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Practicing the Law of the World from New York

PRACTICUM: FORM AND POLICY

The *International Law Practicum* is a semi-annual publication of the International Law and Practice Section of the New York State Bar Association. The *Practicum* welcomes the submission of articles prepared by practicing attorneys. The length of an article, as a general rule, should not exceed 3,500 words, footnotes included. Shorter pieces, notes, reports on current or regional developments, and bibliographies are also welcomed. All manuscripts must be sent in laser printed triplicate accompanied by a 3 1/2" disk formated in Microsoft Word or WordPerfect to: The *Practicum*, c/o Daniel J. McMahon, Esq., New York State Bar Association, One Elk Street, Albany, N.Y. 12207-1096. Both text and endnotes must be double-spaced. Endnotes must appear at the end of the manuscript and should conform to *A Uniform System of Citation* (the Harvard Bluebook). Authors are responsible for the correctness of all citations and quotations. Manuscripts that have been accepted or published elsewhere will not be considered. The *Practicum* is primarily interested in practical issues facing lawyers engaged in international practice in New York. Topics such as international trade, licensing, direct investment, finance, taxation, and litigation and dispute resolution are preferred. Public international topics will be considered to the extent that they involve private international transactions or are of general interest to our readership.

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Multinationals Confront Sarbanes-Oxley

Editor's Note: The following is an edited transcript of the presentations made at the Annual Meeting of the International Law and Practice Section of the NYSBA on 22 January 2003.

I. Welcoming Remarks

KENNETH A. SCHULTZ: Good morning. For those of you who don't know me, my name is Ken Schultz, and I am Chair of the International Law and Practice Section for just a few more hours. But I am delighted to welcome you here this morning.

As all of you have noticed, the subjects Enron, Worldcom, Tyco and Sarbanes-Oxley are weaving their way through the entire program of the New York State Bar Association this week. You may wonder: Why another program? We have a somewhat different twist. The legislation has created a very significant impact here in the United States, but what makes a particularly interesting legal matter for our Section is that the repercussions are spilling onto the shores of our neighbors overseas, and lawyers throughout the world are wrestling with the process of squaring Sarbanes-Oxley with the legislation in their home countries.

Our distinguished group of panelists today have been wrestling with those issues, and they are going to provide you with some insight into the problems that Sarbanes-Oxley is creating and hopefully some insight into how they are going about solving those problems.

So with that, I would like to call forward Jim Duffy, who is chair of this morning's program and the incoming Chair of the International Law and Practice Section.

JAMES P. DUFFY, III: Thank you very much, Ken. Well, we have a lot of work to do, and we hope we have a very interesting program for you. Our first panel is going to be a group of experts from foreign countries who are going to discuss very specifically the impact of Sarbanes-Oxley from their individual perspectives. Our second panel is going to be a roundtable discussion based on a fact pattern that you will find in your materials. And, as to that panel, we would encourage audience participation as actively as you might wish. And then our third panel is going to be a small roundtable discussion that is going to focus entirely on the ethical issues for all lawyers that Sarbanes-Oxley addresses. And again we are going to encourage active audience participation of that panel as well. I don't mean to discourage questions in the course of the initial panel, but during the second two panels we will encourage questions throughout from the audience.

Now I will turn the program over to Paul Frank.

II. The Impact of Sarbanes-Oxley on Foreign Issuers

A. Introductory Remarks

PAUL FRANK: Thank you, Jim. I am Paul Frank from Alston & Bird in New York. I have a very limited role because we are very short on time this morning, with a great many things to accomplish.

As Jim said, the first panel in the first hour is going to be a discussion of Sarbanes-Oxley, led by Mark McElreath and followed by comments by lawyers from Spain and Germany. We will then take a look at some practical issues that have developed already in this country.

Let me first introduce the individual panelists and then turn it over to Mark. We hope there's time not only for discussion among the panelists, as we have expected and arranged, but also for questions. I'll leave it to Mark and the other panelists as they are going along to take questions as appropriate at the time.

To my immediate right is Mark McElreath, who is head of the Northeast Capital Markets Group of Alston & Bird and based here in New York. Originally from Georgia, Mark is a graduate of Columbia Law School, where he was a Harlan Fiske Stone Scholar.

Next is Javier Villasante. Javier is from Cuatrecasas in Barcelona and Madrid. He is the managing partner of the New York office for his firm.

Laura Hoguet is next in seating but will be the fourth speaker. Laura graduated from Radcliffe College and the University of Chicago Law School. She was with White & Case for many years and in 1996 started her own firm, Hoguet, Newman and Regal.

And lastly, Jan Geert Meents is a German lawyer who studied in Munich and Marburg. He is based with the firm of CMS Hasche Sigle in Munich, has been in the Atlanta office of Alston & Bird for the last six months and has come to New York for the month, which is why we are able to have him here today.

Mark, I think you can take it from there.

B. Overview of Issues Affecting Non-U.S. Issuers

MARK F. McELREATH: Thanks, Paul. Well, I guess I qualify in some part as having a perspective in foreign countries since I spent about half of my years in Georgia before moving to New York.

I would like to spend about fifteen minutes to give everyone a baseline on the parts of Sarbanes-Oxley that affect foreign private issuers or non-U.S. issuers. Some of you are probably aware of these issues, and some of you may not be, but we wanted to give you a baseline so that everybody would have those issues in mind. Then we will proceed to some discussions of specific jurisdictional issues.

The Act was passed last July 30, to be exact, and, when President Bush signed it, he made the comment that it was the most far-reaching reform of business in America since the time of Franklin Delano Roosevelt.

I think that it's pretty well accepted that whether the reform is going to be seen as beneficial to U.S. capital markets as well as to the non-issuer participants in those capital markets is still undecided.

There are many who believe that the Act was passed in great haste without proper advice from the SEC or the markets themselves and was poorly worded and poorly drafted, such that it will be very difficult to actually put the rules in place and then very difficult to enforce them effectively. That is still undecided. There certainly has been a great deal of discussion and consternation about it.

The Act generally covers accounting and corporate governance reform. Some of the provisions of the Act were effective immediately on July 30, and a vast majority of the others were to become effective over a period of approximately one year, as the SEC wrote the rules to actually put the Act into effect.

I note that this Sunday, the 26th of January, 2003, is one of the most important deadlines under the Act for the SEC to adopt final rules. There is an open meeting today, starting at 10:00 a.m., of the Commission to adopt a set of final rules. There's another open meeting tomorrow at 10:00 a.m. to adopt another set of final rules. So literally in the next four days clearly twenty-five to fifty percent of the rule proposals under the act are going to become final. Those include the attorney-conduct rules, rules on audits, auditor independence and what the auditors are allowed to do for public companies, non-GAAP financial disclosure, and off-balance sheet financial disclosure.

I'll also mention that the last sort of big deadline will be April 26, 2003. That's when we expect most of the rest of the rules to become final. So that by June of 2003 we will have a pretty good picture of what we are going to be dealing with for the next few decades, a whole other groundbreaking reform.

When the Act was being discussed in Congress, if you read the legislative history, there was extensive discussion about what to do with foreign issuers, whether the Act covered foreign issuers. And it was deemed politically incorrect, so to speak, to distinguish between U.S. issuers and foreign issuers in U.S. capital markets. And the temperatures ran pretty high regarding the position that there shouldn't be special leniency given. Again, if there had been more consultation with the Commission and with practitioners, that may have changed. But Congress really didn't spend much time talking to the outside world as they deliberated. So the Act itself has no general provisions exempting foreign private issuers. Under the Act and under the Securities Exchange Act and the Securities Act, the SEC does have pretty broad exemptive powers. But the SEC, under Chairman Pitt, who still sits as chairman although he has resigned, has made it clear that they don't intend to take on the U.S. Congress at this point and use their exemptive power too broadly. They have been taking their lead from the Administration. They don't feel that would be politically acceptable at this point. We hope maybe in the future that they will. And as I will mention later, there are some signs that they are heading down that road.

The Act generally applies to all companies that file reports under the 1934 Act. And in general terms, that means that, if you are representing an issuer that is listed on the New York Stock Exchange or one of the other stock exchanges or NASDAQ, by the requirements of those exchanges and NASDAQ, you would have to register. A very easy test is that, if you're trading under one of the American exchanges, you're going to be subject to the Act.

Another catch is that companies that have filed a registration statement under the 1933 Act are subject to the Act. And for foreign issuers this happens most often, at least as seen in the last few years, when they do Rule 144A debt offerings. This is so because they generally agree in those debt offerings to do a follow-on exchange and register the debt under the '33 Act so that it is more freely tradeable in the United States. That will catch the issuers as well and make them subject to the Act.

Finally, I'll note that Rule 12g3-2(b) companies (i.e., exempt foreign issuers who have a certain number of shareholders who might otherwise get caught under the '34 Act) are not subject to the Act. This would include tier-one ADR issuers. We have them in the United States, but they are not listed on an exchange, that is, the underlying security is not listed on an exchange.

The two biggest sections of the Act I think most people have heard about, because they have been out there for six months, are the two certifications: one under Section 906 and one under Section 302. And as I

have talked to many of my colleagues in the European market, the biggest source of consternation for them is that they don't understand why there are two different certifications. Well, quite frankly, neither do we. But it's fairly easy to explain.

At the time Congress was trying to adopt the Act, there was a very clear interest in having the executives of the companies subject to criminal penalties for having misleading information in their documents and knowing that it was misleading. In order to do that, you had to put one of the certifications under the federal criminal code, under the Department of Justice. There was also an interest in having a securities regulation that required them to certify the filings, the quarterly and annual reports, as they were made. That ended up under the '34 Act, and that's why you have Section 302. Because of their two different purposes, you ended up with two different certifications. The Department of Justice and SEC have indicated verbally and in presentations that they intend to begin (and have already begun) discussions about putting the two certifications together. But we don't expect that to happen before the end of 2003.

The Section 906 certification, which carries criminal penalties, is a certification that's required for foreign private issuers on Form 20-F or 40-F, the annual form. And it simply has to say that the report complies with the '34 Act and doesn't have any misleading information in it. It is accepted that the 906 certification is not required on 6-Ks or any other filings, and foreign issuers don't file quarterly reports, so that wouldn't trigger a certification either.

Now, as adopted, Section 906 did not have any materiality qualifier in it. The certification says that there is nothing in the form that is misleading. And there was a great deal of consternation about that, because, as lawyers, you can imagine that a CFO or CEO of a large corporation has a very difficult time about being absolute about something like that. The Department of Justice—not used to dealing with or having to talk to the market and issue documents and discuss things initially—was silent as to whether they would accept materiality qualifiers. But they have recently, in the last two months, indicated verbally, but not in writing, that adding a materiality qualifier to the certification would be an acceptable practice.

The Section 302 certification goes a little further. It is very similar in the sense that it is a statement that there's nothing misleading in the filing. But it has in it an interesting set of certifications that the company's disclosure controls and procedures and internal controls are in place; they are designed to be effective and to produce the information necessary for the filing.

It is very important for foreign issuers to realize that a 20-F certification, although it won't actually be made until the first 20-F (which will be due for most companies June 30th of 2003), encompasses a disclosure that your controls were effective for all of the filings since the date when the Act passed in July. So, the 6-Ks coming in since July and up until the time the 20-F is filed will be encompassed in this certification that there is in place a program to yield all the information to make the 6-K filing accurate. And I think it is relevant for us to make sure we talk to our clients to advise them to focus on what procedures they have in place to ensure that information flows to the top, to the person in charge of the reporting function.

The Section 302 certification doesn't carry with it any criminal penalties. It is subject to potential penalties under the '34 Act or SEC action. It is also subject to a private action, which is something U.S. issuers are very used to under a 10-b5 query, and it is not settled yet whether foreign issuers would be subject to a 10-b5 action. That's something as yet to be developed.

Briefly, I'm going to run through a few of the other provisions of the Act.

Another provision that has had great attention abroad is the prohibition on loans to directors and executive officers, simply because it is a more common practice among foreign issuers to extend various types of credit to executives and directors of the company. The Act does flat-out prohibit this. The Act includes very broad language that has not been subject to SEC clarification or rulemaking, and so the broad language of the Act is all we have to go on. And you could read it very conservatively to prohibit all types of things, including relocation loans, stock purchase loans, cash with stock-option exercises, in addition to other things.

There is a growing body of thought in the United States among practitioners that this provision is being read too broadly; that that wasn't the intent of the Act. And I think practice will settle down such that the actual enforcement will be on the types of activities that Congress intended to catch, which we found in Enron, Worldcom and especially in Tyco. Here, the SEC does have broad exemptive powers to exempt not only U.S. issuers, but again, they have given no indication that they intend to do so in the near term.

Another big aspect of the Act that has actually been stalled is the public company accounting oversight board. I don't know if you have followed the news over the last six months, but we have had an appointment of a chairman and resignation of a chairman and then the appointment of a new chairman, but this has delayed the effectiveness of the body in getting started.

It is supposed to be in place sometime in the summer of 2003, and once in place it will be the regulatory body for accounting firms who wish to practice before the SEC, meaning those firms representing companies that are companies reporting to the SEC.

Let us now turn to the Audit Committee and Auditor Independence Rules. The Audit Committee Independence Rules came out just a couple of weeks ago, and this is one of the places, as I mentioned earlier, where we see signs that the SEC is finally listening to some of the concerns of foreign practitioners. As written, the Act required that the audit committee members all be independent, meaning they couldn't be in any way associated with the issuer, whether by employment, by stockholding or by consulting or other fees. When the rules came out, those provisions, of course, were in there, but there are exceptions now built into the proposed rules that recognize that there can be non-management employees and shareholders on the audit committee in certain circumstances, primarily, if the law of the jurisdiction in which the issuer is located or some governmental authority there requires it. It also contains an exemption that recognizes a two-tiered board system. While the SEC believes that the supervisory or management board is the proper board from which to draw the audit committee, they at least recognize that the two-tier board system exists and are open to suggestions as to how to make that work for those jurisdictions. So in these rules that came out a couple of weeks ago we for the first time see that the SEC may actually be leaning toward drawing some distinctions between U.S. and foreign issuers.

Let me make another comment just briefly on the audit committee. The audit committee will become the primary body for selecting the auditors, overseeing their work, hiring outside counsel, if need be, to determine if there's a problem, and firing the auditors if the audit committee doesn't approve of their work.

The provision regarding executive compensation hasn't received a whole lot of attention, and it may not. We'll see if it is actually something that's useful. But it provides that, if there is ever any activity by the company that is deemed to be misleading and is a result of someone's misconduct—although it is not defined whose—the SEC has the ability to force the executives to give back to the company any bonuses they have received in the previous twelve months. We are not exactly sure how they intend to enforce this because there are so many provisions of it that are undefined. But I thought I would raise it because it will apply to foreign issuers as well.

And finally, let me touch upon a few miscellaneous topics. The code of ethics that will be required is going to cover foreign issuers as well. You're not required to have one; you're simply required to disclose whether you have one, and if you do not, why not. This most likely will lead to the adoption by most everybody of a code of ethics of some sort.

The SEC now has the power to prevent certain persons from acting as directors and executive officers of listed companies. The Act requires that companies put into place and enforce protections for whistle-blowers. You cannot discharge employees simply because they have gone to governmental authorities to report what they believe to be violations of securities laws, local laws, or environmental laws. This, among others, has raised some eyebrows because of problems in foreign jurisdictions.

And then finally, there are the attorney-conduct rules, which you've probably heard quite a bit about. The Act itself only required that the SEC adopt rules mandating up-the-ladder reporting of problems by attorneys. In other words, the attorney couldn't simply stop at identifying the problem to whoever their contact was at the company. If they didn't receive what they felt was a reasonable response, they had to continue reporting it up the ladder, all the way to the board of directors.

When the SEC adopted the rule, they decided to put in a few more bells and whistles, including a requirement that, if ultimately you don't get the proper response from the company, you will have to withdraw as the attorney on record for the company and notify the SEC that you are withdrawing and publicly disavow any filings that the company has made that may, based on your knowledge, contain misleading information. Those rules are the subject of tomorrow's open meeting at the SEC. And there's been an enormous amount of comment on them. So we will be interested to see what the SEC actually does tomorrow in the final rules.

With that, I'm going to turn the panel over to Javier and ask him to give us his thoughts on how Sarbanes-Oxley is being interpreted, accepted and dealt with in Spain and some of the issues it is going to present for practice there.

C. Perspective from Spain

JAVIER VILLASANTE: Thank you. Well, actually in looking at these aspects and how they apply to a country like Spain, I note that, as you might imagine, Spain has not been, let's say, safe from the wave of corporate rulemaking you've had in this country over the last year or so. Actually, in Spain we have also had our share of corporate scandals over the last several years, and they have involved some of the most respected businessmen in our country. It has been several years since the chairman of the Santander Central Hispano

(SCH), which is one of Spain's biggest banks, was the subject of an inquiry because the bank had made an attractive investment product that it actively promoted among its customers and that enabled them to avoid paying taxes. The tax administration has, for a number of years, been seeking to have certain high executives at the bank indicted, and the case is still pending.

Banco Bilbao Vizcaya Argentaria (BBVA), another of the largest Spanish banks, was a respected financial institution. As you may know, they had problems when it was discovered that the bank had been financing a Venezuelan leader. They also have had problems because they placed a significant percentage of the bank's profits in a tax haven many years ago, apparently as a way to have money set aside, off the balance sheet, in the event that an executive of the bank were kidnapped by the Basque separatist organization, ETA. Actually, one of the highest executives of the bank, one of its directors, was kidnapped and killed by the ETA some twenty years ago. So apparently there was a reason for BBVA's doing this, but twenty years later the money was still there.

And you also may know about another scandal that involved a person who was perhaps the most respected businessman in Spain, Juan Villalonga, the chairman of Telefonica. As you may be aware, he allegedly traded in stock options two months before announcing a Telefonica alliance with MCI and Worldcom, a deal that later fell apart. Following a probe of this alleged insider trading, Mr. Villalonga resigned from his position at Telefonica.

So there has been, I would say, a wave of what they call in Spain "corporate responsibility" measures, and this wave has been in a way very much stronger here after Sarbanes-Oxley this summer. Also, there have been initiatives from different Spanish companies. First, all of the biggest Spanish companies—like Telefonica, SCH—have publicly declared that they intend to comply with Sarbanes-Oxley. And more than that, many of these companies have declared that they have indeed taken some action over the last months.

Telefonica is, I would say, the clearest example. In October, the first action that they took was the publication of an ethics code. An aim of this ethics code was to prevent high executives and the officers of the company from investing and trading in Telefonica's shares for several months before the announcement of any deal or within one month before and after quarterly annual results are published. So this was the first measure that they have taken.

Coincidentally, on the same day that Telefonica announced that it had enacted an ethics code, the Spanish newspaper *El Mundo,* whose reporting had figured in Mr. Villalonga's resignation, reported that the current chairman of Telefonica (who was formerly the head of Spain's telephone monopoly) founded a company that was later passed on to his nephew. Through the use of this company and a loan secured by the chairman, a certain investment was made before certain information (allegedly known to the chairman and later resulting in skyrocketing share prices) was made public. *El Mundo* reported that Spain's anti-corruption office was opening an investigation into the share dealings and alleged insider trading. An earlier investigation by Spain's equivalent to the SEC, the *Comisión Nacional del Mercado de Valores*, had found no evidence of insider trading.

There are other measures that Telefonica has enacted. In November, they published new internal regulations that boast a much better system for auditing and financial control. This will make possible in practice that the chairman, the chief executive officer and the chief financial officer of Telefonica certify the accounts of the company, as Mark was pointing out. What they intend to do is to set up internal mechanisms that will lead to this certification.

As you may know, Telefonica and some of the other Spanish companies that I am talking about today are quoted on the New York Stock Exchange. So this is obviously a very important issue for them. And in December they also announced that they are now putting on their Web site a special section that would deal with corporate responsibility issues. Other Spanish companies have done a number of things that would lead the investing public to believe that they are doing their best to enhance their corporate responsibility, such as a enacting a corporate governance code and publishing an annual report just dealing with internal audit issues. These have been very well-received by analysts and investors.

Also in Spain over the last months, a commission has been working to produce a report that was then actually published on January 8. There had been a predecessor report, issued in 1998, which was well-known by the companies but not by shareholders, so, at the end of the day, the recommendations of that older report were not widely adopted. But the current report has gone further, taking advantage of the new Sarbanes-Oxley environment. You should be able to find the report on the Web site of Spain's SEC, *Comisión Nacional del Mercado de Valores*, which can be found at www.cnmv.es. And I think it is useful to have a look at it since it makes recommendations addressing the special aspects of Spanish companies. Thus far, the wave of corporate responsibility measures has not entered the legislative sphere in Spain. So we are talking about recommendations that are voluntarily adopted by the companies and perhaps widely known among the investors

and financial community, but which are not necessarily adhered to. The principles set out in this report, as you may imagine, are similar to those under Sarbanes-Oxley: first, transparency; second, a stress on the fiduciary duties of directors. The report endorses a system under which you either do what you are supposed to do or explain openly and frankly to the investor community why you didn't do so.

In Spain, they also stress something that is not clear-cut here in the States, namely, that the chairman of the board should not be the chief executive officer. So, they try to find a balance of power between those two figures. They also talk extensively about three different kinds of committees that all the big Spanish companies are promoting: the accounting and control committee, the appointments and compensation committee, and another committee that is typically known as the strategy and investments committee. These reports also deal with the kinds of services that may be rendered to companies in Spain. In November of 2002, a new law was enacted, the purpose of which was to reform the financial system and to prevent auditors from rendering services to the same company for more than a certain number of years. However, due to strong lobbying by the accounting industry, the legislation requires only that the partner in charge must change, which is not an entirely satisfactory outcome.

These are the main issues in Spain: all addressed by measures other than legislative action.

MR. McELREATH: Thank you very much, Javier. Jan, how about your perspective from Germany?

D. Perspective from Germany

JAN GEERT MEENTS: Ladies and gentlemen, thank you very much for your attention. I'm delighted to have the opportunity to give you an idea of some of the particular legal problems under German law arising out of Sarbanes-Oxley.

As Mark has already pointed out there is no final version of the Sarbanes-Oxley rules in force; therefore my presentation is based on the latest information available. Some of the previously mentioned problems might be corrected or deleted in the final rules, as we have heard.

So what are the consequences of Sarbanes-Oxley in Germany? Besides the question of applicability of the Act, which is very controversial and maybe too large a question for this session, I can think of three main areas of legal problems in connection with the Act from a German perspective: first, the authority for choosing an auditor of a company subject to the Act; second, the independence of members of the audit committee under the Act; and third, the liability of German lawyers rendering advice to companies subject to the Act. I would like to discuss these issues in a bit more detail.

As you know, pursuant to Section 301(2) of the Act, the audit committee of an issuer, in its capacity as a committee of the board of directors, is directly responsible for the appointment, compensation and work of any registered public accounting firm employed by that issuer for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm is to report directly to the audit committee. The purpose of this concept is understandable. However, it is not compatible with German regulations and the German Stock Corporation Act. According to Section 119(1)(4) of the German Stock Corporation Act, auditors have to be chosen at the stockholders meeting and given their mandate by the board of directors. This responsibility cannot be assigned by the stockholders to another body of the company.

The second problem of the audit committee from a German legal point of view is that the independence of the audit committee conflicts with the provisions of the German Employees Participation Act. Pursuant to section 301(3) of Sarbanes-Oxley, each member of the audit committee of the issuer must be a member of the board of directors of the issuer and otherwise independent. If a foreign private issuer does not have an audit committee—which is the typical situation, since this corporate structure does not exist under German law—according to Section 2(a)(3) of the Act the complete board of directors is considered to be the audit committee, which means that the board of directors in its entirety has to be independent from the company. As long as there is no general exemption for foreign issuers, this is a point where the German and the U.S. systems heavily conflict.

A characteristic of the German system is the participation of employees on the board of directors. Pursuant to the German Employees Participation Act, the board of directors of a German corporation (*Aktiengesellschaft* or "*AG*") has to consist equally of delegates of the corporation's stockholders and delegates of its employees. Taking this into account, an employee delegate could never be a member of the board of directors of an SEC-listed company since the employee delegates would not be independent in this sense. However, this is an obligatory prerequisite under the German Stock Corporation Act.

The third and from a lawyer's perspective the most important result of Sarbanes-Oxley is how the American regulations would affect the attorney/client relationship in Germany, and also what sanctions German

lawyers would have to fear if they rendered advice to clients subject to the new law who violate its provisions.

As we heard previously, the current rules under the Act do not distinguish between German and foreign attorneys and would therefore basically impose the same strong sanctions and hefty fines on German attorneys as on their American colleagues. This might be the reason why the Act could be referred to as the Unlimited Lawyers Liability Act.

Let us think about this scenario on the basis of a simple example, assuming that the Act is applicable to foreign law firms. A partner of a German law firm is sued by disappointed shareholders of an SEC-listed company. What does this mean for the German law firm? Does a liability arising out of this lawsuit affect only the respective attorney who represented the company before the SEC, or is the entire firm liable? What would be the typical effect under German civil and corporate law?

Here's another example: A German attorney of an international law firm with an office in Germany and the United States learns of circumstances that would be the subject of notification under the Act. However, his U.S. colleague in the same firm does not know of these issues. Under the current legal system, this would be a violation of the Act, but who would be liable? Is it just the German attorney, just his U.S. colleague, or the entire law firm? Furthermore, would any ban by the SEC really affect any lawyers practicing in Germany? I cannot imagine and do not know of any legal basis for an international professional ban based on national law.

These problems and several more that I could not address due to the tight schedule are still unsettled. I hope the SEC solves at least a few of them in the final version of the rules. However, I fear that some CFOs and CEOs of German companies subject to the Act will reexamine whether being registered with the SEC is still worthwhile. And this would be a significant step backward in the globalization and internationalization of the economy.

Thank you very much.

MR. McELREATH: Thank you, Jan. Laura, please give us your thoughts on some of the effects and repercussions you've seen.

E. International Litigation Perspective

LAURA B. HOGUET: I'll try. In my firm, which is a litigation practice in New York with a lot of international clients that are referred to us by people we know and law firms that have worked with us through the years, we are trying to take a somewhat more cheerful view of the Sarbanes-Oxley Act than we have heard this morning. You can deplore it as a terribly badly written piece of legislation, as a kind of naive response to a moment of hysteria in American history, and there are a lot of other things you can say about it. Or you can look at it as a great benefit to the legal profession, because it is generating a vast amount of work for us.

I guess I would point out three areas that people have been calling us about—lawyers and clients around the world, really. The first one I would put in the general category of "Does this thing apply to us?" Now, as for what it applies to, to whom it applies, and what it means, we have been apt to say often that you have to get into these SEC Webcasts to find out whether it is going to really mean this or that. Nobody knows what it means.

Most clients internationally are quite relieved to find that the Act has absolutely nothing to do with them, because most of the businesses doing business from abroad in the United States are not public companies. And they all breathe a great sigh of relief. It really doesn't apply to companies that are not selling securities in the United States.

Then, of course, they have a second thought about that. Suppose we might want to do that: what is going to happen to us if we do want to sell securities in the United States? What are the negatives; what are the downsides? And I think there's a lot of counseling work for a lot of lawyers in the future in that area.

The two specific problems that have come up in the litigation context that is my daily bread and butter are more practical, if you will. One has to do with the whole topic of loans, because loans and extensions of credit, or one or another of their infinite variety, are pretty basic to the way a lot of European and Asian companies run their businesses. And, when they come over here and discover that these forms of executive compensation, as they perceive them, are illegal or deemed by the United States to be conflicts of interest, they are not happy about it. One set of clients simply wants to comply with the law and figure out how to revise their structures so that it works, and another set of clients wants to figure out how to paper it so that they won't get into trouble. And then there's the third set of clients who want to collect the loans that are now illegal.

All of these things have cropped up and created problems, and I think that, until the SEC works out with the international legal community reasonable definitions of what is going to be considered a prohibited loan, i.e., what is a loan that arises from a situation that

in some sense is a conflict of interest and what is not, the issue is going to be a source of lots of work for me, my partners and our associates.

Then the third category of problems that is coming up has to do with the whistle-blower provision. And this set of problems has two aspects, A and B. A is counseling clients whose employees have reported to them that there is something wrong somewhere in the system. A great deal of judgment and discrimination are involved in investigating one of these problems. And it is the type of thing that lawyers are going to have to learn to do, to meet with witnesses, to extract information from people who are reluctant for various reasons to give it, to make some judgments about whether what they are hearing is gossip or something that actually violates a law. A lot of exercises of judgment are involved beyond what people ordinarily think of when they just read the newspapers. That's side A of the whistle-blower Act.

Side B is what we call the preemptive striker. It is the employee who is about to be fired and, seeking to prevent this from happening, he leaves a memo on somebody's desk, the classic three-page single-spaced document which says that "the following eighteen things that I have witnessed in the last six months are fraudulent," thinking that he has thereby prevented the company from firing him.

Now this problem arises under Sarbanes-Oxley and under a number of state whistle-blower protections, and our international clients are always astonished to hear us say, "Wait a minute, let's not just fire him, let's think about this"—or her, because sometimes it is a she. Anyway, sometimes it is prudent not to fire the person. Sometimes it is prudent to investigate it. Sometimes it is prudent to fire the person. But all of this requires a lot of thought, and Sarbanes-Oxley isn't very clear, and neither are most of the other statutes, about whether it matters whether the allegations are well-founded or not. Sarbanes-Oxley has a reasonableness qualification: if the allegation is unreasonable, the company is not required to stay its hand. However, that requires another judgment to be made, so all of this requires legal judgments every day. There is no bright line in any of this, and therefore I think one ought to have quite a cheerful view of the impact of Sarbanes-Oxley on our legal profession.

Thank you.

F. Questions and Comments

MR. FRANK: We have been told we can use a few extra minutes, and with that being the case, perhaps there are some questions.

I have a question for Jan Geert. If the problems are sufficiently severe, as you suggest, in regard to compliance with German law, so that there's the risk at least of having to withdraw, has anyone considered the complications of trying to withdraw, that they may be even worse than complying?

MR. MEENTS: Yes, I think that, at the moment, the issue is that a lot of companies are quite unsure about what the Sarbanes-Oxley Act really means for them, and they seek international legal advice in order to find out whether they can comply with the Act or whether they have to change something.

As an interesting aside, I read a couple of days ago in a newspaper that a former CEO of a German company which is listed with the SEC actually informed the SEC that the company's accounting firm had made some mistakes and asked the SEC to investigate this. So there may be significant consequences, even for a German company, arising from Sarbanes-Oxley in a situation like that.

MR. McELREATH: I'd like to make one final comment. I thought Laura's comments were well-taken, and I agree with her, that there are certainly some unanticipated benefits here. Literally in the last few days, as the fiscal year (which is a calendar year for a lot of companies) has closed and we're approaching the annual reports for the U.S. issuers, we have been receiving some calls from some of the executives who are not the CEO or CFO but are some of the lower-level executives of the companies who are being required to give certifications up to the CEO and CFO so that they in turn have something to base their certifications on. And these lower-level executives have concerns because they know of some things over the last year or so that they reported that have been ignored, and they are worried about their own personal liability if they sign the certification and pass it along, knowing that some of the reported items were not properly dealt with. They don't know what their personal liability or responsibility is. This is not an avenue that we really anticipated coming along for us to deal with. So there are certainly a lot of areas that I think will develop.

MR. DUFFY: Thank you very much, Paul, and thanks to a very interesting panel.

I would like to introduce to you Calvin Hamilton. He's an attorney with the firm of Monero, Meyer & Marinel-Lo, Madrid, Spain. And Calvin is going to have an open roundtable discussion of the fact pattern that is in your materials. We would encourage—and Calvin, you can elaborate on this, but Calvin will encourage questions from the floor throughout the panel discussion. Calvin.

III. The Impact of Sarbanes-Oxley on Executive Officers, Directors and Auditors

A. Introductory Remarks

CALVIN HAMILTON: Thank you, Jim. Good morning and thanks for joining us at the second panel of the Sarbanes-Oxley application to our everyday lives. In particular we will discuss how it affects executives, directors and auditors.

As we know, the Act pretends to be very far-reaching. The extraterritorial reach is yet to be determined. But what I can say is that it's caused a lot of furor in a lot of different jurisdictions, for the Europeans in particular. And to that I can speak, because I live and practice in Spain. In particular, Spain is very concerned even though they can understand the intent of it. They think that you've got a problem, so take care of it, but don't involve them.

In Europe, we've got to contend with more than thirty-five different codes of conduct, eleven of which are in the U.K. alone. And these were developed and promulgated during the '90s, prior to the Enron fiasco and Global Crossing and the like. They think that they are ahead of the curve, and they can take care of their own business, thank you very much, and they don't need the extraterritorial reach. Whether or not they can stay away from the financial markets in the U.S. is another practical issue. If the answer is they can't, then they will have to succumb to the Act and have it apply to them.

In any event, jurisdictions like Germany, Denmark, and, to some extent, Holland, which already have a two-tier approach to corporate governance and believe that their supervisory committees—the other one is the management committee—can do the job that Sarbanes-Oxley purports to want to do, argue that the Act shouldn't apply to them in any event. They also point out that there has also been a historical deference by the SEC to local jurisdictions, and, all of a sudden with Sarbanes-Oxley, this is going to change.

Without further ado, you would have received the fact pattern in the handouts, and what I wanted to do was just discuss the various issues as outlined in that fact pattern and as they would be resolved, if at all they would be, by Sarbanes-Oxley.

To help me with this we have got, from my left, Jorge Juantorena, who is a partner at Cleary, Gottlieb, and practices in the area of mergers and acquisitions, with a particular emphasis on Latin America. I'm hopeful that Jorge would provide us with some issues as raised in Latin America.

To his right, Larry Shoenthal, who is an attorney in New York and a CPA and has been practicing and counseling lawyers and clients particularly in areas that would affect audits and other accounting practices.

To his right, Dennis Block, who is the head of the corporate department at Cadwalader. Dennis practices in the areas of mergers and acquisitions and has done a lot of work in the areas and with the different issues that we are going to be discussing today.

And last, but certainly not least, Charles Dorkey. Can I call you Trip? Trip Dorkey is a partner with the international Canadian law firm Torys, and Charles is the managing partner of the New York office.

The fact pattern describes a situation where a Spanish company has its securities traded on a U.S. stock exchange, and there are a whole bunch of different issues and occurrences described in the fact pattern. What I hope to do is just go through them. And as we talk among ourselves, we don't want to exclude you, so I would like to have you participate.

The fact pattern begins by talking about a company, a Spanish company, that functions and works in three different sectors: telecommunications, the financial sector, and the utilities sector. And my first question to the panel is whether these three different sectors raise any issues that ought to be immediately addressed by Sarbanes-Oxley. Jorge.

JORGE JUANTORENA: Sure, I think it raises sort of an immediate issue in the context of certification as this company thinks about certifications to be provided by the CEO and CFO and it thinks about disclosure controls that have to be implemented. One thing to bear in mind is there is no one-size-fits-all approach. You have to modify your procedures to take into account the geographic scope of the company as well as the scope of its different operations, its different business segments. I think that's one clear issue that would have to be taken into account.

MR. HAMILTON: What immediately comes to mind are the disclosure requirements, which I'm a bit confused about, because every time I go through the different articles and material that I read they talk about sections 302, 404, and 906.

Dennis, can you help us along about what exactly would be the responsibilities now for a foreign company like our example here?

B. Independent Boards and Audit Committees

DENNIS BLOCK: Well, the first problem is that you have to read Sarbanes-Oxley alongside the stock

exchange listing rules, because they work hand in glove and are meant to complement each other. The emphasis is on both independence of the board and the utilization of an audit committee, and that is supposed to oversee a good deal of what happens in the financial reporting arena. The problem for any board of directors, independent or otherwise, and any audit committee in a company that is sort of a conglomerate having three very different segments is to understand the whole business. It is hard enough to understand one core business, let alone three significant industries combined into one company.

So if a board is going to meet four times a year and a committee meets a half hour in the morning before the board meets, they are going to have a great deal of difficulty understanding the company's business. If you can't understand the company's business, you're going to have a much bigger problem understanding the company's financial position and being able to ask intelligent questions.

Now the way the Act works is that the audit committee doesn't really have any special role with respect to the 302 certification. It does have a role in the 906 certification, since you're supposed to clear that with the audit committee. But I assume in any functioning board you clear all of your financials that existed under law long before Sarbanes-Oxley, and the concept of directors' duties, even without Sarbanes-Oxley, assumes that the board is, in an informed manner, to sign off on the company's financials. I think it is a very hard thing to be an expert in three different areas of industry.

MR. HAMILTON: Our fact pattern.

CHARLES DORKEY: Just thinking out loud here. I raise the question whether it makes sense to have three different audit committees or subcommittees of the audit committee in order to learn the substance of the underlying business.

MR. BLOCK: It is a thought. It isn't terrible to assume that an audit committee of a multi-industrial conglomerate will have each of its members sort of become expertized in one of the three different areas, and you're allowed to rely on your colleagues on the audit committee. So it is an idea. I think corporate law assumes you're going to learn a lot about all three businesses.

MR. JUANTORENA: One other thought on that. I think it presents an issue about which a lot of our clients have been asking us. If you have an SEC registrant that has subsidiaries that are not SEC registrants, not considered issuers for purposes of Sarbanes-Oxley, what is the responsibility of the audit committee of the parent company? For example, what role does it have to play with respect to the auditors of the subsidiaries? I think many of those issues still haven't been worked out, but that's something that will have to be addressed by many of us in the coming months.

MR. HAMILTON: In terms of the disclosure, Larry, would it make a difference whether the accounts are done on a consolidated basis?

LARRY SHOENTHAL: Well, under the rules now—and I take it the rules haven't changed under this—you have to have a report on a consolidated basis. Even though each one of these industries may have different functions, they still have to have the same auditing principles, the same accounting principles.

MR. HAMILTON: Okay. Our fact pattern: we don't have an audit committee. What we do have is a board of directors. And, Trip, how would you counsel Spitzer as they go forward and as they want to comply with Sarbanes-Oxley?

MR. DORKEY: Well, it is a company that would be subject to the Act since it is listed on a stock exchange. Although it is not clear which exchange, it is listed. And, as already raised by Dennis, in addition to your advising the client with respect to Sarbanes-Oxley, you have to advise the client with respect to the regulations of the various stock exchanges.

We would advise them to get an audit committee, because that's one thing that you have to do. I mean, without an audit committee all the directors have to be independent, and in this case we have twenty directors, with a vast majority of them not independent by any means at all. So with an audit committee, we would have the independent directors look over the finances of the company.

MR. DORKEY: Well, the SEC, I believe, in the last couple of days pursuant to Sarbanes-Oxley has basically said that you can't be listed on a national securities exchange unless you have an audit committee, so that probably is going to settle that question.

MR. HAMILTON: Can they come back and argue, "Well, okay, we don't have the audit committee, but we are prepared to have our regular board do the things we have to do, and will try to make them independent." Would that be something you would say as counsel to them, as a way to go forward?

MR. DORKEY: My experience with boards is that people have to put in a lot of effort to do the job right. And if you spread the job over too many people, it doesn't get done. It just doesn't get done right. You have to focus in on people who are truly committed and engaged to do the job. So I tell them that you should shrink the size of the group of people responsi-

ble, put in an audit committee, and charge them with responsibility for overseeing the finances.

MR. BLOCK: Well, you know, the certification rules that require you to have procedures and policies in place in order to oversee and ensure the accuracy and adequacy of your financial statements assume that you're going to have a functioning audit committee. And I think that's exactly right, if the audit committee is the board, one is going to have difficulty finding that they have a functioning auditing committee.

MR. HAMILTON: Our CFO in the fact pattern has a special relationship with the external auditors. There's no audit committee. How do we counsel Spitzer to address this situation, again, in the light of Sarbanes-Oxley? Jorge, do you want to take that?

MR. JUANTORENA: Sure. I think that, under the rules proposed by the SEC, it is likely that the auditor in this case would not be considered independent. Larry might be more of an expert on this than I am, but if he had previously been a partner with the accounting firm and now he's essentially in a supervisory role in connection with the preparation of the company's financial statements . . .

MR. BLOCK: His problem is he's only been away from his accounting firm for six months, and there's a cooling-off requirement. He would have to spend at least a year away from his accounting firm. And he could do that as an employee of the company, but not as an employee who has anything to do with the financial records or financial reporting of the company.

MR. SHOENTHAL: One thing with this is that right now there isn't a public company accounting oversight board. And these rules, as far as the independence of the accountant and this cooling-off period are concerned, don't start until you have registered accountants. And since it is already six months into it, I take it that, by the time that there is a requirement for this to come into place, he probably will be out for the year. And whether that would be enough of a cooling-off period—it may be.

MR. BLOCK: I think many of the things we are going to talk about aren't in place yet, and maybe it would be helpful for the hypothetical to assume that it is all in place.

MR. HAMILTON: This morning, particularly, there's an article in the *New York Times*, and I got the impression that they are backing away from this cooling-off period requirement. And in the event that they do back away from it, what other requirement or protection will they put in place to sort of satisfy the intent of the Act?

MR. DORKEY: Well, whatever they put in place, it would seem to me that we have to go back to what led to the Sarbanes-Oxley law to begin with. And that is the perception, indeed the reality, that there was a—let me use the word "hypothetical"—cozy relationship between accountants and the companies. And I think for anybody advising the company, you must have an independent audit committee, you must have an independent CFO, whether measured in terms of the statutory language or what you truly believe. I mean I would counsel people that just because you meet the letter of the rule with a one-year cooling-off period doesn't necessarily mean the person is independent. You want to make sure that your books are being done in an objectively analyzed, independent way to protect you from problems, not just from the SEC, but also from private plaintiffs.

MR. BLOCK: Well, you know this is a foreign company, and state law looks to the state of incorporation, so you go back to your own home jurisdiction. But assuming this was an American corporation, I think what Trip is saying is really important, because there's an overlay here. The duty of care hasn't been changed by Sarbanes-Oxley. But what do you have to do to satisfy that duty as a director? Your duty of care has been expanded because you, in performing that duty of care, need to take into account all of the requirements set forth in Sarbanes-Oxley. So if you're not doing what under Sarbanes-Oxley is required or you create a process that doesn't allow you to do it, you're going to run afoul of your duty of care.

MR. DORKEY: But knowing prosecutors, as we all do, the fact that you comply with the law doesn't necessarily mean that you're going to get a free pass if they don't like what you're doing.

MR. HAMILTON: Larry, the fact pattern calls for a number of non-audit services to be provided by the external auditor. You and I had a conversation yesterday and you indicated some concern about this. I think, if I understood you correctly, you thought it was too stringent. I don't know if you want to develop some of your ideas.

MR. SHOENTHAL: Well, there are nine prohibited acts under the Act. One is bookkeeping and other services related to accounting records or financial statements of the audit client. These are the other things that cannot be done by the accountants: financial information systems design and implementation; appraisal or valuation services, fairness opinions and contribution-in-kind reports; actuarial services; internal audit outsourcing services; management functions or human resources; broker or dealer, investment adviser, or investment banking services; legal services and expert

services unrelated to the audit (although nobody really knows what expert services unrelated to the audit are); and the catch-all, which is any other services the public company accounting oversight board determines by regulation is impermissible. And since the board isn't in service yet, we don't know what that is.

Anything else, however, would be acceptable if it is preapproved by the audit committee—and here we don't have an independent audit committee, so I don't know that you can have the preapproval, but let's assume that they will have an independent audit committee. And the problem that I have with this is that these directors that would be on the independent audit committee are not stockholders. They can't be. They have to be independent.

MR. BLOCK: They can be stockholders. They can even be big stockholders.

MR. SHOENTHAL: I stand corrected. But how many people unrelated to the company will want to be directors and have that type of liability?

MR. HAMILTON: What are the concerns that would arise for Spitzer in particular?

MR. JUANTORENA: Under Spanish law, for example, the shareholders have responsibilities and authority to perform certain acts and activities, and one of them is naming the auditors. So this Act obviously takes away the authority that is given to them by Spanish company law. So that is going to provide an interesting set of circumstances. There's a direct conflict between Spanish law and the SEC. Do you think that, as the discussions go forward, this historical deference to local jurisdiction will carry the day? In other words, would the Spanish company be able to say, "Look, I have complied with my law, my law is mandatory, and I'm sorry I can't do yours"?

MR. DORKEY: I've often been fooled in life, but generally I try to believe people are rational in their beliefs, even when it comes to government bureaucrats. I would think the Spanish law is designed to achieve the same result, that is, someone with other than a potentially cozy relationship with the accountants—the shareholders of the company, who certainly more than anyone else have an interest in the success of the company—have by local law direct oversight over the accountants. That should satisfy the concerns being addressed by the SEC and Congress in Sarbanes-Oxley.

C. Delisting and Going Private

AUDIENCE MEMBER: Calvin, this is a question directed to everybody, but particularly Mr. Block, because I know he's very active in the capital markets here in New York. Are the capital markets in the United States so important to, say, EU companies that these companies would not consider simply delisting from the New York Stock Exchange or the NASDAQ and only having their market on the London exchange?

MR. BLOCK: Well, I would have answered that question very quickly with a yes two years ago. But looking at the Dow at the moment, maybe I'm not so certain that that's the case. I think historically raising capital has required a U.S. component for any large capital-raising effort. I believe that fact will continue to motivate companies offshore to comply with our rules.

Again, you know, I'm great at criticizing the rules—it's good for articles you write—but a lot of what's in Sarbanes-Oxley that gets criticized really isn't so terrible. The point that we have certain auditing services that are not permitted to be rendered by the auditor, well, all that is designed to do is what I think is pretty much common sense. An auditor shouldn't be auditing what he does. That's a pure conflict. I don't find that so offensive.

Any time Congress tries to write rules in a specialized area we are going to have areas of mistakes and things that don't make a lot of sense because Congress sometimes doesn't make a lot of sense. But I think a lot of the intent, which is basically to restore investor confidence, will be achieved. And I think that's good for offshore as well as domestic companies.

MR. DORKEY: I would add that, in terms of people delisting, in respect of smaller companies or midsize companies for which the cost of complying with rules is high in relation to the capital raised, you'll see some delistings or decisions not to raise money in the United States. And I agree with Dennis, it's the game for any company wanting to raise big money.

MR. BLOCK: Trip, I'll make my prediction for 2003. I then won't make any more predictions. You will see more going-private transactions in the U.S., not delisting, because that doesn't make a lot of sense. You will see going-private transactions because the cost and intrusiveness of the regulation will make it impossible for companies or at least not palatable for companies to continue to be public companies.

AUDIENCE MEMBER: If a company were to delist, don't they stay liable for x amount of years once they are out?

AUDIENCE MEMBER: Forever.

AUDIENCE MEMBER: Assume I don't want to comply, and I leave—I'm a European company, and I'm currently listed here—because in the past year I've done something unusual. I mean, the fact that you're going to delist automatically turns on a lightbulb somewhere, so that you are going to be investigated—who knows, possibly, because of that. How many years would they

have to wait until they are free, shall we say, from being investigated for actions taken prior to their delisting?

MR. JUANTORENA: I'd like to make just one point clear. I think there's been a little bit of confusion. A delisting by itself is not sufficient to get you out of most of the Sarbanes-Oxley requirements. It might get you out of some of the requirements, for example, the audit committee requirement, which applies only to companies that have listed securities here in the U.S., but most of the requirements apply to companies that have SEC-reporting obligations. So if you merely delist and have more than three hundred security holders in the U.S., you would still be required to comply with your SEC-reporting obligations, and basically you would still be subject to most of Sarbanes-Oxley. And that's one of the reasons why I think at the end of the day many companies won't do that. I think Dennis is right: you have to essentially go private and not just delist.

D. Financial Expert

MR. HAMILTON: We haven't said anything about the financial expert that the law obliges companies to have. And Larry, can you just take us through what sort of qualifications this person must have?

MR. SHOENTHAL: I don't think I really know or anyone else knows. But there is an out, that if you don't have it, you can explain on your statement as to why you don't have it. The problem you have here is that you have a conglomerate. When you have a conglomerate, you have many businesses, and there is no one person that's going to be an expert in all of these businesses.

MR. HAMILTON: But the law does provide for some minimum requirements.

MR. BLOCK: Someone who, through education and experience as a public accountant or as a CFO, controller or principal accounting officer of a public company or other relevant experience has (1) an understanding of GAAP and financial statements; (2) experience in preparing and auditing financial statements of comparable public companies; (3) experience in GAAP in connection with accounting for estimates, accruals and reserves; (4) experience with internal accounting controls and understanding of audit committee functions. The head of the Bureau of the Budget couldn't satisfy that definition!

I think the issue is that it's very hard to find someone who meets those qualifications. And if you found that person, why would he want to be on an audit committee of a public company? It is putting a target on his back for all things that go wrong in the corporation.

When I say Congress is capable of silly things, I put this toward, if not at, the top of the list of silly things. The current rule, which in my view is silly enough and which the stock exchanges came up with as a result of the blue-ribbon commission that looked at governance two years ago, says that members of the audit committee should be financially sophisticated. That is, in comparison to what I just read, a much more reasonable definition of what financial expertise should be.

MR. DORKEY: So in thinking about what's going to happen in the coming years, it may come to pass that companies will simply say they don't have any financial experts on their audit committee and disclose that to the investing public for the reasons Dennis just gave.

MR. BLOCK: Well, can you picture the Ford Motor Company saying that or some Fortune 100 company saying that? You know, it is one thing for a mid-cap company, which isn't going to find that person, because he or she is just not going to be available to them. But could you imagine a large public company in America actually saying that?

MR. DORKEY: If they all said it, people would know what the joke was.

MR. JUANTORENA: It is even a harder case for most foreign companies as well. I think they would be hard-pressed to find someone who meets these requirements.

E. Restatement of the Financials

MR. HAMILTON: We have got a situation where there was a restatement of the financial accounts, and there is a requirement under the Sarbanes-Oxley that, in the event there may have been profits, there is a disgorgement requirement. How would that work in effect? Jorge?

MR. JUANTORENA: Sure. Sarbanes-Oxley generally provides that essentially any loan or incentive stock option or equity-based compensation that the CFO or CEO receives during the twelve months after the publication of the financial statements subsequently restated are subject to disgorgement. It is somewhat unclear what that means and how recovery would occur. If the restatement is the result of misconduct due to a material violation of financial reporting requirements—I think pretty much every restatement I've ever seen is a result of that, although I suppose in theory you could imagine it not being the result of that—the CEO and CFO might be off the hook because it appears that the restatement and erroneous financial statements occurred before Sarbanes-Oxley.

One other interesting issue that comes up in the fact pattern is that they apparently made some money from selling the stock of a subsidiary. You might have thought initially that that profit would be subject to disgorgement. But if you undertake a literal reading of the rules, it would appear that it is only profit from the sale of the issuer's stock. So it looks like they might get a freebie here in terms of the profit they realized from the sale of the subsidiary stock. That probably would raise other issues (such as insider trading or perhaps issues under the home country's rules), but it wouldn't raise an issue under Sarbanes-Oxley.

MR. BLOCK: The penalties are very harsh. I had a client call to ask if there was some way we could compensate around the Act. I said I didn't think we wanted to have disclosure about our compensation around the Act. But I do believe that the law would have allowed the SEC and certainly the Mel Weisses of the world to pursue individuals for misstated financials, to recover those kinds of profits that were made by executives in a company that overstated its financial condition.

MR. HAMILTON: I think the requirement, though, is that there must have been some wrongdoing. In other words, if the Spanish company had to restate to comply with U.S. generally accepted accounting principles, that wouldn't be "wrongdoing" for purposes of Sarbanes and the disgorgement requirement, is that correct?

MR. BLOCK: Why not?

MR. HAMILTON: That's my question. I don't know.

MR. BLOCK: Violations of GAAP in and of themselves don't violate the securities laws, but they might. If it was intentional, it would.

MR. HAMILTON: But there is a consideration here, and this happened to one of the big Spanish banks. They were forced to restate because they had filed documents based on the accounting principles in Spain, and there they had done it correctly. It would be overly burdensome to penalize them for complying with the rules of their own local jurisdiction. I mean there's no intent to want to commit anything wrong.

MR. BLOCK: Isn't there something in Sarbanes-Oxley that says you're exempt if you're consistent with the law of your jurisdiction? This would mean you should all go back to your countries and tell your legislatures that the way to deal with this issue is to create something in local law inconsistent with Sarbanes-Oxley.

MR. SHOENTHAL: The other inconsistency with GAAP in the reporting is that there is a certification, and since they stated that it is under GAAP, the restatement would show that their certification was purged.

MR. BLOCK: But that doesn't necessarily mean violations of GAAP don't equate to misstatements or fraud.

MR. HAMILTON: Right.

MR. BLOCK: Having said that, the SEC does have discretion to seek penalties if in fact you have to restate.

F. Attorney-Client Privilege; Withdrawal

MR. HAMILTON: I think what a lot of us are interested in—at least we lawyers practicing in the foreign jurisdictions that find themselves caught under the net of the Sarbanes-Oxley—are the attorney/client privilege issues. Now, I read this morning that it would seem that the SEC is going to back off from the requirement to have this sort of whistle-blower kind of thing: withdrawal in the event that counsel is unable to sway the opinion of his client.

Some of us think that that's good, because, you know, we don't want to be thought of as squealing on a client, and some of us think that it may actually affect the relationship that we enjoy with our client. But under the fact pattern here, we have got a situation where there is a wrongdoing. The outside counsel does try to convince his client to change his ways and is not successful in doing so.

Now, how would that work out in practice under the law, Trip?

MR. DORKEY: Under the law now, talking about the in-house counsel, not the outside counsel?

MR. HAMILTON: Yes.

MR. DORKEY: Starting with the in-house counsel, his job is to go up the ladder. And I think in this hypothetical, as I remember it, I think he has complied with this obligation. He just can't sign off. He has to disaffirm any SEC filings. He's not required to withdraw from representing the client.

MR. HAMILTON: But he's in-house counsel.

MR. DORKEY: Yes, that's the in-house counsel, that's what we are talking about.

MR. HAMILTON: But he's employed by this company.

MR. DORKEY: That's why the SEC has decided he doesn't have to quit his job, which reflects at least some amount of reasonableness on the part of the SEC about how real life works. But the outside counsel has to

report to the chief legal officer, and if that doesn't work he has to go up the chain. And then there has to be a noisy withdrawal, withdrawal that draws attention to the fact that he's leaving.

MR. JUANTORENA: One interesting point that comes out in the hypothetical is you've got two lawyers: you've got an outside counsel and an in-house counsel. It looks like the inside—actually maybe it is the outside counsel who is the one working for the Spanish subsidiary that was sold. Here you may have a lawyer in Spain who is basically advising his client, a Spanish company on the sale of a subsidiary that it has. And if you look at the SEC's release in terms of what it means to be practicing before the SEC, if that transaction is sufficiently material, then that purchase and sale agreement is going to be filed before the SEC; thus, that attorney can be deemed to be basically practicing before the SEC. Their proposed rules are sufficiently broad to pull that in.

This is just one of several examples of a kind of extraterritorial reach. The outside counsel for the issuer itself is, I think, probably on more notice that he is practicing before the SEC because his particular client happens to be an SEC registrant. But that's not the case with the other lawyer.

MR. BLOCK: There are several real themes running through here. This is most deplorable of all because I'm a lawyer. Of all the provisions in Sarbanes-Oxley, I guess, if I were an insider in a corporation, I would question the fact that I couldn't get a loan from my corporation going forward. But as a lawyer, this particular section is really a problem. And there's a real history to this.

During the '80s, when I was a much younger person, the bar had a major fight with the Securities and Exchange Commission over the SEC's current method of disciplining lawyers who do something inappropriate in connection with the SEC's processes. That's the way it is described. And the SEC took action against two prominent lawyers in New York back in the '80s and sued them in essence for not stopping their client from putting out a false and misleading press release. And that was an administrative hearing that took place in Washington over a long period of time, resulting in a lot of negative communication between the bar and the SEC. The SEC conceded at some point in the late '80s when general counsel Cleary took a position that the SEC would narrow its use of the rule at issue only to actual lawyer misconduct before the SEC. That was a conclusion that was applauded and made a lot of sense.

The second theme that runs through this is that we all know the Code of Professional Responsibility Rule 1.13 says that a lawyer represents a client, and, when you're dealing with a public corporation, the client is the corporation. So it is logical to say that when you're giving advice that's not being accepted by employees of the corporation, all the way up to the CEO, your responsibility is to tell the decision-maker in the corporation, the board of directors, that there's a problem and they should deal with it.

The third issue is that of confidentiality and attorney/client privilege. As we learned in law school, the reason for the attorney/client privilege is to encourage the free and frank flow of information between the lawyer and the lawyer's client, so the lawyer can give good advice because he or she can get the information to give the advice. And the thought always was, if you didn't preserve that privilege, no one would ever give you the correct information to help the client make a correct decision.

All three of these themes are very important in the SEC's noisy-withdrawal circumstance because, yes, it is all right to go above the general counsel if you have to and even the CEO; it is not career-enhancing, but it is all right to do that because you have an obligation to the entity. But your obligation should end at that point. You shouldn't be out criticizing to the SEC a document that you believe is not correct. You're not a judge, after all, and you might not even be right. But the concept of identifying to the SEC, if you're a lawyer, the document that's incorrect would be a clear violation of your obligations of confidentiality and the attorney/client privilege.

There's another funny part of Sarbanes-Oxley dealing with this issue, which is that this concerns not only false statements made in financial statements or other SEC documents. Sarbanes-Oxley talks about noisy withdrawal in the context of knowing that your client has breached its fiduciary duty. Well, if there's a lawyer smart enough in this room or in this building right now—and there are a lot of smart lawyers in this building, I believe—who can tell me what a breach of fiduciary duty is with certainty, I applaud that individual. Because the smartest lawyers in New York City and this country on a daily basis fight over this with each other, in the Delaware and other courts over what constitutes a breach of fiduciary duty, and each believes as he argues with all of his heart that he's right. So the obligation to report some breach of fiduciary duty to the SEC is a mind-boggling concept.

MR. JUANTORENA: I share Dennis's outrage. I think there are two interesting things in the proposal. And I was glad to see that the SEC—if you believe the *New York Times*—is going to backtrack. First, if you go back and look at the proposed release, it is based on a faulty premise. It says essentially the duty of the lawyer is to do what's in the best interest of his or her corpo-

rate client and its shareholders. As Dennis points out, the duty is really owed only to the company, not to the shareholders.

But secondly, I think it mischaracterizes the role of a lawyer. I don't think the lawyer's job is to do what's in the best interest of the corporation. I think the lawyer's job is to zealously represent the corporation. You are not the decision-maker. You cannot tell the company exactly what to do. You can give them advice, and hopefully they are giving you exact information, but ultimately they call the shots, not the lawyer.

There is something ironic in the approach the SEC was taking. Because in the context of disclosure they have always indicated that companies cannot go out and try to use code words to fail to directly disclose something. That's not considered adequate disclosure. In this context, they are basically saying that it is not a breach of your fiduciary duty to your client, and that you're not violating the attorney/client privilege because we are not asking you to tell us exactly what they did wrong. "We want you to just tell us you are resigning for professional reasons, and tell us which filing you disavow, but don't say anything else." You're off the hook. It is ironic they have taken that view, and I think that's clearly inconsistent with law.

AUDIENCE MEMBER: Well, you know, that's clearly the standard for a litigator. If a client is making a false statement to a court, that's standard. You cannot disclose the confidential communication, but you must make a withdrawal that essentially is a noisy withdrawal. I mean it is exactly the same standard for litigators.

MR. JUANTORENA: But I think it is novel to apply it in the context of not doing it before a court but going before a regulator. You're essentially deputizing every lawyer in the world that has anything to do with the SEC.

MR. DORKEY: The court context is different from a regulatory context, especially when you get a breach of fiduciary duty in a corporation that may not be tied to a specific SEC disclosure document. And I would also submit that the role that corporate lawyers play in advising clients is much broader than what litigators do in presenting a case in the court, where it is very focused.

MR. BLOCK: The real issue is, do you make a lawyer incapable of doing his job if a lawyer has to live in fear—and this is the distinction—in fear that in telling a corporation what its options are, he or she some day is going to face the loss of his or her license because the SEC doesn't like the ultimate piece of paper that is issued by the corporation? It is not a realistic kind of thing to require a lawyer to take the position that he or she is absolutely right and that all these smart corporate executives who know their own business are absolutely wrong, and to require further that he or she stand up and complain to the government and probably ruin his or her own career by doing so.

MR. JUANTORENA: One other complaint that no one has touched on yet. If you just go through the requirements of the noisy withdrawal, there is a series of steps along the way in terms of discovering that there's evidence of wrongdoing. Well, what is that? It is whatever a reasonable person thinks is evidence of wrongdoing. Well, hindsight is 20/20. After the fact, of course, everyone is going to turn around and say, "Well, gee, here was the smoking gun, why didn't you recognize it?" You have to speak to the chief legal officer or CEO or to the audit committee; did they respond appropriately—well, who knows what an appropriate response is? There are a host of incredible subjective factors built into that, and it is something that would have a very detrimental effect on the relations between lawyers and their clients.

MR. HAMILTON: I think it was Senator Enzo who made the comment that, when they passed this law, the legislators had no intent to have the extraterritorial reach. They had no intent to govern the way foreign lawyers, for example, practice in respect of this particular issue. And so I think we should start from that premise, and I think the SEC has decided that they are not going to pursue this as vigorously as they might have; they are not going to impose this restriction or obligation on lawyers to have this noisy withdrawal. I think that would be consistent with the intent of the legislation.

MR. DORKEY: I could be wrong but I would just add that, if the SEC is going to come up with something that's less than what they have now, I would be surprised if most of us are going to be happy with the new suggestion.

MR. BLOCK: They could solve their problem by just forcing the corporation to make a disclosure, and that does away with all the problems we have just described. It is not comfortable, but it certainly solves the problem.

G. Undue Influence

MR. HAMILTON: The last thing, just before we break up: there is in the hypothetical the undue pressure brought to bear on the external auditor by the CFO to have a transaction reflected on the books for 2002 rather than 2003, because the deed transfer would have been consummated and in effect in 2003. And it has to do with this Enron-esque situation in which the special purposes vehicles were taken off and these off-the-balance-sheet transactions were never shown. Here we have a situation where there will be an influence, a

direct influence, on the revenues of this company if the transaction is reflected in 2002. I thought, Larry, you might want to say a few words about this, the pressure and undue influence.

MR. SHOENTHAL: Well of course, if there's pressure and undue influence, then the person is no longer independent. The one thing that's in the Act is that the company cannot potentially mislead the auditor.

MR. HAMILTON: So, we have a certification requirement.

MR. SHOENTHAL: But you have something else here. Remember that the auditor itself now has to register to practice before the SEC, and the government may review the work papers and everything else that the auditor has. So, if the company later goes south, there is a good chance that this government board will ask for the auditor's work papers. And there is a good chance that the auditors could be barred from practicing before the SEC.

MR. BLOCK: The whole thrust of the Act and the new stock exchange proposals are aimed at exactly this. In the future under the Act and under the listing requirements, the auditor will work for the audit committee. He will be retained and fired by the audit committee. He will discuss his audit, both before and after completion, with the audit committee. And every audit committee in America will start its interview of the independent auditor with the question: Was there any undue pressure on you by anyone in management to do anything? And did you use principles that were less or more aggressive and less conservative than you otherwise might have used because management suggested that you do that? So the Act really ought to deal with that issue.

When I was a younger lawyer, I recall the three-day rule. The three-day rule was, well, if you were a manufacturer and if you had the goods out on the loading deck, and if the truck pulled out within three days of the date you had the truck at the loading deck, within three days after the month in which you're going to book it, well, you could book it for the prior month. That was the three-day rule. Most companies that used the three-day rule, and their accountants allowed it, ultimately used the 150-day rule and 30-day rule and 45-day rule. Because at end of the day you could never fill the hole. So the concept today is to prevent that, to make sure that the auditors responsible for that do their jobs and can say to the audit committee, "No, I didn't do anything like that."

MR. SHOENTHAL: It is more than that. One of the absolute requirements is that an auditor has to report to the auditing committee on alternative accounting treatments. So they have to bring to the audit committee's attention that there are other ways of doing this, and it is up to the audit committee to decide.

MR. HAMILTON: That's all the time we have. I want to thank Jorge, Larry, Dennis and Trip for spending time with us. I know your schedules are very heavy and busy, and I thank you very much.

IV. Ethical Conflicts for Common Law and Civil Law Lawyers in Complying with the Disclosure Requirements of Sarbanes-Oxley

A. Introductory Remarks

MR. DUFFY: Ladies and gentlemen, I am James Duffy, and I am going to be moderating this portion of our program. I would like to introduce you to our speakers. On my right we have Jonathan Goldsmith, who is Secretary General of the Common Bar Counsel of the European Union. Prior to that, Jonathan was Secretary General of the Law Society of England and Wales. Jonathan is basically a common-law-focused attorney, but his main constituency now is the Council of the Bars and Law Societies of the European Union (CCBE), a body of civil law lawyers, even though there are common law lawyers involved in the various bar associations in the European Union. So Jonathan has a very interesting perspective that he can bring to this, because he sort of sits astride the distinction between common law lawyers and civil law lawyers. And perhaps we'll hear some of that in some of the discussion that we are going to have.

To my left is Michael Maney from Sullivan & Cromwell. And Michael of course is a common law lawyer, and he is a member of the New York bar, and he will be focusing on the common law issues.

I think it was toward the end of our last panel that we started to touch upon the types of things that we want to discuss here. We want to talk about what ethical issues are presented by Sarbanes-Oxley, as we now understand it, and recognizing that it is probably going to be refined a good bit through the regulatory process and perhaps even through the amendment of the legislation as time passes. And we have the luxury of not having the SEC making pronouncements as we speak; that will happen tomorrow, or maybe tomorrow or in the coming days. So right now we are sort of speaking against an unknown background.

I am going to play the role of Larry King, not nearly as well as he would play it.

But to get us started, Michael, how do the ethical obligations of New York lawyers and common law lawyers accord with the obligation of Sarbanes-Oxley on lawyers?

B. Definition of Lawyer; Noisy Withdrawal

MICHAEL MANEY: Well, first of all, may I just point out one of the outgrowths of Enron—and I'm with Sullivan, Cromwell LLP—today's *New York Times* suggests that maybe some of our fear and trembling is perhaps somewhat unwarranted, but as long as the press keeps talking to academics, there's always that risk that they will repropose material and enact it.

The rule as proposed starts on page 507 of your heavy book; the actual text of the rules starts at page 576, if any of you haven't already read it or haven't read all the way through it without falling asleep. One of the issues, of course, is ethics, the definition of "lawyer." And as has been pointed out repeatedly here, the definition encompasses not only foreign lawyers, but it encompasses lawyers who may be acting in respect of an issuer not in the context of an SEC filing. Maybe a lawyer who is doing a real estate portion that is reflected in the annual report that gets filed with the SEC, and, given the way they talk about acting on behalf of the issuer, that lawyer would get picked up in the definition. So the notion of what's the relationship of the attorney and the client is much fuzzier here, and some of the ethical issues get compounded. Representing any party is part of the definition.

MR. DUFFY: Michael, can I just interrupt you? I'm reading one of the definitions here that says an attorney is one who holds himself out as otherwise qualified to practice law.

MR. MANEY: Yes.

MR. DUFFY: Does that mean in your understanding that maybe you don't have to have to be an attorney to be an attorney under these definitions?

MR. MANEY: Oh, I think it would clearly cover law clerks who are not admitted yet. It would cover Leonardo DiCaprio. It would probably cover a good many accountants. But it also would cover many foreign persons—a question is, would it cover a *notaire*? Would it cover a tax advisor, who is not necessarily an attorney under certain European systems?

AUDIENCE MEMBER: I just have a comment. I'm as appalled as everybody with lots of aspects of the rule. But this is an issue in a lot of foreign jurisdictions—I mean, Japan is the one that comes to mind most obviously, since the chief legal officer in most Japanese corporations is not licensed to practice law. So there are a lot of instances where it's perfectly appropriate for the purposes of these rules that you treat as a lawyer someone who has significant legal responsibility of the corporation, notwithstanding the fact that he doesn't have a license.

C. Attorney-Conduct Rule: New York Perspective

MR. MANEY: Regarding one of the issues—and this is where I take some issue with comments made by the previous panel—you're talking about reporting evidence of a material violation. And what is that evidence of a material violation? They say it is evidence that a reasonable lawyer would consider to be a violation of the securities laws. Now, is that a malpractice standard? Does that mean that there's an objective standard? At least it purports to be an objective standard. Does that mean that the evidence is one as to which the SEC in hindsight says, "Oh, a reasonable lawyer should have detected this as a violation"? Or is it, as I say, a malpractice standard pursuant to which any reasonable lawyer would have concluded that it was a violation? And if some people say, "Well, I don't think it was a violation," then you're off the hook. That's quite unclear. If it is a malpractice standard, then perhaps the rule isn't nearly as onerous and as terrifying as it seems on first reading, because you also have a question of the level. I mean, are we imposing on lawyers the standard of being an SEC-qualified lawyer? Those of us who practice federal securities law all the time have perhaps a sensitivity to what may or may not be material that a lawyer who is normally not involved with all that stuff might or might not have. In the same way that we might not be as sensitive to other issues that lawyers who practice in other fields might be sensitive about. What kind of standard are we applying?

But let's get on to the question of what is the obligation. I don't think there's a problem in reporting up the ladder. The ethical rules are that the corporation is the client, and you go up—you would go all the way up to the full board—if you encounter a violation. The obligation of a lawyer would be to try to convince the client to correct a violation. And I'm going to ignore for the moment this notion of a qualified legal compliance committee, which is sort of a slight distraction perhaps, because I don't think any company would have one, since that committee would be one that would be obligated to then report to the SEC. It is very nice for the lawyers, but I don't believe we will have it. So the real issue comes up on the so-called noisy withdrawal obligation, and you look and see how is that consistent with our ethical rules.

I was mentioning to Jonathan before the break that I was sort of surprised reading a book by Antonia Fraser called *Faith of Treason* about the Gunpowder Plot of 1605, with which you're all familiar, that contrasted the priest/penitent privilege with the attorney/client privilege and indicated that, in England in those days, maybe lawyers were not permitted to divulge the admission of a future crime, which is something I found shocking because I think here in this country, in most

jurisdictions, if a client admits that he's going to commit a crime, then the lawyer is permitted to reveal it: not obligated—except perhaps in New Jersey—but permitted to reveal it. Although I think somebody said that, in California, they may not be.

Let me just review briefly some ethical obligations, and I'm reading now from the New York code. Under Ethical Consideration 4-7, a lawyer has professional discretion to reveal the intention of a client to commit a crime and cannot be subjected to discipline either for revealing or not revealing such intention. A lawyer may reveal confidences or secrets to the extent implicit in withdrawing a written or oral opinion previously given by the lawyer and believed by the lawyer still to be relied upon by a third party where the lawyer has discovered that the opinion or representation was based on materially inaccurate information. So this is again consistent with what they are talking about.

Under Canon 5, where the client is an organization, the lawyer representing goes right up to the top, as we said, and if (i) despite the lawyer's efforts—and I'm reading from Disciplinary Rule 5-109(c)—the highest authority insists upon action or a refusal to act, (ii) it is clearly—clearly—a violation of law, and (iii) it is likely to result in a substantial injury to the organization, the lawyer may resign: not "must" but "may" resign in accordance with Disciplinary Rule 2-110.

Now, the resignation language in DR 2-110 says a lawyer may not withdraw until the lawyer has taken steps to the extent reasonably practicable to avoid foreseeable prejudice to the rights of the client. So I don't think that Rule 307 of Sarbanes-Oxley contemplates steps to avoid foreseeable prejudice to the rights of the client, but the lawyer may withdraw from representing the client if withdrawal can be accomplished without any material adverse effect on the interests of the client; if the client persists in a course of action that the lawyer reasonably believes is criminal or fraudulent; or if the client has used the lawyer's services to perpetrate a crime or fraud.

Now, those are the ethical obligations. And the point is that the main difference is "may" or "must." Rule 307, as presently proposed, is a "must" rule. If you don't get the results you want or think are required, then the lawyer must withdraw. And it's a noisy withdrawal. Under the ethical obligations, at least in New York, you may withdraw, but you are not obligated to.

Then, of course, the issue comes up as to whether withdrawal means withdrawal just by the individual lawyer. I doubt it. I think it means the whole firm. Does it mean withdrawal just in respect of the engagement that triggered this obligation? Or does it mean withdrawal from all representation of that client? Does that include representation in litigation, where you may require the approval of the court before you could withdraw? That presents another ethical conflict. And that may be a terrible prejudice to the client if you must withdraw from all representations.

MR. DUFFY: Why don't we just hold it here. Jonathan, I would like to put the same question to you, and then I think we'd like to come back and revisit some of these issues that Michael has raised and I'm sure you will raise also in your answer.

D. Extraterritorial Reach of the Attorney-Conduct Rule: European Perspective

JONATHAN GOLDSMITH: Okay, I will move from the general to the particular. You will be surprised that the European bars and law societies which I represent most strongly objected to the extraterritorial reach of the proposed attorney-conduct rule, which we think is unheard of. I mean occasionally there is extraterritoriality in crime and in tort areas, but in professional regulations we certainly haven't come across it.

The reason at root why we object to it is not so much because it breaches the sovereignty of nations and the generally accepted notion that lawyers should be regulated locally (which is accepted everywhere, including in the United States), but actually because it leads to lawyers' being faced with impossible conflicts. I mean we have this in the European Union where we do have the equivalent of extraterritorial regulation within our own legal services regime within the EU. In the EU, lawyers can move about with great ease, and, when they do cross borders, they are subject to what is called "double deontology," which means they are subject to two sets of rules, that is, the rules of their home bar and the rule of the host bar where they are established or where they are providing temporary services.

In terms of Sarbanes-Oxley, the conflicts which European lawyers will be faced with will surface in two ways. The first way is in terms of reporting up the ladder and the second way is in terms of noisy withdrawal. I think the problem facing European lawyers is a very curious one. I think it is in everybody's deontological code, ethical code and express duty, if not implied duty, that they should only advise on what they know. What is bizarre about the attorney-conduct rule is that people are being deemed to advise on what they do not know, in other words, U.S. securities law, because the trigger for reporting up the ladder is a very specific U.S. trigger about reasonable belief of a material violation. I'm not talking about European lawyers who may be established in the United States or even who may be expressly providing services knowing that they are doing so by flying into New York. I'm talking about European lawyers who may be advising European cor-

porations whose parent companies may be residing in the U.S. and have no knowledge of U.S. securities law and maybe no knowledge of any securities law. It's even more bizarre in our view because the practice of U.S. law is forbidden for those who are not qualified as U.S. lawyers. In some states it is a criminal offense; in all states it is contrary to professional codes. And here is a rule that is deeming European lawyers to be practicing U.S. law, even when they are totally unaware of it, don't want to do it, and are completely ignorant of it. This strikes us as very bizarre and is the first of the great ethical dilemmas facing European lawyers.

The second is in relation to noisy withdrawal, and we are faced with some of the same issues that you are faced with, but not entirely all of them. Because the professional secret—as we call it in Europe—is not the same as the attorney/client privilege. As Jim said in his introduction, we cover civil law and common law jurisdictions, and whereas the professional secret doubtless shares the many vital characteristics with your own attorney/client privilege, the civil law equivalent is not at all the same in terms of concept. At end of the day the two come to more or less the same result, but they are not at all the same thing.

You also can become an expert like me on this subject if you look at our Web site, which is www.ccbe.org, where there is the most fantastic report written by somebody called David Edward, who is now a judge in the European Court of Justice. And he did a report—it is now a few years old and we are updating it, but the principles are unchanged—where he looked at differences between the civil law and the common law concepts.

Essentially, in the civil law countries, the professional secret is found always in the penal code, and that represents a very great difference for a start. It is a criminal offense for the lawyer to breach a professional secret. In some countries, such as Spain, it is found in the constitution, quite expressly. In the common law countries the privilege belongs to the client, and the client is able to waive it. But in the civil law countries it belongs to the lawyer, and, even if the client wants it to be waived, the lawyer cannot in some countries and in some circumstances waive it at all.

Now, I know there's a great love/hate relationship between America and France going both ways, but you might have to thank the French. For if the reports are true that the attorney-conduct rule is going to be watered down, it is because of the French concept of attorney/client privilege. The SEC had some very fancy idea: they told us, when the rule was out for consultation, that what they would do is provide that any company which lists with the SEC would, as a term of the listing, automatically waive the attorney/client privilege, which would then allow the lawyer to make a withdrawal without breaching the attorney/client privilege. But unfortunately that does not wash in France, Belgium and Luxembourg, where the secret belongs to the lawyer, and the lawyer is the absolute master of the secret. And even if the client wants it to be waived, it cannot be waived. And it is a criminal offense if it is disclosed.

So briefly, those are the ethical problems facing us in Europe.

E. Lawyer Employed by a Corporation as Members of the Bar

MR. DUFFY: Thank you, Jonathan. I would like to pick up on Larry Darby's question of a few minutes ago. Is it possible for a lawyer in France or some other civil law jurisdiction to remain a member of the bar if they are employed by a corporation?

MR. GOLDSMITH: Well, that's a very interesting question. The reason why this report by David Edward, to which I referred you, was written was because in the European Union there are two—well, there are more than two—but there are two basic approaches. In the common law countries and in Spain, for instance, an employed lawyer can be a member of the bar. In France and in Belgium, an employed lawyer cannot be a member of the bar because it is held that, if you are employed and if you have an employer, you are no longer independent. And so there is a great difference between the positions in Europe. And there was a 1982 case, under which this report arises, which held—it is called the *AM&S* case, and I know it causes great anger in the United States because it has ramifications for foreign lawyers as well—that employed lawyers do not have privileges. The European Commission wanted to seize documents in a competition case and the employed lawyer was not allowed to withhold them, and *AM&S* says the employed lawyer was not allowed.

F. Zealous Representation of the Client

MR. DUFFY: I would like to focus now on something that I think is probably common to both common law and civil law. It may be expressed a little differently, but, as in the case of attorney/client privilege versus professional secrecy, they both get you to the same spot even though they may take different routes getting there. But certainly in common law terms, Michael, would you agree that lawyers are obligated to zealously represent their clients' interests within the limit of the law? And to what extent does Sarbanes-Oxley change that obligation, if it does?

MR. MANEY: Well, I think one thing that has been hinted about is the fact that the ethical obligations of lawyers have always and traditionally been a matter of state law. I mentioned the New York rules, but they do differ from one state to another. And the ABA has its code, which is different again from New York's. And I'm sure that the ethical obligations of lawyers in Europe and South America and in Japan are again different. I think it is the first time there's been a federal attempt to regulate what would be an ethical issue. I think that, within the confines of the reporting within the organization, zealous representation of a client includes zealously attempting to convince the client to do the right thing. And that's part of the obligation of the lawyer, and that's one of the things that I think those of us who have been talking to the SEC say, namely, that you don't know the number of times that lawyers convince the client to do the right thing because you only see the times when the client doesn't do the right thing. Don't discourage the clients from communicating with their lawyers and the lawyer's ability to talk the client into doing the right thing, because there may be a very stiff price to pay!

What Sarbanes-Oxley may do, if they go ahead to that step of the disaffirmance and then say that that's not a breach of the attorney/client privilege—baloney!—for, as my senior partner was quoted in today's paper as saying, you then turn the lawyer into a policeman. And that then removes what was always considered to be this very close relationship of trust and confidence between lawyer and client. Because then the client is saying, "Well, can I trust these people? Can I talk to my lawyers? I mean, what if they think it is a violation? I don't think it is a violation." I mean that becomes a real stinker.

And by the way, all of these steps have to be documented. You know darned well they will be coming in afterwards and wanting to see the documentation, and so will the plaintiff's bar. There is no way you can withhold that stuff eventually if you end up in litigation. There has been a lot of commentary about the noisy withdrawal. There was a letter from seventy-seven law firms that basically said that the state ethics groups and the ABA and the bar should be given an opportunity to consider this and think it through, and that one didn't have to go that far. The statute doesn't go that far. Require the up-the-ladder reporting all the way to the full board, if need be, but then stop. And at that point, as far as I'm concerned, putting aside the whole issue of non-U.S. lawyers, which is another sticky wicket, I think it would be consistent with most rules.

MR. DUFFY: Maybe. Now, Jonathan, we can ask you that same question. Is this consistent with the European civil law lawyers' obligation to zealously represent the client to the limits of the law?

MR. GOLDSMITH: Well, it is a very hot topic in Europe. And although we have clearly the same duties as American lawyers do to represent our clients zealously, the relationship between lawyers, clients and the state has been regrettably the subject of continuing interest in two areas, really. One is in relation to anti-money laundering activities and the other is in relation to competition.

Unfortunately, the reason why we were so prepared with everything when the Sarbanes-Oxley came along is because we just had to rehearse the arguments which we put a year or so earlier to the European institutions in relation to the money laundering directive, which unfortunately we lost. European lawyers now are under a duty to denounce their clients, to act, as Michael says, as policemen in relation to suspicious transactions in certain circumstances. We very much regret that. That is coming to you, too, because the Financial Action Task Force, which is a Paris-based international governmental agency of which the United States is also a party, is about to adopt the equivalent of the EU Money Laundering Directive and apply it worldwide.

That was also one thing about which the competition authorities are hot on the heels of the European bars. It is in connection with the rules they make and whether they are or are not anticompetitive, although there we have a success to report. A year ago there was a very significant decision of the European Court of Justice in relation to the Dutch bar and multidisciplinary partnerships, where effectively they said that—although a ban on multidisciplinary partnerships was at first glance anticompetitive—because bars exist to protect core values such as independence, avoidance of conflicts of interest and confidentiality, they can take actions which are anticompetitive in order to protect those core values.

So yes, we are under obligations to represent our clients, but the state and the public interest frequently intrude.

MR. DUFFY: Would Sarbanes-Oxley be an acceptable intrusion under those standards?

MR. GOLDSMITH: No. The answer is no. We are very unhappy indeed about the money-laundering directive. We opposed it hotly, and we oppose Sarbanes-Oxley, and we would not consider it acceptable for the reasons I said in my opening remarks.

MR. DUFFY: I had a very interesting discussion the other day with a senior executive whose company is subject to Sarbanes-Oxley but is not a U.S. company.

His general approach was that your SEC is turning lawyers into judges, juries and—I think the most important word was—executioners.

Michael, do you have any thoughts about that?

MR. MANEY: Well, let me just respond. I mean there is somewhat of a judgment call when you get into the question of securities laws. You talk to any two lawyers and ask, "Is this a material fact that ought to be disclosed?" And you can argue about it. And obviously, the wimpy lawyer will always say, "Oh, well, let's disclose it, it can't hurt, and it covers us." But it may be something that you don't believe is true. I mean somebody reports that some terrible thing is happening, and you may look around for the evidence of whether that is in fact true, and then the question is, are you going to be a coward and just say, "Well, let's report it anyway, even though it may not be true, even though it could be very injurious to the client"? Or are you going to stand up and say, "I don't see there's evidence that it really is taking place," because the chief executive officer, who knows the business—I mean they are not all crooks—reviews this thing and says that he doesn't think that's happening, then you accept that. "All right," you say, "I'm satisfied."

But obviously, I think one of the problems with this whole thing is that everybody is going to run scared. And everyone is going to be terrified of being second-guessed, and that's where the frightening part comes in. I mean there have been cases where lawyers have exercised their judgment to say, "No, this is not something that we need disclose; in fact, it would be more injurious to the markets and to the stockholders to disclose this because it is unlikely to be true," and then later on somebody says, "Oh, you should have disclosed it." Obviously, it's going to go to the most timid, who will be the ones who are going to be running this thing. And that's what I think is frightening.

MR. DUFFY: Jonathan, let's put that same question to you. Have we turned lawyers into executioners?

MR. GOLDSMITH: Well, as I said in my previous comments, we are completely opposed to that. But we fear that that is the case already in Europe with the money laundering legislation, where lawyers now are under a duty to report suspicious transactions relating to their clients to the authorities, and that is exactly what the position is. We do not want to say it extends to the Sarbanes-Oxley Act. And as I say, I would alert you to the fact that the money-laundering terms will likely be coming to your shores rather soon as well.

MR. DUFFY: We have a rather draconian law in Monaco, by the way, which is very interested in eliminating its reputation as being a place for money laundering. The only time money-laundering types of information are privileged at all is when the information is given to a lawyer in the defense of a criminal prosecution. That's a very, very tough standard. So I guess what you're saying is then that Sarbanes-Oxley is not more offensive than the money-laundering rules.

MR. GOLDSMITH: No, no, Sarbanes-Oxley is Act II, and we are really beginning to wonder about Act I. We feel we lost Act I in relation to money laundering when we opposed it. And there are now thoughts in Europe that we should say that, when a lawyer is acting as a financial intermediary alone, without giving legal advice, the lawyer may be subject to reporting requirements. In other words, if you're acting for a client but only by way of purchasing or investing money, but not giving legal advice, then those activities of a lawyer, which, in other words, do not involve access to law and justice, should be subject to reporting. So we are, because of the enormous pressure on us, beginning to wonder whether we should change around a bit. No, no, Sarbanes-Oxley is a continuation unfortunately of what we already know.

MR. DUFFY: Now, one thing that I would like to pick up on is something that you were talking about, Michael. And I know we have a number of litigators in the room, and I imagine that most litigators feel that they can take either side of almost any case and make something out of that.

MR. MANEY: Or both sides.

MR. DUFFY: Normally not at the same time.

Now, if highly skilled people can take differing positions on the same facts, how do you shape your judgment as a lawyer? And picking up on your comments that sometimes disclosure can be more injurious than no disclosure, how do you reconcile this?

G. Exercising Professional Judgment

MR. MANEY: Well, I think in today's—I mean pre-Rule 307—world, lawyers and corporate advisors are always dealing with that. You get the facts as best you can, you exercise your professional judgment, and you advise your clients. And sometimes you have to advise your client that what they are proposing to do is technically all right, but that it doesn't pass a smell test, and that they therefore shouldn't do it. In some cases you're anticipating what the law will be, and probably you look at some of the facts behind Enron or something similar to that, and you say, "This thing stinks." And maybe some tax lawyer says technically, "Oh, it is perfectly okay." That's what lawyers are supposed to be doing; they are supposed to be acting as sort of a Jiminy Cricket as well as the advisor on the technical requirements of the law, but that's within the confines of your representation.

The question is, are we going to create a new specialty for lawyers known as ethics specialists? And I bring that in response to your point about what the standard is. Is it a basic malpractice standard or is it a "reasonable lawyers" standard? In our code of professional responsibility under DR 5-105, there is this concept of "the disinterested lawyer" in making a decision as to whether or not you can represent multiple clients. And there's a standard as to what constitutes a disinterested lawyer, which I think is comparable in a sense to what a reasonable lawyer's decision is. I mean there is a standard. So my question is, would there be a sort of market or a place for a lawyer who is close to an Enron situation to say, "I'm so close to the situation, and I'm giving the best advice I can, but I want to sort of step out and get a legal opinion from someone else"—without breaching the confidences of the client to be able to get some sort of assurance that the person's decision is the decision of a reasonable lawyer? I think those of us who are fortunate to be practicing in firms frequently do just that. We consult our partners.

MR. DUFFY: Let's get Jonathan on this.

MR. GOLDSMITH: I'm amused to hear the question because people often express puzzlement at English solicitors and barristers. But that's in fact exactly how English solicitors and barristers operate. If there is something difficult or complicated going up, they go to counsel and get an opinion, and that covers them. They have consulted and been given an opinion, and that covers them. So there is a precedent for it out there in the world.

MR. DUFFY: Let's be practical about some of this. Michael, you've got someone proposing something, and it is a set of facts that you decide I could argue either side if I had to. I'd rather argue one side over the other, but I could argue either. And now you say, "Well, you know, there is this Sarbanes-Oxley legislation and we have to be concerned about it. Maybe we should get more lawyers involved or get other opinions, get other points of view." And the client says that that's very nice, but asks who is going to pay for it, or says that he can't afford to pay for it or doesn't want to pay for it. The client says, "You're a lawyer. Make up your mind and advise me." How do we handle that? I mean you're talking about an ethical issue. I don't think the lawyer stops because he's not getting paid to consult with other people in his firm.

MR. DUFFY: No, no, I'm not suggesting that. But, it is possible that a reasonable lawyer might accept a point of view that would violate Sarbanes-Oxley, in which case we might want to hire another lawyer and get a separate opinion.

MR. MANEY: Well, that's my big issue with the definition, since, in the way it is written, it purports to be an objective standard. Now, it seems to me that, if I give myself credit for being a reasonable lawyer, and I've consulted with a number of my partners whom I also consider to be reasonable, and we conclude that it's not a material violation, then the fact that some wimp is going to say it is, I think, should not change the situation for us; we should be okay. But that needs to be clarified, and one would hope that the Commission in promulgating the final rule will be a little bit more precise as to what is the standard there.

MR. DUFFY: Jonathan.

MR. GOLDSMITH: I think that must be right. It depends on how wide the test is: provided that the reasonableness test means that reasonable persons can come to a conclusion either way, the lawyer should be protected if there is a band of reason. It should not be a problem.

H. Audit Inquiry Letters; Engagement Letters

AUDIENCE MEMBER: I would like to come at this from a hard case point of view. When I was an assistant general counsel in a corporation, once a year I sent out audit letters to all the law firms that represented us all around the world. Now, what I would like to hear from our U.S. panelist is how I will do that. Assume that there are many transactions that have occurred all over the world. Should I now be telling my outside lawyers that, by the way, I understand that the transaction they advised on or closed or participated in has been characterized by the accountants in thus and such a fashion, and ask them if they agree with that? And from a European lawyer's point of view, what would they like to see in that audit opinion request letter, and have I gone too far? Have I done something really untoward? I'm handing off the hot potato, I think, across the Atlantic. That's a hard case for corporate practitioners, and I think it is a hard case for the lawyers around the world. Could you discuss that a little bit? Because this is where the stuff is quite possibly going to come out.

MR. DUFFY: That leads into the final question that I was going to ask, and so I'll put that question then, and perhaps our panelists can deal with both of them. Is there anything that we as lawyers should be thinking about including in our retainer agreements or engagement letters to address Sarbanes-Oxley as well?

MR. MANEY: Let me respond to both. We have, as part of and beyond the lawyer-conduct rule, all these provisions about adequate controls, the certification rules, the audit rules. All of them affect the adequacy of the financial disclosures. And we get back into that

time-honored fight between asking the lawyers to give an opinion on accounting practices and asking the accountants to give legal opinions, and then there's the stilted language you get in these audit inquiry responses, where we say we are responding in accordance with the ABA blah blah blah. It is going to be very difficult when the CEO asks you, "I'm going to sign this certification that says that everything is fine, that I've got adequate controls, and that there's no misstatement or omission of fact in these financial statements; is that okay?" That embraces a lot of financial material that goes to accounting principles or auditing standards, and the lawyers are going to do everything possible to avoid advising on that. I mean so far, at least, we have been saying that we don't opine on financial reporting. How long that can survive I don't know. But I think Sarbanes is pushing us into that tar baby. How long we can avoid it is another question.

MR. GOLDSMITH: Assuming that the reporting-up-the-ladder provisions are in Sarbanes-Oxley tomorrow and assuming that they extend to foreign lawyers, I suppose there is an extension of the answer to that: the fact that we European lawyers say that we don't opine on U.S. law won't protect us under the rule, but it might put our clients on notice as to what we are up to. I think my general answer would be no, in terms of the retainer.

There's a whole range of legal responsibilities that lawyers have, not all of which can be recited in a retainer letter. I mean, if the client is deemed presumably to understand the basic concepts of what a lawyer is doing, in principle I would be against that idea, I must say.

MR. DUFFY: All right, I would also presume that there are some duties of a lawyer that are so inherent in what a lawyer does that a client shouldn't be asked to waive them or perhaps can't waive them. Would you agree with that?

MR. GOLDSMITH: Absolutely, yes.

MR. DUFFY: How about you, Michael?

MR. MANEY: Well, the client can waive them if he wants. At least it is my understanding that, in the United States, if a client waives privileges, the lawyer has no say in the matter.

MR. DUFFY: Can a privilege be waived in advance? Would it be effective if I put a provision in a retainer agreement that says that I could respond to any questions put to me in the context of Sarbanes-Oxley and you waive all privileges that attach?

MR. MANEY: That sounds like the things I sign when I go in the hospital.

MR. DUFFY: Can that be a knowing waiver?

MR. MANEY: No, I don't think so.

MR. DUFFY: Therefore would it be effective?

MR. GOLDSMITH: Well, as I've mentioned before, in some civil law countries it would be completely irrelevant because the client can't waive the secret; it belongs to the lawyer.

MR. DUFFY: We've come to the end of our allotted time. I want to thank you for being here and thank you for your attention.

A Tale of Three Cities: Reflections on the Practice of the Law (and the Laws of Practice) by Foreign (Particularly Non-European) Lawyers and Firms in London, Paris and Madrid

By Clifford J. Hendel

I. Introduction

The inclusion of legal services on the agenda of the Doha Round of trade talks has been referred to by a lawyer at one of the leading U.S.-based global firms as "not a new fight—it's the same fight we fought in Western Europe a generation ago. We simply want to offer high-quality legal services in whatever markets our clients serve."[1]

My practicing, and having become—not without some trials and tribulations—admitted to practice locally in a number of European jurisdictions, gives me a certain perspective on the ability of foreign (particularly non-EU) firms to offer high-quality legal service in Europe.[2]

My own evaluation of the situation is that (i) while there are indeed elements of protectionism and/or "fortress-Europism" in certain European jurisdictions, where the legal profession acts somewhat like a medieval guild, in large part the differences in the prevailing rules and practices among the various jurisdictions relate more to the respective visions of the profession prevailing in each country and to the varying respective paths to local qualification for local lawyers applicable in each country; and (ii) non-EU, particularly U.S. firms, have not been materially hindered by the sometimes highly disparate local rules and practices in their efforts to offer high-quality legal services to their clients wherever their clients are active, and thereby "exploit the value of their brands" worldwide.[3]

Given the increasingly harmonious and permissive treatment of the admission to local practice by EU national lawyers duly qualified in their "home-state" under Directive 98/5/EC of 16 February 1998 as implemented (more or less) in the various EU jurisdictions and as discussed separately in this session, this piece will focus on these issues as they affect non-EU (e.g., U.S.) nationals and firms.[4] Indeed, subject to the likely forthcoming liberalizations in favor of inter-state legal practice in the U.S. as a consequence of the ongoing debate over what we refer to in the U.S. as multi-jurisdictional practice (MJP), today at least the ability of a U.S. lawyer to engage in MJP in other U.S. states is quite limited when compared with that of an EU (national) lawyer engaging in MJP in other EU member states. As noted by one observer:

> Multistate legal practice is now a reality within the European Union. Lawyers and law firms from any EU state are able to represent clients on a continuous basis throughout the European Union, practice in almost all commercial law fields in any EU country, and form multinational law firms with offices as desired in any EU commercial center. In short, lawyers are able to carry on freely modern international legal practice throughout most of Europe. This picture is in sharp contrast with the much more limited legal rules governing interstate law practice within the United States. The rules of admission to the bar and rights of practice, including any tolerance of interstate practice, are set by the states. These states rules have traditionally been founded upon a dual concern for effective representation of clients, a type of consumer protection interest, and for the efficient administration of court litigation, a civil and criminal justice interest. Arguably, however, rules ostensibly set and enforced with these concerns in some instances mask a desire to protect the local legal profession against interstate competition. Although the United States Supreme Court has to some degree limited state rules in order to protect lawyers' rights under the Privileges and Immunities Clause of the Constitution, the Court has in large measure accorded great discretion to the states in setting professional qualification standard and delineating the right of legal practice.[5]

II. Spain

A. Rules for Admission of Local Lawyers in Spain

The key distinguishing feature of the Spanish rules for admission to legal practice is that, as in the case of most professional qualifications, Spain tends to treat the academic degree (in our case, the law degree) as tantamount to full professional qualification. A Spanish *licencia* has a surface similarity to an American "degree" or a French *maitrise,* but in fact each represents "very diver-

gent substantive realities; whereas the [non-Spanish] degrees mentioned are generally strictly of academic nature, the Spanish *título* of *licenciado* generally carries with it, in addition to academic consequences, immediate professional qualifications as well."[6] The Spanish *licenciado*—under current rules at least—has no need to pass a qualifying exam, undertake a period of practical training or pursue any kind of practical study after having obtained his "*título*"; he simply pays his dues and becomes a fully-qualified *abogado*.

B. Rules for Admission of Foreign (non-EU) Lawyers and Firms in Spain

Since the only way for a Spanish lawyer to become admitted is to obtain a Spanish law degree, without the need to cross any additional hurdles such as a bar exam or period of practical training, it is easy to understand that the only available routes for a non-EU lawyer to became admitted in Spain are either to (i) obtain a Spanish law degree (i.e., pursue a full-time four- or five-year university curriculum, which is hardly a realistic option); or (ii) seek a determination from the Spanish Ministry of Education "homologating" or "convalidating" the lawyer's foreign academic credentials as substantially equivalent to those of a Spanish law graduate, which determination—if the "curricular deficiencies" identified in this process are not excessive—generally will require the applicant to be tested by a law school of his choosing in the areas in question.

The "homologation" process has rightly been characterized as "Kafkaesque,"[7] because: (i) it can take as long as or longer from beginning to end than the four- or five-year Spanish university legal course of study; (ii) it has yielded wildly differing results in very similar cases—after all, in order to be ABA-accredited, all U.S. courses of legal study are very similar, but while some U.S. lawyers have been "homologated" without exam, others have been required to sit for exams (with no apparent rhyme or reason as to the areas designated) and still others—perhaps the majority—have had their applications rejected out-of-hand; and (iii) it is quite opaque: just as there appears to be little coherence in the administrative "homologation" process, so too are the exams administered by the various Spanish law schools wildly divergent and lacking in transparency. The result is that only a relative handful—the luckiest, or most persistent, or both—of U.S. lawyers are locally admitted in Spain, since obtaining a Spanish law degree or surmounting the Kafkaesque homologation process tend to be hurdles too steep for busy professionals to overcome.

C. Spanish Market and Market Practice for Foreign (non-EU) Lawyers and Firms

The "Big Mac" test has become a well-established benchmark for comparative cost-of-living studies. I have long advocated a "softball" test as a shorthand measure for the degree of market penetration by foreign (in particular, U.S.) law firms. The utility of this measuring rod occurred to me some ten years ago, while I was working with a U.S. firm in Paris and captaining its team in the lawyers-only summer softball league held in the Bois de Bologne. While some of the fifteen- to twenty-member teams were composed entirely of French lawyers (these tended to be the weakest teams), ours and several others were roughly one-half American—and there were some twenty teams in the league in all. In short, a quite sizeable number of U.S. lawyers, and a solid score on the softball "index."

But in Madrid (and indeed in Spain generally), things are rather different: not only is a lawyers' summer softball league an utter impossibility in Spain, but even fielding a single team of fifteen to twenty U.S. lawyers taken from all over the country would be difficult, if not impossible. Only four U.S. firms are established in Spain, one of which is without local law capacity or aspirations, and the remaining three—while well-established and quite serious and able competitors—significantly do not represent any "money center" practices from New York, Chicago, Los Angeles or Washington.

The question, then, is whether there is a cause-and-effect relationship between the relatively inhospitable and antiquated Spanish rules for local admission of foreign (non-EU) lawyers and the relative absence of the bevy of globalizing U.S. firms as, for example, have opened offices in Italy over the past several years. My own view on this issue is that there is no such cause-and-effect relation. Rather, the relative neglect of Spain by U.S. firms is due to a perception (with which I do not entirely agree, of course!) of relative insignificance on the one hand, and competitive difficulties on the other, of the Spanish market. Those U.S. firms and lawyers that have opted to establish themselves in Spain have not been materially impeded by the local rules, and to my knowledge none of them has had any problems with the local bar association or anyone else even if their practices included one or more U.S. lawyers not admitted locally.

III. France

A. Rules for Admission of Local Lawyers in France

The French rules for admission to practice for local lawyers are among the most stringent in the EU. Unlike the Spanish rules summarized above, where essentially nothing more that a law degree is required, after four years of university study culminating with a *maitrise,* the French law graduate must complete a one-year course of study of both theory and practice (including drafting of documents and pleadings, professional ethics, etc.), undertake a period of training with a

lawyer, company legal department or government agency, pass a rigorous oral and written bar exam called "CAPA" (certificate of aptitude for the professional of *avocat*), and then undertake a period of practical training (*stage*) of two years. Only after all these requisites are satisfied, at least three years after graduation, is the French law graduate entitled to become an *avocat*.

B. Rules of Admission for Foreign (non-EU) Lawyers and Firms in France

A short historical digression will help put in context the current French position regarding admission of non-EU lawyers. Prior to 1992, the French legal profession was "split" between *avocats* ("true" lawyers, with ability to represent parties in civil and criminal proceedings) and *conseils juridiques* (office lawyers). The path to admission as a *conseils juridiques* for a foreign lawyer was simple: no exams, no *stage*, just a period of continuous physical presence. Since the vast majority of foreign lawyers were, and wanted to remain, "office lawyers," the *conseils juridiques* route was perfect: large numbers of foreign lawyers, including some with scant knowledge of French and French law, were admitted as *conseils juridiques*. And large numbers of foreign firms became serious competitors to local firms. So effective 1 January 1992 the two French legal professions were "merged" and this "loophole" was closed: all *conseils juridiques* became "grandfathered" as *avocats*, and from that point onward, only the *avocat* (and the rigorous path to admission outlined above) remains.

For some years after the new law took effect, it appeared that no more foreign (non-EU) lawyers might ever be admitted in France. But more recently, the position has been clarified: a highly rigorous mini-bar exam (actually, "mini" is a euphemism; the written part is a comprehensive across-the-board exam and the oral exam can be an unpredictable and tricky challenge) under Article 100 of the Decree No. 91-1197 of 27 November 1991 has been introduced, and a handful of non-EU lawyers (including several U.S. lawyers) have managed to pass it. Indeed, a preparatory course has recently been made available for applicants.[8] Curiously (or not so curiously), the Article 100 route to admission has been used more frequently by U.S. qualified *French* nationals than for U.S.-qualified *U.S.* nationals: in 2001, according to the French National Bar Council, the number of U.S.-qualified French nationals sitting the Article 100 exam more than doubled the number of U.S.-qualified U.S. nationals sitting the exam.[9]

C. French Market and Market Practice for Foreign (Non-EU) Lawyers and Firms

The role of Paris as the leading international legal center on the Continent, together with the ability of "office lawyers" to ply their trade as *conseils jurisdiques* on an essentially automatic basis for many years, has resulted in Paris being home to a large number of foreign (non-EU) firms and lawyers, not to mention a booming summer softball league.

The "floodgates" of admission to practice via the *conseil juridique* route have now been closed for more than a decade, but foreign (including U.S.) firms continue to set up operations in Paris, or grow existing operations, without apparent concern for the rather remote chances of their foreign lawyers being able to survive the Article 100 exam and become locally qualified.

IV. England

A. Rules of Admission for Local Lawyers in England

Two basic avenues are available for admission of English nationals as a solicitor: the law degree route, with generally three or four years of legal study followed by one year of professional training (the "legal practice course") plus a two-year period of practical training with a firm or approved organization (formerly referred to, in quaint Dickensian terms, as "articled clerkships"); or the non-degree route (essentially, for those not having studied law at university and thus involving a one-year course of legal study and, again, followed by the legal practice course and two years of articles).

B. Rules of Admission for Foreign (Non-EU) Lawyers and Firms in England

It is in the area of practice rights for foreign lawyers and firms that England demonstrates an almost diametrically opposite philosophy from many of its Continental counterparts, including the two discussed above. If the French and Spanish approaches inevitably smack of anti-competitive protectionism (albeit often cloaked in philosophical/ethical language), the English approach is commercial and transparent. France and Spain essentially grant a monopoly on the provision of legal advice to *avocats* and *abogados*, respectively; the English approach is much more in the nature of "*caveat emptor.*" Neither France nor Spain recognizes the concept of foreign legal consultant (FLC), as is in place in a number of leading U.S. jurisdictions. But England recognizes, and indeed actively welcomes, registered foreign lawyers. The extreme difficulty of the French Article 100 exam for admission by non-EU nationals has been noted above, as has the arbitrary and "Kafkaesque" Spanish "homologation" process. England, on the other hand, has long had a conversion test—the "Qualified Lawyers Transfer Test: or QLTT—which permits foreign lawyers to sit for a mini-bar exam (one which any U.S. lawyer should find quite familiar and entirely manageable) and become qualified as a solicitor. What is notable about the QLTT is its extreme transparency: it is an open-book exam (the rules of which permit test-tak-

ers to bring as many materials as they like so long as they do not "obstruct the gangways"!) for which a variety of review courses are available, focusing on past exam questions.

C. English Market and Market Practice for Foreign (Non-EU) Lawyers and Firms

It is commonplace, and altogether accurate, to describe London as the beachhead of U.S. firms in Europe. In perhaps no other jurisdiction in the world are foreign (non-EU) lawyers accorded similar freedoms to practice: there is no requirement to qualify locally; there is transparent and relatively easy access to local qualification for those interested in "converting," and a generally commercial, non-protectionist attitude and approach to the role and economic importance of English law and lawyers in a globalizing world. Both the Law Society (the solicitors' governing body) and English society at large seem to view the internationalization of English law and the globalization of English law firms as commercially, economically and socially desirable. To a real extent, the global "battle" for international legal pre-eminence is being waged between the large U.S. and the large English firms, with English law and firms having perhaps a certain advantage in Asia (and, of course, Western Europe) and U.S. firms in the fore in Latin America and Eastern Europe.

V. Conclusion

Despite the wide variety of approaches taken in different European jurisdictions to the practice by non-EU firms and lawyers, my own impression to date is that U.S. firms have been able to ply their trade and exploit their brands with real success in Europe as, when and to the extent they have opted to do so: in Madrid, despite only a handful of U.S. firms and dual-qualified lawyers; in Paris, with many dozens of U.S. firms and dual-qualified lawyers; and in London, with dozens of U.S. firms and several hundred dual-qualified lawyers. While it may well be true that the English rules of practice for non-EU nationals are much more liberal and transparent than the French rules, which in turn are more liberal and transparent than the Spanish rules, I do not necessarily see a cause-and-effect relation between the relative liberality of the rules of practice and the on-the-ground presence of non-EU firms and lawyers. Instead, I think commercial and strategic perceptions explain why my "softball index" yields such varying results across the EU.

One of the paradoxes of the inclusion of legal services in the Doha Round is that the ensuing rules might render more difficult—rather than less so—the continued ability of U.S. firms to operate globally. In this regard, the International Bar Association—due to the perception that clients today need daily advice from cross-border commercial practitioners on the laws of jurisdictions in which they are not admitted—has set up a task force charged with issuing non-binding best practice recommendations by the end of this year for cross-border commercial practice.[10]

Endnotes

1. Goldhaber, *Globalists' Mighty Wedge*, American Lawyer, April 2003, at 15, *quoting* G. Spak of White & Case.
2. For additional information about my trials and tribulations, see Hendel, *From New York to Madrid via Paris: Smaller Pond, Bigger Fish,* in M. Janis and S. Swartz, eds., Careers in International Law (ABA Section of International Law and Practice 2d ed. 2001).
3. Goldhaber, note 1 *supra*, at 17, *quoting* A. Kawamura of Anderson Mori in Tokyo.
4. For the full text of the Directive, and practical information and a useful series of links to other sites detailing qualification requirements across the EU, *see* the European Lawyers Information Exchange and Internet Resources (Elixir) at http://elixir.bham.ac.uk.
5. Goebel, *The Liberalization of Interstate Legal Practice in the European Union: Lessons for the United States?*, 34 Int'l Law. 307 (2000).
6. García-Velasco García and González Cueto, *Títulos Expaòoles y Extranjeros, Especialidades y Ejercicio Professional de la Abogacía en Espaòa*, in *Abogaíca Espaòola* at 47 (2003).
7. Nahmias, *Two Lawyers for the Price of One - Transnational Licencing in the EU for U.S. Practitioners*, ACCA Docket at 104 (June 2003).
8. *See also* Keeleghan, *Passing the French Bar Exam: How a California Lawyer Becomes a French Lawyer*, International Law Section Newsletter of the California Bar (Summer 1998), available at www.calbar.org/ils/newletter/v11n1/franc.htm.
9. *Conseil National des Barreaux, Admission des Avocats Etrangers, Bilan des Travaux de la Commission d'Admission des Avocats Etrangers Pour la Mandature 2000-2002* at 3.
10. *See* Peláez-Dier, *Planning a Revolution*, Legal Week Global (August 2003). For some fairly recent quantitative data and analysis on the international activities of U.S. firms, see Silver, *Globalization and the U.S. Market in Legal Services-Shifting Identities*, 31 Law & Policy in Int'l Bus. at 1108 (2000); Silver, *Lawyers on Foreign Ground*, in M. Janis and S. Swartz, eds., Careers in International Law (ABA Section of International Law and Practice 2d ed. 2001). See also the July 2003 issue of *The American Lawyer*, noting that "Between 1992 and 2002, the number of Am Law 100 lawyers rose in 13 of the country's 15 largest legal markets. . . But the biggest growth occurred outside the United States: In 2002 there were more than *three times* as many Am Law 100 lawyers working outside the U.S. as in 1992." (Emphasis supplied.)

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Corporate Control Contests in Europe: A German Perspective

By Philipp von Braunschweig

I. Overview of German Corporate Governance Rules

A. Introduction

1. AGs

All German corporations listed on a stock exchange as well as certain non-listed corporations (especially those anticipating a listing in the future) are in the legal form of a stock corporation (*Aktiengesellschaft*, or AG). The presentation under Part II.B below deals exclusively with AGs.

2. GmbHs

For a complete picture of the German corporate environment, however, it should be noted that the large majority of small and medium-sized enterprises as well as many larger closely held companies of the German *Mittelstand* have remained a limited liability corporation (*Gesellschaft mit beschränkter Haftung*, or GmbH) or a limited partnership (GmbH & Co. KGs). In numbers, AGs constitute less than five percent of all companies organized in Germany.

With regard to corporate governance and shareholder value issues, the German GmbH Act of 1892 has undergone hardly any conceptual changes. The GmbH follows, in principle, a shareholders' model (as opposed to a stakeholders' model): Under the GmbH Act, the only corporate bodies of the GmbH are the shareholders' meeting (*Gesellschafterversammlung*) and one or more managing directors (*Geschäftsführer*). The managing directors are strictly subject to instructions by the shareholders' meeting, and the shareholders' meeting is entitled to issue such instructions, even with regard to day-to-day business matters. Managing directors of a GmbH can be appointed and dismissed at will (without prejudice to their compensation entitlements, which are governed by a separate employment agreement) by shareholder vote with a simple majority. Thus, the activity of GmbH managing directors is closely linked to shareholders' interests, as evidenced by the majority vote of the shareholders' meeting. Protection of minority shareholders is effected through certain mandatory statutory super-majority requirements (such as a mandatory seventy-five percent approval for mergers and capital increases) as well as fiduciary duties among the shareholders.

GmbHs with more than five hundred employees in Germany must, at the request of the employees, establish a supervisory board, which must be composed in accordance with the rules applicable to stock corporations (see Part I.B.2 below), but the supervisory board has significantly less influence on the conduct of the business.

B. Corporate Bodies of a German AG

1. Generally

In contrast to the single-tiered board structure of Anglo-Saxon corporations (as well as corporations in many European civil law jurisdictions), a German AG has a two-tiered board structure.

That is, according to the Stock Corporations Act, the members of the managing board (*Vorstand*) are elected and dismissed by simple majority vote of the supervisory board (*Aufsichtsrat*). The managing board is elected for a period of up to five years. Premature dismissal is possible only for cause or in the event of a shareholder vote of non-confidence. Only the managing board, and not the supervisory board, is engaged in actively running the business.

The supervisory board is not actively engaged in the management: its duties are limited to passive supervision of the managing board and it has no rights to actively instruct the managing board. Thus the role of the supervisory board is largely limited to supervisory functions.

In companies with fewer than five hundred employees, all supervisory board members are elected by the shareholders' meeting for a period of up to five years. A simple majority suffices for election, but a seventy-five percent majority vote is required for premature dismissal. The articles of association may provide for up to one-third of the supervisory board seats to be reserved for specific shareholders (a provision rarely used for public companies). As a matter of law, supervisory board members must independently act "in the interest of the Company" and are not subject to instructions from specific shareholders.

2. Employee Co-Determination

In German companies with five hundred or more employees, part of the supervisory board members are elected by the employees in a separate proceeding. In companies between five hundred and 1,999 employees, one-third of the supervisory board members are elected by the employees of the company in accordance with

the Co-Determination Act of 1952 (*Betriebsverfassungsgesetz* 1952).

In companies with two thousand or more employees in Germany, one half of the supervisory board seats are reserved for the employee side in accordance with the Co-Determination Act of 1976 (*Mitbestimmungsgesetz* 1976). Some of the employee representatives are elected by the employees of the company and some of them are delegated by trade unions. Even under the 1976 Act, the chairman of the supervisory board is elected from the supervisory board members elected by the shareholders' meeting. In case of a tie vote in the supervisory board, a second vote takes place in which the chairman has a casting vote. Thus, the employees cannot exercise control over the company if the shareholder-elected supervisory board members vote as a bloc.

3. Summary

In sum, the managing board of a German AG has considerable discretion in running the business, and shareholder control over management is exercised only indirectly via a supervisory board that is not subject to active shareholder instructions.

When comparing the *status quo* of German corporate governance to other legal systems such as the U.S., it is probably fair to say that shareholder control over management is less direct and less tight than in many other jurisdictions. That fact makes it comparatively difficult for shareholders to tie management to shareholder value. Contrary to the perception of many non-German clients, this is not primarily due to employee co-determination issues (which are, in practice, mitigated by holding separate discussions among the shareholder-elected supervisory board members a day before the regular supervisory board meetings takes place). Rather, deficits in shareholder-value-driven corporate governance are inherent to the German two-tiered board system and the historical development of case law on corporate governance generally.

II. The Relevance of Shareholder Value for German Corporate Governance

A. Historical Development

1. Origins

The original German laws on stock corporations enacted in 1870 and 1884 were, in principle, based on a shareholders' model rather than a stakeholders' model. Similar to Anglo-Saxon jurisdictions, the managing board members were regarded as agents of the shareholders, who were to run the corporation for the benefit of the profit interests of the shareholders. While the law generally followed a shareholder-oriented approach, the statutory rights of minority shareholders were very limited, which effectively increased the power of the managing board.

2. From World War I to World War II

The First World War (1914-1918) brought about strong interference by the government with German corporations. The same was true after 1919, when left-wing governments pursued tendencies of nationalization. The economic crises during the period of the democratic "Weimar Republic" from 1919 through 1932 were largely perceived as crises of liberal capitalism. By and large, concepts of stakeholder orientation were introduced into statutory and case law.

The stakeholder-oriented concepts of the "Weimar" era were subsequently abused by the Nazi government after 1933 for its own ideological purposes. A new Stock Corporations Act was introduced in 1937 which provided, for the first time, that the shareholders' meeting had no direct influence on the election of managing board members. Managing board members were obligated by law (section 70 of the Stock Corporations Act of 1937) to independently run the business of the company "for the benefit of the enterprise, its constituency ("*Gefolgschaft*"), the German people and the *Reich.*" It is noteworthy that the shareholders were not even mentioned as stakeholders.

3. The Post-war Era

Interestingly, it took the post-war German legislature until 1965 to enact a new Stock Corporations Act. In the meantime, section 70 of the 1937 Act was applied by the courts *mutatis mutandis*: that is, the ideologically motivated exclusion of shareholders and the reference to concepts of "German People" and "*Reich*" was disregarded, but the stakeholders' model as such remained unaffected.

On that basis, the center-left government of the 1970s introduced the concept of employee co-determination into the Stock Corporations Act in 1976.

4. Introduction of Share Value Concepts

Globalization of capital markets and international competition forced Germany in the 1980s and 1990s to introduce certain concepts oriented toward shareholder value into its corporate law:

- Listed companies were permitted to set up their consolidated accounts in accordance with US GAAP or IAS/IFRS, which in practice limit the possibilities of management to build or dissolve hidden reserves in order to influence artificially the profit situation.
- The purchase of treasury stock was facilitated by the Corporate Control and Transparency Act (*KonTraG*) in 1998.

- The *KonTraG* also introduced the concept of Anglo-Saxon-style stock options to German corporate law (notably, the legislation explicitly states that it is desirable to tie the management's interest to "long-term increase of shareholder value").

Elements of a shareholder value concept are also included in the German Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*, WpÜG), which came into effect on 1 January 2002. The WpÜG generally prohibits actions outside the ordinary course of business that would jeopardize a takeover bid (section 33, para. 1 WpÜG), except if authorized by a seventy-five percent vote of the shareholders' meeting or (arguably) by the Supervisory Board for no more than eighteen months in advance (section 33, para. 2 WpÜG).

B. Current Status

Recent amendments to the Stock Corporations Act have focused on the duties of auditors and supervisory board members and have increased the required standards of care. But the concept of indirect shareholder control through a two-tiered board system has, in principle, remained unaffected. Therefore, the managing board continues, in practice, to have broad discretion on how to run the business "in the best interest of the enterprise" (*Unternehmensinteresse*).

The term "*Unternehmensinteresse*" continues to be defined on the basis of a stakeholders' model—and not just the interests of shareholders alone. In several cases, the Federal Constitutional Court (*Bundesverfassungsgericht*) and the Federal Supreme Court (*Bundesgerichtshof*) have held that the relevant interests to be taken into account are the interests of the shareholders, of employees and of the public. The courts have not given much substantive guidance as to the ranking of these interests. Rather, the Federal Constitutional Court has developed the theory of "practical concordance" (*praktische Konkordanz*), which gives considerable discretion to the managing board itself as to how to value the various interests.

The current status of the law is therefore subject to dispute in legal literature. The status of discussions can be summarized as follows:

- A conservative view believes that a managing board must pursue the primary objective of maintaining the substance of the company's business intact, and the increase of shareholder value is subordinated.
- A liberal view advocates a prevailing importance of shareholder value.
- Intermediate views believe that a managing board is permitted but not obliged to weigh shareholder value interests higher than the interests of other stakeholders.

Transactional practice in German is largely based on the intermediate view.

C. Examples

Areas where the general discussion on shareholder value has become relevant in recent practice include the following:

- Is it permissible to link management stock option programs exclusively to the development of the stock price? Some courts have held that this is permissible, but there is clear tendency in practice, supported by recommendations of the informal Corporate Governance Commission (composed of government officials and representatives of blue chip companies), pursuant to which specific performance targets should be set.
- Is the managing board permitted to allow a bidder to perform a due diligence prior to a block trade (with or without subsequent tender offer)? The conservative view believes due diligence is impermissible, while the more liberal view is that the managing board has broad discretion and may even permit access only to certain selected bidders if that can be justified as in the "best interest of the enterprise." Typically, operative synergies with a bidder are strongly stressed in justifying due diligence.
- Is the company permitted to grant incentives to management for effecting an increase of the bid in supporting a tender offer? In practice, transaction-oriented bonuses are frequently granted but justified with post-acquisition synergies rather than increase of stock price. The "Esser" case involving the grant of a EUR 30 million bonus to the CEO of Mannesmann in the course of the tender offer by Vodafone—will shortly be dealt with by the criminal courts. Defendants include supervisory board members such as the CEO of Deutsche Bank and the former head of the Trade Union for the Metal Industry.

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Expanding Extraterritorial Application of U.S. Antitrust Laws: What Are the Borders?

By Robert D. Paul

I. Introduction

Fair or unfair, the application of U.S. antitrust laws to international trade has become increasingly important in a world that now embraces a global economy. Indeed, for many U.S. and non-U.S. entities and individuals, U.S. antitrust policy now governs international conduct and is the norm.

There is substantial basis for this belief. For one, the U.S. Department of Justice (DOJ) continues to broaden its global reach by targeting international cartel activity through criminal prosecutions and investigatory tactics abroad that often result in enormous fines and penalties. Since 1997, the Antitrust Division of the DOJ has obtained over $2 billion in criminal fines, over ninety percent resulting from the prosecution of international cartel activity.[1] Second, on the civil side of this expansion abroad, victims of alleged cartel activity increasingly look to the broadening scope of U.S. antitrust laws and U.S. class action provisions as an irresistible means to obtain treble damages, not obtainable elsewhere in the world.

These aggressive multinational enforcement activities present serious risks to foreign, as well as domestic, corporations and individuals who are often unaware of their exposure. Adding to these risks, courts in the U.S. have become more willing to expand the jurisdiction of the U.S. antitrust laws to conduct that occurs outside of the U.S., and in some instances, to suits brought in the U.S. by foreign plaintiffs. As a result, savvy multinational corporations use U.S. antitrust standards to govern their conduct.

This article discusses the current status of U.S. case law in determining U.S. jurisdiction over international cartel activity wherever conducted, and the expanding reach of extraterritorial civil and criminal U.S. antitrust enforcement, and examines the practical implications of U.S. antitrust enforcement in the global marketplace.

II. The Changing Scope of Extraterritorial Jurisdiction of the U.S. Antitrust Laws

A. An Historical Perspective

The primary antitrust law that is applicable in an examination of foreign conduct is the mainstay of U.S. antitrust laws, the Sherman Act. The Sherman Act applies to "every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations" and to "every person who shall monopolize, or attempt to monopolize, or combine or conspire . . . to monopolize" such trade or commerce.[2] The application of the Sherman Act to foreign trade and conduct abroad, however, has always been murky. The Foreign Trade Antitrust Improvements Act of 1982 (FTAIA), intended to clarify the extraterritorial reach of the U.S. antitrust laws, has in many ways contributed further to the uncertainty.

The purpose of the FTAIA was to establish a "single, objective test—the 'direct, substantial and reasonably foreseeable effect' test" to "serve as a simple and straightforward clarification of existing American-law. . . ."[3] The FTAIA expressly "exempt[s] from the Sherman Act export transactions that did not injure the United States economy."[4] In addition, the FTAIA provides that before a U.S. District Court can apply the Sherman Act to foreign conduct abroad, it must first find that:

> (1) such conduct has a direct, substantial, and reasonably foreseeable effect on domestic trade or commerce; and
>
> (2) such effect gives rise to a claim under the provisions of sections 1 to 7 of the Sherman Act.[5]

U.S. law has long presumed that, unless a contrary intent appears, legislation normally is meant to apply only within the territorial jurisdiction of the U.S. In interpreting the antitrust laws, however, U.S. courts gradually have overcome the presumption against extraterritoriality in cases where certain intended effects could be expected in the U.S.

The case law on foreign jurisdiction of the U.S. antitrust laws has expanded dramatically in recent years. To appreciate the developments, one must be familiar with earlier case law.

In *American Banana Co. v. United Fruit Co.*,[6] the U.S. Supreme Court considered the application of the Sherman Act in a civil action involving conduct that occurred entirely in Central America and that had no discernable effect on imports into the U.S. The plaintiff, an Alabama corporation operating in the banana trade

in Panama, alleged that the defendant, a New Jersey corporation in the banana trade, had long demonstrated an intent to prevent competition and monopolize the banana trade through its conduct abroad in acquiring competitors and entering into contracts to regulate quantities, as well as agreements to fix prices. At the time of the defendant's conduct, Panama was in the process of becoming an independent republic with certain territory remaining in de facto control of Costa Rica. The plaintiff alleged that the defendant instigated Costa Rican soldiers and officials to seize cargo supplies and a part of his plantation, and to stop plantation construction. The court found that "the acts causing the damage were done, so far as appears, outside the jurisdiction of the United States, and within that of other states."[7] The court further opined that

> [w]ords having universal scope, such as "every contract in restraint of trade," "every person who shall monopolize," etc., will be taken, as a matter of course, to mean only everyone subject to such legislation, not all that the legislator subsequently may be able to catch.[8]

The Second Circuit presented a less restrictive view in *United States v. Aluminum Co. of America (ALCOA)*,[9] by holding that the Sherman Act, properly interpreted, proscribed extraterritorial acts that were "intended to affect imports [into the United States] and did affect them."[10] In *Alcoa*, the defendant Alcoa, a Pennsylvania company, and Aluminum Limited, an independent Canadian spin-off company of Alcoa, participated in a foreign cartel to restrict the price of aluminum products by a system of quotas and royalties for various countries, including the U.S. The cartel or "Alliance," as it was called, was incorporated in Switzerland and based on an agreement between Alcoa and Aluminum Limited as well as French, German, Swiss, and British aluminum producers. All "Alliance" agreement participants were also shareholders. The agreement, which was silent as to sales in the U.S., specifically provided that no shareholder was to buy, borrow, fabricate or sell aluminum produced by anyone not a shareholder absent consent by the "Alliance's" board. The court found an effect on U.S. aluminum imports in violation of the Sherman Act, in part because "a depressant upon production which applies generally may be assumed, *certeris paribus*, to distribute its effect evenly upon all markets."[11] In a widely followed opinion, Judge Learned Hand wrote that a "state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends."[12] Under Alcoa's "effects test," jurisdiction turns on whether the cartel activities had an effect on U.S. commerce, and not where the conduct took place.

Nearly fifty years after *Alcoa*, the U.S. Supreme Court validated Judge Hand's opinion in the landmark decision of *Hartford Fire Ins. Co. v. California*, mentioned above. The *Hartford Fire* Court deemed it "well established by now that the Sherman Act applies to foreign conduct that [1] was meant to produce and [2] did in fact produce some substantial effect in the United States."[13] Although the *Hartford Fire* decision was based primarily on the law of comity, the Court endorsed the above two-part "substantial effects" test for determining jurisdiction.

In *Hartford Fire*, the defendants were four domestic U.S. primary insurance companies, two domestic trade associations, a domestic reinsurance broker, and foreign reinsurers based in London who allegedly engaged in various conspiracies to force certain primary insurers to alter the terms of their standard commercial general liability insurance policies in conformance with the policies for sale by the defendants in the U.S. The plaintiffs, nineteen U.S. states and numerous domestic private plaintiffs, claimed that the four primary insurer defendants encouraged "key actors" in the London reinsurance market, a market that indemnifies for North American risks, to withhold reinsurance for coverage written on industry standard forms ("1984 forms") to which the four primary insurer defendants objected. Most primary insurers relied on both the standard form and the support services provided by the defendant trade associations. The London-based conduct caused the replacement of the 1984 forms with a form containing new provisions favoring the defendants in the U.S. In applying the "substantial effects" test, the court found that the "London-based reinsurers' express purpose to affect U.S. commerce and the substantial nature of the effect produced, outweighed the supposed conflict [between U.S. and English law] and required the exercise of jurisdiction," despite the alleged conduct occurring entirely in a foreign country, England.[14] The decision in *Hartford Fire* remains today the most recent U.S. Supreme Court opinion on extraterritoriality.

One recent case not governed by the FTAIA illustrates the difficulties in determining antitrust jurisdiction over foreign conduct. In *Dee-K Enter., Inc. v. Heveafil Snd., Bhd.*,[15] the foreign defendants, nine Southeast Asian producers of extruded rubber thread, were alleged to have engaged in a price-fixing conspiracy. The facts revealed that

> The conspiracy was largely foreign with some domestic elements, but not limited to the United States import market. Indeed, the conspiracy mixed foreign and domestic elements in several respects: it included many participants with foreign affiliations, but a

> few who also had United States affiliations; acts that range[d] from a series of conspiratorial meetings, all held abroad, to routine communications, a few in the United States; and a target market [that] embrac[ed] dozens of nations including the United States.[16]

The plaintiffs, U.S. purchasers of rubber thread, argued at trial that the price fixing by the foreign producers had a substantial effect on the domestic U.S. market. The jury, using the two-part *Hartford Fire* substantial effects test, found that, although a conspiracy to fix prices was *intended* to affect the U.S. markets, it did not, in fact, have a substantial effect on these markets.

On appeal to the Fourth Circuit, the plaintiffs argued that the substantial effects standard of *Hartford Fire* applies only to conduct that is "wholly foreign" and did not govern foreign conspiracies that result in the sale of price-fixed goods directly into U.S. commerce, as was found here. The plaintiffs contended that a more lenient standard used in domestic claims applied instead. In determining which standard to apply, the Fourth Circuit examined whether the alleged antitrust violations were primarily foreign or primarily domestic. In particular, the court considered a full range of factors including: the nationality of the participants; the location of their acts; the target of their conduct; and the location of its effects.[17] The Fourth Circuit found that the cartel's links to the U.S. were outweighed by the global nature of the conspiracy, the formation of its agreements entirely outside the U.S., the targeting of a global market, and that all conspirator participants were foreign. Thus, it concluded that the alleged conspiracy was primarily foreign, and applying *Hartford Fire*, affirmed the ruling of the district court finding no substantial effect on U.S. commerce.

B. A Growing Controversy: Causal Connection Between Injury and Effect on U.S. Commerce

U.S. courts have accepted conclusively the broad principle that alleged antitrust violations predicated on wholly foreign conduct that has an intended *and* substantial effect in the U.S. are within the jurisdictional reach of Section 1 of the Sherman Act. Recent court decisions, however, have focused on whether a plaintiff's claim must arise from the U.S. effect of the anticompetitive conduct in order to establish jurisdiction under the FTAIA. In other words, must the plaintiff demonstrate that his injury was caused by the alleged effect on U.S. commerce? U.S. courts remain split on this question, with the Second and Fifth Circuits issuing conflicting decisions. The U.S. Supreme Court has yet to resolve the issue.

1. Restrictive View: Cases Requiring Causal Connection Between Injury and Effect on U.S. Commerce

Under the Fifth Circuit's restrictive interpretation, based, in part, on the "plain meaning" of the statute, the Fifth Circuit stated in *Den Norske Statoil ASA v. HeereMac v.o.f.* that "the FTAIA requires more than a 'close relationship' between the domestic injury and the [foreign or domestic] plaintiff's claim; it demands that the domestic effect 'gives rise' to the claim."[18] In *Den Norske*, the plaintiff, a Norwegian oil corporation, conducting its business solely in the North Sea, alleged that the defendants, providers of heavy-lift barge services in the North Sea, the Gulf of Mexico, and the Far East, conspired to fix bids and allocate customers, territories, and projects. The illegal conduct occurred entirely outside the U.S. The plaintiff, contending that it paid inflated prices for services in the North Sea, argued that the market for heavy lift services was a single, unified, global market that included the U.S. and therefore "gives rise" to any claim based upon the conspiracy. In rejecting this argument and thus, jurisdiction, the Fifth Circuit found an effect on U.S. commerce in the form of higher prices paid by U.S. companies for heavy-lift services in the Gulf of Mexico, but concluded that the plaintiff's injury did not stem from that effect. The court reasoned that the commerce giving rise to the foreign plaintiff's action was not U.S. commerce with foreign nations, but rather commerce between or among foreign nations. Thus, the plaintiff failed to meet the requirements under prong two of the FTAIA—that the effect on U.S. commerce gives rise to the plaintiff's claim.

Following a petition for certiorari to the U.S. Supreme Court, the U.S. antitrust agencies filed an amicus brief opposing certiorari and agreeing with the Fifth Circuit decision.[19] In their brief, the agencies sided with the view "that the FTAIA requires that the anticompetitive effects on United States commerce must give rise to a plaintiff's claimed injuries."[20] The agencies reasoned that the text of the FTAIA contained "no hint of a statutory purpose to permit recovery where the situs of the injury is entirely foreign and the injury exclusively arises from a conspiracy's effect on foreign commerce." Moreover, the agencies argued that the Fifth Circuit view did not preclude the government from prosecuting violations of the FTAIA by global cartels because international cartel activities that have a "direct, substantial and reasonably foreseeable effect" on domestic commerce under prong one of the FTAIA, automatically "give rise" to a claim by the U.S.—as opposed to a private plaintiff that must demonstrate causality. The U.S. Supreme Court declined certiorari.[21]

The Fifth Circuit is not alone in its more restrictive interpretation of the FTAIA. For example, in *McGlinchy v. Shell Chemical Co.*,[22] the Ninth Circuit reached a conclusion similar to *Den Norske*. In *McGlinchy*, the plaintiffs, a California-based distributor of resin abroad and its owner, alleged anticompetitive conduct by defendant, Shell Chemical Company and its London-based affiliates, in the form of concerted and unilateral refusal to deal in various foreign markets. The original contract between the parties covered the promotion and sale of polybutylene pipe resin exclusively in foreign markets. The plaintiffs claimed only antitrust injury to foreign customers or potential customers located in Southeast Asia. Moreover, nowhere in their complaint did the plaintiffs allege injury to the competitive markets for polybutylene. In rejecting subject matter jurisdiction, the Ninth Circuit found that the plaintiffs failed to allege either prong of the FTAIA and concluded that the claims related "only to foreign commerce without the requisite domestic anticompetitive effect."[23] The court reasoned that to meet the requirements of the second prong, a plaintiff "must allege antitrust injury to the market or to competition in general, not merely injury to individuals or individual firms."[24]

Ferromin Int'l Trade Corp. v. UCAR Intern., Inc.,[25] is another decision supporting the Fifth Circuit view. The Eastern District of Pennsylvania held that, based on its plain language, "the FTAIA permits jurisdiction over antitrust claims of foreign plaintiffs who were injured in foreign marketplaces only where the complained-of conduct had a direct, substantial and reasonably foreseeable effect on the domestic marketplace and that this anticompetitive effect on the domestic marketplace gave rise to their injuries."[26]

In *Ferromin*, twenty-six foreign company plaintiffs brought actions for alleged violations of the Sherman Act caused as a result of price fixing and market allocation in the worldwide market for graphite electrodes. The defendants were both foreign and domestic entities engaged in the manufacture and sale of graphite electrodes globally. The court found that of the $229 million worth of graphite purchased by the plaintiffs during the alleged conspiracy period, nearly $205 million of the alleged purchases had "no connection whatsoever to the United States—the electrodes were all manufactured outside the United States, shipped to plaintiffs' locations outside the United States, invoiced outside the United States and used in steel mills outside the United States."[27] The court dismissed the claims of those plaintiffs who used graphite electrodes that were neither purchased nor manufactured in the U.S. The court, however, allowed jurisdiction for eleven of the plaintiffs who used graphite electrodes that were purchased, manufactured and invoiced from the U.S. The court reasoned that "[w]hile the mere fact that goods were manufactured in the United States is insufficient to establish jurisdiction under the FTAIA . . . we find that the fact that some of the electrodes these 11 plaintiffs purchased were invoiced in the United States satisfies the causal requirement that these 11 plaintiffs were injured as a result of higher prices for graphite electrodes in the United States market."[28]

2. Expansive View: Recent Cases Broadening U.S. Jurisdiction

In stark contrast to the view of the Fifth Circuit, the Second Circuit's expansive interpretation of the FTAIA eliminates the requirement of a causal connection between injury and effect on U.S. commerce—thus allowing a plaintiff to sue for injuries that do *not* arise from the effects of anticompetitive conduct abroad on U.S. commerce as long as the conduct's "domestic effect violated the substantive provisions of the Sherman Act."[29]

In *Kruman*, buyers and sellers of art auction items outside the U.S. sued the world's two largest art auction houses for conspiring to fix prices in the U.S. and abroad for their auctioneering services, leading to inflated commissions. The court found that under Second Circuit precedent, "anticompetitive conduct directed at foreign markets" has the requisite "effect" if it "injures domestic commerce by either (1) reducing the competitiveness of a domestic market; or (2) making possible anticompetitive conduct directed at domestic commerce."[30] The court reasoned that the language of the FTAIA had not changed the *National Bank of Canada* standard (not requiring that the "effect" on domestic commerce be the basis for the alleged injury) and that the FTAIA's "give rise to a claim" language only requires that the "effect" on domestic commerce violate the substantive provisions of the Sherman Act.[31] Thus, the Second Circuit held that the FTAIA did not shield the defendants' conduct from scrutiny under the Sherman Act. Following reported settlement by the parties, the U.S. Supreme Court dismissed the defendants' petition for certiorari.[32]

Less than one year after the Second Circuit's ruling in *Kruman*, the D.C. Circuit Court of Appeals took an intermediate interpretation of the FTAIA in *Empagran S.A., et al. v. F. Hoffman-LaRoche, Ltd., et al.*[33] Under the D.C. Circuit's view, foreign purchasers injured in their foreign commerce solely by the effect of an alleged global price-fixing conspiracy could bring suit in U.S. federal courts so long as there was also *some* harm to a private party in the U.S. that the Sherman Act was intended to prevent. *Empagran* involved a private class action arising from the U.S. antitrust agencies' prosecution of a global vitamin price-fixing cartel. The D.C. Circuit considered whether foreign companies that purchased products from various vitamin manufacturers

involved in the cartels could bring a class action in the U.S. District Court to recover damages under the Sherman Act. Once again, all purchases were made outside the U.S.

The D.C. Circuit held that "where the anticompetitive conduct has the requisite effect on United States commerce, FTAIA permits suits by foreign plaintiffs who are injured solely by that conduct's effect on foreign commerce. The anticompetitive conduct itself must violate the Sherman Act and the conduct's harmful effect on the United States commerce must give rise to 'a claim' by someone, even if not the foreign plaintiff who is before the court."[34] According to the D.C. Circuit, the "gives rise" requirement could be satisfied where some private person or entity suffers an injury (actual or threatened) "as a result of the U.S. effect of the defendant's violation of the Sherman Act."[35] The court followed the dissenting opinion of the Fifth Circuit's Judge Higginbotham in *Den Norske*, which noted that "[i]f the drafters of FTAIA had wished to say 'the claim' instead of 'a claim,' they certainly would have."[36] The court further relied on Judge Higginbotham's argument on deterring cartel activity, noting that "[a]llowing suits by those injured solely in foreign commerce, where the anticompetitive conduct also harmed U.S. commerce, forces the conspirator to internalize the full costs of his anticompetitive conduct."[37]

Once again, the U.S. antitrust agencies filed an amicus brief, this time supporting a rehearing *en banc* and opposing the views of the Second and D.C. Circuits. In their brief, the agencies disagreed with the court's literal reading of the FTAIA's "'a' claim," asserting that Congress did not intend to alter existing concepts of antitrust injury or antitrust standing. The agencies further disagreed with the rationale that an expansive interpretation of the FTAIA was necessary to deter international cartel activity and noted that such a broad view actually would impair its enforcement abilities. "By permitting suits for treble damages by overseas plaintiffs whose injuries arise from overseas conduct, the majority's decision, if allowed to stand, would create a potential disincentive for corporations and individuals to report antitrust violations and seek leniency under the Corporate Leniency Policy or, when amnesty under the policy is unavailable, to cooperate with prosecutors by plea agreement."[38] In addition, the agencies reasoned that an expansive interpretation would burden the federal courts in the U.S.[39] Ultimately, the D.C. Circuit denied the petition for rehearing *en banc.* The petitioners filed for a writ of certiorari in November 2003, which the U.S. Supreme Court granted on 15 December 2003.[40] The Court is expected to hear the case next April and issue a decision by late June 2004.

3. U.S. Supreme Court Review

Given the split among the Circuits and the potential impact on U.S. antitrust enforcement activities, the U.S. Supreme Court will need to be decisive. The policy considerations underlying the FTAIA appear to favor the restrictive view of the Fifth Circuit. Congress originally adopted the FTAIA to *limit*, rather than expand, the court's subject matter jurisdiction under the Sherman Act. Prior to the FTAIA, American exporters could not compete effectively in foreign markets for fear that their anticompetitive conduct abroad, albeit necessary to succeed in the foreign markets, could subject them to liability under the Sherman Act.[41] Consequently, requiring a causal link between the injury and the domestic effect is arguably proper, given the fundamental purpose of the FTAIA, which is to protect American exporters from liability when conducting business transactions abroad by eliminating jurisdiction in the U.S.

C. U.S. Antitrust Agencies' Perspective

1. Agencies' Guidelines

On 5 April 1995, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) released joint antitrust enforcement guidelines for International Operations (the "1995 International Guidelines") that set forth the agencies' current policies and priorities in this area. The 1995 International Guidelines assume that anticompetitive conduct that affects the U.S. or foreign commerce may violate the U.S. antitrust laws regardless of where such conduct occurs or the nationality of the parties involved. For example, the Guidelines state that imports into the U.S. by definition affect the U.S. domestic market directly and will therefore almost invariably provide the necessary intent. Whether they in fact produce the requisite substantial effect will depend on the facts of each case. For conduct involving foreign commerce other than direct imports, the 1995 International Guidelines state that direct, substantial and reasonably foreseeable effects on U.S. domestic or import commerce will apply to establish jurisdiction.

2. The 1995 International Guidelines—Illustrative Examples

The 1995 International Guidelines focus primarily on jurisdiction over foreign companies. In general, the examples indicate that the agencies will take a broad view of activities that fall under the purview of the U.S. antitrust laws. The agencies will assume jurisdiction over anticompetitive practices in foreign countries that are directed toward or hurt U.S. importers or exclude U.S. companies. The agencies believe that under *Hartford Fire* they have jurisdiction where a foreign cartel makes substantial sales directly into the U.S.[42] The agencies also assert jurisdiction where the cartel mem-

bers sell to an intermediary outside the U.S. that they know will resell the product into the U.S., even where the intermediary is not part of the cartel and is not controlled by the cartel.[43] The agencies further contend that jurisdiction arises where the cartel members agree to fix U.S. prices and undercut prevailing U.S. price levels to harm U.S. manufacturers, even where consumers may benefit from lower prices.[44] In addition, the agencies indicate there would be jurisdiction where a foreign cartel takes "all feasible" measures to keep U.S. competitors out of its country's market and the action is aimed at a U.S. exporter (direct and foreseeable effect on U.S. commerce) and results in foreclosure from the that market (substantial effect on U.S. commerce).[45] Jurisdiction is also asserted by the agencies where international cartel participants are members of a trade association that develops standards often adopted by their country's regulatory authorities and agree to refuse to adopt any U.S. technology to boycott the distribution of U.S. equipment. The agencies, however, would not assert jurisdiction where the volume of trade of the product to the cartel's country was de minimus.[46]

3. International Comity

International comity is a doctrine that counsels voluntary forbearance when a sovereign that has a legitimate claim to jurisdiction concludes that a second sovereign also has a legitimate claim to jurisdiction under principles of international law. In *Hartford Fire*, the U.S. Supreme Court limited the application of the principle by suggesting that comity concerns would operate to defeat the exercise of jurisdiction only in the few cases in which the law of the foreign sovereign *required* a defendant to act in a manner incompatible with the Sherman Act or in which full compliance with both statutory schemes was impossible. Because the conduct leading to antitrust liability was not mandated in the United Kingdom, the U.S. Supreme Court in *Hartford Fire* refused to apply rules of comity. Similarly, in *Nippon Paper*, discussed below, the conduct with which the defendant was charged was illegal under both Japanese and American law, thereby alleviating any concern about the defendant being buffeted between the laws of separate sovereigns.

The U.S. antitrust agencies employ comity considerations in determining whether to pursue a violation of the U.S. antitrust laws. After contacting the antitrust authority in the offender's home country, the U.S. agencies would consider whether that authority is in a better position to address the competition problem and is prepared to act, and in turn, whether the U.S. agencies would consider working cooperatively with the foreign authority or staying their own pending enforcement efforts by the foreign authority.

4. Jurisdiction in Criminal Prosecutions by the United States

In a groundbreaking decision, the First Circuit in *United States v. Nippon Paper Industries Co., Ltd.*,[47] extended the principle of extraterritoriality in *Hartford Fire* to a criminal antitrust action. In *Nippon Paper*, a Japanese manufacturer of fax paper had met with various other co-conspirators in Japan and agreed to fix prices throughout North America. These companies then sold the paper in Japan to unaffiliated trading houses on the condition that they charge specified (inflated) prices for the paper when they resold it in the U.S. The trading houses then sold the fax paper to their U.S. subsidiaries that passed the higher prices on to U.S. consumers. The U.S. brought action alleging a substantial adverse effect on U.S. commerce and unreasonable restraint of trade in violation of the Sherman Act. The First Circuit found that the Sherman Act applied to "wholly foreign" conduct. In rejecting the defendant's comity-based argument, the court reasoned that "[w]e live in an age of international commerce, where decisions reached in one corner of the world can reverberate around the globe in less time than it takes to tell the tale. Thus, a ruling in [the defendants'] favor would create perverse incentives for those who would use nefarious means to influence markets in the United States, rewarding them for erecting as many territorial firewalls as possible between cause and effect."[48]

Since *Nippon Paper*, the DOJ has built a successful track record of enforcing U.S. antitrust laws abroad. Some of the more recent cases further demonstrate the effectiveness of DOJ's long arm approach. For example, in *U.S. v. Mitsubishi Corporation*,[49] the defendant, Mitsubishi Corporation, owned 50 percent of the stock of UCAR International, a U.S. producer of graphite electrodes. Mitsubishi aided in a price-fixing cartel among graphite electrode producers by encouraging UCAR to fix prices, facilitating cartel meetings, selling products for manufacturers at prices it knew to be fixed, and concealing the cartel from customers. Mitsubishi was convicted of aiding and abetting the five-year conspiracy to fix prices and allocate sales volumes. The court sentenced the company to a $134 million fine, the fourth largest ever imposed in a U.S. antitrust case. *Mitsubishi* established that DOJ will "hold accountable parent companies, organizational shareholders, joint venture partners, and/or trading houses if they had knowledge of, aided, and profited from a cartel."[50]

In an investigation resulting in what remains today the highest in criminal fines, *United States v. F. Hoffman-La Roche Ltd*.[51] involved an alleged conspiracy between Swiss pharmaceutical giant F. Hoffmann-La Roche (and its executives) and other manufacturers of vitamins to

fix, raise, and maintain prices and allocate market shares of vitamins sold in the U.S. and elsewhere. In addition, the conspirators allegedly allocated contracts with customers for vitamin premixes as well as rigged bids for those contracts in the U.S. The defendants pled guilty, leading to a record-setting $500 million in fines for Hoffman-La Roche.

In another far-reaching case, DOJ investigated companies and individuals involved in Egyptian wastewater treatment activities. The targets of the investigation were companies and individuals who rigged bids on water construction contracts in Cairo that were funded by the U.S. Agency for International Development (USAID). The cartel involved bid-rigging activities in the form of payoffs to co-conspirators in the millions of dollars aimed to restrain competition and raise prices on USAID projects. The DOJ brought actions against U.S.-based American International Contractors, Inc; Switzerland-based ABB Middle East & Africa Participations AG; German-based Phillip Holzmann AG; and Bilhar International Establishment of Liechtenstein. The resulting indictments brought a mix of both settlements and convictions totaling more than $141 million in fines and $10 million in restitution to the U.S. government. The case was significant in that, although the international cartel focused its activities solely in a foreign country, it still victimized U.S. taxpayers.

In a criminal action that ultimately led to the class action lawsuits in *Kruman*, DOJ investigated a price-fixing scheme by the world's two dominant art auction houses in *U.S. v. Sotheby's Holdings, Inc*.[52] The anticompetitive conduct involved top officials at both Sotheby's and Christie's, which together controlled over ninety percent of the world's auction business. The officials colluded to defraud sellers of art, antiques, and collectibles on the seller's commissions charged by the auction houses. Specifically, the activity limited competition for the sellers' goods through agreements by the officials of the two companies to raise commissions and cease negotiating discounts from the published rates. Christie's defected from the cartel through the DOJ's corporate leniency program. The convictions resulted in $45 million in fines against Sotheby's.

More recently, in the last year DOJ investigated Arteva Specialties, S.a.r.l., d/b/a KoSa, a Luxembourg-based manufacturer of polyester staple with principal offices in the U.S. The investigation centered around a conspiracy by Arteva, its former executives, and unnamed co-conspirators, to fix prices and allocate customers in the North American market for polyester staple, a man-made petroleum-derived fiber used in the manufacture of textiles.[53] DOJ determined that "the business activities of the defendant and its co-conspirators . . . were within the flow of, and substantially affected, interstate and foreign trade and commerce."[54] The defendants eventually pled guilty, agreeing to pay $28.5 million in fines.

III. Extraterritorial Imperialism in U.S. Antitrust Enforcement

In recent years, the U.S. Department of Justice has increased dramatically its aggressive targeting of international cartels. The prosecution of international cartel activities has produced record-setting fines and considerable publicity. The numbers are huge. For example, as indicated earlier, of the over $2 billion in criminal fines imposed by the DOJ since 1997, over ninety percent were obtained from the prosecution of international cartel activity.[55] Moreover, in thirty-three of the thirty-nine cases where DOJ's Antitrust Division secured a fine of $10 million or more, the corporate defendants were foreign-based, as shown by the DOJ chart set forth in Appendix A hereto. Increasingly, foreign nationals, including CEOs of major foreign corporations, pay individual fines and serve jail terms in the U.S. The average jail sentence in these cases reached a new high in FY 2002 of more than eighteen months and "[f]oreign defendants from Canada, Germany, Switzerland, Sweden and France have served prison sentences in US jails for violating US antitrust laws."[56] At present, approximately fifty sitting U.S. grand juries are conducting investigations, and close to one-half of those investigations involve international cartel activity.[57]

A. Global Cartel Enforcement Is Big Business

Aside from the strong deterrent effect of fines and jail sentences on cartel behavior, the DOJ recognizes that prosecuting domestic and foreign corporations and individuals for global conspiracies involving price-fixing, market division, and customer allocation, is a lucrative business that gets noticed on Capitol Hill and around the world. The record-setting fines and significant prison terms, especially for foreign corporations and individuals, has generated enormous publicity for the U.S. antitrust agencies and raised their profile and bragging rights among Congress and the international antitrust community.

The DOJ has prosecuted foreign executives from Belgium, Canada, France, Germany, Italy, Japan, Korea, Mexico, The Netherlands, South Africa, Sweden, Switzerland, the United Kingdom, and most recently Norway.[58] In the graphite electrodes prosecutions, for example, SGL Carbon's CEO, Robert Koehler (a German citizen living in Germany), was fined $10 million and had to travel to the U.S. to appear before a federal judge concerning the adequacy of his fine. In addition, two former top executives of UCAR International, Inc., Robert Krass and Robert Hart, each served prison terms and paid seven-figure fines. Similar individual penalties

were levied in the DOJ's investigation of Sotheby's and Christie's auction houses. Sotheby's former Board Chairman, Alfred Taubmann, was convicted at trial for his role in the conspiracy and sentenced to a $7.5 million fine and one year in prison. In the vitamin prosecutions, Hoffman-La Roche's former director of worldwide marketing (a Swiss citizen living in Switzerland) agreed to pay a $100,000 fine and to serve a four-month prison term; the former president of Hoffman-La Roche's Vitamins Division, also a Swiss citizen and resident, agreed to pay a $150,000 fine and to serve a five-month jail sentence. Six other foreign national corporate executives from Hoffman-La Roche and BASF served between three to five months in jail. Moreover, several foreign nationals who agreed to serve time in U.S. jails were from countries where the U.S. has no extradition treaty for antitrust crimes.

Recovery of huge criminal fines from participants in international cartels, and big headlines, were a hallmark of the administration of Joel Klein, Antitrust Division Chief from 1997 to 2000. Under the subsequent Division leadership of Charles James from 2001 to 2002, there was a sentiment that headlines about record fines may have gone a bit too far, and imposition of penalties was reined in to some degree (but not extinguished, by any means). The new head of the Antitrust Division, Hewitt Pate, confirmed by the U.S. Senate on 20 June 2003, has indicated that his administration will return to a heavy emphasis on criminal prosecutions and fines. Mr. Pate recently stated:

> An effective anti-cartel enforcement program should be the top enforcement priority for every antitrust agency, and it will continue to be so for us . . . . We have continued our decade-long concentration of criminal resources on our international cartel program.[59]

Moreover, the DOJ has advocated increasing the U.S. dollar amount for criminal fines under Section 1 of the Sherman Act from $10 million to $100 million.

Antitrust investigations into a given product market frequently lead to investigations in other related product markets—birds of a feather (and similar feathers) tend to flock together. Nearly half of the current roughly fifty sitting antitrust grand juries in the U.S. "were initiated by evidence obtained as a result of the investigation of a completely separate industry."[60] The DOJ is an expert at discovering such new product conspiracies by dangling amnesty to the first confessor in the related industry and reduced penalties in the industry initially under investigation (known as "Amnesty Plus"). Indeed, the DOJ has made a very profitable science of pursuing this theory in the U.S. and internationally. This raises the stakes even higher for multi-national corporations. Additional product lines and new co-conspirators create additional leverage for prosecution and fines for the antitrust authorities.

B. U.S. Reach Is Global

The DOJ takes the position that it is irrelevant where the illegal conduct under U.S. law takes place—it only matters whether the conduct has *any* substantial effect on U.S. commerce. While the DOJ might take into account, in terms of intent or relative culpability, the fact that a foreign target of an antitrust investigation considered that its activities were legal under the law of its own nation and the countries in which it conspired, the fact remains that the DOJ will consider such corporations or individuals responsible for a conspiracy if there is a substantial effect on U.S. commerce. The DOJ also is likely to prosecute an allocation agreement whereby a foreign corporation with no U.S. sales, assets, or personnel agrees to sell its product only in Europe if, but for the agreement, that corporation would have competed in the U.S.

As a practical matter, the power of the DOJ over foreign corporations and nationals is immense. Businesses increasingly are multi-national and most have ties with the U.S., a fact of which the DOJ takes full advantage. If a corporation has a presence in the U.S., either through direct operations, subsidiaries, divisions, offices or assets, the DOJ may well assert jurisdiction over it. Moreover, even if a firm has no presence in the U.S., it must take into account future potential expansion of operations into the U.S.

The implications are just as serious for individuals. At first blush, a witness or target sought by the U.S. government who is a foreign national and resides abroad may ask why a foreign national in a foreign land, with few or no contacts in the U.S., should cooperate with a U.S. antitrust investigation. If the individual is employed by a company that does business in the U.S., however, the answer is often clear: if the individual travels to the U.S. on company business, then he or she must be concerned about being detained via a U.S. border watch. Even if the individual is an ex-employee of a corporation under investigation, he or she may be seeking new employment, and likely would not want to disclose to a potential employer that his or her travel must exclude one of the most economically desirable markets in the world. For retired employees, it may be that they have relatives or friends in the U.S. that they wish to visit, or they simply enjoy shopping in the Big Apple.

Technology has made border watches fairly easy and inexpensive. Any number of individuals can be put on the border watch for an indefinite period of time.

Passports are checked within fractions of seconds at both the U.S. and Canadian borders to determine whether an individual is on a border watch. This is an important tool used by the DOJ to apprehend targets and witnesses and serve subpoenas.

The only individual who can plausibly ignore the seemingly global reach of the U.S. antitrust authorities is a foreign national who resides outside this country, who has not been served with a subpoena or other process in the U.S., and is willing to avoid travel to the U.S. Even then, however, circumstances always can change as to a person's need (or perceived need) to visit the U.S. In addition, if a person is a target and is indicted by the U.S., he or she must be concerned about possible extradition to this country, although to date the U.S. has never caused extradition from a foreign country for U.S. antitrust violations. Certain officials at the Antitrust Division have advocated that this precedent be broken. Also, in areas other than antitrust, U.S. criminal enforcement authorities have arranged with foreign officials to have individuals detained abroad and brought to the U.S. to appear before a U.S. court without the formality of extradition. In 2001, the Antitrust Division adopted a policy of placing indicted fugitives on a "Red Notice" list maintained by INTERPOL. Under this arrangement, INTERPOL member nations are requested to arrest fugitives with a view toward extradition.

C. Investigations Are Multi-Jurisdictional

Successful international cartel enforcement has led to increased international cooperation. Despite the DOJ's strong crackdown on international cartels, there are some limits to the DOJ's assertion of jurisdiction over foreign companies and individuals to enforce U.S. antitrust laws abroad. As noted above, comity is also a consideration. Hence, we see increased cooperation between the U.S., Canada, the EU, and an increasing number of other nations, including the United Kingdom, Mexico, Japan, Brazil, Israel, and Australia. This trend will continue, with information being exchanged and enforcement effected among more and more foreign jurisdictions.

One of the paradigm examples of international cooperation is simultaneous international "dawn" raids. The graphite electrodes investigation was the first occasion (June 1997) on which the U.S. and the EU antitrust authorities conducted simultaneous raids on several companies in the U.S. and Europe to seize corporate documents and other evidence. Since then, multi-jurisdictional orchestrated raids have become almost routine.

Also, "record" fines are contagious. If the DOJ obtains a "record" fine as to a global cartel, the antitrust authorities outside of the U.S. may not be satisfied with anything less than a corresponding "record" fine. Multinational cartel investigations can create a penalty-feeding frenzy spread over several jurisdictions.

D. The Importance of Leniency Programs

Enacted in 1978 and substantially expanded in 1993, the DOJ's leniency program provides essentially that the DOJ will not prosecute the first corporation that qualifies for leniency by reporting its illegal conduct and cooperating fully with the DOJ, regardless of whether the defendant comes forward before or after an investigation has been initiated.[61] Under the 1993 revisions, amnesty is automatic where there is no pre-existing investigation, unless the company is the "ringleader." Where an investigation is underway, amnesty still may be granted for cooperation. Very significantly, such amnesty from criminal prosecution is provided to all officers, directors, and employees who cooperate. These revisions, coupled with the policy that only the first company gets immunity, have sparked a surge in amnesty applications, increasing from just one application per year to more than one per month. Indeed, the majority of major international investigations by the Antitrust Division have been aided by this program. While not without consequence, such as ensuing private treble damage actions, the opportunity to escape criminal prosecution is a powerful incentive to cooperate with authorities.

The U.S. is taking further steps to make its leniency program more attractive to cartel participants. Legislation recently reported out of the U.S. Senate Judiciary Committee enhances the program in a number of ways.[62] First, it would increase the current three-year maximum jail sentence for cartel violations to a maximum of ten years. Second, the bill would increase the statutory maximum fines under the Sherman Act from $350,000 to $1 million for individuals and from $10 million to $100 million for corporations. Third, it proposes to limit damages that could be recovered from a corporation meeting the DOJ's strict criteria of its leniency program. This de-trebling would provide a further incentive for corporations to self-report violations. Moreover, all other conspirator companies would remain jointly and severally liable for treble damages. DOJ fully supports these new initiatives. As noted recently by Hewitt Pate, "The time has come to consider measures to toughen our cartel enforcement program."[63]

International antitrust enforcement activities have made antitrust leniency programs all the more important, as more countries model their programs after that of the DOJ. Canada, Brazil, the United Kingdom, Germany, France, Ireland, the Czech Republic, and Korea all now have some form of leniency program. Canada

has modified its own immunity program to resemble closely the U.S. leniency program, including a "first in" provision. The EU's leniency program, adopted in 1996, also saw significant revision in 2002. The EU's new program is far more transparent and predictable, along the lines of the DOJ's program. Such convergence in policies has facilitated companies to come forward simultaneously in the U.S., Europe, and Canada.

The vitamin price-fixing investigation illustrates the importance of leniency programs. Rhône-Poulenc, the French pharmaceutical company, cooperated with the DOJ's investigation under the corporate leniency program and escaped fines in the U.S. According to the DOJ, "the cooperation of Rhône-Poulenc, together with information provided by others, led directly to the charges filed . . . and the decision of the defendants not to contest the charge . . . ."[64] In contrast to Rhône-Poulenc, Hoffman-LaRoche and BASF paid a combined total of $725 million in fines, and six Swiss and German executives from the two companies were convicted and served prison time.

The graphite electrodes investigation illustrates the escalating risks in delaying reporting to the DOJ. After a grant of amnesty to the first applicant, the second company to cooperate paid fines of $32.5 million, followed by a third and a fourth company who paid fines respectively of $110 million and $135 million, respectively.

E. Coping with Multinational Investigations

Multinational investigations create enormous legal risks, multiple costs, and huge logistical problems for the companies involved. Investigational targets must worry about the DOJ; private treble damage actions in the U.S., including antitrust class actions, and shareholder and securities fraud suits; Canadian antitrust enforcement and private single-damage actions; EU civil prosecution and private actions in Europe (although historically nowhere near the same level as the U.S.); possible EU member state enforcement; and investigations by other foreign jurisdictions, such as Japan, Brazil, or Australia.

The difficulties for a corporation involved in multinational cartel activity are complicated by multi-jurisdictional enforcement and the differing methods and approaches to enforcement. The corporation also must decide what efforts and costs (including legal and travel expenses) it will undertake to protect and support its senior management and other employees that may have been involved in or witnessed illegal conduct. Particularly in criminal investigations, individuals may require separate antitrust counsel, and their interests may differ from those of the corporation and other employees. Thus, a corporation can be involved in a scenario where it is being investigated by three or more separate jurisdictions—either civilly or criminally or both—while it simultaneously must consider the interests of the corporation and its shareholders, and the interests of present and former employees. These issues are complicated further by what corrective or disciplinary actions a corporation must or should take with respect to employees—both present employees and possibly former employees still accruing benefits from the company.

Furthermore, settlement and plea bargains with the various antitrust jurisdictions do not necessarily bring an end to this complex scenario. Settlements invariably will be conditioned on full cooperation by the company and the employees covered by the settlement, which typically involves full disclosure of information, the production of documents and the production of present (and sometimes former) employees.

Endnotes

1. *See* James M. Griffin, *The Modern Leniency Program After Ten Years, Remarks before the American Bar Association Section of Antitrust Law* (12 August 2003).
2. 15 U.S.C. §§ 1-2 (1890).
3. H.R. Rep. No. 97-686, at 2.
4. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 796 (1993).
5. 15 U.S.C. § 6(a)(1)-(2).
6. 213 U.S. 347 (1908).
7. *Id.* at 355.
8. *Id.* at 357.
9. 148 F.2d 416 (2d Cir. 1945).
10. *Id.* at 444.
11. *Id.*
12. *Id.* at 443.
13. *Hartford Fire Ins. Co. v. California*, 509 U.S. at 796.
14. *Id.* at 797.
15. 299 F.3d 281 (4th Cir. 2002).
16. *Id.* at 287.
17. 299 F.3d at 294-95.
18. *Den Norske Stats Oljeselskap As v. HeereMac Vof*, 241 F.3d 420, 427 (5th Cir. 2001).
19. Brief for the United States and the Federal Trade Commission as Amici Curiae, *Statoil ASA v. HeereMac v.o.f.*, 122 S. Ct. 1059 (2002) (No. 00-1842).
20. *Id.*
21. *Statoil ASA v. Heeremac V.O.F.*, 534 U.S. 1127 (2002).
22. 845 F.2d 802 (9th Cir. 1988).
23. *Id.* at 815.
24. *Id.*
25. 153 F. Supp. 2d 700 (E.D. Pa. 2001).
26. 153 F. Supp. 2d at 705.
27. *Id.* at 702-03.
28. *Id.* at 706 (citations omitted).

29. *Kruman v. Christie's Int'l PLC*, 284 F.3d 384, 400 (2d Cir. 2002).
30. 284 F.3d at 394 (citing the Second Circuit's pre-FTAIA holding in *National Bank of Canada v. Interbank Card Assoc.*, 666 F.2d 6, 8 (2d Cir. 1981), establishing a standard for jurisdictional review of foreign antitrust cases).
31. 284 F.3d at 399.
32. *Christie's Int'l v. Kruman*, No. 02-340, 2003 WL 21855875 (8 Aug. 2003).
33. 315 F.3d 338 (D.C. Cir. 2003).
34. 315 F.3d at 341.
35. *Id.* at 352.
36. *Den Norske*, 241 F.3d at 432.
37. 315 F.3d at 357.
38. Brief for the United States and the Federal Trade Commission as Amici Curiae in Support of Petition for Rehearing En Banc at 13, *Empagran S.A., et al. v. F. Hoffman-LaRoche, Ltd., et al.*, 315 F.3d 338 (D.C. Cir. 2003) (No. 01-7115).
39. *Id.*
40. *Empagran*, 315 F.3d 338 (D.C. Cir. 2003), *cert. granted*, 72 U.S.L.W. 3356 (U.S. 15 Dec. 2003) (No. 03-724).
41. *See, e.g., In re Copper Antitrust Litig.*, 117 F. Supp. 2d 875, 887 (W.D. Wis. 2000) ("Congress extends domestic jurisdiction to extraterritorial conduct only when the plaintiffs have been injured by the effects on the domestic market. This is consistent with the main purpose of the Foreign Trade Antitrust Improvements Act, which was to protect American exporters from liability under the Sherman Act where the exporters were operating abroad.").
42. *See* U.S. Dep't of Justice and Federal Trade Comm'n, Antitrust Enforcement Guidelines for International Operations § 3.11 (1995) (Illustrative Example A54).
43. *Id.* at 3.121 (Illustrative Example B).
44. *Id.* (Illustrative Example C).
45. *Id.* at 3.122 (Illustrative Example D).
46. *Id.* (Illustrative Example D).
47. 1997 WL 109199 (1st Cir. 1997).
48. *Id.* at 9.
49. Crim. No. 00-033 (E.D. Pa. 2001).
50. *See* Scott D. Hammond, *A Review of Recent Cases and Developments in the Antitrust Division's Criminal Enforcement Program, Remarks before the American Bar Association Section of Antitrust Law* (7 March 2001), at 5, *available at* http://www.usdoj.gov/atr/public/speeches/10862.htm.
51. No. 3:99-CR-184-R (N.D. Tex. 1999).
52. No. 00 Cr.1081 (S.D.N.Y. 2000).
53. *United States v. Arteva Specialties, S.a.r.l., d/b/a KoSa.*, 3:02CR229-V (E.D.N.C. 2002).
54. DOJ Information Brief at 3, *Arteva Specialties.*
55. *See* Griffin, note 1 *supra*, at 2.
56. *Id.* at 3.
57. *Id.* at 2.
58. Griffin, note 1 *supra*, at 3. *See also* Press Release, U.S. Dept. of Justice, Norwegian Shipping Company and Two Executives Agree to Plead Guilty in International Parcel Tanker Shipping Investigation (29 Sept. 2003).
59. R. Hewitt Pate, The DOJ International Antitrust Program—Maintaining Momentum, Remarks before the American Bar Association Section of Antitrust Law (6 February 2003), at 2, *available at* http://www.usdoj.gov/atr/public/speeches/200736.htm.
60. Griffin, note 1 *supra*, at 9.
61. *See* DOJ Corporate Leniency Policy (1993), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,113.
62. *See* H.R. 1086, 108th Cong. (2003) (passed by the U.S. House of Representatives on 10 June 2003).
63. R. Hewitt Pate, *Vigorous and Principled Antitrust Enforcement: Priorities and Goals, Remarks before the American Bar Association Section of Antitrust Law* (12 August 2003), at 3, *available at* http://www.usdoj.gov/atr/public/speeches/201241.htm. *See also* Makan Delrahim, Department of Justice Perspectives on International Antitrust Enforcement: Recent Legal Developments and Policy Implications, Remarks before the American Bar Association Section of Antitrust Law (18 November 2003), at 7-8, *available at* http://www.usdoj.gov/atr/public/speeches/201509.htm (the bill "in our view would go a long way to improving cartel enforcement.").
64. *Hoffman-LaRoche, BASF Plead Guilty*, 76 Antitrust & Trade Reg. Rep. (BNA) No. 1910, at 558 (20 May 1999).

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APPENDIX A

ANTITRUST DIVISION
Sherman Act Violations Yielding a Fine of $10 Million or More

Defendant (FY)	Product	Fine ($ Millions)	Geographic Scope	Country
F. Hoffmann-La Roche, Ltd. (1999)	Vitamins	$500	International	Switzerland
BASF AG (1999)	Vitamins	$225	International	Germany
SGL Carbon AG (1999)	Graphite Electrodes	$135	International	Germany
Mitsubishi Corp. (2001)	Graphite Electrodes	$134	International	Japan
UCAR International, Inc. (1998)	Graphite Electrodes	$110	International	U.S.
Archer Daniels Midland Co. (1997)	Lysine & Citric Acid	$100	International	U.S.
Takeda Chemical Industries, Ltd. (1999)	Vitamins	$72	International	Japan
Bilhar International Establishment (2002)	Construction	$54	International	Liechtenstein
Daicel Chemical Industries, Ltd. (2000)	Sorbates	$53	International	Japan
ABB Middle East & Africa Participations AG (2001)	Construction	$53	International	Switzerland
Haarmann & Reimer Corp. (1997)	Citric Acid	$50	International	German Parent
HeereMac v.o.f. (1998)	Marine Construction	$49	International	Netherlands
Sotheby's Holdings Inc. (2001)	Fine Arts Auctions	$45	International	U.S.
Eisai Co., Ltd. (1999)	Vitamins	$40	International	Japan
Hoechst AG (1999)	Sorbates	$36	International	Germany
Showa Denko Carbon, Inc. (1998)	Graphite Electrodes	$32.5	International	Japan
Philipp Holzmann AG (2000)	Construction	$30	International	Germany
Arteva Specialties (2003)	Polyester Staple	$28.5	International	Luxembourg
Daiichi Pharmaceutical Co., Ltd. (1999)	Vitamins	$25	International	Japan
Nippon Gohsei (1999)	Sorbates	$21	International	Japan
Pfizer Inc. (1999)	Maltol/Sodium Erythorbate	$20	International	U.S.
Fujisawa Pharmaceuticals Co. (1998)	Sodium Gluconate	$20	International	Japan

Defendant (FY)	Product	Fine ($ Millions)	Geographic Scope	Country
Dockwise N.V. (1998)	Marine Transportation	$15	International	Belgium
Dyno Nobel (1995)	Explosives	$15	Domestic	Norwegian Parent
F. Hoffmann-La Roche, Ltd. (1997)	Citric Acid	$14	International	Switzerland
Merck KgaA (2000)	Vitamins	$14	International	Germany
Degussa-Huls AG (2000)	Vitamins	$13	International	Germany
Akzo Nobel Chemicals, BV (2001)	Monochloracetic Acid	$12	International	Netherlands
Ueno Fine Chemicals Ind., Ltd. (2001)	Sorbates	$11	International	Japan
Eastman Chemical Co. (1998)	Sorbates	$11	International	U.S.
Jungbunzlauer International AG (1997)	Citric Acid	$11	International	Switzerland
Lonza AG (1998)	Vitamins	$10.5	International	Switzerland
Morganite, Inc. (2003)	Carbon Products	$10	International	British parent
Akzo Nobel Chemicals, BV & Glucona, BV (1997)	Sodium Gluconate	$10	International	Netherlands
ICI Explosives (1995)	Explosives	$10	Domestic	British Parent
Mrs. Baird's Bakeries (1996)	Bread	$10	Domestic	U.S.
Ajinomoto Co., Inc. (1996)	Lysine	$10	International	Japan
Kyowa Hakko Kogyo, Co., Ltd. (1996)	Lysine	$10	International	Japan

Source: http://www.usdoj.gov/atr/public/criminal/12557.htm

"Extraterritoriality" in Competition Law from a European Perspective

By Alastair Sutton

I. Introduction

A. Extraterritoriality as a Concept

There is no clear definition for "extraterritoriality," although the term can possibly be defined as the power to secure the enforcement of a law outside the jurisdiction in which the law was made. Extraterritoriality as defined in the previous sentence is a controversial and unresolved issue under public international law, although the problem can be attenuated by reinforced cooperation, especially bilaterally between the European Union and United States and multilaterally through the OECD and ICN.

A less dramatic definition of extraterritoriality, and the way in which extraterritoriality is most often encountered in practice, is the *de facto* or *de jure* impact of EU/EC law outside the territory of the European Union, or the extent to which EU/EC law is taken into account by foreign jurisdictions (such as the United States).

There has been a mutual recognition in the United States and the European Union that extraterritoriality has achieved legitimacy to some degree—primarily through the application of the so-called "effects doctrine." The effects doctrine, meaning the legitimacy of a state regulating conduct taking place outside its territory but which nevertheless has an effect or impact within the territory of the state, is reflected in the *Dyestuffs* and *Woodpulp* cases in the European Union.[1]

Nevertheless, the "territoriality" principal is a fundamental concept of public international law, although attempts by nations, or confederations of nations such as the European Union, to apply or enforce their laws extraterritorially are limited as much by concepts of comity as they are by law.[2] For example, there is the concept of "negative comity," as reflected in Article VI of the European Commission-US 1991 Agreement on cooperation in competition policy,[3] which implies that the parties will seek to avoid conflicts over enforcement activities. On the other hand, Article V of the 1991 Agreement reflects "positive comity," in that it requires cooperation between the parties to reach complementary or non-conflicting outcomes.

Globalization has made more acute the need for Nation States and the European Union to address the issue of jurisdictional conflicts, particularly in the field of competition law. As a consequence, there have been various bilateral initiatives, such as those between the United States and the European Union and Japan and the European Union, on cooperation in competition policy, as well as multilateral actions such as the International Competition Network (ICN), the WTO "Singapore agenda" and so-called "soft" cooperation in the OECD, including non-binding recommendations on competition law and policy adopted by the OECD Council.

Nevertheless, recent experience suggests, that, while international cooperation is easy to agree upon in principle, the resolution of individual cases is more problematic, as we will see below in regard to the *Intel* and *Microsoft* cases. Yet more effective EU-US cooperation is crucial to any effective multilateral system—and the continuing territorial extension of the EU competition *acquis* to third countries increases the risk of conflict or overlap between the competing US and European Union "models." Thus the question remains open whether the so-called "modernization" and decentralization of EU competition law from 1 May 2004 will improve or make more difficult such international cooperation.

B. "Extraterritoriality" in Practice

Set forth below in this paper is a discussion of three different examples of extraterritoriality in practice. Those three examples are the following.

1. The EU/EC Law as Model

The European Union has adopted a strategy of projecting an extraterritorial effect for its laws and concepts by achieving treaties and agreements with various Nation States. Among those agreements and treaties are the following:

- The European Economic Area (EEA) Agreement
- Association Agreements, especially the "Europe Agreements" with applicant States
- Stability and Cooperation Agreements with the former Yugoslavia and the Western Balkans
- Partnership and Cooperation Agreements (PCAs) with Russia and other CIS States
- Preferential agreements, such as with Switzerland, South Africa, Mexico and the Mercosur states

- The WTO and other UN specialized agencies where the European Union, its twenty-five Member States and "related" nations tend to dominate law-making activities[4]

2. The *Intel* Case

The *Intel* case, currently on a petition of certiorari to the United States Supreme Court, was an action for discovery by AMD in the United States court system for production of documents for use in anti-trust proceedings in the European Union. This case is a possible example of insufficient respect by the US courts, as well as the executive branch of the US government, for European Union competition law practice.

3. The *Microsoft* Case

The *Microsoft* case in the European Union, with its threat of different and more extensive remedies being imposed by the European Union on matters already decided in the United States, where one company in one global market was nevertheless confronted with different solutions in different jurisdictions, is a possible example of insufficient respect by the European Commission for decisions already taken in the US's legal system.

II. EU/EC Law as a Model

A. EU Law as a Global Model

Some have suggested that the law of the European Union, including its competition law, may be a possible global model, such as for the WTO, applicable on a worldwide basis. In fact, European Union law and US law are increasingly in competition as to which will be the prevailing model in a worldwide legal system. This competition has become all the more intense in light of the diminished prospects for a WTO agreement on competition policy after Cancun. Thus, the temptation of agreements with either the European Union or the U.S., either through mutual recognition agreements (MRAs) or cooperation agreements in areas such as competition policy, will become increasingly difficult for third countries to resist.

The European Union has preferential economic agreements with more than one hundred WTO Members out of a total of one hundred fifty, with each agreement containing at least "best endeavors" clauses for the modeling of third-country economic law, including competition, on the basis of EU/EC legislation.

And, of course, the very expansion of the European Union furthers the expansion of European law as a universal model. Thus all States applying to join the EU *must* accept the *acquis communautaire*[5] as a pre-condition of membership.[6]

Note the widening "ripple effect" of the extraterritorial application of the broadening extraterritorial application EU law, such as in competition policy, within the enlarged European Union, which is occurring at the same time as there is a decentralization of enforcement activities within the European Union itself. Nevertheless, despite the fact that market integration throughout the European Union will continue to increase, such as through the use of a common European currency, it is not at all certain precisely what will be the effect of this decentralization—even as some fear that the enlargement of the number of Member States in the EU will reduce the integrative forces within the Union and possibly cause a regression back to a glorified free trade zone. Be that as it may, the enlargement of the European Union will further the advance of European law as a model for relations between the Member States and also in relations between non-EU states with each of the individual European Union Member States. In this respect, the trend for US law to serve as a basis for extraterritorial impact in other countries would appear to have considerably less momentum, with the possible exception of some relations among South American countries.

B. The Mitigation of Extraterritoriality through International Agreements, Arrangements, or "Comity"

The globalization of the world economy has provoked a response among various regulatory authorities throughout the world to adopt various agreements to coordinate regulatory review of such economic activities, especially in the area of competition law, and also to reduce the amount of regulatory conflict between various jurisdictions.

Among those agreements are the following:

- The 1991 Agreement between the European Commission and the United States on the application of competition laws
- The 1998 Agreement between the European Commission and the United States on the application of positive comity principles in the enforcement of their respective competition laws
- The European Union and the United States best practices on cooperation in merger investigations
- The 2003 Agreement between the European Commission and Japan concerning cooperation on anti-competitive activities
- The International Competition Network established in 2001
- The draft European Commission Notice on cooperation with the Network of Competition Authorities

III. The *Intel* Case

The *Intel* case began when AMD complained to the European Commission of alleged anti-competitive activities by AMD's competitor, Intel, within the European Union. AMD asked the European Commission to widen the scope of its inquiry through additional Article 11 letters to obtain documents in an earlier US litigation, but the Commission rejected the request.

At that point, AMD instituted a discovery action against Intel in the US federal courts, utilizing Section 1782 of Title 28 of the United States Code, which is designed to compel discovery to assist an action in a "foreign court or tribunal." Discovery under Section 1782 was upheld by the United States Court of Appeals for the Ninth Circuit,[7] and a certiorari application is now pending before the United States Supreme Court.

The key legal issue is whether the finding of the United States Court of Appeals that an investigation of the European Commission was a "proceeding before a foreign court or tribunal" within the meaning of Section 1782. But there is also the question of what is the potential impact of the Ninth Circuit's ruling on the European Commission's confidentiality policy, its "leniency program," and the Cooperation Agreement on competition between the United States and the European Union. The US Solicitor General filed an amicus brief in October of 2003 supporting the grant of certiorari, because the Solicitor General would, on the basis of the US-EU Agreement on cooperation in competition cases, refuse discovery in the present case. Thus the Solicitor General has urged the Supreme Court to take the case and settle and clarify law. There is likelihood that the Supreme Court will hear the case, and it is hoped it will address key issues in regard to EC-US cooperation (or "peaceful coexistence") in competition policy.

Thus the position of the Solicitor General, representing the US government, is that US courts have the discretion to order discovery on a case-by-case basis, but that the European Commission, which itself can invoke Section 1782, does not need the requested discovery in this particular dispute between Intel and AMD. There is, of course, still the question as to whether proceedings before the EC are the requisite "proceedings before a foreign court or tribunal," for the purposes of Section 1782, or whether the virtual automatic reference of matters to the CFI (such as contesting Commission decisions not to proceed with investigations) fulfills this particular statutory requirement. Significantly, there appears to be apparent agreement by all governmental authorities that threats to the Commission's leniency program should be avoided—which is a positive sign for EU-US cooperation in competition matters.

The Supreme Court is therefore being requested to "ensure greater predictability and national consistency in this internationally sensitive area by prescribing generally applicable rules of practice to resolve such cases." The issue here is to avoid the possibility of conflicting rulings by the US Courts of Appeals in the various circuits in the absence of a Supreme Court ruling, which could lead to inconsistent approaches by the US judicial system to the US-EU cooperation in specific competition cases. As it is, there is uncertainty among the regulatory authorities of both the European Union and the United States on the limits to national autonomy, the definition of "extraterritoriality," and the need for and scope of international cooperation. As usual, the devil is in the details of the difficult individual cases, while at the same time there appears to be agreement on the concepts of the need for cooperation and the avoidance of conflicts between the US and the European Union.

IV. The *Microsoft* Case

A. Background

The United States government's investigation and litigation in regard to Microsoft, which began in 1998, involved four key claims: (i) exclusive dealing arrangements foreclosing distribution of Netscape Navigator; (ii) attempted monopolization of the Web browser market; (iii) illegal tying of Internet Explorer to Windows; and (iv) unlawful maintenance of a monopoly position in the market for Intel-compatible personal computer operating systems. After a federal appellate court substantially reversed earlier District Court rulings against Microsoft in June 2001,[8] the Department of Justice and nine state Attorneys General reached a settlement with Microsoft in November 2001. Disappointed US claimants then pursued broader remedies before the European Commission.

B. Analysis

This is not a classic case of "extraterritoriality," which is a concept suggesting a conflict between jurisdictions provoked by an arguably illegitimate extension of one party's jurisdiction and authority into a foreign territory. Rather, the *Microsoft* case emphasizes the need for common rules, procedures, and genuine "comity" in deciding cases which have a multinational or global reach or impact. Thus *Microsoft* raises fundamental issues of principle in those situations which involve global companies in global product markets: it is a genuine test case for arrangements and agreements on international competition in areas of competition policy, including the ICN, the WTO and bilateral arrangements between the European Union and the United States. The question is whether these organizations or arrangements are useful instruments for creating global systems and policies, or are they useless talking shops?

Thus the *Microsoft* situation raises the question of whether there has been a breach of the principle of *ne bis in idem*, or the risk of excessive punishment for the same "offense," or multiple prosecutions for the same facts or conduct.

Specifically, if the US settlement provides that computer makers and consumers will have the possibility to disable or remove access to a particular feature, this particular remedy would have worldwide effect. At the same time, if the European Commission requires that Microsoft must offer a version of Windows without certain features, or even to carry features offered by competitors, those remedies would also apply on a worldwide basis—and would conflict with the remedies already imposed in the United States. So far there is little evidence of effective cooperation between the two jurisdictions in this particular landmark case.

The European Commission has stated, as a general policy matter, that "it is clearly desirable that the two competition authorities dealing with the same case should not reach conflicting results in a common jurisdiction, that the results in their respective jurisdictions should not be contradictory and that, all things being equal, the remedy imposed in its own jurisdiction by one authority should not be much more or much less rigorous than the remedy imposed in its own jurisdiction by the other." As it is, Article VI of the 1991 Agreement between the European Commission and the US reflects this "negative comity" principle. But as noted above, there is little evidence that this principle has in fact been honored in the *Microsoft* case.

V. Conclusion

The *Intel* and *Microsoft* cases both show a certain tendency toward jurisdictional autonomy, not only of the executive branches of the two jurisdictions, but also the courts. This jurisdictional autonomy seems to be prevailing over "self-restraint" or concessions in favor of international cooperation. It would be a hopeful sign of greater cooperation if the US Supreme Court grants certiorari and upholds the line advocated by Intel and the US Solicitor General in that case. The outcome in regard to *Microsoft* is less certain.

Endnotes

1. Case 48/69, *Imperial Chem. Indus. Ltd. v. Commission*, 1972 E.C.R. 619 ("*Dyestuffs*"); Cases C-89/85, C-104/85, C-114/85, C-116/85, C-117/85, C-125/85, C-126/85, C-127/85, C-128/85 and C-129/85, *A. Ahlström Osakeyhtiö and Others v. Commission*, 1988 E.C.R. 5193 ("*Woodpulp*").
2. See Whish, Competition Law at 368-389 (1993); Brownlie, Principles of Public International Law at 456-488 (1992).
3. Agreement Between the United States and the European Communities on the Application of Their Competitive Laws, 23 Sept. 1991, U.S.-E.C., 30 I.L.M. 1487 (1991).
4. This list does not take into account the EU's use of "power politics," where, despite the absence of a legal basis for the extraterritorial extension of EU/EC law, the European Union uses its political and economic influence to obtain the extraterritorial application of its laws (e.g., the tax on savings interests Directive and the Code of Conduct on business taxation). The attempted extraterritorial application of the OECD "Report" on harmful business taxation is another example of this phenomenon.
5. The term *acquis communautaire* (for which there is no direct English translation) embraces the whole compass of EU/EC law and policy, including primary legislation (the Treaties), secondary legislation (Regulations, Directives and Decisions), "soft law" such as Opinions, Recommendations, Guidelines, Communications, Notices etc., the case-law of the European and national courts, White and Green Papers and the *practice* of over one thousand Committees, which meet on a regular basis to settle policy and practice in every area of EU activity (e.g., competition, state aids, tax, customs, trade, agriculture, environment, financial services, consumer protection, etc.).
6. Ten Central and Southern European States will join the EU on 1 May 2004 (the same date as the planned decentralization of EC competition law), bringing EU membership to twenty-five Members. In addition, applications are pending, expected or "on ice" from countries such as Norway, Switzerland, Croatia, the Western Balkans and Ukraine.
7. *Advanced Micro Devices, Inc. v. Intel Corp.*, 292 F.3d 664 (9th Cir. 2002).
8. *United States of America v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001).

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The Move Toward a Common European Securities Market

By Pim Horsten

I. Introduction

Since the 1980s, various EU directives have had the intention of contributing to the creation of a single European securities market, in such fields as the licensing of broker/dealers and asset managers and the offering of securities.

A. Investment Services Directive

Thus the Investment Services Directive (ISD) introduced the so-called European passport for broker/dealers and asset managers established in EU member states. This is based on the principles of home country control and the mutual recognition across the European Union of licenses granted by an institution's home regulator. An institution licensed as a broker/dealer or as an asset manager in its home member state may also offer and render its services in other member states on the basis of its home license, subject to notification of the host member state regulator. In other words, its home license constitutes a passport that enables it to offer and render its services to investors across the European Union without the need to apply for a license wherever it operates.

As such this system works reasonably well. But there are certain flaws that still work against the idea of a single market and a single set of rules. For example, while there is a European passport for securities firms in principle, under the ISD they also must comply with national investor protection rules in each member state where they operate. These rules can be overlapping or even contradictory. In other words, there is in principle a single authorization, but not really a single set of rules across the EU.

B. Offering of Securities

While a European passport for securities firms exists, the situation is different when it comes to offerings of securities. On paper, there is a system of mutual recognition of prospectuses that have been prepared for listings or public offerings.

The idea is as follows. A listing or public offer prospectus that has been approved in one member state may also be used for a public offer in other member states. In other words, it must be recognized by the regulator of other member states where the offer is made as well. All that needs to be done is submit a copy of the prospectus to that other regulator, together with a certificate of approval from the regulator that approved the prospectus, stating that the prospectus complies with the EU prospectus directives. The regulator of that other, "receiving" member state may only require the addition of information that is specifically relevant for investors in that country, which in practice comes down to a taxation section.

In practice, however, the situation is much different, largely but not only because of language requirements. The reality is that making a pan-European retail offering is a nightmare. Many regulators require a public offer prospectus to be drawn up in their national language. Not so in the Netherlands, by the way, where English is accepted. A flaw that the Dutch system currently has, though, is that when an issuer does a public offer in the Netherlands and wants to use the prospectus for a public offer in other member states, and therefore asks a certificate of approval from the Dutch regulator, the issuer will not get one. The reason given by the Dutch regulator, the AFM, is that there is no basis in the law that it is or has the authority to issue such certificate of approval. Euronext Amsterdam, the Amsterdam stock exchange, does issue certificates of approval for prospectuses approved by it for listing purposes. Thus, the current situation in the Netherlands is that when an issuer does a public offer without a listing in the Netherlands, the issuer cannot get a certificate of approval that it could use for a public offer elsewhere in the EU. The issuer can get such certificate, however, if it lists in Amsterdam.

II. The EC's Response to These Issues

The European Commission recognized these and other flaws in the European securities legislation and in 1999 adopted the Financial Services Action Plan to create finally a true single market for financial services. It was recognized that this would require a whole new set of financial markets legislation, covering many different aspects, ranging from the offering of securities, via ongoing transparency obligations for listed companies, to insider dealing and market manipulation. In 2000, the European Council endorsed this Plan. The year 2005 was set as the target date for implementation.

The Financial Services Action Plan itself already foresaw that measures would be needed to speed up the process of developing the necessary new EU legislation. The existing EU legislative process was considered

too slow and rigid, and resulted in legislation that was at the same time unduly detailed and ambiguous, mixing high-level principles with very detailed rules. It often took several years to create new European legislation. Because of rapid new developments in the financial markets, it often appeared that the detailed rules laid down in the directives had become outdated. It was impossible to update the legislation concerned within a time frame that kept track with the market. In addition, too much detail in the legislation leaves room for loopholes and uneven national implementation.

A Committee of Wise Men, chaired by one Mr. Lamfalussy, was set up in 2000 to look at the regulation of the European securities markets and give recommendations on how the objectives of the Financial Services Action Plan could be achieved while avoiding the flaws that characterized the existing set of legislation.

The Lamfalussy Committee issued its report in 2001. It confirmed the flaws in EU legislation that the Commission had recognized as well. The legislation was found to be rigid, over-prescriptive and lacking transparency, all contributing to an uneven national implementation. Elaborating further on the path already set out in the Financial Services Action Plan, a new approach to legislation was proposed, placing only the essential requirements in legislation (i.e., directives), while leaving technical issues to be dealt with by the Commission, giving guidance to national regulators. The Committee came up with what came to be known as the Lamfalussy process for developing EU legislation. This distinguished among four levels:

- *Level 1*: This is the highest level, that of the primary legislation itself, i.e., the directive. The legislation was to be adopted under the shortened co-decision procedure under Art. 251 of the EC Treaty that had been used since 1997 and that required a review by the European Parliament and the Council of Ministers before becoming effective. At this level, the lawmakers (i.e., the Parliament and the Council) should only provide broad framework principles, and delegate power to the Commission to develop technical implementing measures.
- *Level 2*: This is the level of technical implementing measures adopted by the Commission on the basis of a procedure called "comitology," which comprises advice from a Committee of European Securities Regulators (CESR, comprising national regulators) and approval from a European Securities Committee (ESC).
- *Level 3*: This is the level of implementation of EU legislation into national legislation, in which process national regulators co-operate among themselves in order to ensure consistent day-to-day implementation and interpretation. On the basis of Level 2, CESR may provide guidelines and non-binding common standards.
- *Level 4*: At this level the Commission checks compliance by member states with the legislation and takes action where it sees delays or inconsistencies in implementation and interpretation.

In order to enhance transparency and reduce the risk that increased speed creates unworkable solutions, provisions for consultation were built into each stage. Also, Level 2 procedures could start when Level 1 procedures had started but had not yet been completed. Clearly this has a risk that Level 2 implementing measures that are provisionally finalized will become obsolete if Level 1 policies and principles eventually go another way. Prior to giving its Level 2 advice, CESR consults with interested market parties. The structure it put in place to conduct these consultations is beyond the scope of this paper.

National implementation at Level 3 is subject to the technical implementing measures issued by the Commission at Level 2. Since that is influenced by CESR, national implementation at Level 3 cannot steer away too far from CESR's Level 2 work. CESR's guidance, while not formally binding, is hoped to have a forceful effect on its members, the national regulators, when they get to Level 3 implementation. This is sometimes referred to as the "boomerang" effect.

In 2001 the European Council endorsed the Lamfalussy report, followed (though only in 2002) by the European Parliament. The Commission took immediate steps in 2001 to put the Lamfalussy process in action, establishing CESR and the European Securities Committee and putting forward two proposals for new directives, on prospectuses and market abuse (including insider dealing and market manipulation). These did not entirely follow the Lamfalussy process, however, because the proposals had already been drafted prior to the Lamfalussy report and were published without prior public consultation. In this sense, the first true Lamfalussy directive is the proposed new ISD, a proposal for which was put forward by the Commission in November 2002 following consultation. Prior consultations were also held for the proposed Transparency Directive. These directives have not yet come as far as the other two directives, however.

A. Market Abuse Directive

The first directive that was adopted, in December 2002, is the Market Abuse Directive, more formally titled the Directive on Insider Dealing and Market

Manipulation. This new directive was thought desirable to deal with the present scattered approach to these issues across the EU. While there had been a Directive on Insider Dealing since the 1980s, this was implemented in many different ways by the various member states. The Commission found this needed improvement under the Financial Services Action Plan.

After the first reading of the proposal by the European Parliament, thus before the adoption of the Directive, Level 2 procedures were instigated. CESR was asked to give technical advice on possible implementing measures relating to some core provisions of the Directive. CESR first published a draft and then held rounds of consultation, including open meetings. CESR's final advice was published in December 2002, shortly after the adoption of the Directive itself. In March 2003 the Commission released working documents containing proposed legislation for the technical implementing measures. After having received responses on these working documents, the Commission commenced the process of drawing up its formal proposals in April. In the meantime, in January 2003, the Commission has asked CESR for advice on a second set of technical implementing measures, to which CESR has responded. The expectation is that the final form of Level 2 implementing measures will be ready around the end of 2003 or in the first quarter of 2004, after which national regulators can begin their domestic consultation and implementation processes. The actual contents of the Market Abuse Directive and the current status of the Level 2 technical implementing measures are beyond the scope of this paper.

B. Prospectus Directive

While having progressed less quickly than the Market Abuse Directive, the new Prospectus Directive arguably must play an even more important role in the furtherance of a true single European securities market. That is because it deals with the core of financial markets, namely, the initial public offering and/or listing of securities. The full text of the final Directive became available in December 2003. CESR has given its advice on the content and format of prospectuses, i.e., Level 2.

Already back in 2000, the Forum of European Securities Commissions (FESCO), which could be seen as the predecessor of CESR, issued a consultation paper under the title "A European Passport for Issuers." As this title suggests, this paper explored the possibility of making it easier for issuers to do pan-European offerings on the basis of a single prospectus. Many elements of the consultation paper reappeared in the proposal for the Prospectus Directive. Once approved by a home regulator, a prospectus should be a passport for the issuer that may be used for public offerings (or admission to trading) in other EU member states as well. The regulators in other member states should not have the power to subject the prospectus to their review and approval, or to impose further requirements as to content and form.

Despite this aim, it can be questioned whether this has in fact been achieved or is achievable. This is largely related to two issues: language and prospectus liability. Under the Directive, if an issuer wants to do a public offer in its home country and in other member states, the prospectus must be in a language accepted by the home country (which will include its national language but may also include others—the Netherlands accepts prospectuses in English only) and, at the issuer's choice, in either the language of the country where the offer is made or "a language customary in the sphere of international finance" (a safe presumption is that this is English). The Directive requires that a prospectus must have a summary. Where "receiving" member states cannot require that an entire prospectus be translated into their language (as noted above, they must accept English if the foreign issuer so chooses), they may require the translation of the summary into their national language.

Recognizing that not all Europeans understand English (and even if they do generally, they may not understand English well enough to comprehend prospectuses in English) many potential investors will only be able to read a summary, not the prospectus as a whole. At the same time, the Directive prescribes that the summary must contain a warning to the effect that it is to be read as an introduction to the prospectus and that any investment decision should be based on the prospectus as a whole. The investor is left wondering how he should accomplish that, if he can't read or fully understand the whole document. The Directive goes on to say that no civil liability will attach solely on the basis of the summary, including translations thereof, unless it is misleading, inaccurate or inconsistent when read together with the rest of the prospectus. Presumably this means that, apart from the exceptions just mentioned, there can be no civil liability for translations of the summary when the prospectus is in another language than the translated summary. It remains to be seen how courts would view this. Moreover, the Directive addresses only civil liability, not criminal liability. The silence on this issue is also not encouraging to issuers.

III. Conclusion

Where do we stand and where are we going in Europe? The Lamfalussy process is under way, but no legislative project has yet been completed under it. The Market Abuse Directive has progressed most, but that

too has not reached the stage where Level 2 is completed. Clearly there will always be discussion as to how much detail should go into Level 1 and what can be left for Level 2 to deal with. Especially on politically sensitive issues, member states that care about a particular point will try and have it dealt with at Level 1. Again, too much detail at Level 1 leads to inflexibility in the sense of not being able to respond quickly to changing markets, and leaves room for loopholes and uneven national implementation.

At the same time, Level 2 should not become too detailed either. As already mentioned, no Level 2 implementing measures have been finalized yet. Also because CESR, comprising national regulators, advises at Level 2 giving guidance for implementation at the national Level 3, there is a concern that Level 2 will become an amalgam of all currently existing detailed national rules. Needless to say, the stage of Level 3, where consistent implementation and interpretation by all member states is to be ensured, constitutes a further challenge.

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