ELAN, ENRON, AND THE AFTERMATH OF SCANDAL:
A COMPARATIVE ANALYSIS OF RECENT IRISH AND
AMERICAN CORPORATE GOVERNANCE LEGISLATION

MANISH GUPTA*

I. INTRODUCTION

Worldwide business thrived in the late 1990s. Stock markets were exuberant,¹ multinational companies were selling to the far corners of the planet, and the world was more or less at peace. But like a reverse month of March, the twentieth century ended like a lamb and the twenty-first started like a lion. The 2000 American presidential election proved to be an affair more complex than simply counting votes; September 11, 2001, became a date forever etched in the collective mind; and in


November of 2001 the fifth-largest American company, Enron Corporation, went bankrupt. In lemming-like fashion, companies around the world followed Enron in disclosing scandalous corporate and accounting practices.

Responses were swift, especially in the corporate governance arena. In the United States, Congress passed the Sarbanes-Oxley Act of 2002 (SOX), a bill that would set the example for how governments worldwide, including in Ireland, would regulate corporations. For its part, the Celtic Tiger—named for the exceptional economic growth that Ireland experienced in the 1990s—had what might be called economic growing pains. From 1996 through 2005, Ireland saw its real Gross Domestic Product grow an average of 7.2% per year, compared to 2.8% in the European Union and 3.0% in the United States. With a low 12.5% corporate tax rate established in 1997, Ireland has experienced a “Delaware effect” in becoming a favored site for incorporation in the European Union. This growth came quickly, outpacing the development of a suitable regulatory scheme. The inevitable incongruence in the market—in particular scandals at Elan Corporation and Allied Irish Banks—fomented new legislation that mirrored the regulatory scheme of the United States.

This article reviews and compares how the United States and Ireland responded to corporate scandals. Part II introduces the basics of Irish corporate law to facilitate an understanding of the context in which various scandals and legislation occurred. Because Ireland


3. See infra Part III.

4. Irene Lynch Fannon, The Luck of the Irish or Just Plain Old Tax and Regulatory Planning? The Success of Venture Capitalism in Ireland, 1 ENTREPREN. BUS. L.J. 231, 231-32 (2006). Ireland’s economic growth is often compared to the growth of the “Asian Tigers” in the 1980s. Id.

5. Id. at 236.

6. Taxes Consolidation Act, 1997 (Act No. 39/1997) (Ir.). The rate was originally 10%, but it was raised to 12.5% because of pressure from the rest of Europe. Fannon, supra note 4, at 242 n.35.

7. Fannon, supra note 4, at 244. Other factors that make Ireland a favorable location for incorporation include: favorable individual and capital gains tax rates compared to the rest of Europe, tax incentives for property development, and short setup times and small capital requirements for new firms. Id. at 243-44.
belongs to the European Union, this section also contains a description of basic EU corporate law. Part III discusses the corporate scandals that took place in Ireland and Europe, and Part IV describes the Irish corporate governance legislation brought about by the various scandals. Once again, this section also reviews those EU regulations, directives, and proposals that are germane to corporate law in Ireland. A brief review of SOX is included for reference and comparison with the new Irish Legislation. Finally, Part V analyzes the Irish legislation to conclude that it is out of proportion to Irish problems, but that the legal changes fit into a trend of convergence in which the United States provides the model for corporate governance and the European Union acts merely as a competent, almost academic body to facilitate the unification of diverse corporate practices. Ireland, for its part, is a prime example of such convergence.

II. INTRODUCTION TO IRISH AND EUROPEAN CORPORATE LAW

To better understand the recent changes in Irish corporate law and to provide a backdrop of the legal context in which the various old world scandals occurred, this Part provides a brief introduction into Irish and European corporate law. Part II.A gives a description of the structure and history of basic Irish corporate law. Part II.B outlines the EU regulations and directives that impact Member States, including Ireland.8

A. Irish Company Law

Ireland uses the term “company law” to refer to the body of law that governs corporations.9 The general structure of Irish company law is closely modeled on England’s laws.10 Since declaring its independence in 1916, Ireland has continued to use English statutes as models and since acceding to the European Union in 1973, it has drafted many statutes to comply with various EU directives.11 More

8. EU law has “primacy” over Irish law. NIGEL FOSTER, FOSTER ON EU LAW 166 (2006).
11. Tomran II, 891 A.2d at 347.
recently, Ireland has been using examples from the United States.\textsuperscript{12} Irish company law is contained in eleven statutes starting with the first Companies Act in 1963. However, much of the current Irish regulatory scheme is relatively new, having its foundations in the Company Law Enforcement Act, 2001 (CLEA) and the Companies (Auditing and Accounting) Act, 2003 (CAAA). The CLEA and the CAAA are described in detail in Part IV.

Irish corporations come in two basic forms: private companies (denoted by “Ltd.” following the name) and public limited companies (with “plc” indicating the corporation’s public status).\textsuperscript{13} Forming a company requires payment of a registration fee to the Companies Registration Office (CRO),\textsuperscript{14} as well as submitting and filing Form Al and two constitutional documents: a Memorandum of Association and Articles of Association.\textsuperscript{15} The Memorandum must contain the company name, an objects clause describing what the company has the capacity to do, a statement of limited liability, and the initial number of shares and share capital.\textsuperscript{16} The Articles act as bylaws for the company. If a newly-formed company does not register Articles with the CRO, the Companies Act, 1963, supplies model articles which will govern the internal rules of the company.\textsuperscript{17}

Once a company is formed it has perpetual existence. The company ceases to exist when it is “wound up” by its members (voluntary liquidation) or when a court orders a bankrupt company to fold (compulsory liquidation).\textsuperscript{18} Creditors often seek voluntary liquidation, a sort of private bankruptcy where the company deliberately agrees to fold and pay off debts.\textsuperscript{19}

\textsuperscript{12} See infra Part IV for a comparison of the various legislative responses to corporate scandals.


\textsuperscript{15} PAUL EGAN, IRISH CORPORATE PROCEDURES 19-20 (2d ed. 1996).

\textsuperscript{16} CHRISTOPHER DOYLE, THE COMPANY SECRETARY 4-6 (2d ed. 2002).

\textsuperscript{17} EGAN, supra note 15, at 19-20.

\textsuperscript{18} Id. at 6; see also Companies Act, 1963 (Act No. 33/1963) (Ir.) § 213 (describing procedures for court-ordered wind-ups).

\textsuperscript{19} SINEAD McGRATH, COMPANY LAW 358-59 (2003).
Irish corporations have a separate legal personality and shareholder liability is limited to the amount of subscribed share capital.\textsuperscript{20} Though shares must have a par value,\textsuperscript{21} shareholders in a public company need only pay twenty-five percent of their share’s nominal value and shares in private companies need not be paid up at all.\textsuperscript{22} Public companies must issue a minimum of €38,092\textsuperscript{23} in share capital.\textsuperscript{24} Upon winding up, the liability of shareholders for company debts is limited to any amount unpaid on their shares.\textsuperscript{25}

Pre-incorporation contracts are binding on the company;\textsuperscript{26} however, companies may only contract to do those acts listed in the objects clause of their Memorandum. Consequently, objects clauses often run many pages. Under the doctrine of \textit{ultra vires}, a corporation can avoid a contract on the ground that one of the contracting parties is attempting to do some activity not authorized by its incorporating documents.\textsuperscript{27} This doctrine is still alive in Ireland, and courts may refuse to enforce contracts if a company tries to do an act not listed in its objects clause.\textsuperscript{28} However, the doctrine of \textit{ultra vires} has been modified by statute to protect third parties who were reasonably unaware of the company’s violation of its own objects clause.\textsuperscript{29} Courts have discretion to pierce the corporate veil if justice so requires.\textsuperscript{30}

\begin{footnotesize}
\begin{enumerate}
  \item See Salomon v. Salomon & Co. Ltd, [1897] A.C. 22 (H.L.); \textsc{Price Waterhouse Cooper\textregistered}, \textsc{Doing Business and Investing in Ireland} 13 (2005), \textit{available at} http://www.pwc.com/ie/eng/ins-sol/publ/pwc_dobiz05_full.pdf [hereinafter PWC].
  \item Egan, \textit{supra} note 15, at 21.
  \item \textit{Id.} at 22.
  \item The €38,092 figure had previously been set at IR£30,000, but with the 1999 change to the Euro it became the oddity that it is today.
  \item PWC, \textit{supra} note 20, at 15.
  \item Doyle, \textit{supra} note 16, at 1.
  \item Egan, \textit{supra} note 15, at 21.
  \item See Companies Act, 1963 (Act No. 33/1963) (Ir.) § 8(2).
  \item Id. § 8(1).
  \item Power Supermarket v. Crumlin Invs. and Dunnes Stores (Crumlin) Ltd., [1981] Unreported (H. Ct.) (Ir.) (lifting the corporate veil on a group structure because "the justice of the case so requires"); see also State (McInerney & Co., Ltd.) v. Dublin County Council, [1985] I.R. 1 (Ir.) ("The arm which lifts the corporate veil must be that of justice.").
\end{enumerate}
\end{footnotesize}
Whether to issue dividends is a board decision and dividends may only be paid out of the profits of a solvent company. Companies may issue common, preferred, and redeemable shares. Public companies can issue shares by offering them to the public (usually with the underwriting of an Irish merchant bank, called an "issuing house"), or by offering them to preexisting shareholders either as a stock dividend or under right-of-first-refusal circumstances. Public companies may list with and trade securities on the Irish Stock Exchange under regulations known as the "Yellow Book." Among the more important rules found in the Yellow Book are: at least one quarter of a company's shares must be held by the public, a company must have been a going and solvent concern for at least three years prior to listing, and a company must have a market capitalization of at least €1.14 million.

Irish companies with un-issued capital commonly issue bonus shares that are a dividend to existing shareholders. These dividends are not simple share dividends (i.e., a three for one split where the holder of a share worth $100 receives three shares each worth $33.33). They are a distribution of rights to existing capital (i.e., a one for three bonus will give a shareholder owning three shares worth $100 per share one additional share that is also worth $100. His shareholdings increase from three to four and the value of his shares increases from $300 to $400). The company's capital is not diminished; rather, the rights to that capital are divided among current shareholders.

Irish bonds, commonly called debentures, are usually secured with company assets; thus they are closer to mortgages than American-style corporate debt. A debenture-holder can secure his debt via

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31. See Bond v. Barrow Haematite Steel Co., [1902] 1 I.L.R. 353 (Ir.).
33. EGAN, supra note 15, at 32.
34. DOYLE, supra note 16, at 26.
35. McGRATH, supra note 19, at 204-05.
36. EGAN, supra note 15, at 34.
37. DOYLE, supra note 16, at 27.
38. Id. at 28.
39. Id. at 244.
40. Id. at 193.
either a fixed charge or a floating charge. A fixed charge is secured by a specific asset, whereas a floating charge becomes fixed (crystallizes) only if the company goes bankrupt or the parties agree that a specific event will fix the charge.\textsuperscript{41} In the event of bankruptcy, fixed charges have priority over floating charges and both have priority over shares.\textsuperscript{42}

Irish companies have the same basic stakeholders as the Anglo-American system, though their nomenclature and minimums are different. Shareholders in Ireland are called members.\textsuperscript{43} Public companies must have a minimum of two members\textsuperscript{44} and private companies must have a minimum of one member and a maximum of fifty members with an exception for current and former employees.\textsuperscript{45} Member meetings must occur at least once every calendar year and meetings cannot be more than fifteen months apart.\textsuperscript{46} Shares in public companies are freely transferable whereas shares in private companies may be transferred only with board approval.\textsuperscript{47}

With regard to board composition, all companies must have at least two directors and one secretary, though one person can simultaneously act as both a director and a secretary.\textsuperscript{48} The secretary need not be a natural person—often an accounting firm acts as this board member.\textsuperscript{49} Collectively, the directors and the secretary are the officers of the company.\textsuperscript{50} Directors have almost unlimited powers to exercise the objects of the company; they are limited only by the fiduciary nature of their position, which may be further restricted by the Articles of Association and shareholder resolutions.\textsuperscript{51} In Ireland, shareholder derivative suits are "uncommon and difficult to sustain."\textsuperscript{52}
Instead, if a director's failure to properly oversee the company leads to insolvency, the director may be personally liable for the debts of the company.\(^53\) Irish law has no mandatory requirements for board meetings,\(^54\) though each year one-third of the directors must offer to resign.\(^55\)

The secretary is usually the chief administrative officer and holds the power to enter into contracts on behalf of the company.\(^56\) The secretary's functions are wide-ranging but ill-defined: he is obligated to fully oversee the administration of the company, including its compliance with the Companies Acts. Perhaps the secretary's most important legal duty is to make and file the annual return with the Registrar of Companies.\(^57\)

Irish companies have a number of involuntary stakeholders in a "pre-bankruptcy system"\(^58\) designed to save companies rather than see them fold. A court may appoint an examiner when a company is unlikely to have the ability to pay its debts. Appointment of an examiner is intended to save a company before a receiver or liquidator is appointed.\(^59\) The examiner's goal is to give a distressed company "breathing space," akin to the protection provided by a Chapter 11 bankruptcy in the United States.\(^60\) The examiner researches the affairs of the company and reports to the court whether he thinks the company can continue as a going concern and what changes are necessary to achieve that goal. The court may order the examiner to take over management from the board.\(^61\) Debenture-holders whose debt has fallen into arrears can ask a court to appoint a receiver.\(^62\) The receiver's task is to sell the attached assets and pay off the debenture.\(^63\) The appointment of a receiver suspends the directors'
powers with regard to the charged asset. The receiver is a fiduciary not to the company but to the debenture-holder; his duty to the company is only to report a "statement of affairs." The appointment of a receiver is often the last step before bankruptcy. When a company is bankrupt, a court appoints a liquidator, except in the case of voluntary liquidations, in which the company appoints its own liquidator. In either case, the liquidator is a fiduciary to the company who must sell the company's assets, pay the company's debts, and distribute any surplus to shareholders.

**B. European Corporate Law**

EU legislation takes the form of regulations and directives. Regulations are enforceable in all Member States, while directives merely require that Member States achieve a certain goal without dictating how that goal should be obtained. The European Union also issues recommendations and various other guidelines, notices, and resolutions, all of which do not have binding legal force. Current EU corporate law is comprised of three regulations, thirteen directives or proposals for directives, and three recommendations.

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64. *Id.* at 306.
65. *Id.* at 305-06.
68. *Id.* §§ 258, 275.
70. *RALPH H. FOLSOM,* *PRINCIPLES OF EUROPEAN UNION LAW* 30 (2005); *FOSTER,* *supra* note 8, at 90.
71. *FOLSOM,* *supra* note 70, at 31; *FOSTER,* *supra* note 8, at 90.
72. *FOLSOM,* *supra* note 70, at 30; *FOSTER,* *supra* note 8, at 92.
While corporations must still incorporate in Member States, the European Union has taken steps towards a “European Company.”\(^\text{76}\) In 1985, a little-used company form called the European Economic Interest Grouping (EEIG) became the first supranational business entity in Europe.\(^\text{77}\) The EEIG allowed a framework for independent companies to cooperate, but it “gained only limited importance.”\(^\text{78}\) In 2001, the European Union passed a regulation creating the European Company or “Societas Europaea” (SE).\(^\text{79}\) An SE may operate throughout Europe on the basis of one legal and administrative regulation, but starting an SE is difficult as the company must have a minimum share capital of €120,000 and the SE must emerge from a pre-existing Member State-incorporated company.\(^\text{80}\)

One other regulation affecting European corporations mandates that publicly traded companies meet International Accounting Standards Board regulations when preparing public accounts.\(^\text{81}\) Further, EU accounting directives regulate a wide range of corporate behavior, including: disclosure of a company’s constitutional documents; minimum capital requirements for public companies; Member State laws governing mergers and divisions; the layout and content of balance sheets and profit and loss statements; preparation of


77. See Council Regulation 2137/85, European Economic Interest Grouping, 1985 O.J. (L 199) 1 (EC).

78. Kellerhals & Truten, supra note 76, at 75.


80. Kellerhals & Truten, supra note 76, at 72, 77-78.

consolidated accounts for companies with subsidiaries; qualifications for auditors; rules for branches of companies operating in other Member States; and the existence of single member private limited liability companies.\(^{82}\) Finally, recommendations call for quality assurance systems for statutory audits; recognition, measurement, and disclosure of environmental issues; and propose fundamental principles for statutory auditors.\(^{83}\)

### III. SCANDALS

The previous section summarized the legal playing field in which numerous corporate scandals occurred. While accounting scandals in the United States are well known on both sides of the Atlantic,\(^{84}\) most Americans and much of the Irish public are unaware of the instances of corporate malfeasance on the eastern side of the Atlantic. The scandals described here served as catalysts for drastic legal changes in Ireland and throughout Europe.

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82. See sources cited supra note 74.

83. See sources cited supra note 75.

A. Irish Scandals—Elan & Allied Irish Banks

Though headquartered in New York City and San Diego, Elan Corporation is an Irish pharmaceutical company by virtue of its place of incorporation.\(^8^5\) It focuses on discovering and selling drugs for neurological, autoimmune, and pain management purposes.\(^8^6\) In its 2002 annual report, Elan reduced its 2001 income by $73 million and its cash flow by more than $500 million.\(^8^7\) Elan’s market capitalization fell 97% from $20 billion in June 2001 to $600 million just over a year later.\(^8^8\) Elan became the target of a 2004 securities class action lawsuit in which plaintiffs estimated that Elan inflated revenue by $648.8 million between 1999 and 2001.\(^8^9\) Plaintiffs alleged that

Elan inflated its revenues and earnings through several manipulative accounting schemes, most of which involved Elan investing monies in, or loaning monies to, other entities (e.g., joint business ventures) which then funneled the same monies back to Elan by “purchasing” Elan products or licenses. The common thread among these schemes was that all of the initial funding that Elan conveyed to the separate entities was immediately returned to Elan and booked as revenue, while Elan booked its payments to the entities as capital investments or loans.\(^9^0\)

This accounting practice, called “roundtripping,” came in four schemes: Joint Business Ventures (JBVs), a product rationalization program, risk sharing arrangements, and Special Purpose Entities (SPEs).\(^9^1\)

Elan inflated sales income by entering into JBV s with third parties. Elan contributed money to the JBV s which the JBV s then used

\(^{85}\) In re Elan Corp. Sec. Litig. (Elan I), No. 02 Civ. 865, 2004 U.S. Dist. LEXIS 9913, at *4 (S.D.N.Y. May 18, 2004).
\(^{86}\) Id. at *1.
\(^{87}\) Id. at *3 n.1.
\(^{88}\) Shame About the Name, ECONOMIST, July 13, 2002.
\(^{90}\) Elan II, 385 F. Supp. 2d at 367.
\(^{91}\) Elan I, 2004 U.S. Dist. LEXIS 9913 at *6-7.
to purchase a license from Elan for medical technology.\textsuperscript{92} Elan subsequently recorded the money received from the sale of the licenses as income, and used the JBV\textsc{\textregistered}s to shift substantial research and development expenses to other entities.\textsuperscript{93} In its product rationalization program, Elan sold drug royalties to third parties, which paid for the royalties with funds provided by Elan, and Elan recognized income from the sale of royalties without recording the expense of financing the transaction.\textsuperscript{94} Elan also recognized the entire amount of income from the sale in the year the sale took place rather than spreading the income over the length of the royalty contract.\textsuperscript{95} In its risk-sharing arrangements, Elan financed its research and development by selling royalty rights for products under development.\textsuperscript{96} Elan characterized the money it received as sales when in fact the funds were reimbursements for research and development costs already incurred.\textsuperscript{97} In a variation of the JBV scheme, Elan sold the stock of its subsidiaries to three SPEs at great profit.\textsuperscript{98} The SPE\textsc{\textregistered}s did not have cash to buy the securities so they recorded debt for the purchases, while Elan recorded profit on the sale, even though it never received cash.\textsuperscript{99} In 2000 and 2001, Elan recorded gains of $40 million on the sale of securities.\textsuperscript{100} Elan further guaranteed the SPE debt, but did not record the guarantees as debt on its own balance sheet.\textsuperscript{101}

In addition to the roundtripping schemes, Elan had an ingenious executive compensation scheme that defrauded shareholders out of $20 million.\textsuperscript{102} Elan paid "royalties" to a company called Monksland, which distributed its good fortune to its own shareholders, all of whom were Elan executives.\textsuperscript{103} With Monksland as a conduit, Elan

\begin{itemize}
\item \textsuperscript{92} \textit{Id.} at *7.
\item \textsuperscript{93} \textit{Id.} at *8-9.
\item \textsuperscript{94} \textit{Id.} at *9-10.
\item \textsuperscript{95} \textit{Id.} Elan's income recognition scheme violated SEC Staff Accounting Bulletin 101. \textit{Id.} at *9.
\item \textsuperscript{96} \textit{Id.} at *10.
\item \textsuperscript{97} \textit{Id.}
\item \textsuperscript{98} \textit{Id.} at *12-13.
\item \textsuperscript{99} \textit{Id.}
\item \textsuperscript{100} \textit{Id.}
\item \textsuperscript{101} \textit{Id.}
\item \textsuperscript{102} \textit{Id.} at *13-14.
\item \textsuperscript{103} \textit{Id.}
\end{itemize}
conveyed cash to executives without disclosing the compensation to shareholders. On the basis of this behavior, in April of 2005, the court approved a $75 million class action settlement.

In a scandal nine times larger than the Elan debacle, the $691 million lost at Allied Irish Banks (AIB) set the standard for European bank scandals until the 2008 trading fiasco at French bank Société Générale pushed European bank scandals into the billions. At Allfirst Bank, a wholly-owned AIB subsidiary in Maryland, rogue trader John M. Rusnak lost millions in currency arbitrage. According to AIB’s investigation,

The fraud was carefully planned and meticulously implemented by Mr. Rusnak, extended over a lengthy period of time, and involved falsification of key bank records and documents.

Mr. Rusnak circumvented the controls that were intended to prevent any such fraud by manipulating the weak control environment in Allfirst’s treasury; notably, he found ways of circumventing changes in control procedures throughout the period of his fraud.

Mr. Rusnak’s trading activities did not receive the careful scrutiny that they deserved; the Allfirst treasurer and his treasury funds manager—the principal persons responsible for Mr. Rusnak’s supervision—failed for an extended period to monitor Mr. Rusnak’s trading.

At both the AIB Group and Allfirst levels, the Asset and Liability Committees ("ALCOs"), risk managers, senior management and Allfirst internal auditors, all did not appreciate the risks associated with Mr. Rusnak’s hedge-fund style of foreign exchange trading; even in the absence of any sign of fraudulent conduct, the mere scope of Mr. Rusnak’s trading activities and the size of the positions he was taking warranted a much closer risk-management review.

104. Id.


106. A lone trader, Jérôme Kerviel, was accused of losing €4.9 billion by taking unauthorized positions on futures linked to European stock markets. Le Rogue Trader, ECONOMIST, Jan. 24, 2008.

Allfirst and AIB senior management heavily relied upon the Allfirst treasurer, given the treasurer’s extensive experience with treasury functions and foreign exchange trading in particular. In hindsight, this heavy reliance proved misplaced.

Nothing has come to attention during the course of the review that indicates that anyone at AIB or Allfirst, outside of the Allfirst treasury group, were [sic] involved in, or had any knowledge that, fraudulent or improper trading activity was occurring at Allfirst before the discovery of the fraud.  

An AIB shareholder, Tomran, Inc., filed a derivative suit alleging that AIB and Allfirst directors “were negligent and grossly negligent in their oversight of Rusnak, which resulted in the loss to Allfirst


109. Tomran actually held American Depository Receipts instead of shares. Tomran I, 862 A.2d at 455.

An ADR is a receipt that is issued by a depositary bank that represents a specified amount of a foreign security that has been deposited with a foreign branch or agent of the depositary, known as the custodian. The holder of an ADR is not the title owner of the underlying shares; the title owner of the underlying shares is either the depositary, the custodian, or their agent. ADRs are tradeable [sic] in the same manner as any other registered American security, may be listed on any of the major exchanges in the United States or traded over the counter, and are subject to the Securities Act and the Exchange Act. This makes trading an ADR simpler and more secure for American investors than trading in the underlying security in the foreign market.

ADRs may be either sponsored or unsponsored. An unsponsored ADR is established with little or no involvement of the issuer of the underlying security. A sponsored ADR, in contrast, is established with the active participation of the issuer of the underlying security. An issuer who sponsors an ADR enters into an agreement with the depositary bank and the ADR owners. The agreement establishes the terms of the ADRs and the rights and obligations of the parties, such as the ADR holders' voting rights.

Pinker v. Roche Holdings Ltd., 292 F.3d 361, 367 (3d Cir. 2002) (citations omitted).
Bank." Tomran sought money damages and declaratory and injunctive relief. The Maryland Court of Appeals dismissed the suit, holding that Irish law does not provide for shareholder derivative suits.

Rusnak pleaded guilty to bank fraud and was sentenced to seven and one-half years in prison. He was also ordered to repay the $691 million in monthly increments of $1000, a rate at which it would take him 57,583 years to fully repay his debt.

B. European Scandals—Ahold and Parmalat

Dutch food retailer Royal Ahold N.V. (Ahold) has been described as Europe’s Enron. "Like many American firms during the bubble years, Ahold started to bend the accounting rules, claiming profits of acquired firms as ‘organic growth,’ booking capital gains from sale-and-leaseback deals as profit, and keeping billions in debt off its balance sheet." In February of 2003, Ahold announced that “it was restating its reported earnings by $500 million for fiscal years 2001 and 2002 due to a series of accounting inaccuracies related to promotional allowances” at its American subsidiary, U.S. Foodservice, Inc. (USF). As a result, Ahold’s stock price dropped more than sixty percent. In 2002, Ahold had losses of $1.4 billion and in 2003, it wrote off $3.1 billion in debt related to USF. Two accounting practices in particular caused most of Ahold’s problems:


111. Tomran I, 862 A.2d at 455.

112. Tomran, Inc. v. Passano (Tomran II), 891 A.2d 336, 342 (Md. 2006).

113. Ex-Currency Trader Sentenced to Seven and a Half Years, N.Y. TIMES, Jan. 18, 2003, at C14.


116. Id.


118. Id. at 344-45, 348.

improperly booking income from vendor rebates and inflating revenue from joint ventures.\textsuperscript{120} USF prematurely booked rebate revenue and colluded with vendors to falsely inflate rebate amounts.\textsuperscript{121} In its joint venture scheme, Ahold attributed the entire revenue from five joint ventures to itself when it only should have recorded revenue proportionate to its ownership of the ventures.\textsuperscript{122} Ahold restated its revenue downward for 2001 and 2002 by $24.8 billion.\textsuperscript{123}

Perhaps to underscore the paradigm set by the Houston energy company Enron, the accounting problems at Italian dairy giant Parmalat Finanziaria SpA (Parmalat) have also been described as Europe’s Enron.\textsuperscript{124} The company understated debt by $10 billion and overstated assets by $16.4 billion.\textsuperscript{125} Parmalat’s problems stemmed from a need for continual cash infusions to cover losses in certain South American ventures, to service debt, and to fund the lifestyle of CEO Calisto Tanzi and his family.\textsuperscript{126} To obtain cash from banks, the company had to look healthy; to look healthy, Parmalat either engaged in complex transactions with its 130 subsidiaries\textsuperscript{127} or told outright lies, at one point booking a fictitious sale of $620 million worth of powdered milk to Cuba.\textsuperscript{128} In a typical transaction, Parmalat would send a phony invoice to a subsidiary and would subsequently record an accounts receivable asset.\textsuperscript{129} It would then sell the subsidiary’s debt to banks in exchange for cash.\textsuperscript{130} When the bank sought payment from the subsidiary, Parmalat lent the subsidiary cash, recording the transaction as an investment in a subsidiary rather than a loan.\textsuperscript{131} The bank loans Parmalat obtained meant more debt to service which

\textsuperscript{120} Royal Ahold, 351 F. Supp. 2d at 344-45.
\textsuperscript{121} Id. at 345.
\textsuperscript{122} Id.
\textsuperscript{123} Id.
\textsuperscript{125} In re Parmalat Sec. Litig., 375 F. Supp. 2d 278, 282 (S.D.N.Y. 2005).
\textsuperscript{126} Id. at 283.
\textsuperscript{127} Goodman, supra note 124.
\textsuperscript{128} Parmalat, 375 F. Supp. 2d at 283-84.
\textsuperscript{129} Id.
\textsuperscript{130} Id.
\textsuperscript{131} Id.
required more cash infusions.\textsuperscript{132} Parmalat issued bonds thirty-five times between 1995 and 2003, creating $5 billion of debt.\textsuperscript{133} As stated by the United States District Court in a 2005 securities suit, "Parmalat and its confederates were operating something akin to a Ponzi scheme."\textsuperscript{134}

In accordance with Italian law, Parmalat switched auditors from Grant Thornton to Deloitte & Touche in 1999.\textsuperscript{135} To hide its fraud from Deloitte, Parmalat assigned its fraudulent transactions to its Caribbean-based subsidiary Bonlat, which was still audited by Grant Thornton.\textsuperscript{136} Parmalat’s scheme collapsed under its own weight in late 2003, when the company was unable to pay bonds, its stock lost half its value, trading was suspended for a few days, and the company announced that a Bank of America account ostensibly worth $4.9 billion did not actually exist.\textsuperscript{137} It filed for bankruptcy on December 24, 2003.\textsuperscript{138}

\textbf{C. American Scandals}

Perhaps the best known bankruptcy, though not the largest,\textsuperscript{139} involved Houston-based energy trader Enron Corporation. Enron hid assets and liabilities in over 2000 business entities, many of which were wholly-owned special purpose entities that were not included on Enron’s financial statements.\textsuperscript{140} Enron booked cash it received from loans as revenue and then sold the loan debt to an SPE, again

\begin{itemize}
  \item \textsuperscript{132} Id. at 283.
  \item \textsuperscript{133} Goodman, supra note 124.
  \item \textsuperscript{134} Parmalat, 375 F. Supp. 2d at 284.
  \item \textsuperscript{135} Id.
  \item \textsuperscript{136} Id.
  \item \textsuperscript{137} Id.
  \item \textsuperscript{138} Id.
  \item \textsuperscript{139} WorldCom’s bankruptcy filing in 2002 was the largest bankruptcy in U.S. history. In re WorldCom, Inc. Sec. Litig. 388 F. Supp. 2d 319, 357 (S.D.N.Y. 2005); Retirement Systems of Ala. v. J.P. Morgan Chase & Co., 386 F.3d 419, 422 (2d Cir. 2004). Enron had pre-bankruptcy assets of $63 billion, making it the second largest bankruptcy behind WorldCom, which had pre-bankruptcy assets of $104 billion. See BankruptcyData.com, The 15 Largest Bankruptcies 1980–Present, http://www.bankruptcydata.com/Research/15_Largest.htm (last visited Aug. 1, 2008).
  \item \textsuperscript{140} Hamilton, supra note 84, at 8-9.
\end{itemize}

For its part, Andersen is the common denominator of corporate malfeasance in the United States, because it served as auditor to numerous malfeasant companies, including WorldCom, Qwest, and Global Crossing. But its greatest entanglements, and greatest conflicts, were with Enron. According to the plaintiffs in an Enron securities lawsuit, Andersen was “not independent” of Enron, generating in excess of $50 million in annual fees from the Houston energy company, which was Andersen’s second largest client. Indeed, Andersen served as both internal and external auditor to Enron and generated more revenue from consulting services ($27 million)

141. Id. at 9.
143. Id.
144. Id.
145. Hamilton, supra note 84, at 12.
146. Id. at 8.
147. Id. at 22; In re WorldCom, Inc. Sec. Litig., 315 F. Supp. 2d 527, 530 (S.D.N.Y. 2004).
149. Jennings, supra note 84, at 215; Enron, 235 F. Supp. 2d at 674.
151. Id. at 673.
152. Id.
than from auditing services ($25 million). The plaintiffs further alleged that over 300 accounting and finance positions at Enron were filled with former Andersen auditors and professionals, a fact that provided comfort to Enron because it knew that Andersen would be less likely to question improper accounting if done by former employees. After a conviction for obstruction of justice for shredding Enron-related documents, Andersen ceased to be an auditor of public companies and shut down completely soon after.

Virginia-based telecom giant WorldCom, Inc., became the largest bankruptcy in United States history when it restated earnings downward by $3.8 billion in June 2002. By booking cash expenses as capital investments, WorldCom kept the asset side of its balance sheet even, despite the fact that it was spending cash. Once it emerged from bankruptcy, WorldCom had a market capitalization of less than $1 billion, 115 times below its highest value. It also changed its name to MCI.

Both Qwest Communications International Inc. (Qwest), the dominant local phone company in fourteen states from Minnesota to Washington, and Global Crossing, Ltd., the builder of an underwater fiber optic network that provided cross-continental Internet access, engaged in a scheme of "swapping" capacity for accounting purposes. Swapping with Global Crossing and Enron, Qwest was caught with $1.16 billion improperly listed as current profits rather than capital investments. While making its restatement in 2002, Qwest wrote off $20 to $30 billion in intangible assets.

155. Hamilton, supra note 84, at 8.
157. See sources cited supra note 139.
158. Hamilton, supra note 84, at 21.
159. Owen, supra note 142, at 170.
161. Id.
163. Id.
Crossing filed for bankruptcy in January 2002 because it failed to earn any real revenue.\(^{164}\)

The first disclosure that Adelphia Communications Co. had $2.2 billion in unreported off-balance sheet liabilities was buried in a footnote to a press release announcing its 2001 fourth quarter and full-year results.\(^{165}\) One of the largest cable television providers in the country before its bankruptcy, the company announced in June 2002 that it had $500 million less in revenue than it had previously reported over the prior two years.\(^{166}\) Various members of the controlling Rigas family were charged with securities fraud\(^{167}\) and the company filed for Chapter 11 bankruptcy, claiming $18.6 billion in debt.\(^{168}\)

Manufacturing conglomerate Tyco International, Ltd.’s $4 billion in profit in each of 2000 and 2001 came crashing down with a reported loss of over $9 billion in 2002.\(^{169}\) Tyco lost $100 billion in market capitalization and its CEO, Dennis Kozlowski, was indicted on thirty-five counts of various white collar crimes.\(^{170}\) Kozlowski, along with CFO Mark H. Swartz, “stole more than $100 million in three ‘bonus’ larcenies in 1999 and 2000 and many millions more in other thefts” for which they were sentenced to eight to twenty-five years in prison.\(^{171}\)

Samuel Waksal, CEO of ImClone Systems, Inc., learned on Christmas Day 2001 that the Food and Drug Administration (FDA) planned to reject ImClone’s application for approval of the cancer


\(^{165}\) United States v. Rigas, 490 F.3d 208, 212 (2d Cir. 2007).

\(^{166}\) Id.; Hamilton, supra note 84, at 23.

\(^{167}\) Rigas, 490 F.3d at 214.

\(^{168}\) Hamilton, supra note 84, at 23-25.

\(^{169}\) Ezra Charitable Trust v. Tyco Int’l, Ltd., 466 F.3d 1, 2-3 (1st Cir. 2006).


drug Erbitux.\textsuperscript{172} When the market opened on the following day, Waksal along with his family and friends began selling ImClone shares.\textsuperscript{173} Two days later, ImClone publicly announced the FDA rejection and its share price dropped from $70 to $10.\textsuperscript{174} Waksal and his friends saved $9 million by selling ImClone shares prior to the public announcement.\textsuperscript{175} While Waksal was caught and eventually pleaded guilty to insider trading,\textsuperscript{176} one of his friends, lifestyle doyenne Martha Stewart, was convicted of obstruction of justice for lying to authorities about her sale of ImClone stock.\textsuperscript{177} Her punishment included a five-month prison term,\textsuperscript{178} but of more immediate impact was her paper loss of $186 million within thirty minutes of the guilty verdict when the share price of Martha Stewart Living Omnimedia dropped from $17 to $10.86.\textsuperscript{179}

IV. LEGISLATIVE RESPONSES TO SCANDALS

A. Irish Response—CLEA and CAAA

Prior to 2001, Ireland had scant corporate governance regulation. Under Section 150 of the Companies Act, 1990, a court could ban misbehaving directors from directing any company for five years.\textsuperscript{180} Section 160 was even harsher on those convicted of crimes involving companies; they were automatically banned from acting as a board member, auditor, or serving as an involuntary controller.\textsuperscript{181} Yet beyond the criminal code and the concomitant civil penalties, Ireland lacked a way to enforce norms of corporate behavior. The need for

\begin{footnotes}
\textsuperscript{172} Hamilton, supra note 84, at 28-29.
\textsuperscript{173} Id.
\textsuperscript{174} Id.
\textsuperscript{175} Id.
\textsuperscript{176} Id. at 29.
\textsuperscript{177} David Glovin, Judge Refuses to Cut Stewart’s Detention, WASH. POST, Apr. 12, 2005, at E1.
\textsuperscript{178} Id.
\textsuperscript{179} Neil Irwin, For the Stewart Brand, an Uncertain Future, WASH. POST, Mar. 8, 2004, at A4.
\textsuperscript{180} Companies Act, 1990 (Act No. 33/1990) (Ir.) § 150. Commonly known as a “Section 150 Order.”
\textsuperscript{181} Id. § 160.
\end{footnotes}
enforcement was obvious: when it came to filing corporate compliance returns, just thirteen percent of 136,000 companies did so.\textsuperscript{182} Ireland needed a watchdog, which it received in 2001 with the passage of the Company Law Enforcement Act (CLEA).

The CLEA created the Director of Corporate Enforcement (DCE), a regulator with broad powers over Irish companies.\textsuperscript{183} The DCE was given the power to investigate and prosecute breaches of the Companies Acts,\textsuperscript{184} supervise the activity of liquidators and receivers,\textsuperscript{185} demand to see a company’s minutes without reason,\textsuperscript{186} and demand to see any other books or documents if he suspects fraud.\textsuperscript{187} Companies must inform the DCE of the appointment of a receiver.\textsuperscript{188} The DCE can petition a court for search warrants and has the police power to search a dwelling.\textsuperscript{189} Failing to comply with a DCE document request, submitting false or misleading documents to the DCE, and destroying documents are criminal offenses under the CLEA.\textsuperscript{190} The DCE can also petition for the disqualification of a director by seeking a Section 150 Order.\textsuperscript{191}

The DCE has power over numerous corporate actors. Since an individual who has filed for bankruptcy cannot serve as a director,\textsuperscript{192} the DCE can require a director whom he reasonably believes to be bankrupt to make a statement of his personal financial position.\textsuperscript{193} The court has the power to freeze the assets of an officer if the court thinks the officer might frustrate a civil judgment by disposing of his own or company assets.\textsuperscript{194} Application for such an order may be made by

\textsuperscript{183} Company Law Enforcement Act, 2001 (Act No. 28/2001) (Ir.) § 7.
\textsuperscript{184} Id. § 12(a), (c).
\textsuperscript{185} Id. § 12(e).
\textsuperscript{186} Id. § 19.
\textsuperscript{187} Id. § 29.
\textsuperscript{188} Id. § 52.
\textsuperscript{189} Id. § 30.
\textsuperscript{190} Id. § 29.
\textsuperscript{191} Id. § 40; see also Companies Act, 1990 (Act No. 33/1990) (Ir.) §§ 150, 159-60.
\textsuperscript{192} Companies Act, 1963 (Act No. 33/1963) (Ir.) § 183.
\textsuperscript{193} Company Law Enforcement Act § 40.
\textsuperscript{194} Id. § 55.
companies, directors, shareholders, creditors, receivers, liquidators, or the DCE.\textsuperscript{195} Prior to the CLEA, Irish courts had the power to examine directors’ conduct only during involuntary wind-ups.\textsuperscript{196} With the passing of the CLEA, courts and the DCE can supervise even voluntary wind-ups.\textsuperscript{197} The court may order inspection of a company’s books and may order a director to make a statement to the court concerning any company property he may have in his possession or any debts he owes to the company.\textsuperscript{198} The director may not refuse to answer for fear of self-incrimination.\textsuperscript{199} The liquidator of a bankrupt company must apply for Section 150 Orders for the removal of all of a company’s directors, regardless of who was actually responsible for the bankruptcy.\textsuperscript{200} If a liquidator uncovers a criminal offense during the course of his work, he must report it to both the state criminal prosecutor and the DCE.\textsuperscript{201} The DCE can demand to see liquidators’ work regardless of the solvency of the winding-up company.\textsuperscript{202} The DCE has oversight of liquidators and of their professional bodies.\textsuperscript{203} The CLEA also imposes obligations directly on directors and secretaries, including the obligation to “ensure that the requirements of the Companies Acts are complied with by the company.”\textsuperscript{204}

Auditors also face DCE oversight because the DCE can demand to see the qualifications of an auditor and the failure to produce such qualifications is a criminal offense.\textsuperscript{205} Accounting bodies must report evidence of a member’s breach of the Companies Acts.\textsuperscript{206} Similar to SOX’s “report up, report out” requirement for lawyers,\textsuperscript{207} Irish

\textsuperscript{195} Id.
\textsuperscript{196} Companies Act, 1963 (Act No. 33/1963) (Ir.) § 245.
\textsuperscript{197} Company Law Enforcement Act § 49.
\textsuperscript{198} Id. §§ 43, 49.
\textsuperscript{199} Id. §§ 44, 49.
\textsuperscript{200} Id. § 56.
\textsuperscript{201} Id. § 51. In Ireland, criminal prosecutions are handled by the Director of Public Prosecutions. See id.
\textsuperscript{202} Id. § 57.
\textsuperscript{203} Id. §§ 56-57.
\textsuperscript{204} Id. § 100.
\textsuperscript{205} Id. § 72.
\textsuperscript{206} Id. § 73.
auditors who reasonably believe that a company or director has broken the Companies Acts must report that belief to the DCE.\footnote{208}

While the CLEA predates SOX, the Companies (Auditing & Accounting) Act 2003 (CAAA) has firm roots in the U.S. legislation. Just as SOX established the Public Company Accounting Oversight Board, the CAAA established the Irish Auditing and Accounting Supervisory Authority (IAASA).\footnote{209} The mandate of the IAASA is to supervise how accounting bodies monitor and regulate their members, to promote adherence to professional standards in the accounting industry, to monitor whether companies' accountings comply with the Companies Acts, and to serve as a source of advice to the Minister for Enterprise, Trade and Employment.\footnote{210} To carry out its mandate, the IAASA is empowered with the authority to: recognize accounting bodies; approve accountants' investigatory procedures, constitutions, and bylaws; oversee any investigations that accounting bodies may undertake; sanction those bodies that do not comply with approved investigatory procedures; investigate and sanction breaches of accounting standards; and review companies' annual accounts.\footnote{211} The IAASA also has the power to review a company's accounting if it questions whether that accounting complies with any of the Companies Acts.\footnote{212} If the IAASA finds accounting irregularities, it can petition the court to force a company to revise its accounts.\footnote{213}

The CAAA does not go as far as SOX in barring auditors from doing non-audit consulting; it only requires companies to disclose what they paid their auditor for both audit and non-audit work.\footnote{214}

Directors must prepare statements that describe their company's internal financial procedures for securing compliance with the Companies Acts, Irish tax law, and "any other enactments that provide a legal framework within which the company operates and that may

\footnotesize{\begin{itemize}
\item \footnote{208}{Company Law Enforcement Act § 74.}
\item \footnote{209}{Companies (Auditing & Accounting) Act, 2003 (Act No. 44/2003) (Ir.) § 5(1).}
\item \footnote{210}{Id. § 8(1).}
\item \footnote{211}{Id. § 9.}
\item \footnote{212}{Id. § 26(3).}
\item \footnote{213}{Id. § 26(6).}
\item \footnote{214}{Id. § 44.}
\end{itemize}}
materially affect the company's financial statements." Directors must then acknowledge that they are responsible for securing compliance and whether "they are of the opinion that they used all reasonable endeavors to secure the company's compliance with its relevant obligations..." Auditors then review the directors' statements and decide if they are "fair and reasonable."

Companies must include in their annual accounting a statement as to whether their accounts have been prepared in accordance with "applicable accounting standards." If their accounting does not comply with those standards, the company must include a statement describing the material departures, the effects of any departures, and the reasons for such departures. Failure to include such a statement is a criminal offense. Companies must disclose the accounting policies they followed in determining the numbers on their balance sheets and profit and loss statements.

Section 42 of the CAAA requires that every public company establish an audit committee that must review the company's accounts for compliance with applicable accounting standards; monitor the performance and quality of the auditor's work and independence from the company; and report to the board of directors its choice of auditor and its recommendation on awarding non-audit work, though the ultimate choice of auditor still lies with the board as a whole. The audit committee must have at least two members, and these members may not be current or recent employees of the company.

215. Id. § 45.
216. Id.
217. Id.
218. Id. § 41
219. Id. This provision is often referred as the "Comply or Explain" requirement. It contrasts with what is commonly known as the "Comply or Else" provision found in Sarbanes-Oxley Act section 302. See Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C. § 7241 (2006).
220. Companies (Auditing & Accounting) Act § 41.
221. Id. § 43.
222. Id. § 42.
223. Id. The Companies (Auditing & Accounting) Act bars those who have been employees of the company within the last three years from serving on the audit committee. Id.
B. EU Response

On May 21, 2003, the European Commission issued a report entitled “Modernising Company Law and Enhancing Corporate Governance in the European Union.”224 This report, commonly called the “Action Plan,” contains proposals for legislative and non-legislative action that the European Union plans to implement over the coming years. The Commission concluded that there was no need for a Europe-wide corporate governance code. It instead proposed that the EU’s role in improving corporate governance was to facilitate convergence and exchange of best practices.225 The Action Plan addressed ways to enhance corporate governance disclosure, strengthen shareholders’ rights, modernize the board of directors, and coordinate Member State corporate governance efforts.

The Action Plan proposed that public companies include a statement of their corporate governance structure in their annual reports. The statement should include a list of shareholders’ rights, a description of how the board and its committees operate, a list of major shareholders and how their ownership affects voting and control rights, disclosure of any other relationships between the company and these major shareholders, disclosure of material transactions with other related parties, and disclosure of the existence and nature of a risk management system.226 The Action Plan further proposed that institutional investors should be required to disclose their investment policy and their policy on exercising voting rights, and to disclose, when beneficiaries ask, how the voting rights were exercised.227 The Action Plan then proposed that companies use electronic means to send relevant information to shareholders in advance of shareholder

224. Communication from the Commission to the Council and the European Parliament: Modernising Company Law and Enhancing Corporate Governance in the European Union—A Plan to Move Forward, COM (2003) 284 final (May 21, 2003) [hereinafter Action Plan]. The Action Plan addresses corporate governance, capital maintenance and alteration, groups and pyramids, corporate restructuring and mobility, the European private company, the European Co-operative Society, and other EU legal forms of enterprise, and enhancing the transparency of national legal forms of enterprise. Id. While the Action Plan covers many subjects important to corporate law, this article only reviews those relevant to corporate governance.

225. Id. at 11-12.

226. Id. at 12-14.

227. Id. at 13.
meetings in order to allow shareholders to more effectively exercise their rights to ask questions, to table resolutions, and to participate and vote electronically when absent.\footnote{Id. at 13-14.} The Commission suggested that an EU directive would best solve the legal difficulties involved in implementing the plan and stated that such a directive was a short-term priority.\footnote{Id.}

The Action Plan proposed that independent directors should make decisions where executive directors have conflicts of interest, particularly in the areas of director remuneration and audit supervision, and the Commission further suggested that shareholders should receive information regarding individual directors' remuneration and that shareholders should give final approval of any director stock compensation.\footnote{Id. at 15-16.} To force the necessary collective responsibility on directors for financial statements and the annual corporate governance statement, the Commission proposed that the European Union adopt a recommendation providing for enhanced responsibilities.\footnote{Id. at 16.} Similarly, the Commission stated its support for other recommendations intended to increase director responsibilities, including granting shareholders who hold a certain percentage of shares a special investigation right into the affairs of the company, holding directors personally liable for failing to adequately deal with the company’s debts, and requiring the disqualification of directors throughout the European Union for issuing misleading company statements.\footnote{Id. at 17.}


\begin{thebibliography}{9}
\bibitem{228} Id. at 13-14.
\bibitem{229} Id.
\bibitem{230} Id. at 15-16.
\bibitem{231} Id. at 16.
\bibitem{232} Id.
\bibitem{233} Id. at 17.
\end{thebibliography}
despite meeting numerous times it has made only one substantive recommendation: that the European Union adopt a directive that would make cross-border shareholder voting easier.  

Beyond the Action Plan, the Commission adopted recommendations on directors’ remuneration and on the role of independent directors on listed companies’ boards. The former recommends that Member States force companies to disclose their policy on remuneration and inform shareholders how much money individual directors earn, and seeks to ensure that shareholders are given adequate control over these matters and over share-based remuneration schemes. The latter focuses on the role of non-executive or supervisory directors in key areas where executive or managing directors may have conflicts of interest, and recommends minimum standards for the qualifications, commitment, and independence of non-executive or supervisory directors.

The European Union has adopted two directives regarding accounting practices. On May 31, 2001, the European Union adopted a directive mandating that Member States permit or require the use of fair value valuation methods to account for certain classes of financial instruments in companies’ annual financial statements. This directive will enable European companies to prepare annual financial statements in accordance with international developments. Companies will be required to provide additional information in the notes to the accounts on the items that have been valued at fair value.

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238. See 2004 O.J. (L 385) 55, supra note 236.

239. See 2005 O.J. (L 52) 51, supra note 237.


241. Id.
18, 2003, the European Union adopted another directive requiring public companies to use International Accounting Standards from 2005 onwards and allowing Member States to extend this requirement to all companies, including private ones.  

The European Union has also proposed a directive that would tighten audit rules in Member States. Inspired by SOX's establishment of the Public Company Accounting Oversight Board (PCAOB), the proposal calls for public oversight of auditors and regulatory cooperation among national oversight bodies. The directive would end European auditors' self-regulation by mandating that Member States set up regulatory bodies like the PCAOB and the IAASA. Public companies would be required to establish American-style independent audit committees responsible for hiring, overseeing, and firing auditors. Auditors from outside the European Union would have to register with the Member State's auditor regulator. The proposal does not call for a complete ban on auditors providing non-audit services; it instead would ban these services if they would compromise independence and would ban auditor involvement in making company management decisions.

C. U.S. Response

With the passage of the Sarbanes-Oxley Act on July 30, 2002, the oversight and responsibilities of numerous corporate actors greatly increased. Prior to SOX, auditors self-regulated, but that practice changed with the establishment of the PCAOB. The PCAOB sets

244. See id. at 2. The proposal is careful, however, not to seem like an impulsive response to corporate misconduct. It states "[t]his proposal is not a knee-jerk reaction to recent corporate scandals. It is the logical consequence of a reorientation of the EU policy on statutory audit started back in 1996." Id.
245. Id. at 26.
246. Id. at 16.
247. Id. at 22.
Audit standards, investigates violations of Securities and Exchange Commission rules and regulations, and can punish violators with censures, removal from auditing projects, limitations on activities, suspension, and fines of up to $15 million.\textsuperscript{250} Its activities are funded by mandatory fees assessed on the auditing companies that it regulates.\textsuperscript{251} Audit firms must register with the PCAOB before issuing audit reports to the public, and are required to maintain work papers for seven years\textsuperscript{252} or longer if the PCAOB deems it necessary.\textsuperscript{253} Large audit firms (those that audit at least 100 clients) can expect an annual PCAOB inspection, and smaller firms can expect one at least every three years.\textsuperscript{254} Audit firms must rotate the partner in charge of a certain client file every five years.\textsuperscript{255} SOX applies with equal force to foreign audit firms as it does to firms headquartered in the United States.\textsuperscript{256}

Perhaps the biggest change to the auditing profession is that auditing firms may no longer provide non-audit services to their public company clients, including "financial information system design and implementation, appraisal or valuation services, internal auditing services, investment banking services, legal and expert services unrelated to the audit, brokerage services, and actuarial services."\textsuperscript{257}

Board structure is now the subject of congressional mandate as SOX requires that public companies have an audit committee that is solely responsible for choosing, paying, and receiving the work of external auditors.\textsuperscript{258} Congress also mandates that directors who sit on the audit committee have no consulting, advisory, or compensatory connection to the company or its subsidiaries.\textsuperscript{259} The audit committee must establish procedures to receive complaints about accounting

\begin{itemize}
\item \textsuperscript{250} Id. § 105.
\item \textsuperscript{251} Id. § 109.
\item \textsuperscript{252} Id. §§ 102, 103(a)(2)(A)(i).
\item \textsuperscript{253} Id. § 104(e).
\item \textsuperscript{254} Id. § 104(b).
\item \textsuperscript{255} Id. § 203.
\item \textsuperscript{256} Id. § 106(a)(1).
\item \textsuperscript{257} Romano, \textit{supra} note 84, at 1533; \textit{see also} Sarbanes-Oxley Act § 201(a).
\item \textsuperscript{258} Sarbanes-Oxley Act § 301.
\item \textsuperscript{259} Id.
\end{itemize}
matters and must receive confidential, anonymous submissions by employees concerned about accounting practices. An auditor’s client is now the audit committee instead of the corporation’s senior management.

A company’s CEO and CFO must sign financial statements to certify that the statements do not contain material misrepresentations or omissions and that the financial statements “fairly present in all material respects the financial condition and results of operations of the [company] . . . .” The signing officers must certify, under threat of criminal penalty, that they are responsible for establishing and maintaining internal controls. Implicit in the certification requirement is that executives implement internal controls and that they monitor these controls; SOX goes further and makes that requirement explicit by requiring corporations to file reports assessing the internal controls. If executive misconduct causes a corporation to restate its financial reports, the malfeasant executives may have to forfeit bonuses, incentive-based compensation, and any profit from the sale of stock or options made during the previous year. Prior to SOX, executives at Enron, WorldCom, Tyco International, and Adelphia Communications were given hundreds of millions of dollars in low- or no-interest loans from their companies’ coffers. Consequently, SOX now prevents corporations from making loans to executives or directors.

Like auditors, attorneys were primarily self-regulated prior to the enactment of SOX. By passing the corporate governance legislation, Congress created a “report up, report out” system where lawyers who find evidence of financial misconduct must report their findings to the

260. Id.
261. Lucci, supra note 84, at 225.
262. Sarbanes-Oxley Act § 302.
263. Id. § 906(a).
264. Id. § 302(a)(4).
265. Romano, supra note 84, at 1540.
266. Sarbanes-Oxley Act § 404.
267. Id. § 304.
268. Romano, supra note 84, at 1538.
269. Sarbanes-Oxley Act § 402(a). Sarbanes-Oxley exempts loans made in the "ordinary course of the consumer credit business" or loans which are "generally made available . . . to the public.” Id.
corporation's CEO or chief in-house counsel.\textsuperscript{270} If the executive does not remedy the situation, the attorney must report his findings to the audit committee or the board of directors.\textsuperscript{271} If the situation is still not remedied, the attorney should make a "noisy withdrawal" where he publicly quits his engagement with the company.\textsuperscript{272} In addition, the Securities and Exchange Commission has the power to create standards of professional conduct for attorneys appearing before it,\textsuperscript{273} encroaching on the disciplinary area once wholly reserved for state bars.

V. ANALYSIS: CONVERGENCE AND PROPORTIONALITY

Two points for comparison arise when discussing international corporate scandals and legislative responses: whether the responses are proportionate to the problem and whether countries are coming up with similar solutions to similar problems. To assist the analysis of convergence, Table 1 provides a comparison of numerous new provisions in both the United States and Ireland. It also lays the groundwork for a discussion of proportionality, because the side-by-side comparison illustrates to what extent a particular requirement was put into legal effect.

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{270}] Id. § 307.
\item[\textsuperscript{271}] Id.
\item[\textsuperscript{272}] Lucci, supra note 84, at 222.
\item[\textsuperscript{273}] Sarbanes-Oxley Act § 307.
\end{enumerate}
\end{footnotesize}
### TABLE 1

<table>
<thead>
<tr>
<th>New Requirement</th>
<th>U.S. Specifics</th>
<th>Irish Specifics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Audit Committee</strong></td>
<td>Members must have no current connection to company</td>
<td>Members must not have worked for company in last three years; minimum of two members</td>
</tr>
<tr>
<td><strong>Financial Statement Certification</strong></td>
<td>Executives must certify</td>
<td>Directors, companies, and auditors must certify</td>
</tr>
<tr>
<td><strong>Regulatory Bodies</strong></td>
<td>PCAOB—regulators independent of the audit firms they regulate</td>
<td>IASSA—regulators from the audit firms they regulate DCE</td>
</tr>
<tr>
<td><strong>Client Malfeasance Reporting</strong></td>
<td>Attorneys must report up, may report out</td>
<td>Attorneys must report to DCE</td>
</tr>
<tr>
<td><strong>Auditor Regulation</strong></td>
<td>Auditors barred from providing non-audit services; head audit partner rotated every 5 years; auditors answer to audit committee</td>
<td>Auditors may provide non-audit services</td>
</tr>
<tr>
<td><strong>Attorney Regulation</strong></td>
<td>Attorneys must report up, may report out; SEC may create professional conduct standards</td>
<td>None</td>
</tr>
<tr>
<td><strong>Company Loans</strong></td>
<td>Executives barred from taking non-ordinary loans</td>
<td>None</td>
</tr>
</tbody>
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### A. Convergence

A flowchart mapping the development of corporate governance might show that new ideas come from the United States, are distilled by the European Union, and applied by Member States as they see fit. Ireland saw fit to copy the audit regulator, the audit committee, and the requirement that directors must personally sign off on financial statements.\(^{274}\) European countries do not wholly plagiarize U.S. legislation, however; the Irish statutes borrow provisions relating to audit regulators, audit committees, and sign-off rules but require

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\(^{274}\) See *supra* Parts IV.A, IV.C.
different behavior from each.\textsuperscript{275} Nonetheless, corporate governance rules are converging and Irish laws show this movement.

The governments of Ireland, the European Union, and the United States all require foreign auditors to register with a regulatory body, and all three have tightened rules about how auditors may provide non-audit work. The IAASA followed the PCAOB in taking away auditor self-regulation. If the European Union had its way, auditors’ self-regulation would end completely because every Member State would set up an auditor regulator of its own.\textsuperscript{276} The PCAOB and IAASA surely have their differences: the members of the PCAOB are all independent regulators, whereas accounting bodies comprise IAASA membership.\textsuperscript{277} But auditors on both sides of the Atlantic are now governed by and paying fees to a regulator that did not exist prior to the corporate scandals.

Convergence in board structure has brought the audit committee to Ireland, and it has been described as “a new concept in Irish company law.”\textsuperscript{278} Where previously optional, audit committees are now required in the United States and Ireland, and the European Union wants all Member State companies to have them. All three governments insist that the committees be comprised of independent directors even though they define independence differently.\textsuperscript{279} Here, there are issues of efficacy:

\begin{footnotesize}
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\item \textsuperscript{275} See discussion supra Part IV.
\item \textsuperscript{277} Companies (Auditing & Accounting) Act, 2003 (Act No. 44/2003) (Ir.) § 6. The following bodies are statutory members of the Authority: the Irish Business and Employees Confederation, the Irish Congress of Trade Unions, the Irish Association of Investment Managers, the Irish Stock Exchange, the Pensions Board, the Irish Financial Services Regulatory Authority, the Revenue Commissioners, the Director of Corporate Enforcement, and the Law Society of Ireland. Id.
\item \textsuperscript{279} The European Union would have the committee “consist only of board members who do not participate in the day-to-day management, i.e., by board members who are not also managers.” ERIK WERLAUFF, EU-COMPANY LAW: COMMON BUSINESS LAW OF 28 STATES 559 (Hanne Grøn trans., 2d ed. 2003). In Ireland, the CAAA bars those who have been employees of the company within the last three years from serving on the audit committee. Companies (Auditing & Accounting) Act, 2003 (Act No. 44/2003) (Ir.) § 42. SOX mandates that directors
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[the] parallels with America’s corporate scandals do not end with the fallibility of auditors. The lack of independence of non-executive directors on the board is another issue in common. Parmalat’s was stuffed with family members and local cronies. Despite a 1999 reform that imposed independent directors on listed Italian companies, big ones such as Parmalat were allowed to opt out.  

Both SOX and the CAAA make directors personally liable for their company’s financial statements by requiring that they sign the statements to attest to their accuracy. There are differences between the laws as well: Ireland requires directors, companies, and auditors to sign off on the accuracy of financial statements, whereas the United States only requires executives to sign compliance statements. Some have questioned whether this will hurt Ireland’s position as an attractive location for foreign investment.

Enron was the catalyst for change in Europe as well as in the United States. The EU Action Plan stated that its goal was to “review further corporate governance and auditing issues in the light of the Enron case.” Similarly, commentators have noted “Europeans should stop smugly believing that corporate malfeasance is an

who sit on the audit committee have no consulting, advisory, or compensatory connection to the company or its subsidiaries. Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 7211 (2005).


282. Companies (Auditing & Accounting) Act § 45.


284. See, e.g., PJ Henehan, Section 45 Will Kill Irish Competitiveness, IRISH TIMES, Feb. 25, 2005 (“In the opinion of a senior executive in an Irish subsidiary of a large US company that carries on a wide range of sophisticated activities employing hundreds of people in [Ireland], this section ‘at the stroke of a pen makes Ireland uncompetitive’. . . . The perception is that things have gone too far in the US. What is of concern is that the market perceives that Ireland has gone further than even the US.’”).

American vice that cannot occur in the old continent. Instead, they should fix their corporate-governance and accounting problems with as much vigour as their American cousins showed after the Enron wake-up call.” Others have commented on the impact of U.S. legislation in Europe, stating that SOX “seems to have kicked Europe’s protracted process into gear. ‘Parmalat was an extra boost, but the real motor was Sarbanes-Oxley . . . Europe had to stand up and be counted.’”

B. Proportionality

Commentators often note how quickly SOX became law: Enron collapsed on November 9, 2001, and President George W. Bush signed SOX into law less than nine months later. By contrast, the Irish took more time before passing legislation. The reason for this disparity may be founded on the size of the problem faced in the respective countries.

The U.S. scandals were much larger than those in Ireland. In the United States, scandals were measured in billions, while the Irish scandals were only measured in millions. A U.S. imprimatur touches every old-world scandal: Elan is headquartered in New York, trades on the New York Stock Exchange, and conducts its activities mainly in the United States. AIB’s troubles came from an American trader working at a U.S. subsidiary; it was sued by an American investor in an American court. Ahold’s problems were the result of

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289. The Companies (Auditing & Accounting) Act was signed into law on December 23, 2003, twenty-five months after Enron’s collapse and months from the time that Elan’s “questionable accounting practices” were first reported. See Elan II, 385 F. Supp. 2d 363, 366 (S.D.N.Y. 2005).


malfeasance at USF, an American subsidiary.\textsuperscript{292} Parmalat could not have hidden so much debt for so long without the complicity of Bank of America, Grant Thornton, and Deloitte & Touche. Clearly, scandals in Ireland and Europe are as much American as they are Irish and European.

When Ireland passed the CAAA, it responded harshly to scandals small in comparison to those in the United States. The CAAA contains many provisions similar to SOX: both create auditing regulatory bodies, address auditors and non-audit work, mandate audit committees, have “report up, report out” provisions, and require certification of financial statements.\textsuperscript{293} However, there are numerous differences among the similarities: the CAAA has criminal penalties; Irish auditors are only barred from providing services that lead to conflicts of interest whereas U.S. auditors may not provide any non-audit services; Irish directors, even if they are not currently employed by the company, may not sit on the audit committee if they worked for the company within the last three years; and Ireland requires directors, companies, and auditors to certify the accuracy of financial statements whereas the United States only requires executives to sign compliance statements.\textsuperscript{294} SOX merely allows attorneys to “report up, report out” whereas the CLEA requires auditors to report company law breaches to the DCE.\textsuperscript{295} Furthermore, Irish companies have to deal with the DCE whose sole job is to enforce the Companies Acts—criminal provisions and all. When one considers the full extent of the Companies Acts,\textsuperscript{296} the vast power of the DCE, and the fact that Ireland had less of a corporate crisis to begin with, Irish attempts to

\textsuperscript{292} But cf. Europe's Enron, ECONOMIST, Mar. 1, 2003 (The fact that Ahold's accounting problems occurred primarily at an American subsidiary “has led some observers to say that this is less a European problem than yet another American accounting failure. Such an outlandish claim absolves Ahold's bosses of responsibility for their acquisitions and ignores the persistent, firm-wide tendency to test the limits of acceptable accounting.”).

\textsuperscript{293} See discussion supra Part IV.A.

\textsuperscript{294} See, e.g., Henehan, supra note 284 (“While there is a cost of scandal, there is also a cost of compliance. In this regard, Section 45 goes beyond what is required of companies in other jurisdictions, particularly the US.”).

\textsuperscript{295} See discussion supra Part IV.A.

\textsuperscript{296} This includes, for example, Section 150 Orders. See supra text accompanying note 180.
prevent future corporate malfeasance are disproportionate to the problem.

Surely Ireland had corporate problems, but they were compliance issues, not governance issues. Ireland’s compliance problems received their due response: a watchdog in the DCE. The CLEA deals more with compliance than governance—it was passed in early 2001, before Enron and the other corporate scandals came to light, and it forced companies to answer to the government rather than to various stakeholders. Even so, the CLEA is harsh; the DCE has incredible power—police power, prosecutorial power, regulatory power, even banishment power.297 The Director himself can make a company’s life very hard; there is not any one U.S. regulator with that much influence.

With regard to the EU’s role in its Member States’ affairs, the British newspaper The Economist concisely explained the need for EU corporate regulation:

Italy has a reputation for poor corporate governance combined with the shameless exploitation of minority shareholders. But much the same can be said of other European countries, including France, the Netherlands and Switzerland, where this week Adecco, the world’s largest temporary-employment agency, said it expects to delay the announcement of its 2003 results because of “possible accounting, control and compliance issues...in certain countries.” Most European countries have mere codes of practice for corporate

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“Tybalt is dead, and Romeo—banished;”
That “banished,” that one word “banished,”
Hath slain ten thousand Tybalts. Tybalt’s death
Was woe enough, if it had ended there:
Or, if sour woe delights in fellowship
And needly will be rank’d with other grieves,
Why follow’d not, when she said “Tybalt’s dead,”
Thy father, or thy mother, nay, or both,
Which modern lamentations might have moved?
But with a rear-ward following Tybalt’s death,
“Romeo is banished,” to speak that word,
Is father, mother, Tybalt, Romeo, Juliet,
All slain, all dead. “Romeo is banished!”

WILLIAM SHAKESPEARE, ROMEO AND JULIET act 3, sc. 2.
governance, rather than legal statutes, and progress towards meeting the standards of the codes has been patchy at best.\(^{298}\)

Yet instead of mandating those statutes, the EU’s response seems more academic than binding. The main conclusion of the Action Plan was that the European Union did not need a Europe-wide corporate governance code.\(^{299}\) The European Union sees its role as a body that facilitates the exchange of best practices rather than as a creator or enforcer of such practices.\(^{300}\) In such a role, the European Union should study the effects of SOX, the CLEA, and the CAAA and propose their pearls to other European countries. The European Union created the European Corporate Governance Forum to do just that, notwithstanding the fact that the Forum has had the predictable result of much talk and only one substantive recommendation.\(^ {301}\)

VI. CONCLUSIONS

Convergence is necessary because Parmalat was not just an Italian problem, AIB was not just an Irish concern, and Enron was not just an American crisis. “The question is whether Europe’s principles-based approach can endure.”\(^{302}\) The answer seems to be no: with Ireland as an indication, Europe is moving to a rules-based approach where government mandates accounting standards and nearly every aspect of the company is regulated.

Convergence, however, is not without its critics. As reported in The Economist:

America’s rules are much more prescriptive and numerous. For example, the American ban on accounting firms providing some (but not all) non-audit work to audit clients, the certification of company accounts by company bosses and the requirement that a

\(^{298}\) Parma Splat—Europe’s Corporate Governance, ECONOMIST, Jan. 17, 2004. Note that Switzerland is not a member of the European Union.

\(^{299}\) Action Plan, supra note 224, at 11.

\(^{300}\) Id. at 11-12.

\(^{301}\) See supra notes 234-36 and accompanying text.

“financial expert” (painstakingly defined by the SEC) be on each audit committee do not feature in the . . . [EU] proposals.303

Europeans have questioned the efficacy of some American ideas: "[r]otation of auditors—one of the more controversial measures introduced in July 2002 by the Sarbanes-Oxley act [sic] . . . seems to have been of little use [in the Parmalat scandal]."304 Even if the rotation of auditors was of little use in Parmalat, we simply cannot know how many time bombs such an auditor rotation may have diffused.

On balance, the United States has the soft power to influence worldwide corporate governance and the European Union has the hard power to converge its Members’ laws. Through its legislative power to direct Member State law, the European Union can streamline European corporate law and governance. If proposals and action plans are any indication, the European Union plans to do more. Ireland is a prime example of the European move towards American-style, rule-based governance.

303. Id.
