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THEMES AND VARIATIONS: THE CONVERGENCE OF CORPORATE GOVERNANCE PRACTICES IN MAJOR WORLD MARKETS

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INTRODUCTION

The generally accepted definition of the phrase "corporate governance" comes from the seminal report of the Committee on the Financial Aspects of Corporate Governance, which was chaired by Sir Adrian Cadbury.[1] The Cadbury Report defines corporate governance as "the system by which companies are directed and controlled."[2] It has been defined by others as "a system of checks and balances between the board, management and investors to produce an efficiently functioning corporation, ideally geared to produce long-term value."[3] At its most basic, corporate governance deals with the relationships among various stakeholders with respect to the control of corporations. Above all, corporate governance addresses the relationship between the owners of a company – the shareholders who are the principals—and those who manage the company's operations – the executives hired to run the company as agents of the principals.[4] Corporate governance encompasses the weight given to various factors in connection with the process for making strategic decisions, the adequacy and transparency of disclosures, the reliability of financial reporting, and compliance with laws and regulations.[5]

Over the past several years, scholars have written extensively about the con-

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1. Report of the Committee on the Financial Aspects of Corporate Governance (Dec. 1, 1992), *available at* www.worldbank.org/html/fpd/privatesector /cg/docs/cadbury.pdf (last visited Feb. 1, 2004) [hereinafter *Cadbury Report*].

2. *Id.* at § 2.5.

3. *Governance and Executive Compensation: Hearing Before the Senate Committee on Finance*, 107th Cong. 2 (2002) (testimony of Dr. Carolyn Kay Brancato, Director, Global Corporate Governance Research Center, The Conference Board, before the Senate Finance Committee on April 18, 2002, at 2), *available at* http://finance.senate.gov/hearings/testimony/041802cbtest.pdf (last visited Feb. 1, 2004).

4. *Cadbury Report*, *supra* note 2, at § 2.5.

5. *See id.*

vergence of corporate governance practices around the world.[6] In the post-Enron era and with the passing of the first anniversary of the Sarbanes-Oxley Act,[7] we can clearly see that the pace of change has hastened; in some markets where corporate governance was nascent, it has advanced considerably in a short period of time as regulators around the world are united by a desire to restore the confidence of investors in the world's securities markets. Despite the swift change, the convergence of governance practices will never be complete for many reasons, although certain core principles will be recognized in virtually every country as fundamental to a market economy

This article reviews some of the factors affecting this convergence process and also looks at the status of convergence between the United States' governance laws and practices and those of certain other major markets. Specifically, the article briefly reviews recent corporate governance changes in Canada, Germany Japan, Mexico and the United Kingdom from the perspective of a practitioner who has been involved in various governance issues in subsidiaries and acquisitions in these markets. In each of these countries, one constant is that the corporate governance principles to which companies are subject are imposed through several sources. In the United States, for example, principles of corporate governance applicable to a public company created under the laws of Delaware are derived from the Delaware General Corporation Law,[8] state and federal securities laws, and the listing standards of any stock exchanges upon which that company's stock is listed.[9]

FACTORS AFFECTING CONVERGENCE

Internal and external factors influence companies to establish good governance practices. While certain factors that influence companies in the area of corporate governance are specific to the country, or even the state or province in which a company is domiciled, many of these factors transcend geographic borders. Many different factors, such as the philosophical approach, market forces, political forces

6. *See generally* Douglas M. Branson, *The Very Uncertain Prospect of 'Global' Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321 (2001); William W Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference*, 38 COLUM. J TRANSNAT'L L. 213 (1999); John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641 (1999); Gustavo Visentini, *Compatibility and Competition Between European and American Corporate Governance: Which Model of Capitalism?* 23 BROOK. J. INT'L L. 833 (1998); Edward B. Rock, *America Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L. Q. 367 (1996).

7 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 15 U.S.C. 7201 et seq. (2002).

8. 8 Del. Code §§101 et seq. (2003).

9. *See generally* Hillary A. Sale, *Delaware Good Faith*, 89 CORNELL L. REV. 456 (2004); Robert B. Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, And Federal Regulation*, 38 WAKE FOREST L. REV. 961 (2003); and William B. Chandler, III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PENN. L. REV. 953 (2003).

and the cooperation of various global entities, have played a role in the progress toward convergence.[10]

THE PHILOSOPHICAL APPROACH TO GOVERNANCE

One impediment to complete convergence is the varying philosophical approach to governance regulations. Some countries approach corporate governance in a manner that differs substantially from the approach adopted in the United States. With the passage of the Sarbanes-Oxley Act and the adoption by the Securities and Exchange Commission of various enhanced corporate governance standards, the United States has progressed even further into a law-based, or rules-based, approach to governance.[11] The legislation, regulations, and stock exchange listing requirements relating to governance are extremely detailed. Failure to comply with these highly specific rules may result in penalties.

Conversely, in some of the world's other markets, the approach is a principles-based approach.[12] In those countries favoring a principles-based approach to the regulation of corporate governance, the government may adopt – or even allow self-regulatory organizations such as the stock exchanges to adopt – general principles of corporate governance.[13] A simple explanation of the difference between the two approaches is illustrated by the different concepts conveyed by the terms "law" and "guideline."[14] The result is a different mindset with respect to corporate governance in the United States, which applies a rule- or law-based approach, where what is not prohibited is permitted, compared to a principles-based approach where greater discretion is vested in a company's management to make decisions regarding governance activities.

A principles-based approach to governance is one in which guidelines are clear, but compliance with them is voluntary Some countries have adopted a "comply or disclose" approach to corporate governance, which requires corporations to disclose whether they comply with governance guidelines.[15] Other countries have adopted a "comply or explain" approach, which requires corporations not only to disclose whether they comply with governance guidelines, but also require the explanation of any reasons for non-compliance.[16] Typically, the compliance or non-compliance disclosure is made in a filing with either the stock ex-

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10. *See generally* Alex Y Seita, *Globalization and the Convergence of Values*, 30 CORNELL INT'L L. J. 429 (1997).

11. *See e.g.*, William W. Bratton, Enron, *Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV 1023 (2003).

12. *See id.* at 1037

13. *See generally* Bratton, *supra* note 11.

14. *See* PIRATES OF THE CARIBBEAN: THE CURSE OF THE BLACK PEARL (Walt Disney Pictures 2003), where the pirate captain, Barbossa, tells Elizabeth, "First, your return to shore was not part of our negotiations nor our agreement, so I must do nothin' And secondly, you must be a pirate for the Pirate's Code to apply, and you're not. And thirdly, the Code is more what you'd call 'guidelines' than actual rules.

15. *See generally* Bratton, *supra* note 11.

16. *See generally id.*

change or a government agency [17]

THE EFFECT OF MARKET FACTORS ON GOVERNANCE

Good corporate governance is of utmost importance in today's economic environment because it affects investors, capital markets and the companies themselves. In a recent study sixty-three percent of investors said that they would avoid investing in certain companies if those companies had poor corporate governance practices.[18] Fifty-seven percent of investors said they would change their holdings in companies based on the corporate governance practices of those companies.[19] In the alternative, investors in many countries are willing to pay substantial premiums to invest in well-governed companies. In Africa and Eastern Europe, the premiums can be as high as thirty percent, while in Western Europe and North America, the premiums are in the low teens.[20]

These same investors indicated that corporate governance can have a profound effect on the capital market of particular countries.[21] Thirty-one percent of investors said they would avoid holdings in certain countries based on the general governance practices in those countries.[22] Companies from around the word compete against each other for capital in the global markets.[23] The need to go outside the country for capital may be due to the lack of depth of the capital markets in a company's home country, or the possibility of obtaining lower rates abroad.[24] Companies from those countries viewed as having lax laws governing transparency and disclosure will have a competitive disadvantage as the rates they pay for capital in the global markets will be higher.[25]

Rating agencies such as Moody's, Standard & Poor's and Fitch now evaluate, in addition to the financial ratios they have always reviewed, governance issues in

17. *See generally id.*

18. MCKINSEY & COMPANY, GLOBAL INVESTOR OPINION SURVEY: KEY FINDINGS, (2002), *available at* http://www.mckinsey.com/practices/corporategovernance/PDF/GlobalInvestorOpinionSurvey2002.pdf (last visited Feb. 2, 2004).

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *See generally* Christopher J. Mailander, *Financial Innovation, Domestic Regulation and the International Marketplace: Lessons on Meeting Globalization Challenge Drawn from the International Bond Market*, 31 G. WASH. J. INT'L L. & ECON. 341 (1998).

24. *See* James A. Fanto & Roberta S. Karmel, *A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing*, 3 STANFORD J. OF L. BUS. & FIN. 51 (1997).

25. In meeting of the World Economic Forum in Mexico in 2001, Frédéric Sicre, Managing Director of the Centre for Regional Strategies at the World Economic Forum noted that "Management should not consider corporate governance as a straightjacket, but rather as a means to lower its cost of capital. World Economic Forum, *Mexico Meeting 2001 Report: Managing New Expectations and Old Challenges* at 34, *available at* http://www.weforum.org/pdf/Mexico/Mexico_report_2001.pdf (last visited Feb. 2, 2004).

assigning a debt rating to companies.[26] In a competitive marketplace, the rate at which a company can finance debt is directly related to the company's credit rating.[27] Where a company's risk of default is determined to be high by the ratings agencies, the company must pay a higher rate to raise capital, possibly issuing junk bonds which require high interest rates to compensate investors for the high risk of default, than a company which can issue investment grade bonds.

For the companies themselves, governance can have a great impact. Poor governance, as seen in the media over the past two years, can lead to the implosion of respected and successful companies.[28] Poor governance can also affect stock prices, as investors sell stock in companies that have a reputation for poor governance practices.[29] Not only can poor governance affect companies' stock prices, it may also affect courtroom outcomes. A recent study found that seventy-three percent of jurors believe auditors will lie for their clients, while seventy-eight percent believe companies destroy documents.[30] Particularly in the United States, this mistrust of corporations may lead to larger jury verdicts in the future for corporations that have a reputation for poor governance and, perhaps, for all corporations.

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26. S&P Moody's, and Fitch have been designated by the SEC as Nationally Recognized Statistical Rating Organizations. *See Written Statement of Rating and Investment Information, Inc.. Submitted to the U.S. Securities and Exchange Commission In Connection with the November 15 and 21, 2002 Hearings on Credit Rating Agencies* at 2 (Nov. 14, 2002), *available at* www.sec.gov/news/extra/credrate/ratingsinvest.htm (last visited Feb. 1, 2004). Like corporate America, these groups face increased regulations as a result of recent corporate scandals; they did not downgrade WorldCom or Enron until bankruptcy was inevitable. This was the impetus for these organizations to begin scrutinizing governance at the companies they review. *See e.g.*, Claire A. Hill, *Ratings Agencies Behaving Badly: The Case of Enron*, 35 CONN. L. REV. 1145 (2003).

27. For a discussion of the credit rating agencies and their impact on a corporation's cost of capital, *see generally* Frank Partnoy, *The Siskel & Eberts of Financial Markets? Two Thumbs Down for the Credit Rating Agencies*, 77 WASH. UNIV. L. Q. 619 (1999).

28. *See* 2002 Report on the Corporate Performance Project, *Conformance & Performance-Corporate Governance: As Conformance Duty-An Assessment of Progress as Performance Opportunity-Is There Real Potential*, World Economic Forum in Partnership with Deloitte Touche Tomatsu, *available at* www.deloitte.com/dtt/cda/doc/content/WEFreport_2002(2).pdf (last visited Feb. 4, 2004).

29. The Brunswick Group, Opinion Research Corporation Study of U.S. Attitudes Toward Companies Facing Litigation, *Litigation: the Bottom Line*, *available at* www.brunswickgroup.com /index_flash.htm (last visited March 29, 2004). The study showed that in 2003 over sixty percent of investors considered selling stock in companies accused of wrongdoing in lawsuit, compared to just over 50% in 2001.

30. Minority Corporate Counsel Association, *DecisionQuest/MCCA Juror Perception Survey Warns of Intense Corporate Distrust by America' Juries* (October 16, 2002), *available at* http://mcca.com/site/data/researchprograms/surveys/dq_mcca_survey_2002.htm (last visited March 29, 2004).

THE EFFECT OF CORPORATE STRUCTURE AND OWNERSHIP DISPERSION ON GOVERNANCE

The type of corporate structure common in some countries can lead to different results in the corporate governance arena. In Germany, for example, there is a two-tiered board structure consisting of a management board called the *Vorstand* and a supervisory board of outside directors called the *Aufsichtsrat*.[31] Members of the *Vorstand* cannot, at the same time, be members of the *Aufsichtsrat*.[32] The existence, at the highest level in the corporation, of a board of independent, outside directors, arguably abrogates the need in Germany for some of the corporate governance principles gaining traction in the United States, such as requiring independent audit or compensation committees.

Ownership dispersion also differs from country to country, creating different governance concerns in some other countries than those that exist in the United States. In the United States and United Kingdom, ownership dispersion is high, while in France, Canada and Germany ownership dispersion is low.[33] The commonplace family or bank ownership structures in Canada, Germany, Japan and Mexico may make investors in those cultures more comfortable with control of the corporation resting in a limited number of individuals having a high percentage of ownership. Differences in the number of individual investors in comparison to institutional investors may also lead to apposite results in various countries. Institutional investors can be expected actively to monitor firm performance because of the expertise they possess.[34] Further, their large ownership stakes motivate them to engage in active monitoring.

In Japan and the United Kingdom, for example, companies may have commercial dealings with many banks, but rely heavily on one main bank as their primary source of funds.[35] These banks may exercise very little control during period of smooth sailing. Until the company faces a crisis, the banks are likely to eschew intervention. When a crisis occurs, the banks become more active, exercising their rights as lenders and at times, substantial shareholders, to guide the company through the crisis or oversee reorganization by replacing management, restructuring debt and trimming expenses.

During the past two decades, institutional investors such as mutual funds and

31. DR. THOMAS KUSTOR, DIRECTORS AND OFFICERS LIABILITY IN AUSTRIA at 1b, 2 (Freshfields Bruckhaus Deringer, July 2002), *available at* http://www.aiu.com/aiu/PDF/Austria.pdf [last visited March 29, 2004] (discussing the Limited Liability Company Act (GmbH-Gesetz), and The Stock Corporation Act (Aktiengesetz)).

32. *Id.* at 2.

33. Eric R. Gedajlovic & Daniel M. Shapiro, *Management and Ownership Effects: Evidences from Five Countries*, 19 STRATEGIC MGM'T J. 533, 536 (1998).

34. *See e.g.*, David Bank, *CALPERS Won't Back 5 Directors of H-P in Protest of Auditing*, WALL STREET JOURNAL, March 11, 2004 and Tim Burt & Christopher Parks, *The Walt Disney Crisis: A 'Resounding Victory for Shareholders*, FINANCIAL TIMES, March 5, 2004.

35. For discussion of the Japanese Banking System, *see generally* THE JAPANESE MAIN BANK SYSTEM: ITS RELEVANCE FOR DEVELOPING AND TRANSFORMING ECONOMIES (Masahiko Aoki & Hugh Patrick eds., 1994).

pension funds have played an increasingly important role in corporate governance on both a domestic and international level. To some degree, this is the natural effect of the premium investors will pay for well-governed companies in markets recognized as leaders in the areas of transparency and adequate disclosure. Increasingly, however, these institutional investors act as internal insurgents proactively attempting to influence corporations by issuing corporate governance statements[36] and filing shareholder proposals.

The institutional investors will also vote against certain management proposals viewed by the investors as lacking the hallmarks of good corporate governance. For example, most institutional investors will vote against any proposed stock option plan that does not explicitly prohibit the repricing of options.[37] Institutional investments originating in the United States dominate those from other countries. Thus, the type of activism that institutional holders here exert will likely become more prevalent abroad over time. Another effect is that there is pressure exerted by these investors to bring disclosure in other markets up to the levels of disclosure United States investors have learned to expect. The activism of institutional holders helps to shape the goals set by companies with respect to governance.[38] It also helps determine the speed at which various governance issues are addressed by both companies and governments and how issues are prioritized.

This institutional investor activism, which has been prevalent for years in the United States, is being actively exported in the post-Enron era. The California Public Employees Retirement System (CalPERS), for example, has identified several "Global Corporate Governance Principles" that are, in its view, minimum standards of corporate governance.[39] CalPERS takes the position that in all markets, companies should adhere to these standards to attract investment from institutional holders.[40] In April of 2003, CalPERS issued a press release in which it announced a $200 million investment in The Taiyo Fund.[41] The fund, based in Japan, will function within Japan as an activist investor much as CalPERS has in the United States.[42] The Taiyo Fund, to avoid dissipating its influence, will make significant investments in a relatively small number of companies to effect change in the area of corporate governance in Japan.[43]

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36. *See e.g.*, California Public Employees' Retirement System (CalPERS), *Global Corporate Governance Principles* at 3, *available at* http://www.calpers-governance.org/principles/international/global/page01.asp (last visited Feb. 1, 2004) [*hereinafter CalPERS Global Corporate Governance Principles*].

37. *See generally* Randall S. Thomas & Kenneth J. Martin, *The Determinants of Shareholder Voting on Stock Option Plans*, 35 WAKE FOREST L. REV. 31 (2000).

38. *See generally* Klaus Eppler & Paul A. Kemnitzer, *Corporate Governance Activities of Institutional Investors and Other Activists*, 1353 PLI/Corp 11 (2003).

39. *CalPERS Global Corporate Governance Principles*, *supra* note 36, at 5.

40. *Id.*

41. Press Release, CalPERS, *CalPERS Invests $200 Million in Japan Corporate Governance Fund* (Apr. 14, 2003), *available at* www.calpers.ca.gov/whatsnew/press/2003/0414a.htm (last visited Feb. 1, 2004).

42. *See id.*

43. *Id.*

THE EFFECT OF COMPENSATION PRACTICES ON GOVERNANCE

Compensation practices in various countries also play a role in the development of governance practices. Boards of directors use base salaries, bonuses and equity awards, such as stock options or restricted stock, to compensate a corporation's senior management. Certain types of compensation more closely align the interests of the company's management with the interests of the company's owners. For example, long-term incentive plans and stock options will in theory encourage company managers to act in harmony with the long-term good of the company rather than making rash, short-term decisions. Institutional investors pay close attention to compensation practices because compensation that is too generous can dilute their ownership over time. Many institutional holders make it a practice to vote against certain types of compensation plans based on corporate governance concerns. For example, Institutional Shareholder Services recommends that institutional holders routinely vote against any stock option plan that does not explicitly prohibit the repricing of options. Institutional holders also pushed companies to expense stock options out of a sense that certain companies, had they expensed options all along, would not have shown a profit.[44]

Some institutional investors view executive pay issues as a touchstone for whether the board properly oversees the management of the company After all, the board of directors has been elected by the company's owners – the shareholders – to, among other things, hire the executives to run the company on their behalf. Those executives report to the board of directors. If the executives' pay is too high, it results from a board that may be too easily swayed by a powerful personality or by the cache or remuneration of board service.[45]

THE EFFECT OF THE MARKET FOR CONTROL ON CONVERGENCE

Cross-border mergers and acquisitions may also affect corporate governance views and practices. As a company in the acquisition mode examines various target companies in a particular market, it will pay a premium for the well-governed target company. The due diligence process that occurs in connection with an ac

44. *See generally* Stephen Taub, *Coke to Treat Options as the Real Thing*, CFO.com, *available at* http://www.cfo.com/article/1,5309,7452,00.html?f=related (last visited March 29, 2004).

45. D. Quinn Mills, *Paradigm Lost: The Imperial CEO*, 4 DIRECTORS & BOARDS 27 41 (Summer 2003). Professor Mills makes the observation that:

> Initial efforts to retrain strong CEOs have not been promising. Boards have begun to cut back the severance packages of retired or resigned CEOs, especially those under investigation for fraud. Some boards are said to be getting less generous with pay packages. But salary and perks are not the key to the imperial CEO power is. Excessive pay is but a reflection of the dominant position that most CEOs have in their companies. Unless the disproportionate power of the dominant CEO is addressed, it will soon provide him or her a way to again push compensation up dramatically and again afford the independence from checks and balances that enables investors to be defrauded.

Id. at 42.

Mills also observes that board rooms often have "club-like atmosphere" because many directors are themselves CEOs or former CEOs. *Id.*

quisition involves, among other things, examining the governance of the target company, the independence of its directors, the quality of the company's financial reporting and disclosure and the existence of related party transactions between the company and its officers or directors. Similarly, a corporation "window dressing" itself to be an attractive target may implement widely-recognized touchstones of good governance to increase its price.

Even if a company is not a takeover target, as companies from other countries enter into strategic alliances, joint ventures and other similar arrangements, these partnerships will hasten the convergence of governance principles. A United States company entering into a joint venture with an established company in a particular market will expect of that company a certain level of governance discipline. Further, the agreements documenting the relationship between the two companies may put into place governance mechanisms over the business that are designed to provide the American company a level of comfort in the governance of the jointly-run business.

Even within the country, underperforming firms will be purchased by rival firms that are more competitive. In theory, these more competitive firms are so, in part, because strategic decisions are made within a governance structure that allows the best decisions to be made. Decisions that focus on the long-term health of the company rather than ones that serve no purpose other than to entrench management in the company are made.

THE EFFECT OF LISTING STANDARDS ON CONVERGENCE

One factor playing an increasingly important role in the global convergence of corporate governance principles is the listing of certain global companies with the stock exchanges of multiple countries. Each major stock exchange requires that the companies whose stock is traded on the exchange comply with certain listing requirements, many of which directly address issues of corporate governance.[46] There are, for example, approximately 200 interlisted Canadian companies[47] which must comply with not only the Toronto Stock Exchange listing requirements but also the listing requirements of the United States exchange upon which they are listed.[48] Foreign companies have been encouraged to access capital through participation in the United States capital markets.[49] American companies are also ac

46. *See e.g.*, THE TORONTO STOCK EXCHANGE COMPANY MANUAL, *available at* www.tse.com/en/productsAndServices/listings/tse/resources/resourceManual.html (last visited Feb. 4, 2004); THE LISTED COMPANY MANUAL OF THE NEW YORK STOCK EXCHANGE, *available at* www.nyse.com/listed/p1020656067970.html (last visited Feb. 4, 2004); LISTING STANDARDS OF THE BOLSA MEXICANA DE VALORES, *available at* www.bmv.com.mx; ADMISSION AND DISCLOSURE STANDARDS OF THE LONDON STOCK EXCHANGE, *available at* www.londonstockexchange.com/about/pdfs/admiss_standards_2002.pdf (last visited Feb. 4, 2004).

47. *Keeping Up*, CORP SECRETARY 22 (Aug.-Sept. 2003).

48. The Ontario Securities Commission has been lobbying the Securities and Exchange Commission to allow Canadian inter-listed companies to comply only with the Canadian regulations and not United States rules. CORP SECRETARY 10 (Feb./March 2003).

49. Roel C. Campos, *Embracing International Business in the Post-Enron Era*, Remarks at the

tively courted by foreign stock exchanges.[50] As companies seek to comply with multiple listing standards in various countries, those companies may influence global corporate governance in much the same way that global accounting standards have been influenced by multinationals.

Related to the issue of listing standards is the desire of stock exchanges of other countries to give American investors access to the markets in those countries through the use of trading screens in the United States. Several European Union exchanges, in particular, have sought this access.[51] Under the Securities and Exchange Commission's rules, stock exchanges must register with the Commission to offer and sell securities to the public.[52] Further, the securities listed on those exchanges must be registered with the SEC. These exchanges oppose the idea of registration with the SEC and argue that governance by their home country is sufficient. They are also limited because the exchanges could not, through the mere act of registering, force all of the companies listed upon them to register with the SEC. The SEC, above all, is in business to protect investors. The Commission remains concerned that granting other exchanges access to investors on terms different than the terms with which exchanges here must comply creates a competitive advantage for the foreign exchanges. The depth of this country's capital markets is a testament to the SEC's long-standing successes in protecting investors; opening the door to foreign exchanges here without appropriate controls could limit the SEC's ability to exercise the same control in the future.

Centre for European Policy Studies (June 11, 2003), *at* http://www.sec.gov/news/speech/spch061103rcc.htm (last visited Feb. 4, 2004). The Commissioner stated:

> .I wish to reaffirm a simple message: European and other non-U.S. market players are welcome and encouraged to participate in the U.S markets. The SEC has facilitated foreign participation in the past and will continue to do so, all within the framework of protecting investors through our existing securities regulation. With this philosophy in mind, over the past 70 years of the SEC's existence, we have afforded equal treatment to all market participants. Few distinctions have been made based on the domicile of the issuer or service provider. After all, US investors are entitled to the same protections regardless of whether an issuer is foreign or domestic. In addition, placing US market participants at competitive disadvantage negatively affects the vibrancy of US markets and, ultimately, would hurt US investors. Shielding US firms from foreign competition, however, would deprive US investors of the benefits derived from the services and products offered by non-US competitors.

Id.

50. OTC CONSULTING & FINANCIAL SERVICES, DUAL LISTING IN GERMANY, *at* http://www.duallisting.com/index.php (last visited Feb. 1, 2004). This is reference to the DAX marketing materials inviting American companies to consider dual listing on the DAX as well as United States exchanges. Interestingly, blue chip companies' stock is often listed on those exchanges anyway, through programs similar to the unsponsored American Depository Receipt programs initiated by major banks in the United States to "list" the stocks of prominent foreign firms.

51. *See* ICGN, *ICGN History*, at www.icgn.org/history.html (last visited March 29, 2004), and ICGN, ICGN *Statement on Global Corporate Governance Principles* (July 9, 1999), *at* http://www.icgn.org/documents/globalcorpgov.htm (last visited March 29, 2004).

52. U.S. SECURITIES AND EXCHANGE COMMISSION, THE LAWS THAT GOVERN THE SECURITIES INDUSTRY, *available at* www.sec.gov/about/laws.stml (last visited Feb. 1, 2004).

THE EFFECT OF INTERNATIONAL ORGANIZATIONS ON CONVERGENCE

Global organizations are significantly impacting the convergence of core governance principles. Among these organizations are the International Corporate Governance Network, the Organization for Economic Cooperation and Development (OECD), the United Nations, the Export Import Bank, the International Organization of Securities Commissions, the American Society of Corporate Secretaries in cooperation with its sister organizations in other countries, the International Accounting Standards Board, the Institute of Internal Auditors, the Asia-Pacific Economic Forum, and the Asia-Pacific Economic Corporation. Seminars, conventions, publications, and meetings by and among these groups and their members have led to certain principles of corporate governance being generally identified as core principles that must guide the behavior of corporations in a market economy

There are several examples of international cooperation among various government agencies and membership organizations working toward corporate governance convergence. As a case in point, in 1999 the OECD adopted *Principles of Corporate Governance.*[53] These principles do not suggest that any one structure for companies' boards of directors is appropriate; different structures are appropriate in different circumstances for many of the reasons discussed in this section on factors affecting convergence. Similarly, in 1995, the International Corporate Governance Network was formed by a group of institutional investors, such as pension funds and financial institutions, to provide a forum for exchange on international corporate governance information.[54] It published guidelines in 1999 that have been relied on by many institutional investors in forming their own international corporate governance principles.[55] The International Organization of Securities Commissions has also released recent pronouncements on transparency and disclosure, auditor independence and the board's role in the oversight of outside auditors.[56] The International Accounting Standards Board and the United States Financial Accounting Standards Board are at work on global accounting standards; the accounting rulemaking bodies of other countries are also focused on implementing changes that would harmonize standards in their countries with accepted norms of international accounting.[57]

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53. Organisation for Economic Co-operation and Development (OECD) Ad-Hoc Task Force on Corporate Governance, *OECD Principles of Corporate Governance* (1999), *available at* http://www.oecd.org/dataoecd/47/50/4347646.pdf (last visited March 29, 2004).

54. *See* International Corporate Governance Network (ICGN), *ICGN History, at* http://www.icgn.org/history.html and ICGN, *ICGN Statement on Global Corporate Governance Principles* (July 9, 1999), *at* http://www.icgn.org/documents/globalcorpgov.htm, (last visited March 29, 2004).

55. *See* International Corporate Governance Network (ICGN), *ICGN Statement on Global Corporate Governance Principles* (July 9, 1999), *at* http://www.icgn.org/documents/globalcorpgov.htm (last visited March 29, 2004).

56. *See* International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation,* (May 2003), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf (last visited March 29, 2004).

57. *See* Campos, *supra* note 49. In his speech Embracing International Business in the Post-Enron

THE EFFECT OF POLITICAL FACTORS ON CONVERGENCE

The stability of a country's government may also play a role in the development of corporate governance practices in particular countries. Where the government is relatively stable, the government may be able to legislate regarding issues in the corporate governance arena, whereas a less stable government's focus may simply be entrenchment.

Beyond the borders of a single country, the creation of certain international bodies such as the European Union (EU) is leading to convergence in the area of corporate governance practices, as well as in the area of commercial law. The EU has adopted a Financial Services Action Plan that addresses issues relating to corporate law, accounting and auditing, as well as access to the capital markets.[58] A focus on corporate governance principles is a very important part of the EU's goal

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Era, the SEC Commissioner stated:

> European officials and issuers for years have urged the SEC to accept financial state ments prepared under IAS without requiring reconciliation to US GAAP as required at present. SEC staff has noted two important considerations in assessing this requirement: progress in converging IAS and US GAAP and the development of an effective global financial reporting infrastructure for the consistent application, auditing and enforcement of IAS. Because investor protection is the fundamental mission of the SEC, we will look at the quality of the information received by US investors. The standards themselves are very important. No less critical is how standards are interpreted and applied in practice.
>
> With respect to convergence of IAS and US GAAP it is widely agreed that similar, high-quality answers to important accounting issues will benefit cross-border investors. Convergence of accounting standards should translate into greater transparency. This ultimately will increase the comparability of financial statements for investors and lower costs for cross-border issuers. As I mentioned earlier, the FASB and IASB entered into a memorandum of understanding to work together toward the important goal of convergence between US GAAP and IAS. The SEC has fully supported this project.
>
> While the FASB and IASB convergence project is still in its early stages, and involves many complicated issues, I continue to be encouraged by the progress being made. SEC staff is working closely with these organizations to support an agenda that prioritizes consistency among critical accounting standards.
>
> In addition to our work with the IASB and the FASB to encourage short-term convergence, we are working with regulators in other countries and with the accounting and auditing profession on ways to encourage the development of an effective global infrastructure for interpretation, auditing and enforcement of IAS. Such an infrastructure is as important as the accounting standards themselves. It is meant to ensure consistency and accountability. Without such mechanism, a "single" set of standards quickly could devolve, for practical purposes, into multiple standards. In this context, we are encouraged by the EU's work through CESR to develop a supporting infrastructure for IAS within the EU. We continue to see 2005 as an interesting possible target date for evaluating IAS.

Id.

58. *See* EUROPA, COMPANY LAW & CORPORATE GOVERNMENT, *available at* http://europa.eu.int /comm/internal_market/company/index_en.htm (last visited Jan. 21, 2004).

to create a single market for financial services in the EU.[59]

THE EFFECT OF THE MEDIA ON CONVERGENCE

Pressure from the fourth estate is another factor leading to changes in the corporate governance arena. This pressure typically comes from a variety of media sources. There is a tremendous amount of business media coverage in today's climate. Talk show hosts interview executives, regulators and business commentators and articles are written about various companies and industries nearly every day. As a result of Enron, Worldcom and other high-profile frauds, much of the coverage has centered on issues of governance and the independence of directors. The media is now more attuned to issues of this ilk, and specific coverage of companies is likely to include coverage regarding governance practices. The value of the contribution of the media to the governance debate depends on the journalist's background; journalists who cover particular industries or companies gain insights and business acumen that a general journalist will not possess, making their coverage both more accurate and more insightful. Finally, there are a number of governance organizations that use media effectively to orchestrate a "name and shame" process. These organizations will publish "10 best" or "10 worst" lists in an attempt to draw attention to the accomplishments or failings of companies in the corporate governance arena.[60]

THE EFFECT OF GOVERNMENT REGULATIONS ON CONVERGENCE

To some degree, United States government regulations on the subject of corporate governance have an extraterritorial effect, even where the effect was unintended. For example, Regulation FD,[61] which was passed by the Securities and Exchange Commission in August of 2000, is intended to level the playing field be-

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59. The EU has stated that:

> Harmonisation of the rules relating to company law and corporate governance, as well as to accounting and auditing, is essential for creating a Single Market for Financial Services and products. In the fields of company law and corporate governance, objectives include: providing equivalent protection for shareholders and other parties concerned with companies; ensuring freedom of establishment for companies throughout the EU; fostering efficiency and competitiveness of business; promoting cross-border co-operation between companies in different Member States; and stimulating discussions between Member States on the modernisation of company law and corporate governance.

See id.

60. E.g., Press Release, *The Corporate Library, Citigroup has the Highest Risk Board in the US According to the Corporate Library's New Rating of Corporate Directors*, (June 9, 2003) (on file with author), *at* http://www.thecorporatelibrary.net/products/ratings_press_release.html (last visited Jan. 28, 2004).

61. *See* U.S. Securities and Exchange Commission (SEC), *Final Rule: Selective Disclosure and Insider Trading*, Release Nos. 33-7881, 34-43154, IC-24599, 65 Fed. Reg. 51716 (Aug. 24, 2000), *at* http://www.sec.gov/rules/final/33-7881.htm (last visited March 29, 2004).

tween analysts, institutional investors and individual investors. The Commission believed that companies provided more information or earlier information to analysts and institutional investors than to individual investors.[62] Regulation FD requires that companies communicate material information contemporaneously to these groups.[63] As companies from other countries court American investors, they must be aware of the requirements of Regulation FD. Similarly, as American companies deal with investors abroad, those companies will act as they have been trained to act by their United States-based attorneys.

The Sarbanes-Oxley Act[64] also has an extraterritorial effect. Section 906 of the Act,[65] which is the officer certification provision to which criminal penalties attach, applies to periodic reports containing financial statements. This would cover not only Forms 10-K and 10-Q filed by United States issuers, but also Forms 20-F 40-F[66] and 6-K filed by foreign issuers.[67]

Ethiopis Tafara, the Director of the SEC's Office of International Affairs, ac knowledged in a speech that SEC actions have caused concerns in the international community.[68] The concerns include: (i) the required registration and inspection of foreign audit firms, which are covered by the Public Company Accounting Oversight Board's[69] (PCAOB) broad-ranging authority to regulate auditing firms; (ii) the potential violation of privacy laws, which are extremely strict in the European Union and require that companies transmitting personal data take a number of precautions; and (iii) whether the PCAOB's inspection rights, which would give it broad powers to require that foreign audit firms produce work papers relating to their audits, are too broad.[70] The PCAOB will work in a cooperative manner with accounting regulators from other countries to reach a consensus on these matters.[71]

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62. *See* Michael P Daly & Robert A. Del Giorno, *The SEC's New Regulation FD: A Critical Analysis*, ST. JOHN'S J. LEGAL COMMENTARY 461-462 (2002).

63. *Id.* at 463.

64. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 15 U.S.C. 7201 et seq. (2002).

65. 18 U.S.C. §1350(c) (2002).

66. This form is specific to Canadian issuers. *See* U.S. Securities and Exchange Commission (SEC), *Securities and Exchange Commission Forms List*, *at* http://www.sec.gov/about/forms/secforms.htm.

67 The SEC amended Forms 20-F and 40-F to include certifications by the officers. *See SEC, Final Rule: Certification of Disclosure in Companies Quarterly and Annual Reports*, Release Nos. 33-8124, 34-49427 IC-25722 (Aug. 29, 2002), at http://www.sec.gov/rules/final/33-8124.htm (last visited March 29, 2004).

68. Ethiopis Tafara, *U.S. Perspective on Accountancy Regulation and Reforms*, Remarks at the Annual Conference of the Institute of Chartered Accountants in England & Wales, (July 8, 2003), *at* http://www.sec.gov/news/speech/spch070803et.htm (last visited March 29, 2004) [hereinafter Tafara].

69. *See generally* Public Company Accounting Oversight Board, *at* http://www.pcaobus.org/ (last visited February 28, 2004).

70. *See* Tafara, *supra* note 68.

71. "Although the PCAOB's final rules call for registration of non-US firms by April 2004, the PCAOB hopes, before that time, to be able to make substantial progress with its foreign colleagues in developing harmonized registration and oversight models. *Id. See also* Campos, *supra* note 49 (noting that the SEC and the PCAOB have made a number of accommodations to foreign firms, including: not requiring foreign audit firms to provide registration information to the PCAOB if it would violate

Fortunately, the SEC has a long history of cooperation with regulators in other countries. Over the years, many different mechanisms have developed to allow for the regulators of various nations to work together on matters affecting their countries. These include memoranda of understanding between the SEC and its counterparts, as well as arrangements for the sharing of information among regulators and law enforcement agencies around the world.

GOVERNANCE CHANGES IN PARTICULAR MARKETS

All of the factors discussed above have had an effect on the convergence – and speed of convergence – of core corporate governance principles. The section which follows provides an overview of the status of governance in Canada, Germany, Japan, Mexico and the United Kingdom, the similarities to governance laws in the United States, and any recent changes in governance in that market.

CANADA

According to an assistant secretary with a Canadian oil company, in Canada "the bad news is that everything is changing. On the other hand, the good news is that everything is changing."[72] The changes in corporate governance in the United States have had a profound effect in Canada as well. Canada's primary securities regulator is moving to a United States-style, rules-based corporate governance regime.

One factor that significantly impacts securities regulation in Canada is the lack of a single, national agency regulating securities. Instead, there are thirteen provincial and territorial agencies responsible for the regulation of securities in Canada.[73] The Ontario Securities Commission, because the Toronto Stock Exchange is located within its jurisdiction, wields more power than the other regulators in Canada.

Corporate governance issues are complicated in Canada by the lack of harmonization among the various provinces, and by bickering amongst the various provincial securities regulators. In British Columbia and Alberta, for example, regulators favor a principles-based regulatory scheme, while in Ontario, regulators favor a rules-based scheme patterned after new United States laws, such as the Sarbanes-Oxley Act.

It has been nine years since the Toronto Stock Exchange (TSX) first introduced corporate governance disclosure regulations in response to the Dey report.[74]

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the laws of their home country, granting foreign audit firms an additional six months during which to register; and limiting the registration only to those who provide more than ten hours of work on the audit).

72. Sylvia Groves, Assistant Corporate Secretary with Nexen, (quoted in *Keeping Up*, CORP SECRETARY 22 (Aug.-Sept. 2003).

73. *See* Canadian Securities Administrators (CSA/ACVM), *About the CSA* (June 2001), *at* http://www.csa-acvm.ca/html_CSA/about_who_are_csa.html (last visited March 29, 2004).

74. The report is so named because Peter Dey chaired The Toronto Stock Exchange Committee on

The TSX listing standards that were passed in 1994: (i) clearly identified the role of directors as stewards of the corporation; (ii) required that the board have a majority of "unrelated directors;"[75] (iii) noted that the board should review the adequacy and form of compensation of directors; (iv) required that certain board committees be comprised of outside directors, a majority of whom are unrelated directors; (v) required the audit committee to be comprised solely of outside directors; and (vi) required that each company disclose on an annual basis its governance process with respect to the guidelines.

In 2002, the TSX proposed new governance standards.[76] These new standards require, for example, that boards oversee the company's strategic planning process; that all members of the audit committee be financially literate,[77] with at least one member having "accounting or related financial expertise,"[78] and that the audit committee have a charter [79] The new changes would also slightly tweak the definition of "independent directors, defining these individuals as directors "free from any other relationship which could reasonably be perceived to materially interfere with the director's ability to act with a view to the best interests of the issuer."[80] The TSX also went on record as supporting stricter standards such as CEO and CFO certification of the financial statement, but is deferring to legislators on this issue.[81] Following the TSX's guidance, Canadian securities regulators are proposing certification rules similar to the requirements under the Sarbanes-Oxley Act

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Corporate Governance which released its report, "Where Were the Directors?" in December of 1994. *See Guidelines for Improved Corporate Governance*, *at* http://www.ecgi.org/codes/country_documents/canada/dey.pdf (last visited Feb. 3, 2004).

75. An "unrelated director" was defined by the TSE as one who is independent of management and free from any interest and any business or other relationship which could materially interfere with the director's ability to act with a view to the best interests of the corporation. *See* David Armstrong, Corporate Governance in Canada (October 25, 2002), *at* http://www.ffhsj.com/Symposium_Material/GC_fall_02/corp_gov_canada.pdf (last visited March 29, 2004) [hereinafter Armstrong].

76. *See id. See also* Toronto Stock Exchange, Corporate Governance Policy–Proposed New Disclosure Requirement and Amended Guidelines (March 26, 2002), *at* http://www.ecgi.org/codes/country_documents/canada/policy_draft_26mar2002.pdf [hereinafter *TSX Corporate Governance Policy*] (last visited March 29, 2004).

77 Financially literate was defined by the TSE as the ability to read and understand financial statements of complexity and scope similar to the issuer's financial statements. *See* Armstrong, *supra* note 75, at 7.

78. Financial expertise is the ability to understand the issuer's financial statements and the generally accepted accounting principles used to prepare those statements; an ability to asses the application of GAAP with respect to accruals, reserves and estimates; experience, either directly or through supervising others, in preparing or auditing financials in situation that would raise issues similar to the issues the issuer faces; an understanding of internal controls; and knowledge of the audit committee's role.

As in the United States, there is concern that the person designated as the financial expert on the audit committee could be held to higher standard of care than other directors or face liabilities that exceed those of other directors. The CSA did not include a specific safe harbor for the person designated as the "financial expert. Rather, the CSA has stated that the designation will not increase that directors' personal liability. *Id.*

79. *See TSX Corporate Governance Policy*, *supra* note 76.

80. *Id.*

81. *Id.*

that chief executive officers and chief financial officers certify the accuracy of their company's financial reporting.[82]

The Chairman of the Ontario Securities Commission asked that the Canadian Institute of Chartered Accountants address issues of auditor independence, rotation of engagement partners, and possibly rotation of the firm.[83] The Chairman also asked that the Law Society of Upper Canada consider whether to implement Sarbanes-Oxley type rules governing professional conduct before the Ontario Securities Commission and whistle-blowing by outside counsel.[84] On June 27 2003, the Canadian Securities Administrators released proposed rules on governance issues for public comment.[85] The rules cover audit committees,[86] officer certifications and auditor independence.[87] The Proposed Rules follow the U.S. initiative of a rules-based approach to corporate governance as opposed to the traditional Canadian principles-based approach. Subsequently, the efforts of the Canadian Securi-

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82. 18 U.S.C. 1350 (a), (b). (Sarbanes-Oxley Act of 2002). Section 302 of the Sarbanes-Oxley Act required the SEC to adopt rules requiring certification of the quarterly and annual periodic reports filed with it. The SEC adopted Rules 13a-14 and 15d-14 under the Exchange Act. The chief executive officer and chief financial officer must now certify that they have reviewed the report, that to their knowledge the report contains no false or misleading statements and does not omit any material facts, the financial statements fairly present in all material respects the company's results of operations and cash flows for the reporting period, that the signing officers are responsible for internal controls of the issuer and have evaluated those controls within the prior ninety days, that they have disclosed to the audit committee and outside auditors any significant deficiencies in controls and any fraud involving management or employees having significant role in internal controls, and whether any factors could significantly affect internal controls after the evaluation date. The format for this report is prescribed in the SEC's release, and may not be altered.

A similar certification provision is contained in Section 906 of the Sarbanes-Oxley Act. This provision, which has criminal implications, requires that the chief executive officer and chief financial officer certify that the periodic report fully complies with the requirements of the Exchange Act. Section 906(a) and (b) of the Sarbanes-Oxley Act, 18 U.S.C. 1350(a), (b). False certifications can result in penalties of up to a $1 million fine, imprisonment for up to ten years, or both, for non-willful violations and a $5 million fine, imprisonment for up to twenty years, or both, for willful violations. H.R. 3763, 107th Cong. (2d Sess. 2002).

83. Presently under Canadian corporate law, the shareholders select the auditors annually and set the auditors' compensation. *Canada Business Corporations Act*, §162. The approach suggested would differ significantly from the existing approach. *See* Armstrong, *supra* note 75, at 8.

84. *See* Armstrong, *supra* note 75, at 8.

85. *See* OSC, Notice of Request for Comments (June 27, 2003), *at* http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/rule_52-108_20030627_c1notice-roc.pdf (last visited March 29, 2004).

86. With respect to audit committees, the proposed rules are in many ways similar to the audit committee requirements under the NYSE Listing Standards. For example, the audit committee must have written charter. It must recommend the outside auditors and their fees to the full board, oversee the work of the outside auditors, pre-approve non-audit services above a de minimis threshold, review filings and press releases, review hiring of external auditors or former external auditors as employees, oversee the issuer's disclosure processes, and establish complaint procedures. *See* OSCB, Multilateral Instrument 52-108, *Auditor Oversight*, *at* http://www.conferenceboard.ca/GCSR/links/pdfs/OSC_Auditor_Oversight_Jun03.pdf; OSCB, Multilateral Instrument 52-109, *Certification of Disclosure in Companies Annual and Interim Filings*, *at* http://www.conferenceboard.ca/GCSR/links/pdfs/OSC_Certification_Jun03.pdf; OSCB, Multilateral Instrument 52-110, *Audit Committees*, *at* http://www.conferenceboard.ca/GCSR/links/pdfs/OSC_Audit_Committees_Jun03.pdf (last visited March 29, 2004).

87 *See id.*

ties Administrators to lead governance reform in Canada have slowed as regulators from the various jurisdictions have differing views about approaches to reform.[88] If adopted "as is" the rules will become effective next year.

Ontario's government passed several new laws in late 2002 that strengthen governance in Canada.[89] These include increasing fines from $1 million (Canadian) to $5 million (Canadian),[90] increasing prison terms from two years to one day less than five years,[91] increasing fines for insider trading to the greater of $5 million (Canadian) or triple the profit made,[92] strengthening the laws prohibiting market manipulation and fraud,[93] and giving the Ontario Securities Commission new rulemaking authority.[94] This new rulemaking authority empowered the Ontario Securities Commission to require that CEOs and CFOs certify that the financial statements fairly present the issuer's financial condition. Further, certifications regarding internal controls and procedures will be required on filings made after January 1, 2004.[95]

The most recent change is the Ontario Securities Commission's release for comment of a Proposed Policy regarding corporate governance practices.[96] The proposals are being considered by the securities regulators of each province other than British Columbia and Quebec.[97] The OSC requested that comments be provided by April 15, 2004.[98] Among the governance proposals recommended by the OSC are that a majority of board members should be independent and that those directors should meet regularly The chair should be an independent director or a

88. *See* Karen Howlett, *BCSC Head Accuses OSC Boss of Raising Fears Over Reform* (Aug. 27 2003), *at* http://regulators.itgo.com/PI/369.htm (last visited March 29, 2004). The article states that "British Columbia Securities Commission chairman Douglas Hyndman has accused his counterpart in Ontario of raising false alarms about his proposed securities reforms, marking the latest volley in an escalating war of words between the two provincial watchdogs. *Id.* The article further notes that, due to the "widening rift, Hyndman has stepped down from his position as head of the Canadian Securities Administrators, hamstringing the efforts of a group that should play a leading role in governance reforms in Canada. *Id.*

89. *See* Armstrong, *supra* note 75, at 13.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

95. *See* OSCB, Multilateral Instrument 52-109, Certification *of Disclosure in Companies Annual and Interim Filings, at* http://www.conferenceboard.ca/GCSR/links/pdfs/OSC_Certification_Jun03.pdf

96. Ontario Securities Commission, News Release, "Regulators Propose Corporate Governance Reforms for Issuers, (January 16, 2004), *at* http://www.osc.gov.on.ca.en/About/News/NewsReleases/2004/nr_20040116_osc-corporate.htm> (last visited April, 29, 2004); and Ontario Securities Commission, Proposed and Final Rules, "Request for Comment: Notice on Proposed Multilateral Policy 58-201 Effective Corporate Governance, and Proposed Multilateral Instrument 58-101 Disclosure of Corporate Governance Practices, Form 58-101F1 and 101F2 (January 16, 2004), *at* http://osc.gov.on.ca/en/Rulemaking/Policies/pol_20040116_58-201_roc.htm.

97. *See* http://library.lsuc.on.ca/GL/stay_informed_corporate.htm. Both the British Columbia and Quebec Securities Commissioners plan to publish their own corporate governance guidelines in the near future.

98. *See TSX Guidelines for Improved Corporate Governance, supra* note 76.

lead director who is independent should be appointed. A written corporate governance policy should be adoped by the board and this policy should describe the positions of the directors and CEO. Training and director education opportunities should be provided to the board members. A code of ethics should be adopted. The board should create a compensation committee and also a nominating committee that will adopt policies regarding the criteria for selection of new directors. The board will develop assessment tools to review the performance of the entire board, as well as the performance of individual directors. Each of the proposals is written in precatory language, giving issuers the ability to exercise a substantial amount of discretion in deciding how best to apply the practices to its own business.

Once adopted, the TSX's new corporate governance standards would be revoked to the extent they are inconsistent with, or create duplication or regulatory overlap with, the OSC corporate governance standards.[99] These suggested changes by the OSC would bring Canada's listed companies more in line with the governance expected of public companies in the United States. Many of the suggested changes, such as the creation of nominating and compensation committees, are changes that the NYSE already requires of listed companies. Similarly, the direc tor education and assessment tools are similar to recent changes in the United States.

GERMANY

As noted previously, boards of directors of public companies in Germany have two levels – the *Vorstand*, which is a management board, and the *Aufsichtsrat*, which is a supervisory board comprised of outside directors.[100] These are separate groups of people, such that members of the *Vorstand* who serve as members of the company's executive committee are not members of the *Aufsichtsrat*. Further, the *Aufsichtsrat* cannot exercise managerial powers to avoid circumvention of the required two-tier structure.

In the United States, there is a definite trend toward the appointment of a majority of outside directors; in Germany however, the two-tiered structure has for years required independent, outside directors at the highest level. These directors represent both capital and labor. They are appointed by the shareholders at the annual meeting and also by the trade unions; employees appoint directors to the board in furtherance of the system of labor co-determination in Germany [101]

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99. *See generally* http://library.lsuc.on.ca/GL/stay_informed_corporate.htm.

100. *See* Thomas Marx, *Doing Business in Germany* (August 2001), *at* http://www.legamedia.net/legapractice/marx_thomas/2001/01-08/0108_marx_thomas_business-germany_01.php (last visited March 29 2004).

101. Section 102(1) AktG. Different compositions of the board are required under German law, depending on the number of employees a company has. Under the German Shop Constitution Act, a company with more than 500 but less than 2,000 employees must have one-third of the Aufsichtsrat members represent employees. If the company has more employees, the German Co-Determination Act requires that one-half of the Aufsichtsrat members represent employees. *See* Dr. Theodor Baums, *Cor-*

This two-tiered structure has received criticism over the years. Some say that the major banks in Germany exercise too much power and that just a few banks may have seats on the boards of several major companies, leading to interlocking directorates.[102] A conflict of interest could arise from service on the boards of competing companies, but this is addressed through the disclosure of the board members' other positions. Another concern is that the appointment of a labor representative to the board could lead to a fragmented board, with labor and management factions meeting separately with the chairman and meetings being little more than perfunctory gatherings aimed at avoiding unpleasant discussions. The two-tiered structure may also have an unintended effect of limiting the amount of information provided to the board. Attempts to avoid providing certain information to the labor representative on the board may mean that the board would not receive information that, in the United States, a board of directors would receive. One final criticism that has been leveled against the two-tiered board structure is that the structure breeds inefficiencies. While this may be true to some degree, in many respects the *Vorstand* is essentially the same as a United States company's executive committee.

Like Canada's corporate governance code, Germany has a "comply or disclose" corporate governance regime. In July of 2002, Germany enacted the Transparency and Publicity Act ("TransPuG"),[103] an act based on recommendations made by the German Corporate Governance Commission, whose Corporate Governance Code was first published in February of 2002.[104] TransPuG became effective on January 1, 2003. The Act covers disclosure, transparency and accounting issues.[105] Because TransPuG is so new, German courts have not yet addressed the question of whether violation of the Corporate Governance Code creates any liability for the company, but the courts may see compliance with the Code as creating a safe harbor for corporations.[106]

On an annual basis, the *Vorstand* must now file a Compliance and Disclosure Statement with the *Handelsregister* or Commercial Register.[107] That Compliance and Disclosure Statement is a representation both as to compliance during the year and compliance at the time of filing with the principles in the Corporate Govern-

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porate Governance Systems in Europe – Differences and Tendencies of Convergence, Crafoord Lecture, *at* http://www.jura.uos.de/institut/hwr/PDF/a0896.pdf (last visited March 29, 2004).

102. *See* Richard Deeg, *German Banks and Industrial Finance in the 1990'* (October 1996), *at* http://skylla.wz-berlin.de/pdf/1996/i96-323.pdf (last visited March 29, 2004).

103. *See* Commission of the German Corporate Governance Code, *Transparency and Disclosure Law Now in Force* (July 30, 2002), *available at* http://www.corporate-governance code.de/eng/news/transparenzgesetz20020801.html (last visited March 29, 2004) [hereinafter *Transparency and Disclosure*].

104. *See* Commission of the German Corporate Governance Code, *German Corporate Governance Code*, *available at* http://www.corporate-governance-code.de/index-e.html (last visited Feb. 4, 2004).

105. *Id.*

106. Hassan Sohbi, *TransPuG. The Impact of Comply and Explain Regulation*, Speech at 2nd Annual German Investor Relations Conference (Dec. 5, 2002), *available at* http://www.osborneclarke.com/publications/pdf/transpug.pdf (last visited Feb. 4, 2004).

107 *See Transparency and Disclosure*, *supra* note 103.

ance Code.[108] If the company has failed to comply with certain provisions of the German Corporate Governance Code, the company must specifically disclose those provisions with which it failed to comply[109] Certain provisions of the Corporate Governance Code restate mandatory provisions from German corporate law, while other provisions are precatory and simply give guidance as to best practices.[110] Among the precatory provisions are that no more than two members of the *Aufsichtsrat* may be former *Vorstand* members, *Aufsichtsrat* members may not serve on competitors' boards, conflicts of interest must be disclosed, committees shall be formed to perform certain tasks, and audit committee members must be independent.[111]

JAPAN

Commodore Perry's black ship has become a metaphor in Japan for that country's westernization.[112] Recent changes in the corporate governance arena in Japan are further evidence of the country's continuing westernization.[113] Despite the attempts to change, Japan is still viewed as lacking in the transparency and disclosure rules necessary to provide a high level of investor confidence.[114] Japan started to transform governance practices slowly: in 2000, the Tokyo Stock Exchange wrote to all companies listed upon it and requested that they revise their corporate governance practices to take into account shareholder interests to a greater degree.[115] The Tokyo Stock Exchange also established a permanent corporate governance committee to advise the Exchange and listed companies.[116] Today, how-

108. *Id.*

109. *Id.*

110. *See* Government Commission, *German Corporate Governance Code* (May 21, 2003), *available at* http://www.corporate-governance-code.de/eng/download/DCG_K_E200305.pdf (last visited March 29, 2004).

111. *Id.*

112. *See* Naval Historical Center, *Commodore Perry and the Opening of Japan: Background*, (Nov. 25 2002), *available at* http://www.history.navy.mil/branches/teach/ends/opening.htm [last visited March 29, 2004].

113. The United States has been charged with exporting poor corporate governance practices. *See generally* LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT (Yale University Press 2001). Recent changes in governance in Japan, as discussed in this section, make it clear that current thinking in Japan with respect to governance is tracking more closely than ever the United States' approach to governance.

114. *See* Standard & Poor's, *Japan Corporate Governance in Transition: Weaknesses Remain and Challenges Continue* (2002) and *An Overview of Corporate Governance in Japan* (2002). *See also* Michael Solomon Associates, Inc., Interview with Ted White, Director of Corporate Governance, CalPERS, 4 Japan Corporate Governance Report, 2 (Jan. 2003), *available at* http://www.msapr.com/pdf/JCGReport_Jan03_English.pdf (last visited March 29, 2004), in which he states, .Japan needs to strengthen the independence of their boards, improve their disclosure and transparency, pay particular attention to the independence of company auditors, and increase their communication with shareholders.

115. Michael Solomon Associates, Inc., Interview with Takuski Shimoda, Managing Director of the Tokyo Stock Exchange, 5 Japan Corporate Governance Report 2 (March/April 2003), *available at* http://www.msapr.com/pdf/JCGReport_Apr03_English.pdf (last visited March 29, 2004).

116. *Id.*

ever, less than thirty percent of companies listed on the Tokyo Stock Exchange have independent directors.[117]

There may well be cultural reasons for the slow pace of change in the corporate governance area. Corporations in Japan focus on the importance of consensus in decision making. Further, the concept of "family" is extremely important in the Japanese capital market. Due to cross shareholdings, there are interrelationships among many companies in Japan. These *keiretsus* are tied together through a common ownership structure which may, in many instances, involve the primary bank for one or more of the related companies. This ownership structure results in shareholders – even large shareholders – being fairly stable and passive. Despite a substantial shareholding, these shareholders may not exert control in the same ways as might major shareholders in the United States. Another unusual factor in Japan that affects the area of corporate governance has been the lack of hostile takeovers. Unlike other markets where there may be bidding wars or hostile takeovers, the Japanese focus on consensus will not motivate companies to "window dress" for a potential bidding war. Finally, the Japanese government plays a strong role in corporate governance, as the government has shown willingness to intervene to assist troubled companies.

On May 22, 2002, the Diet passed revisions to Japan's Commercial Code.[118] The revisions, effective April 1, 2003, included a number of changes affecting the operation of boards of directors in Japan. The boards of large companies, those most likely to be recipients of foreign investment, are now allowed to either operate using a single tier structure like boards of directors in the United States or maintain their traditional Japanese style structure.[119] Those opting for the new system must establish three committees of the board of directors: a nomination committee, an audit committee and a compensation committee.[120] A majority of the members of each of the three committees must be an outside director. The role of each committee is similar to the role that committee would serve in a United States company. Since the passage by the Diet of the laws allowing creation of American-style board committees, several companies in Japan have announced, or are considering announcing, plans to reorganize their boards of directors.[121]

In addition to the recent revisions to the Commercial Code allowing Japanese companies to operate using American-style boards of directors, Japan is also fol-

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117 *Id.* Not only do few companies in Japan have independent directors, others simply do not see the need for independent directors. For example, Toyota restructured its board in early 2003 to reduce the number of directors from fifty-eight to twenty-seven. It did not before the restructuring, and still does not, have any independent directors on the board. *Id.* at 4.

118. Ryoko Ueda, *Corporate Governance and Reform of Japan Commercial Code*, 2 J-IRIS Research Newsletter 1 (Oct. 2002), *available at* http://www.j-iris.com/newsletter/nl02.pdf (last visited March 29, 2004).

119 *Id.* at 2.

120. *Id.*

121. These include Sony, Orix, Hitachi, Toshiba, Minolta, Konica, and the Aeon Group, among others. JETRO, *Focus: Economic Revitalization—Corporations and Investors Position Themselves to Compete in the New Japan*, (Mar. 19, 2003), *at* http://www.jetro.go.jp/usa/newyork/focusnewsleter/focus21.html (last visited March 29, 2004).

lowing the lead of the United States in crafting reforms in the accounting and auditing areas. Japan's Financial Services Agency's Subcommittee on Certified Public Accountant Regulation has recommended taking steps to enhance auditor independence, such as limiting non-audit services and rotating audit staff, as well as working to increase the number of accountants in Japan.[122] Stronger government of the accounting industry is also among the proposed reforms.[123]

MEXICO

The tenor of the corporate governance debate in Mexico is very different than in the United States. In the United States, the debate deals mainly with creation of the proper balance between the shareholders and the management of companies. In Mexico, the debate—while not overlooking the former issue – deals more with the relationship between majority and minority shareholders.[124] In both versions of the debate on governance, the overriding issue is one of balancing competing interests.

Although there are several different forms of commercial entities in Mexico, all companies listed on the *Bolsa Mexicana de Valores* are organized as limited liability stock corporations having the *sociedad anonima* designation. The general law of corporations is the *Ley General de Sociedades Mercantiles*,[125] while the *Ley del Mercado de Valores*, or Securities Act, is that country's securities law.[126] As provided in these laws, companies are overseen by the board of directors, but in

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122. Michael Solomon Associates, Inc., *Regulatory Watch: A Blueprint for Accounting Reform in Japan: Blue-Ribbon Panel Releases Its Recommendations to the Financial Services Agency*, 4 Japan Corporate Governance Report 3 (January 2003), *at* http://www.msapr.com/pdf/JCGReport_Jan03_English.pdf (last visited March 29, 2004). There are 14,000 CPAs in Japan currently; the report targets having 50,000 CPAs in Japan by the year 2018. *Id.*

123. *Id.*

124. New rules to protect the interests of minority shareholders are contained in the Securities Act, Article 14 Bis 3, sections III and IV The new rules were enacted on June 1, 2001, but became effective the following year in conjunction with the date of the annual meeting for companies affected by the rules. The rules provide, among other things, that:

1. Minority shareholders have the right to appoint at least one member of the board of directors for each ten percent of stock ownership;
2. Minority shareholders who hold at least ten percent of the shares have the right to appoint one comisario, or statutory auditor;
3. Minority shareholders who hold at least ten percent of the shares have the right to cause a shareholders meeting to be postponed for at least three days if they have not received sufficient information about the matters to be voted upon;
4. Minority shareholders who hold at least ten percent of the shares have the right to request that a shareholders meeting be called;
5. Minority shareholders who hold at least fifteen percent of the shares have right to file a civil action against the board of directors; and
6. Minority shareholders who hold at least twenty percent of the shares have the right to oppose shareholder resolutions that have been passed.

125. Carlos Creel C & Alfonso Garcia-Mingo, *Corporate Governance under Mexican Law*, INT'L FIN. L. REV., in THE IFLR GUIDE TO MEXICO 43 (Ben Maiden ed., 2001) [hereinafter Creel C & Garcia Mingo].

126. *Id.* at 43.

addition to the board of directors, the company must have a *comisario,* or statutory auditor who has an obligation to oversee operations of the company and deliver an annual report.[127] Generally, these individuals are the partners of the company's outside auditing firm.

On June 9 1999, a new *Codigo de Mejores Pacticas Corporativas*, or Best Practices for Corporate Governance for Mexico, was introduced.[128] The Code had been drafted through the cooperation of the Mexican Bankers' Association, the Mexican Institute of Finance Executives, the Mexican Institute of Public Accountants, and the *Bolsa Mexicana de Valores*, Mexico's stock exchange.[129] The Code addresses governance issues relating to the structure and function of boards of directors,[130] auditing of the company and oversight of internal controls,[131] and finance, planning, transparency and disclosure in the provision of relevant information to shareholders.[132] Compliance with the Code is voluntary· Mexico has followed a principles-based rather than rules-based approach to governance.[133] Companies must file a report annually with the *Bolsa* identifying any areas of the Code with which they are non-compliant and explaining the reasons for the non-compliance.[134]

Like the United States, Mexico has a single government agency responsible for the oversight of the country's capital markets. The *Comision Nacional Bancaria y de Valores,* or National Banking and Securities Commission, oversees the

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127 Antonio Franck C, Rafael Robles Miaja, & Manuel Galicia R, *Amendments to the Mexican Securities Law*, INT'L FIN. L. REV., in THE IFLR GUIDE TO MEXICO 83, 90 (Ben Maiden ed., 2001).

128. Bolsa Mexicana de Valores, *Corporate Governance Code for Mexico* 1, at http://www.ecgi.org/codes/country_documents/mexico/mexico_code_en.pdf (Sep. 26, 2002) (last visited March 29, 2004) [hereinafter Mexico Code].

129. *Id.*

130. *Id.* at 2. Section 1 of the Code explains that day-to-day operations are the responsibility of management, while the board of directors is to provide strategic oversight. *Id.* Section 1.2 deals with the number of directors, discourages the use of alternate directors, requires that the board include outside directors, and suggests the information to be provided to shareholders to enable them to vote on the slate of proposed directors. *Id.* Section 1.3 deals with the structure of the board and recommends the use of audit, compensation and finance and planning committees. *Id.*

131. *See* Section 3.2 of the Corporate Governance Code for Mexico in Mexico Code, *supra* note 128, at 2.

132. *See* Sections 5.1 and 5.2 of the Corporate Governance Code for Mexico, in Mexico Code, *supra* note 128, at 2. Until recently, it was not the common practice in Mexico for companies to send lengthy proxy statements containing information about the director nominees and other issues; rather, the primary communication tool with shareholders was the company's annual report, which is required by Article 14 of the Ley Del Mercado de Valores (the Securities Act of Mexico). There is still great reluctance, due to security concerns, for companies in Mexico to provide the type of disclosure regarding executive compensation that shareholders in the United States are accustomed to receiving. Rather, if companies do make executive compensation disclosures, they do so by aggregating the compensation information rather than by providing detailed information about specific executives. They may also discuss the general compensation philosophy of the company in the disclosure materials.

133. Bryan W Husted & Carlos Serrano, Corporate Governance in Mexico 15-16, *at* http://egade.sistema.itesm.mx/investigacion/documentos/documentos/9egade_husted.pdf (May 2001) (last visited March 29, 2004).

134. *Id.* at 15.

registration of securities and regulates issuers.[135] The Securities Act sets forth general communications requirements, such as the requirement that a company provide an annual report to shareholders.[136] The company's audit committee must, at the annual shareholders meeting, give a report to shareholders.[137] The Act also defines independent directors and requires that the chair and a majority of the members of the audit committee be independent.[138] Most Mexican companies have only recently begun to establish audit committees and draft charters for those committees; in many instances, they follow the charters used by United States companies as models.

UNITED KINGDOM

It is the United Kingdom which produced the Cadbury Report, one of the first extensive reviews of governance practices.[139] Over the years, a number of other reports issued in the UK have provided further thought on governance practices. These include the Greenbury Report,[140] which focused on disclosure of director pay· the Hampel Report[141] issued in June of 1998, which became the Combined Code and is discussed below; the Turnbull Report,[142] issued in September of 1999 which reviewed companies' approach to internal controls; and most recently the

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135. *Id.*

136. Creel C & Garcia-Mingo, *supra* note 125, at 44.

137 *Id.* at 46. Securities Act, Section 14 Bis 3, subsections IV and V as amended.

138. Franck C, *supra* note 127, at 86.

Securities Act, Article 14, states that the following will not be deemed independent directors:

1. Employees or managers of the company, or persons employed by the company during the prior year;
2. Significant shareholders who, although they are not employed by the company, wield management power;
3. Affiliates of groups providing consulting services to the issuer if the transaction with the issuer represents ten percent or more of that firm's revenues;
4. Customers, suppliers, debtors, creditors, partners, directors or employees of other entities having an important relationship with the issuer;
5. Employees of charitable institutions that receive significant contributions from the issuer, defined as more than fifteen percent of the grants received by the institution;
6. Senior executives of other companies, where senior executive of the issuer serves on the other company's board; and
7. Spouses and other close relatives of those listed above.

139. The Committee on the Financial Aspects of Corporate Governance & Gee and Co. Ltd, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee 1992), *at* http://www.ecgi.org/codes/country_documents/uk/cadbury.pdf (last visited March 29, 2004).

140. *See Greenbury Recommendations*, at http://www.blindtiger.co.uk/IIA/uploads/2c9103-ea9f7e9fbe—7e22/Greenburyreport.pdf (last visited Feb. 9, 2004).

141. *See* G. P Stapledon, *The Hampel Report on Corporate Governance*, 16 COMPANY AND SECURITIES L. J. 408, 408-413 (1998), *available at* http://www.corpgov.com/publications/fulltext/hampelreport.pdf (last visited Feb. 9, 2004).

142. *See* THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES, INTERNAL CONTROL. GUIDANCE FOR DIRECTORS ON THE COMBINED CODE (Accountancy Books 1999), *available at* http://www.ecgi.org/codes/country_documents/uk/turnbul.pdf (last visited March 29, 2004).

Higgs Report,[143] issued in January of 2003.

The issuance of the Higgs Report, commissioned by the Department of Trade and Industry, builds upon the corporate governance foundation laid in the Cadbury report. Some criticized the report, however, as an attempt to go too far in regulating corporations.[144] The concern appears to be that the UK, if not cautious in adopting governance reforms, will be carried along with the reforms in the United States and other countries in adopting a rules-based approach rather than the principles-based approach, which has been the hallmark of governance in the UK.

Primary laws governing UK corporations are the Companies Act of 1985,[145] the City Code on Takeovers and Mergers,[146] the rules applicable to mergers adopted by the Takeover Panel,[147] and the Financial Services Authority's Code of Market Conduct.[148] In addition, the Combined Code on Corporate Governance, as supplemented by the Turnbull Report, applies to all listed companies in the UK, including those listed on the London Stock Exchange.[149] As in Mexico, compliance with the Code is voluntary[150] If companies choose not to comply with the Code, they must disclose the non-compliance in their annual report and state the reasons for the non-compliance.[151]

The Combined Code requires that non-executive directors comprise at least one half of the directors.[152] A majority of these non-executive directors should also be free from any relationship with the company or management that would

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143. DEREK HIGGS, REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS (Jan. 2003), *available at* http://www.dti.gov.uk/cld/non_exec_review/pdfs/higgsreport.pdf (last visited March 29, 2004).

144. *See* Alexandra Johnson, *Kelley Rejects Higgs Criticism as 'Disturbing Complacency* ACCOUNTANCYAGE.COM, (March 12, 2003), *at* http://www.accountancyage.com/News/1132858 (last visited March 29, 2004). The article refers to a speech given by Ruth Kelly, financial secretary to Treasury, in which she defends the Higgs Report. The Higgs Report had been criticized in the UK as rule-book and a step too far toward the US-style rules-based approach to corporate governance. *Id. See also* David Rae, *Former Dixons Chairman Slams Higgs*, ACCOUNTANCYAGE.COM, (March 5, 2003), *at* http://www.accountancyage.com/News/1132772 (last visited March 29, 2004).

145. HALSBURY'S STATUTES OF ENGLAND AND WALES 88, (Andrew Davies, Gilian Bailey, & Eric Roydhouse, eds., Butterworths (1999)).

146. The City Code on Takeovers and Mergers, which was last revised and reissued in July 2000, is similar to the Williams Act of 1968, which amended the Securities and Exchange Act of 1934. The City Code provides for equal treatment of shareholders, disclosure to shareholders, and good faith consideration by the board of offers and prevents market manipulation.

147 CHARLES M. NATHAN & MICHAEL R. FISCHER, AN OVERVIEW OF TAKEOVER REGIMES IN THE UNITED KINGDOM, FRANCE AND GERMANY, (Latham & Watkins, 2003), at http://www.lw.com/resource/publications/_pdf/pub485.pdf (last visited March 29, 2004).

148. FINANCIAL SERVICES AUTHORITY, THE CODE OF MARKET CONDUCT (FSA Handbook, Release 026 2003), *available at* http://www.fsa.gov.uk/handbook/BL2MARpp/Mar/Chapter_1.pdf (last visited March 29, 2004).

149. FINANCIAL REPORTING COUNCIL, THE COMBINED CODE ON CORPORATE GOVERNANCE (2003), *at* http://www.frc.org.uk/documents/pdf/combinedcodefinal.pdf [hereinafter COMBINED CODE] (last visited March 29, 2004).

150. *Id.* at 1.

151. *Id.*

152. *Id* at 7

interfere with the exercise of their independent professional judgment.[153]

The New York Stock Exchange (NYSE) recently acted to require that stock-based compensation plans be approved by the shareholders. Although a version of this rule existed previously, the new rule is more restrictive. Like this provision of the NYSE's listing standards, the Combined Code requires shareholder approval of any new long-term incentive plans.[154] Further, beginning this year, shareholders are required to approve the compensation report to shareholders.[155]

Institutional investors have great influence in the UK, just as they do in the United States. Pension funds, in particular, may hold a large percentage of the stock of a company Many institutional investors in the UK have issued their own corporate governance guidelines, and will vote the stock they hold in accordance with the governance principles set forth in those guidelines. The role of institutional investors in the UK will evolve in coming years from simply voting the shares they hold to engaging management in dialogue regarding significant governance issues.

Although many countries are following the lead of the United States with respect to governance practices, the United States has begun to follow the lead of the United Kingdom in at least one respect.[156] In the United Kingdom, the roles of the chairman and the chief executive officer have been separate for many years.[157] Only recently has this become more commonplace in the United States.

Further governance reforms appear to be needed in the UK. The Institute of Internal Auditors for the UK and Ireland is firmly of the opinion that additional work is needed in the governance area to reach the point at which investors can have a higher level of confidence in the governance practices of UK companies.[158] Specifically that organization has concluded that the UK should migrate from the comply and explain approach to more of a rules-based approach that enforces compliance with governance principles.[159]

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153. *Id.*

154. COMBINED CODE, *supra* note 149, at 14.

155. Disapproval would have no legal effect, but would be an indicator to the full board of the shareholders' dissatisfaction with its actions in the area of compensation.

156. *US Heading for UK-style Governance*, CORP SECRETARY 7 (Feb./March 2003).

157. AccountancyAge.com, *FTSE-100 Fails to Deliver on Higgs*, (Feb. 7, 2003), *at* http://www.accoutancyage.com/News/1132457 (last visited March 29, 2004). Despite the separation of roles which has been the clear best practice for many years in the UK, five percent of companies there still combine the roles. There are no legal prohibitions against combining these roles. *Id.*

159. INSTITUTE OF INTERNAL AUDITORS – UK AND IRELAND, A NEW AGE FOR CORPORATE GOVERNANCE REFORM 3 (2002), *at* http://www.blindtiger.co.uk/IIA/uploads/-38c9a362-ed71ce5fa5—72ff/CorporateGovernanceReformJuly2002.pdf (last visited March 29, 2004).

160. *Id.* at 6. Among other changes recommended by the Institute are that public companies should be required to assess the effectiveness of their internal controls and make disclosures with respect to the effectiveness. This is similar to the requirement set forth in Section 404 of the Sarbanes-Oxley Act.

CONCLUSION

Over the next few years, whether current efforts to reform corporate governance practices around the world are successful will be seen through the eyes of investors. If the world's capital markets perform well, this will be an indication that the degradation of investor confidence in recent years has been arrested and, perhaps, reversed. International organizations will continue to play a key role in formulating governance principles that have international currency Regulators must continue to work together very closely to assure that laws and regulations passed by various countries allow for the free flow of capital into and out of the global capital markets. Finally we are likely to see a continued migration away from principles-based governance to the rules-based governance of the United States.