARBOX directed the SEC to adopt rules for attorneys requiring them to blow the whistle on corporate wrongdoing up-the-ladder to the board of directors if sufficient remedial action is not taken at the management level of the corporation. In the SEC Release adopting the "Rules of Professional Conduct for Attorneys" pursuant to the SARBOX mandate, there is a reference to the benefit that accrues to whistle-blowers from having the board of directors is at the helm:

By requiring attorneys to report potential misconduct up-the-ladder within a corporation, the rule provides a measure of comfort to investors that evidence of fraud will be known and evaluated by the top authorities in a corporation, including its board of directors, and not dismissed by lower-level employees.¹⁸

The Roots of Activism

By placing the corporate oversight function squarely in the boardroom, SARBOX makes it clear that the interests of the board and management are not necessarily aligned. In essence, SARBOX has infused a system of checks and balances into the corporate environment and made "conflict of interest" issues part of the corporate nomenclature. It is now clearer than ever that the board has a duty to serve shareholder interests and that this will often bring it into conflict with management objectives. In this vein, it is worth noting that management bonuses are based upon short-term results and, therefore, there is an incentive to emphasize present profitability even where this means forfeiting opportunities that are clearly more beneficial to the company in the long run. Indeed, inflated earnings statements resulting in overcompensation of CEOs have surfaced recently for venerable government-backed institutions such as Fannie Mae.

Addressing these concerns, section 1103 of SARBOX amends the Exchange Act with a provision that enables the SEC to prohibit a listed company from making extraordinary payments "whether compensation or otherwise" to high-level insiders during an ongoing SEC investigation of violation of the securities laws by those high-level insiders. Recent events have made it evident that where the SEC fails to halt the payout of bonuses that are based upon what are suspected to be inflated earnings figures, the corporation will have a difficult time getting the overcompensated executives to return the undeserved payments.¹⁹

Will the board's oversight responsibilities with regard to the corporation's financial reporting process result in it taking on a watchdog role with respect to other

aspects of the company's business operations? There is a very good chance that many boards will want to have a heads-up on material impairments of company assets in light of the need for a company to file a Form 8-K within four days of a the occurrence of such event. Moreover, looming large as a festering threat to the goodwill of subsidiaries sited in less-developed nations (LDNs) is the Alien Tort Claims Act (ATCA). ATCA creates a U.S. cause of action for acts against humanity, without regard to where such violations have occurred. The U.S. federal district courts have jurisdiction over these civil lawsuits, which hold a real attraction for NGOs seeking to hold MNCs accountable for the substandard labor practices and inhumane conditions that exist in their offshore production plants sited in LDNs.

Since the decision to open an offshore facility is traditionally made by management without input from the board, there is not a high level of commitment to these operations on the part of board. Boards may critically evaluate the risks associated with these offshore plants for the first time in connection with reviewing a Form 8-K that has to be filed to report an impairment of goodwill. It would not be surprising if the board subsequently sought to have a more active role in outsourcing decisions, even to the extent of requesting that a budget be allocated to the board so that it could consult with its own outside experts and/or conduct its own feasibility studies. Judging from the growing popularity of the ATCA lawsuit with both human rights activists and environmentalists, it will become a factor to take into account when establishing offshore facilities.

The Alien Tort Claims Act (ATCA)

Forced Disclosure as a Weapon

First hearing held in Nestlé lawsuit: On February 6th, the first hearing was held in ILRF's [International Labor Rights Fund] suit against the three largest importers of cocoa to the United States: Nestlé, Cargill, and Archer Daniels Midland, for their involvement in trafficking and forced labor of children on West African cocoa farms. The judge did not rule on Nestlé's motion to dismiss the case, asking instead for more information on the legal arguments. Terry Collingsworth argued at the hearing on behalf of ILRF.²⁰

All the more frequently, MNCs are filing financial reports with the SEC in which they disclose being named as a defendant or co-defendant in a class action lawsuit filed under ATCA. As with the cocoa importers lawsuit above, the typical MNC is being sued in a federal court by an NGO acting on behalf of workers laboring under oppressive conditions in an offshore plant of the MNC. Lawsuits filed under ATCA are civil in nature, providing for victims of *torts* to receive monetary damages if victorious.²¹ For a law creating a federal right of action, ATCA is remarkably terse! Indeed, because of the pithy wording of the statute, an MNC named in an ATCA class action lawsuit is immediately branded as a human rights violator or a committer of other crimes against humanity—such as polluting the natural environment by its business operations. As currently codified, ATCA reads as follows:

OFFSHORE OPERATIONS FROM AN IN-HOUSE PERSPECTIVE

The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.²²

Originally enacted in the eighteenth century to give a newly established nation the ability to prosecute pirates, this previously mothballed statute was invigorated in 1980 by a lawsuit filed in a U.S. District Court on behalf of two Paraguayan nationals.²³ The lawsuit sought monetary damages to compensate the Paraguayan plaintiffs for the torture and murder of a seventeen-year old relative (also a Paraguayan citizen) while in the custody of the Paraguayan Police. The plaintiffs were awarded a judgment of \$10.4 million and a moral victory that it is difficult to put a price tag on. Although the monetary award to the Paraguayan plaintiffs remains unpaid to date, the case represented a windfall for the anti-sweatshop movement in that it provided a precedent for using U.S. federal courts as forums for “outing” the widespread complacency of MNCs in the face of flagrant human rights abuses by their overseas affiliates.

The aim of activist groups in filing ATCA lawsuits is not to obtain large financial awards for the victims of human rights abuses. Rather, the goal is to bring MNCs before the court of world opinion, leaving them with no recourse but to admit knowledge of the acts complained of as a prelude to denying culpability based upon a legal technicality, such as the law of agency. Therefore, even where an ATCA defendant is legally exonerated, it remains morally condemned and is thus forced to take steps to rehabilitate its reputation and halt the impairment of its goodwill. It is at this stage (during the MNC’s image-rebuilding phase) that injured parties may reap some material benefits from having filed an ATCA lawsuit since, invariably, an MNC’s rehabilitative effort entails pro-active measures to secure the firm’s status as a “leader in the area of human rights”:

The parties to several lawsuits related to Unocal’s energy investment in the Yadana gas pipeline project in Myanmar/Burma announced today that they have settled their suits. . . . Unocal reaffirms its principle that the company respects human rights in all of its activities and commits to enhance its educational programs to further this principle.²⁴

This news release reveals a paradigmatic MNC shift from uninvolved observer to engaged activist for human rights. It begins with a purposefully vague and abstract third-party account of the settlement of numerous lawsuits that were brought against Unocal for its “energy investment” (a nice euphemism for laying down a gas pipeline) in Myanmar where conscripted labor was utilized to clear a corridor for the Unocal piping. It was the Center for Constitutional Rights (CCR) that filed an ATCA lawsuit against Unocal on behalf of citizens of Myanmar who had been forced by Myanmar’s Military Regime to work as conscripted labor to clear the passageway for the pipeline. Certainly, Unocal had no authority over the military dictatorship in Myanmar; but it had the choice of walking away from the project, of refusing to enter into a contract with a morally bankrupt government. Unlike many other MNCs that discontinued operations in Myanmar rather than deal with the

military dictatorship, Unocal chose to enter into a joint venture with the oppressive regime. In the eyes of human rights activists, Unocal's complicity justified holding it accountable to the world community for the brutal treatment of the Myanmar people; and, Unocal opted to settle the lawsuit.²⁵

As did Unocal, many ATCA defendants elect to settle an ATCA lawsuit after one or two futile attempts to get the courts to dismiss the case on the basis of the U.S. being an unsuitable forum to hear testimony about matters that occurred in another country. Since a publicly traded company must disclose the fact that it is named in an ATCA lawsuit in its financial reports, most MNCs see it as a no-win situation and attempt to settle the case as quickly as possible. In fact, if given a chance, many targeted corporate defendants will settle with the complainants prior to the time an action is actually filed, hoping to avoid negative publicity.

The Liz Claiborne "Settlement"

The fear that an ATCA lawsuit instills is demonstrated by the action that MNC Liz Claiborne took upon being advised that an NGO consortium planned to name it as a co-defendant in a lawsuit being filed on behalf of workers in sweatshops on the Island of Saipan. The NGO consortium provided Liz Claiborne with a draft of the Complaint it planned to file against the firm and a number of other designer retailers and offered Liz Claiborne the chance to settle and be excluded as a named co-defendant. Liz Claiborne accepted the offer, paying an undisclosed amount, and thus was dropped from the Complaint that was eventually filed in a U.S. District Court, and which has become a very high-profile ATCA lawsuit. Nonetheless, under the SARBOX-enhanced disclosure requirements, Liz Claiborne wound up having to disclose details of the pre-litigation settlement in its *2003 Annual Report*,²⁶ despite the fact that the Annual Report also contained the following boilerplate language:

Various legal actions are pending against the Company. Although the outcome of any such actions cannot be determined with certainty, management is of the opinion that the final outcome of any of these actions should not have a material adverse effect on the Company's results of operations or financial position.

This perfunctory treatment of pending lawsuits is standard boilerplate in the "Legal Proceedings" section of the annual and quarterly reports of MNCs. The objective is to give the impression that lawsuits are a routine part of business and that all legal actions are pretty much alike. However, lawsuits vary tremendously in terms of potential to inflict long-term damage on a firm's bottom line.

The Class Action Lawsuit

Class action lawsuits, in particular, can result in negative publicity that harm a firm's public image. Therefore, being named as a defendant in a class action lawsuit can have long-term consequences that belie the perhaps trifling impact paying a damages award has on a firm's current financial position. Because of this, class action lawsuits merit more than a cursory mention in the Legal Proceedings Section of a

corporation's annual and quarterly financial reports. Indeed, in today's spirit of full disclosure and corporate transparency, it is prudent for the management of a firm named as a defendant in a class action lawsuit to provide an in-depth discussion of the nature of the lawsuit as well as a forward-looking assessment of the impairment to goodwill that might result.

Since a class action lawsuit necessarily involves a larger population as plaintiff and most often will result in negative publicity (and possibly impairment of a brand name or trademark), it should not be summarily dismissed in a company's periodic reports as just another "Legal Proceeding." To do so, is to "omit to state a material fact," in the jargon of the SEC, and makes the firm's financial statements false and misleading. This has two important implications. First, it means that a pending class action lawsuit must be given prominent attention in the MNCs' financial statements and thus contributes to the effectiveness of the class action lawsuit as a method of inflicting public disdain upon a named corporate defendant.

Second, given that the company's financial statements must disclose the likelihood of future impairment of goodwill charges, the Audit Committee of the Board, in carrying out its oversight responsibilities, will have occasion to reflect upon the long-term costs associated with utilizing offshore sweatshop facilities. In fact, the more rigorous disclosure requirements under SARBOX indicate that the Board should be in a constant state of alertness for developments that may have an impact upon a company's financial picture. While the prospect of a reduction in production costs is attractive in the short-term, some consideration should be given to the long-term costs associated with linking the company name with offshore facilities that serve to tarnish the parent company image—which, in turn, diminishes the subsidiary's ability to capitalize on the parent's brand equity and trade name.

Conclusion

The exposure of the board of directors to criminal as well as civil liability for approving the release of corporate financial documents containing material misstatements or omissions of fact injects a new dynamic into the board/management relationship. SARBOX leaves no doubt that the board will be held accountable as overseer even though the financial statements originate within the corporation *under the supervision of management*. However, there is more than the fissure created by making the board the final "fall guy" in a reporting process in which management has the greatest input. A short-term orientation is built into the typical compensation package of management in that executive bonuses are computed annually whereas the board, in its role as fiduciary for the shareholders, is oriented toward sustained growth.

Nowhere is this diversity of interests more apparent than in the area of outsourcing. When a corporate board, independently of management, assesses the risks associated with maintaining an offshore facility that is so substandard as to merit charges of human rights violations in an ATCA lawsuit, it is likely to challenge the wisdom of the management's decision to pursue the short-term benefits of cost

CONTROVERSIES IN INTERNATIONAL CORPORATE RESPONSIBILITY

reduction by moving offshore. Even where the corporate commitment to offshore facilities remains firm, the prudent MNC Board will look into establishing a system for close monitoring of offshore operations to make certain that these operations do not attract unwanted attention from human rights activists.

In exercising this type of independent judgment as to how to best fulfill its role as corporate overseer and shareholder fiduciary, the board will require its own budget. It is at this point that the activist board becomes a truly autonomous board, but that is as it should be. The reality of a “global jurisdictional” lawsuit to redress job-related grievances occurring at remote regional outposts, in and of itself, makes it incumbent upon the board to exercise due diligence in investigating ways to lower the risk that the company it is steering becomes a defendant in such a high-profile class action lawsuit.

Notes

1. Financial Accounting Standards Board (FASB), “Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets” (June 2001). <http://www.fasb.org>.
2. *Sarbanes-Oxley Act of 2002*, P.L. 107-204, Title VI, §602, 116 Stat. 794. Hereafter cited as “SARBOX,” with appropriate section number.
3. 15 U.S.C. 78m. A good part of the SARBOX objective of improving corporate transparency is accomplished through amendments it makes to the Exchange Act.
4. Additional form 8-K Disclosure Requirements and Acceleration of Filing Date, Securities Act Release No. 33-8400, Exchange Act Release No. 34-49424, File No. S7-22-02 (2004).
5. The only instance where this responsibility would not fall upon the corporate board is the highly unlikely situation in which the by-laws of a corporation do not require board action to approve the company financial statements before they are released to the public.
6. These class action lawsuits are being brought under the Alien Tort Claims Act, which will be discussed in detail below.
7. Coca-Cola Co., *2005 Annual Report*. Available at http://www2.coca-cola.com/investors/pdfs/form_10K_2005.pdf, p. 18..
8. Section 807 of SARBOX amends chapter 63 of title 18 of the U.S. Code by adding a new section titled, “§1348. Securities Fraud.”
9. Emphasis added. “Sentencing Commission Stiffens Penalties for White Collar Criminals,” U.S. Sentencing Commission News Release (8 January 2003).
10. SARBOX, preamble.
11. Publicly traded companies are required to file current (Form 8-K) and periodic (Forms 10-Q and 10-K) financial reports with the SEC, which makes these filings available to the public through its EDGAR electronic database.
12. Former section 21(d)(2) Exchange Act.
13. “(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.” SARBOX, Sec. 2 (a) (3) (B); Exchange Act, 15 U.S.C. 78 c (b).
14. *U.S. Sentencing Guidelines Manual* §8B2.1 (Commentary) (2004).
15. More specifically, section 805(a)(2)(5) of SARBOX directs the U.S. Sentencing Commission to look at chapter 8 of the guidelines to make sure that they “are sufficient to deter and

OFFSHORE OPERATIONS FROM AN IN-HOUSE PERSPECTIVE

punish organizational criminal misconduct.”

16. Guideline §8B.2.1. Chap. 8, part B, *U.S. Sentencing Guidelines Manual* (2004).

17. “(5) The organization shall take reasonable steps . . . (C) to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.” *U.S. Sentencing Guidelines Manual* §8B.2.1 (b) (2004).

18. SEC proposes rules to implement Sarbanes-Oxley act provisions concerning standards of professional conduct for attorneys, Press Release No.2002-158 (6 November 2002).

19. P. Dvorak and S. Ng, “Companies Discover it’s Hard to Reclaim Pay from Executives,” *Wall Street Journal* (20 November 2006.): A1.

20. ILRF legal update, excerpt from attachment to e-mail correspondence from Eryn Schornick, International Labor Rights Fund. Received by author on 1 May 2006.

21. A “tort” is a private or civil wrong or injury. *Black’s Law Dictionary* 1660 (4th ed. 1968).

22. *Alien Tort Claims Act*, 28 U.S.C. §1350 (1994).

23. *Filártiga v. Peña-Irala*, 630 F.2d 876 (2d Cir. 1980).

24. “Settlement Reached in Yadana Pipeline Lawsuit,” *Unocal Archives* (21 March 2005). Last accessed 10 July 2006. www.unocal.com/uclnews/2005news/032105.

25. In its lawsuit, CCR alleged that Unocal “was aware of and supported slave labor, murder, rape and forced relocation of villagers by the Burmese military during the construction of an oil pipeline from Burmese oil fields to Thailand.” Settlement reached in principle in Unocal Human rights lawsuit, Center for Constitutional Rights Website, last Accessed 29 June 2006. <http://www.ccr-NY.org/v2/search/results.asp>.

26. *Liz Claiborne 2003 Annual Report*. Form 10-K Claiborne Liz Inc. (filed 11 March 2004) (10 July 2006). Available at <http://www.sec.gov/Archives/edgar/data/352363/000035236304000144/liz10k2003.txt>.

The Author

Gwendolyn Yvonne Alexis

