

ROSS PARSONS ADDRESS 2004

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It is a great pleasure to give the Ross Parson's Address for 2004 in the area of company law. It is a particular pleasure to do so in a year in which the lecture coincides with the launch of the Ross Parsons Centre of Commercial, Corporate and Taxation Law.

Company law is a field of law where there is still strong interaction between the British and Australian systems, at both academic and professional levels, despite the increasing influence of European Community law on the shape of British company law. The decisions of Australian courts are frequently cited, notably of course the decisions of the High Court of Australia but also those of the Equity Court and the Court of Appeal of New South Wales. Those decisions are always examined with respect and frequently followed.

I thought it might be appropriate tonight to say a little about the impact of Enron and the other US scandals on corporate law reform in Europe in general and the UK in particular, and to draw some Australian parallels and contrasts. Sufficient time has now passed for us to see the nature of those responses and to make at least a preliminary assessment possible.

The Impact of Enron in Europe

My first point is that it is remarkable that 'Enron' – a term I will now use as a shorthand way of referring to not only Enron itself but also, where appropriate, to the other financial scandals occurring at broadly the same time in the US - had any impact upon European law reform. Although an immensely newsworthy scandal, the collapse of Enron had relatively little economic impact outside the US. The European assets of Enron passed into new hands with little economic disruption. If one thinks of job losses, slimming down by continuing US corporations, such as the car-makers Ford and GM, has had a much bigger impact over the past two years than the collapse of

Enron. It is an indication of the interconnectedness of the world economy and, more precisely of the commonality of approaches to corporate governance across the developed world, that Enron produced impetuses for law reform even in jurisdictions where the collapses caused no economic damage. The fear on the part of governments of other countries that similar events could occur in their jurisdictions was sufficient to drive law reform. The initial reaction found in some quarters in the UK and continental Europe that 'it could not happen here' did not long survive examination – a wise analysis in the light of subsequent European collapses such as that of Parmalat in Italy. What I think needs to be emphasised, however, is that even before Parmalat and Ahold, the process of reform in reaction to Enron had been set in train at both European Community and Member State level. So, if Enron confirms the old adage that there is nothing like a good scandal to produce company law reform, it was novel, perhaps unique, in being a foreign scandal producing law reform in Europe.

Second, taking together action at both Community and Member State level, these post-Enron reform initiatives were very wide-ranging, encompassing not only auditors and auditing, but also board structure and composition, executive remuneration, reporting by financial analysts and the operation of credit rating agencies. One finds these topics identified as early as April 2002 in the Commission's note for the Ecofin Council meeting held in Oviedo and entitled 'A first EU Response to Enron related policy issues'. This led, of course, amongst other things, to an expansion of the remit of the Commission's High Level Group of company law experts and, ultimately, to the Commission's new Company Law Action programme of 2003, which has significant corporate governance elements.

At Member State level the responses were equally broad. This is demonstrated, for example, by a cursory visit to the web-site of the British Department of Trade and Industry. There you will find a whole section of it devoted to 'post-Enron initiatives' – and the plural is used advisedly. At least half a dozen significant reports appeared on this topic in the year after the collapse of Enron. The Companies (Audit, Investigations and Community Enterprise) Bill, currently before Parliament, provides the necessary legal changes to accommodate those reforms, many of which, as with CLERP 9, will be implemented by quasi-independent standard-setters or through stock exchange listing rules, rather than directly in legislation.

The impetus provided by Enron clearly put onto the reform agenda items which were previously not there. Let me give a British example. Between 1998 and 2001, ie ending before Enron, there was a comprehensive government-inspired but independent review of British company law, imaginatively entitled the Company Law Review. I was a member of its Steering Group. We were worried about the independence of auditors, but made only very limited proposals to deal with the issue, because, as we were doing our work, the Government was separately doing a deal with the accountancy professions largely to perpetuate professional control of auditing. We concluded, in the civil service language of these reports, that in the circumstances it would be ‘not helpful’ for us to go further. Post-Enron, of course, in the UK and throughout the EU, professional self-regulation has given or is about to give way to independent regulation of the audit, in terms of auditing standards, the monitoring of audit quality, disciplinary action against failing auditors and ethical guidance for auditors. Moreover, the current Bill I just mentioned is making the necessary legal changes to accommodate these reforms, whilst the earlier but more wide-ranging proposals of the CLR proceed at a much more leisurely pace through the policy-making procedures of the Department and are unlikely to reach the statute book before 2006.

I do not suggest that all the responses to Enron were as dramatic as this one; an equally important impact of Enron was its hastening of reform proposals which were already under consideration for purely domestic reasons, as was the case with controls over directors’ remuneration, as I shall discuss a bit more later on. Furthermore, and this is my third point about Enron, *most* of the reforms promoted or hastened by it seem to me to have been extensions of legal strategies which were already well established in company law rather than novel forms of regulation. In this respect Enron has proved less significant than many thought it would be.

In order to understand why this should be the case, one needs to understand the conventional wisdom about what went wrong in Enron. The bare outlines of what happened are clear enough, even if understanding the detail is ferociously difficult to grasp. The management of the company produced annual accounts which, to say the least, did not provide a true and fair view of the company’s financial position; these

misstatements were not picked up or were not properly appreciated by the company's auditors or the board of directors or any of the board committees, notably the audit committee. Why was this? The prevailing view is that conflicts of interest were at the heart of the story. The management had a self-interest in presenting the company's financial position in a more attractive light than the facts warranted, especially in view of the important role which stock options played in the make-up of their remuneration packages; the auditors had an interest in not investigating the company's accounting arrangements too closely in order to preserve their much more valuable non-audit work with the company; and the non-executive directors had an interest in a quiet life and not rocking the boat.

However, these are, are they not, the standard agency problems, the regulation of which lies at the heart of company law and always has done since modern company law emerged in the middle of the nineteenth century? Therefore, company law has developed tried and tested techniques for addressing these problems and it is perhaps not surprising that the legislative response to Enron has consisted in a further strengthening of those techniques. It is true that alternative analyses have been offered which are more challenging to the notion that the traditional legal strategies of company law can deal with Enron-style problems. But these have remained marginal to the policy-making process, probably for good reasons. For example, in Europe some reform proposals emerged from the partially inaccurate perception that the creation of subsidiaries had been central to the financial obfuscation which the US companies had engaged in. Some therefore suggested going back on the principle which was at the heart of the Gladstonian reforms of the 1840s ie the entitlement of private parties to create a company by going through a simple bureaucratic procedure. Thus, it was said, either state approval for the creation of new companies should be reintroduced or, at least, a waiting period of six months between creation and commencement of business should be introduced. This is a bit like saying that because pens can be used to commit forgeries, all potential users of pens should be required to obtain state permission to own and use one.

Slightly more plausibly, some tried to use Enron to attack the modern cult of shareholder value. Whether the emphasis on shareholder value is good or bad can be debated, but it defies the facts to argue that what management did in Enron was either

intended to or did benefit the shareholders of Enron, unless they were also part of the management of Enron or happened to get out of Enron before it crashed. So, post-Enron legal solutions have generally sat comfortably within the architecture of the prior company law.

Executive remuneration

On the theme of ‘back to the future’ as the method of law reform adopted post-Enron, let me look at two areas rather briefly: executive remuneration, notably the 2002 changes to the British Companies Act, and the ‘Higgs’ reforms to the British Combined Code on Corporate Governance.

The nature of the problem

First, the regulation of executive remuneration. In my view the path to wisdom in this area begins with acceptance of the proposition that allowing executive directors to play a substantial role in the setting of their own remuneration puts them in a very unusual and privileged position and generates a very high-powered conflict of interest situation. Money constitutes a very important part – though of course not the whole – of what people expect to get out of work; and a large income stream and periodic large capital gains generated by share option schemes give those in receipt of them a freedom of action and a level of security which is denied to those who don’t have them. So, to allow any group who receive remuneration in exchange for work to decide on what that remuneration should be is likely to produce high levels of opportunism, or worse, on the part of the remuneration setters - unless of course, as in a partnership or small company, the employers and the workers are the same people, so that no real transfer of resources is involved.

So much was clear to the British company law judges of the Victorian era, who refused to give the board sole authority to decide remuneration issues, by application of the general principle that the company was entitled to the unbiased advice of *all* its directors. If that was not available, because one or more of them was involved in the transaction, any resulting contract would be avoidable and sums payable to the directors would be recoverable, unless the contract had been approved by the company, meaning in this context, not approval by the non-conflicted members of the

board, but the shareholders in general meeting. In this way the shareholders were given a veto right over directors' remuneration.

Even today, that rule still applies in many British companies with regard to the setting of directors' fees (see art 82 of Table A), but it did not survive very long in relation to the setting of directors' remuneration as executives. By use of the semi-fiction that the articles constitute an agreement between the shareholders for the time being and the company it became doctrinally possible to shift decision-making on this issue *back* to the conflicted board of directors, by appropriate provisions in the articles. The articles constituted, it was said, the expression of the shareholders' consent to the decision on remuneration being taken by conflicted agents. That is the position one finds today in all large companies. See articles 84 and 85 of Table A.

No doubt there were some good practical reasons, in terms of speed of decision-making, for giving this task to the board; otherwise, the hiring process for executive talent would be subject to an increased level of uncertainty. But we should not be surprised at the potential for manipulation of payments systems which is created by such an arrangement. And that remark applies as much to the design of so-called performance-related remuneration schemes as much as it does to the setting of basic remuneration – in fact, perhaps it applies even more strongly to performance-related pay whose structure is inevitably more complex than basic salary and which provides correspondingly greater opportunities for distortion.

Some people agree that the legal rules are in principle insupportable but argue that markets come to our rescue. One can rely on the global market for executive talent to produce fair remuneration outcomes and so we do not need to fine-tune the legal rules to achieve this end. This argument seems to me flawed. If across the world remuneration decisions are taken by conflicted directors, the prevailing remuneration rates will not simply be a reflection of the interplay of the forces of supply and demand but rather of the self-interest of remuneration setters. In short, what we are examining is an example of market failure – and market failure on a global scale.

Within the traditions of Anglo-Australian company law, with its abhorrence of using the courts to judge the substantive fairness of remuneration decisions or, indeed, of

directors' decisions in general, there are two main routes for redressing the situation in which directors sit on both sides of the bargaining table on remuneration issues. One is to shift the decision into the hands of a sub-set of the board, ie the independent NEDs, perhaps established as a formal remuneration committee. This is the solution favoured in nearly all the corporate governance codes which have proliferated in recent years, even those applying in countries whose laws require companies to have two-tier boards. For reasons of time, I do not propose to say anything more about this strategy, other than to note that it did not work in Enron and, more generally, there are good reasons to question the forcefulness of the incentives which NEDs have to do a good job rather than to opt for a quiet life. Let me concentrate instead on the question how far we have moved back towards acceptance of the Victorian position that remuneration should be a matter for the shareholders

Weak shareholder involvement

There are, I suggest, a strong and a weak way of involving shareholders in decisions over directors' remuneration. The weak way is simply to require the company to disclose to the shareholders information about remuneration decisions taken by the board and to leave the shareholders to react adversely, if they wish to do so. Formally the remuneration decision remains with the board, but it is capable of being overturned by subsequent shareholder action. To have any chance of success, such a strategy requires a sophisticated set of rules about disclosure of directors' remuneration to the shareholders and a legal regime which makes it easy for shareholders to exercise their governance rights in the light of the disclosures. Of course, it is arguable that social factors alone, such as shareholder outrage (as Prof Bebchuk has termed it) at excessive remuneration decisions, will be effective whether or not shareholders are able to respond legally to the disclosures, but effective governance rights for shareholders give that outrage a sharper edge.

This weak form of decision rights for shareholders is a well-established pre-Enron strategy, at least in the Anglo-US-Australian world. We are used to highly detailed and, importantly, individualised disclosure of executive directors' remuneration, at least for listed companies. In the UK and Australia, though not generally in the US, we are also used to rules making it relatively easy for shareholders to convene meetings and to dismiss directors. By contrast, in continental Europe individualised

disclosure is still resisted in many states (for example, Germany) and removal of directors before the end of their period of office is often not possible, except for gross misconduct. The European Commission's Action Plan proposes individualised disclosure but only via a non-binding Community Recommendation and it is not clear that the Community will in fact stick to even this weak proposal.

Strong shareholder involvement

The stronger version of the decision-rights strategy gives the shareholders an input into the remuneration decision itself, normally by way of a veto right over a decision previously taken by the board. The veto rights strategy is one legislatures have deployed in relation to particular remuneration decisions for some time, in particular in end-game situations, ie where the director is leaving the board. In end-game cases the departing director no longer has the prospect of a continuing relationship with the company to restrain his or her financial demands and the other directors may be tempted to make large pay-offs in order to not to expose divisions in the ranks, not least of all to the shareholders. There is a risk here of the so-called 'rewards for failure', a topic currently much occupying the British government.

Thus, the British Act has long required shareholder approval for payments connected with termination of office, provided, however, they are gratuitous. The British rules do not catch contractual entitlements to pay-offs which in consequence have flourished, giving, for example, directors a contractual entitlement to several multiples of their salary if they resign with a certain period after a change of control. Nor do the British rules catch pension payments on termination, even if they are gratuitous. In this context I was interested to note the new Australian rule subjecting even contractual pay-offs to shareholder approval if they exceed a certain, in my view, rather generous levels. The UK government, by contrast has so-far shrunk away from subjecting contractual payments to shareholder approval, instead relying on ex ante provisions in our Combined Code designed to limit what is contractually agreed – suggesting that in principle the contract or notice period should not exceed one year.

However, pay-offs are only part of the problem. Remuneration decisions for continuing directors are clearly a major issue. Again, we have been used for some

time to requiring shareholder approval for share option schemes (and now other long-term incentive schemes), a rule introduced by way of extension of the principle that share issues by the company should be subject to shareholder approval, to prevent dilution of the shareholders' cash flow or voting rights. In other words, the rationale for this rule was not based principally in the need to subject directors' remuneration decisions to shareholder approval. The current debate over the accounting treatment of share options continues the dilution discussion in a new form.

The recent reforms

Thus, particular elements of the remuneration of directors have long been subject to shareholder approval. What is interesting about both CLERP 9 in Australia and the amendments made to the British Companies Act in 2002 is that they cautiously extend shareholder voting to the whole of the remuneration package. At the same time the quality of the information disclosure to shareholders has been improved. No longer is it necessary just to reveal information about what individuals receive. The board's *policy* on the remuneration front must be explained, ie the board must attempt to provide a justification of the remuneration position rather than just simply reveal the facts and leave it to the shareholders to ask probing questions. In particular, under the British rules, the board must reveal its policy on whether performance conditions are used for share option schemes and other tips (though not for annual bonuses); on its choice of performance conditions, if such were used; and how those conditions were applied in practice. It is clear that one of British government's main reasons for moving to a statutory requirement for a remuneration report was that, under the Listing Rules, where the matter was previously regulated, there was insufficient disclosure of the board's remuneration policies, which one may take as a coded reference to inadequate justification for that remuneration.

The vote on the remuneration report, however, is only advisory. No director's contractual entitlement to remuneration is affected by an adverse vote. The purpose of the advisory vote, one may say, is to make it easier for the shareholders to express an opinion on the information disclosed to them by reducing their collective action problems. The shareholders do not need to convene a meeting or secure the placing of an item on the agenda of a meeting in order to be able to express an opinion on directors' remuneration: they must be given an opportunity to vote at the

shareholders' meeting at which the annual accounts are considered. The vote, if you like, can help to crystallise the investors' dissatisfaction and provide a symbol of the that dissatisfaction which it is difficult for the board simply to ignore.

What can we expect from such advisory votes? It is not likely that shareholders will be interested in lowering the levels of directors' remuneration just for the sake of it, so that those who look at this issue from the point of view of distributive fairness are likely to be disappointed. But it is likely, I think, that shareholders will be interested in making stronger links between directors' remuneration and the performance of the company. Certainly where large sums of money are at issue and where the pay/performance link appears to be negative, one can expect adverse shareholder reaction to be expressed through the advisory vote. This seems to be the British experience to date. There have been two outstanding cases where the advisory vote, or the threat or one, has had an impact on the board's remuneration policy. At the beginning of 2003 the shareholders of the multinational pharmaceutical company, GSK, voted against the directors' remuneration report (the only time so far where this has happened) and the particular element in it which attracted adverse attention was the large sum contractually payable to the CEO if he were removed from office. This was perceived to be an unsustainable example of rewards for failure. More recently, the board of the supermarket company, Sainsbury, withdrew part of a remuneration report in advance of a shareholder vote when it became clear that shareholder response would be unfavourable. The original report involved giving the chairman of the board 88% of his allegedly performance-related share options in a year in which the company's profits and share price fell significantly and the company fell from second to third place in the supermarket rankings in the UK. The protest also led to the chairman's resignation from office.

Are these significant achievements in public policy terms? I think there are, for two reasons. First, they help restore the link between work and pay. Pay can be a motivator of effort, but only if pay is reward for work and not something that is received whether work is done or not. Second, in so far as the growth of executive pay in relation to the rewards of other sections of the community results from sudden, abnormal leaps in pay levels in particular cases which then become part of the norm,

then shareholder advisory votes may in fact do something to slow the rate of growth of executive pay.

Thus, large actual remuneration rewards in the fact of poor corporate performance are likely to be more difficult to push through under the new regime, whether those payments occur on severance or not. Companies are likely to become more sensitive to the question of whether they are crossing this particular line and to consult in advance with their major shareholders when they think they may be. Whether, further, there will be a significant shareholder input into the details of director remuneration packages, notably the details of share option plans and other tips, is much less certain. I think it will not be easy except in egregious cases even for institutional shareholders to judge the appropriateness of performance conditions chosen by the remuneration committee, despite the comparator information the Act requires the remuneration report to contain. Shareholders may find it easier to judge *ex post*, when awards under approved schemes are made, but by then it may be too late.

Should we really go back to the nineteenth century and move from an advisory vote to a veto vote for the shareholders? Should the director's contractual entitlement to remuneration be dependent upon shareholder approval? At the hiring stage, the costs to the company and therefore to the shareholders are likely to be high, because there may be competition for the best executive talent on a global scale and a country which insists on shareholder approval will therefore put its companies at a competitive disadvantage in the hiring process. Boards, in my opinion, should thus be left free to hire in line with their remuneration policy, subject to subsequent reporting to the shareholders and a shareholders' advisory vote. It is less clear, however, that companies need such flexibility in relation to subsequent remuneration decisions. One could envisage a rule in which subsequent remuneration changes would come into force as soon as decided on by the board, but they would be subject to a condition subsequent of shareholder approval. If that approval was not forthcoming, remuneration would revert to the previous level (or some other higher level agreed by the shareholders) but none of the increase actually paid would be repayable. This would sharpen the incentive on boards to formulate remuneration decisions in such a way as to win approval, though it would not make it any easier for shareholders to take

remuneration decisions, and so deference to the board would be likely to continue except in instances of ‘outrage’.

Reform of the Combined Code of Corporate Governance

The second area I would like to look at under the heading of ‘back to the future’ is the report of Mr Higgs on the reform of the British Combined Code on Corporate Governance, one of the major Enron-inspired reports. The main Higgs reforms were as follows: the independent NEDs become one half, rather than one third, of the board; and the roles of the committees which they dominate, especially the audit committee, have been enlarged. Third, the desirability of splitting the roles of the CEO and chairman is now stated in more prescriptive language, and it particular it is said that a retiring CEO should not normally move into the chairman’s slot.

These recommendations generated considerable opposition from the management of large British companies, although in the end they were accepted in substantially the form initially recommended. This opposition, however, appears at first sight paradoxical. The paradox of British management’s reaction to Higgs consists in that, on the one hand, what Higgs recommended was simply more of what was already there in the Combined Code, whose structure had been laid down by Cadbury in the early 1990s. On the other hand, there was fierce resistance to the proposals from management. Thus, even though Higgs proposed no changes in the comply and explain system via the Listing Rules nor, in relation to the substantive content of the Code, was it proposed to introduce new elements but simply to strengthen the existing elements, nevertheless opposition from management circles was especially strong, and not just on the grounds that this was the straw which breaks the camel’s back.

The main ground for management’s opposition, in my view, was the parallel changes which Government had been promoting, independently of Enron, in the role of institutional shareholders as holders of governance rights within companies. Since non-observance of the Code carries sanctions for companies only to the extent that shareholders respond adversely to explanations of non-compliance, a more active shareholder body has the potential to impart to what seem relatively straightforward developments in the Code a qualitatively different character.

The Government's interest making shareholders more active was revealed most clearly with the appointment of Paul Myners to carry out a review of institutional investment, whose report was received in 2001, ie before Higgs was appointed. This report accused institutional shareholders of failing to discharge their obligations to those on whose behalf they held the shares by failing to exercise their voting power at meetings of the company and more generally by failing to exercise their governance rights so as to influence the management of portfolio companies. The Government proposed legislation, partly derived from US model of the ERISA, to require greater activism. For the time being, however, the institutional shareholders seem to have staved off that threat by adopting a voluntary code which commits them to monitoring the performance of portfolio companies, including compliance with the Combined Code; intervening where necessary, up to and including seeking to change the board; and reporting the results of their activities to their clients.

Whatever the institutions' Code ultimately means in practice, the prospect of more active institutional scrutiny of areas where companies were not in compliance with the Combined Code was enough to generate on the part of management of large British companies a spirited opposition to Higgs' proposals, when they were first announced. In particular, management feared that institutions would not take seriously companies' explanations of their reasons for not complying with areas of the new Code, so that the Code would become based *de facto* on compliance, rather than comply or explain.

From the point of view of the theme of the present lecture, however, what is interesting is that at the heart of the government's scheme for improving the corporate governance of British companies lies a very old-fashioned mechanism and one which would have been instantly recognisable by the drafters of the mid-nineteenth century companies legislation, namely, the exercise by shareholders of their governance rights over corporate management.

Accounting Standards and Audit Regulation

Let me turn now away from the theme of back to the future and try to identify an area where I think Enron will produce something novel. This is in the area of accounting standards and the regulation of auditors. As I mentioned, a lot is happening here, at

UK and Community levels and across the Atlantic, in terms of public oversight of auditors, auditing standards, auditor discipline, quality assurance and ethical guidance. For the audit profession, this is no doubt a whirlwind of change. The regulatory techniques being deployed to effectuate this change are not, however, particularly novel. One can find them already in use in the regulation of other occupations and professions. What is striking, by contrast, is the level of convergence in prospect in this area, not only within Europe, but across continents. Whereas in most areas of regulation there are still distinct national and certainly continental differences, even if one can identify a narrowing of the differences, in the area of accounts and audit, substantial areas of difference are in prospect of being eliminated.

Let us take accounting standards first. It is obviously a major cost to investors to have to translate accounts compiled under one set of accounting standards so as to be compliant with the requirements of a different set of accounting standards and, even more important, to understand the significance of the translation. Even if, as I gather is the case, there is software available which will now do the translation task at the touch of a button, the comprehension issue remains an important one. There is now a prospect, however, that International Accounting Standards will become adopted in all the major economies. On the one hand, the European Commission, in its first response to Enron, made the mandatory adoption of IAS for the group accounts of publicly traded companies across the EU a priority – a measure now adopted. On the other, the reputational blow delivered to US GAAP by Enron has made FASB, the US standard setter, more amenable to the approach embodied in IAS. Thus, the IASB and FASB concluded in September 2002 their so-called Norwalk agreement under which:

“each acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, both the FASB and IASB pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.”

IAS are not just a European/US thing either. They have been or are about to be accepted in a number of other major jurisdictions, for example, recently in Australia.

It is important not to become too starry-eyed about this process. It is easy, I think, to exaggerate the differences between principles-based IAS and rules-based USGAAP.

Both are mixtures of the two approaches, though the balance between rule and principles is different in the two systems. Again, the proposition that what Enron did was fully in compliance with USGAAP is challengeable, which limits the extent to which USGAAP can be said to have been in some sense 'responsible' for Enron. And, finally, the convergence process could still lose its momentum if the Member States of the EU cannot hold their act together, as they shows all the signs of failing to do over the adoption of IAS 39. Despite all of that, it is clear that Enron and the rest have created the political circumstances in which genuine agreement on a common core of accounting standards on a global basis is possible.

Accounting standards, however, are only a part of the picture. A bigger part is occupied by the reforms to audit and the regulation of auditors. This is a matter to which the Sarbanes-Oxley Act devoted a great deal of attention, notably through the creation of the Public Company Accounting Oversight Board, irreverently referred to by my US colleagues as 'Peek-a-boo'. What is particularly interesting to me in the area of the regulation of audit and auditors is the close resemblance which the recently announced proposals of the European Commission for the revision of the Eighth Directive on audits and auditors bear to the relevant provisions of the SOA. Also significant in this regard is one aspect of the Commission's corporate governance proposals. These generally take the form of 'soft law' proposals (ie for Recommendations under Art. 249 of the EU Treaty), but not in the area of board responsibility for financial statements, where 'hard law' amendments to the 4th and 7th Directives are suggested. It may be no coincidence that director responsibility for financial statements is one of the issues upon which the Sarbanes-Oxley takes a strong position.

In any event, it is clear that the arguments for functional convergence of the regulatory structures for auditors on both sides of the Atlantic are strong. Otherwise, European audit firms dealing with US listed companies and their subsidiaries may need to meet two very different sets of regulatory authorisation requirements, and vice versa for US audit firms dealing with European listed companies and their subsidiaries.

Of course, given the greater significance of the US capital markets, this is an area where the US regulators have taken the lead, with the Commission coming along

behind. Furthermore, given the political turmoil which accompanied the Sarbanes-Oxley Act, it is likely to be some time before, in the area of auditor regulation, there will be an equivalent to the publicly acknowledged 'Norwalk' agreement struck between IASB and FASBE. Nevertheless, behind the scenes and sub silentio co-operative behaviour on the part of the SEC and European audit regulators does seem to be on the cards and to be desirable.

In conclusion, my overall view, from a European perspective, is that E was 'a good thing'. I would not say that if I were a US employee of E, who lost both job and pension, or a shareholder of E, but as a non-US law reformer, it is possible to take the view that the externalities of the collapse of E were entirely positive.