FIRESIDE CHAT ON CROSS-BORDER REGULATION
Tuesday, September 20, 2005

MS. GABALDON: Good afternoon, and welcome back to the 2005 series of Fireside Chats, sponsored by the Securities and Exchange Commission Historical Society. I'm Theresa Gabaldon, Professor of Law and Carville Dickinson Benson Research Professor of Law, The George Washington University Law School, and host of the chats this year.

The Securities and Exchange Commission Historical Society is a non-profit organization, separate from and independent of the SEC. The Society preserves and shares the history of the SEC and of the securities industry through its virtual museum and archive at www.sechistorical.org. Today's chat will be preserved in the museum, so you can listen to the discussion or read the transcript later.

Today's fireside chat looks at cross-border regulation, and at some of the various aspects of international securities regulation. I would like to extend a special welcome to those from outside of the United States, who are listening in to today's program and to thank those museum visitors who sent in questions for the chat, which we'll incorporate in our discussion.

Our panelists today are Louis Bevilacqua, a partner with Thelen Reid & Priest, LLP, in Washington, D.C., and Richard Booth, Professor of Law at the University of Maryland School of Law.

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Louis, Richard, welcome. I'd like to start today by acquiring just a bit of background on cross-border regulation. I'll admit that, as a starting point, even figuring out which country's laws govern a given situation seems a bit daunting.

Richard, suppose a U.S. issuer is offering securities both here and abroad. Which set of laws must it comply with?

MR. BOOTH: Well, I think as a general matter, the United States laws always apply. And I think the SEC would take the position--we could push it a little bit farther and I think in the absence of some kind of exemption, and Regulation S comes to mind, and I'm sure Lou will have to say more about that, in the absence of some kind of exemption, it doesn't even make any difference if all of the securities are going to be sold offshore. If the activities that are undertaken relate to the distribution of securities, and those activities occur in the United States, then there's United States jurisdiction and the SEC has SEC rules apply, at least in theory.

And I would add that, oddly enough, that applies even if the securities are securities of a foreign issuer, so you can cook up some pretty extreme examples where a foreign issuer is trying to sell securities to foreign investors, and simply using a United States investment bank as an underwriter, and United States securities laws would still apply.

So I think it's pretty clear that there need to be some controls on that sort of thing, and I think that's what Regulation S attempts to do, and it's fair to say, I think, that it continues to be a work in progress, even though it's I think pushing about--what--15 years old? Something like that? It was the early '90s when it was promulgated.

So I think the general answer is: always assume that United States securities law applies.

MS. GABALDON: How about the law of the other possible sovereign? Do you expect to see double coverage?

MR. BOOTH: Oh, absolutely. Double, triple, quadruple. I think that every country could take the same position that the United States takes. It's just that the United States is an 800-pound gorilla, so it's the one that one probably worries about the most.

MR. BEVILACQUA: I would agree with that. I think Section 5 of the Securities Act is very broad. Any time you use the mail to offer or sell a security, then you have the Securities Act involved. And so I think you have to really look at who the potential buyers of the securities are. And you have to focus not only on who might buy it, but also to whom offers are going to be made. And if you find that offers or sales may be made in the U.S., then you're going to have to deal with U.S. securities laws.

And I think it's also very important to look at the local jurisdictions and maybe retain local counsel in situations when you're doing an offering for a foreign issuer or a domestic issuer that's offering securities abroad, because you could end up in a situation where you comply with the U.S. laws very nicely and then you don't comply with foreign laws, and there may be rescission offers under the foreign laws or some other remedy available to the investors.

MS. GABALDON: Lou, I guess Richard opened up the basket on the cobra of Regulation S. Could you tell us a little bit about how that fits in with the overall scheme?

MR. BEVILACQUA: Sure. Regulation S is an exemption from Section 5 of the Securities Act, which requires that a registration statement be filed and a prospectus be delivered in connection with any offer or sale of securities.

Regulation S basically says that if you're selling securities to a non-U.S. person in an offshore transaction, and you're not using directed selling efforts in the U.S., then that offering would be exempt from the registration requirements of Section 5.

The security purchased by the foreign investor would be a restricted security. And there used to be only a 40-day waiting period, so that after 40 days, you used to be able to sell back in the United States.

Now, the same holding period that applies to Rule 144, the one-year holding period, also applies to Regulation 2. So a person buying that security is in effect buying a restricted security and either has to get the resale of that security registered or has to wait a year and comply with Rule 144 or some other resale exemption before they can sell in the U.S.

MR. BOOTH: I think when Regulation S was first promulgated, as you point out, the holding periods were really quite short, and I found it to be a rather remarkable development; and issuers were very quick to take advantage of it. One saw exempt offerings being made offshore with securities being parked in accounts for the minimum period of time and then resold as soon as the clock ticked past day 40. It was really a very common pattern.

And I thought it seemed predictable and it rather surprised me that the 40-day period was ever in there.

MR. BEVILACQUA: Right.

MR. BOOTH: But, as you point out, it's now one year and that's almost infinity in the world of securities transactions.

MR. BEVILACQUA: And there was always the preliminary note in Regulation S, which said, if you comply with the letter of Regulation S, but it's really some scheme to avoid the registration requirements, then you're really not complying with Regulation S, and we may be able to take enforcement action, we being the SEC, against you.

So I think a lot of people were just waiting for the 40-day period to tick and doing offshore offerings just so they could get free trading stock back in the U.S. But the one-year holding period basically puts it on par with what's going on in the U.S. if you do a Regulation D offering. So there's no benefit anymore to selling offshore.

MR. BOOTH: There are a couple of different categories of securities, though, I think that are addressed under Regulation S - the exemption can be broader or narrower depending on what you have. I think the one-year period applies generally to equity securities, where there might be some interest in the United States, and shorter periods, if I recall correctly, continue to apply to foreign debt securities, where there's not any particular active market.

But one of the things that I thought is kind of interesting about Regulation S is that the SEC seems be very vigilant about Regulation S as not being used for purposes of drumming up interest in the U.S. market.

You had mentioned before the no directed selling effort, and I think that's kind of parallel to the rules against gun jumping in domestic offerings. They really don't Regulation S to be used as a publicity stunt, as it were.

I don't know if you've run across any of those situations in your practice.

MR. BEVILACQUA: Not really. I think that the key is you're always subject to the anti-fraud requirements, whether you're making statements in the U.S. or abroad, and so you might be issuing a press release abroad than if you're pumping up a company and it' s unfounded.

The SEC may be able to take enforcement against you, but I haven't come across any exact situations like that.

MS. GABALDON: In this day and age of easy Internet access, et cetera, isn't it somewhat artificial to say that you're not making any directed sales effort in the United States when it's certainly something the United States can get all the information about this particular offering? Is it just the fact that the securities can't be sold to a U.S. citizen?

MR. BEVILACQUA: I think you have to look at who the website is directed to, and there might be controls that you can put on the website to block certain people from accessing it. So I think there are ways that you can control who gets the information and who you're directing that information to.

MR. BOOTH: It’s very difficult to control the flow of information, that’s for sure. But there are additional safeguards I think that can be imposed that can help to insulate the issuer from any kind of charge of bad faith. And what I'm thinking about here are limitations on transfer and instructions that might be given to transfer agents, people who perform those kinds of functions. Plus soliciting a letter of investment intent from the people who are buying the securities and that sort of thing. And I think that the issuers can build a paper trail that looks pretty serious if they sort of think about how people might try to get around the regulation.

I must say that one of the things that I've run across is that sometimes the transfer agents can be a little bit too vigilant. I recall one case that actually ended up in the Fourth Circuit of an investor--this was back in the days when the 40-day limit was still imposed--an investor who had attempted to sell his Regulation S securities back into the U.S. market at a time when it should have been legal to do. It was stopped from doing it by the transfer agent, and, of course, as you might suspect, during the interim, the price of the securities fell.

MS. GABALDON: Of course.

MR. BOOTH: And the guy lost pretty much everything that he thought he had when he started selling the stock and there were all sorts of allegations flowing back and forth about the transfer agent being in cahoots with the company in trying to keep the securities from trading so as to prop up the market in the United States. It all got very ugly very quickly.

I think the point is that there is some dangers for investors in these kinds of situations, too. There are some additional risks that are created by the regulatory scheme that really make this a buyer beware kind of area. Unless you're ready to take some additional risk, you don't want to be a U.S. investor trying to get into this kind of market.

MS. GABALDON: We've been speaking thus far on the basis of a U.S. issuer selling abroad, and I'd like to turn it around now and talk about when foreign issuers must comply with United States laws, and specifically the general U.S. requirements for foreign issuers. Lou, are the registration requirements for foreign issuers basically the same as for domestic issuers?

MR. BEVILACQUA: Well, there a little bit different in terms of both the Securities Act and the Exchange Act registration statements that they file. I mean generally the disclosure is very similar. In terms of the ongoing reporting requirements, the foreign private issuers are required to file a Form 20-F, which is the equivalent of a Form 10-K. It basically has all of the disclosure that you typically find in a Form 10-K and they're required to file that within six months of the end of their fiscal year.

And they're also required to file a Form 6-K upon certain events, including when they make information public under their home country rules, when they voluntarily disseminate information to their stockholders, and when they are required to file something with their local stock exchange.

And then there are also sort of optional times when they should file a Form 6-K upon certain material events, and we're talking here about acquisitions or dispositions of assets, changes in their certifying accountants, any material legal proceedings, defaults on their senior securities, the results of any matter that they have submitted to a vote of security holders, et cetera. And really they should think about filing a 6-K and providing that sort of information any time that they've taken some kind of action that might affect the U.S. market and their securities.

MS. GABALDON: How about the exceptions for registration? Richard, do those work the same for foreign issuers?

MR. BOOTH: Well, my impression is that the registration scheme is pretty much parallel for all.

I suspect that most foreign securities make their way into the United States as traded securities rather than as securities that are offered pursuant to registered offerings in this country.

We haven't talked yet here about ADRs and that, so I don't know if it's on your list of topics to discuss, but I think that more foreign issuers who find themselves subject to United States securities laws end up being in that position as a result of seeking to have existing outstanding securities traded on a U.S. market or conceivably over the counter.

And the rules relating to registration of publicly held securities, that is, company registration as opposed to registration of offerings, are somewhat controversial at this point. The SEC rules essentially require a company that has 500 shareholders worldwide and 300 or more in the United States to register as a publicly traded company for purposes of continuous reporting. And that applies also in connection with ADRs. It's not simply something that applies to a company that, for instance, seeks a listing on a United States exchange. I mean if they do seek a listing on a United States exchange, then they are subject to registration like any domestic issuer would be.

But one of the issues that I think is currently being debated is whether or not those rules are perhaps a bit too strict from the point of view of foreign issuers, and I think the EU has taken the position that some rather higher number of issuers--or some rather higher number of U.S. shareholders ought to be the trigger for continuous reporting purposes. But the number they've picked, which is something like 3,000, I think is sort of off the charts compared to what we think makes a company a publicly traded company.

MS. GABALDON: Before we move on, I would hasten not to just leave those alphabet letters laying on the table, what's an ADR?

MR. BOOTH: ADR is an American Depository Receipt. And actually, the ADR is the thing that forms the holding of foreign shares. Typically, a foreign company would put some number of shares into something like a trust to be held by a bank, which would, in turn, issue ADS's, American Depository Shares, for purposes of trading on the United States market.

Most of the time, when U.S. investors buy shares in foreign companies, they're buying really interests in a trust fund that has been set up that holds those shares whether it's onshore or offshore. It can be anywhere.

So you're not really trading the shares themselves, which means, of course, that the things like voting rights don't necessarily go with the shares. So the nature of the investment is subtlety different from what shares themselves would be. But the SEC has taken the position thatno matter how you slice it, these interests in trusts are the same as securities. I mean, they're securities that have to be registered just as if you were buying the shares directly. And I'm sure that there are people out there who spend entire careers doing issues relating to ADRs and so forth. But that's essentially what my short course in ADRs.

MR. BEVILACQUA: I agree that probably most of the securities traded foreign issuers are going to be ADRs.

Another way, though, that you're seeing lately, is a lot of companies going public, in particular I do some work in China, companies in China that are private companies are being acquired by public companies in the U.S. that really don't have any other assets, sort of like a U.S. shell company. And they're doing this sort of reverse merger transactions with U.S. shell companies because a lot of times, they can't find an underwriter who's willing to underwrite them because the underwriters are looking for commissions on big deals. So instead, they'll do a reverse merger, and they'll couple it with a PIPE transaction, which is a Private Investment and Public Equity.

So they'll do a private placement. At the same time, they reverse merge into a public shell company. So they'll automatically become a public company, and they'll get a smaller amount of financing, maybe $10 million or $15 million instead of $100 million. And so then, they're in sort of a unique situation because they're really a U.S. issuer. But all their operations might be in China or some other foreign country. So they sort of have different issues than a lot of the foreign private issuers, and they may not even qualify under the definition of foreign private issuer.

MS. GABALDON: Very interesting.

MR. BOOTH: Actually, quite a number of U.S. companies have used the same method when -- I hesitate to say it--but frankly, when they're too cheap to do a registration statement on an S-1, like the sort of going public through the front door. One way of going public is by reverse merging into a shell company that's been sitting around and publicly traded for a long time.

MR. BEVILACQUA: The SEC has traditionally frowned upon these type of either backdoor registrations or reverse mergers, and just recently they've actually implemented new rules that sort of legitimize the process. I think what they've seen is that a lot of smaller companies want to get equity capital through the public markets, and they're having an impossible time finding underwriters to underwrite them for smaller offerings, and so they do the reverse merger, coupled with the PIPE, and so it used to be the case that once the reverse merger was affected, you'd have 75 days from the closing before which you had to file the audited financials for the target company that went into the shell.

And so what the SEC didn't like is that people were doing what's called a pump and dump scheme, where they would put out these press releases about the target company that just merged in, how great it is, and the price of the stock would start to increase, and then they'd dump all their stock and then the financials would be filed so the real information is out there, and then the stock price tanks.

And the other problem you had is that the sort of annual report type information, the full disclosure about the target company, would not have to be filed until the next 10-K, which may be some time off into the future.

So the SEC basically closed the loophole on that, and now they're requiring within four days that the 8-K be filed containing both the audited financials for the target company and all the Form 10-type Exchange Act registration type disclosure. So basically, now four days after the reverse merger, you have all this disclosure and all the audited financials.

So they've really I think done a lot, and you're seeing a lot more of these deals. And I think a lot of the foreign issuers like to use these types of structures to go public because --number one, it's faster; and number two, it doesn't involve the underwriter, which, you may or may not have a successful offering depending on how marketable the company is.

If you could line up an investor willing to invest $10 million and they commit to it, then you know you're going to have a successful reverse merger. But there are other problems with that that we don't need to go into

MS. GABALDON: Do you think the American public is losing anything in terms of protection?

MR. BEVILACQUA: I think with this change in the rules, they're not really losing anything, because now all the disclosure is out there-- it's only a four-day period. I think what most people are doing is filing the 8-K the same day they close the deal or the day after, so you're really not missing anything anymore. But what's happening is that these are public companies that have been around for maybe years and so there could be hidden liabilities out there that have never really arisen because there's no money in the company. Now, you put valuable company in there and people are going to start coming out of the woodwork, and you got to wonder whether there are hidden liabilities, so due diligence is key in that process.

MR. BOOTH: I think this market has been tightened up significantly also within the last five years by a requirement that extends the registration requirements for continuous reporting purposes essentially to all companies that are traded on NASDAQ or certainly the New York Stock Exchange. It used to be that there were a fair number of companies that could be traded in a reasonably efficient market on the NASDAQ bulletin board, but the SEC kind of clamped down on that even before Sarbanes-Oxley actually, and essentially said if you're going to be traded in a market in which there is continuous quotation of prices, you have to be registered under the Exchange Act.

I think was that a lot of the shell companies that had virtually no operations left in--no operations at all, which were very attractive for purposes of doing these reverse mergers, would be kept alive, on artificial respiration as it were, just as a potential vehicle for doing this sort of thing and without really much of any other existence.

But when the opportunities to trade on NASDAQ were limited by the registration requirement, I suspect that the population of these companies dropped rather significantly and now really only companies with some operations that are probably in compliance are available to do this kind of transaction.

MR. BEVILACQUA: What happened is that you created a whole new market in the Pink Sheets. There's this other quotation system called the Pink Sheet, it's run by a private company, that you don't have to be an Exchange Act reporting company. You have a market-maker file, what's called a Form 211, which basically includes some information about the company with the NASD, and you go through a review process with the NASD, and then the company can be listed on the Pink Sheets and the market makers can quote stock in it. And so you have shells that are on the Pink Sheets, and you have shells that are on the bulletin board, and the bulletin board ones are obviously more valuable because it's a better market to be in the bulletin board than the Pink Sheets. But the prices of these shells have gone up dramatically. It's incredible.

MS. GABALDON: There's a market for everything.

MR. BEVILACQUA: That's right.

MS. GABALDON: I was just waiting for somebody to say Sarbanes-Oxley or Regulation FD to launch in a slightly different direction. You've both indicated that as far as registration and regular reporting are concerned, the systems applying to foreign and domestic issuers are basically parallel. How about other types of U.S. securities regulations, for instance, Regulation FD, for instance, the requirements of Sarbanes-Oxley? Richard?

MR. BOOTH: Well, Sarbanes-Oxley has been a sore point I think with many of the EU issuers in particular. The issues arise on really many different levels, but I think two of the serious difficulties have had to do with certification of financial reports and the verification of internal reporting methods for purposes of assuring that financial statements accurately reflect what's going on.

I think the EU has generally seen these requirements as excessive. I suspect that their initial reaction was based on the fact that Enron happened here, and it didn't happen there. But in the meantime, Parmalat has happened there, and it didn't happen here, and in many respects is perhaps an even more egregious fraud than the whole Enron or WorldCom episode in this country.

I know that there was at least one company that declined to be traded on the New York Stock Exchange. Porsche just said we just don't need it. The expenses of complying with United States reporting requirements, post Sarbanes-Oxley, are just too much for us, and we don't think that that's really necessary.

There's a side to this that I think is kind of interesting and probably hasn't been widely explored at this point. But I think there's a tendency in the United States to focus on equity securities, and to draft and think about rules and regulations in terms of the interests of equity security holders.

Whereas, the European mentality, at least on the continent, not necessarily in the U.K. I don't think, but the Europeans tend to view the long-term creditors as kind of top dog when it comes to issues of corporate governance. There's always a lot of looking over your shoulder and making sure that the creditors are satisfied, and their rights are really much more significant than creditors rights are thought to be in this country.

So I think that one of the disconnects that might be going on here actually is that our rules seek to protect shareholders; whereas, the Europeans think that shareholders are sort of cowboys taking excessive risks anyway, and maybe they don't need the kinds of protections that we have sought to ensure for them through evermore beefed up rules like Sarbanes-Oxley.

But I pulled some statistics in the last couple of days that I thought were really kind of interesting, and that is that United States holdings of foreign securities are about seven to one in favor of stocks as opposed to bonds. There are roughly $2 trillion worth of foreign stocks held by United States investors. Whereas, there's only about $300 billion worth of foreign bonds held here. And the pattern is exactly the opposite on the continent, or at least in the rest of the world. I haven't really broken it down between the U.K. and the EU, and Japan or anything like that.

But corporate bonds are really much more popular with foreigners than they are with people in the United States. And the rest of the world holds about $1.9 trillion in corporate bonds and only about $1.5 trillion in corporate stocks.

So I think that there may be some regulating at cross-purposes going on here. We think that a different constituency perhaps ought to be the primary beneficiary of these beefed up rules, and the Europeans I think are probably under the impression that the creditors are the ones that are kind of watching the hen house, as it were, and the ones that actually have the tools necessary to do that, so they find our Sarbanes-Oxley kinds of innovations to be a little bit of overkill.

I don't know. That's something that I may well write an article about one of these days, but it's a rough cut at what might be going here.

MR. BEVILACQUA: Basically, Sarbanes-Oxley applies to foreign private issuers. They got a little bit of a break on the Section 404 timing. Their management report on internal controls and the auditors' attestation of that report doesn't have to be filed until the first fiscal year of the company, of the issuer following July 15th, 2006. So for year-end issuers, it will be December 31, '06.

And they'd better get a head start on that because I think it's going to be very difficult for a lot of the foreign private issuers, especially if they have operations in a lot of different countries to get their internal controls in order and ready for an outside auditor to attest to them.

But they're basically subject to the same auditor independence rules, which are sometimes problematic for a lot of companies, but I would imagine in particular for foreign private issuers. One of the auditor independence rules involves pre-approval of the services that are provided to the company by the auditor, a pre-approval by the Audit Committee.

And so what you see with a lot of foreign companies is they have a lot of subsidiaries all over the place, and some of them are maybe not majority-owned. Maybe they're consolidated or maybe they're not consolidated, but in a lot of those cases the services provided by the auditors still have to be approved by the Audit Committee. So you have situations where you may not exactly know on a day-to-day basis what's going on at that subsidiary; yet if the auditor is providing services in order to preserve the auditor's independence, it has to be approved by the Audit Committee.

But they have to make the same CFO and CEO certifications that U.S. issuers make. They're subject to the same enhanced disclosure requirements that came out of Sarbanes-Oxley relating to off-balance sheet disclosures and material contractual commitments and obligations. So it's basically the same regime that's being imposed upon them.

MS. GABALDON: And practically, what are foreign issuers doing about compliance? Richard mentioned an instance in which one simply declined to play ball. Are foreign issuers lobbying for exemptions, lobbying for change, or are they more or less meekly falling into line?

MR. BEVILACQUA: I think there's a lot of chatter by foreign private issuers and their lobbyists trying to change the rules. I'm not sure how that's going to come out. The SEC is talking about a further extension for small business issuers on the timing of compliance for 404 compliance, internal control compliance, so maybe the foreign issuers will get the same extension, but I think the SEC's position on this is that they're going to subject the foreign private issuers to the same sort of Sarbanes-Oxley regime as domestic issuers are subject to.

MR. BOOTH: I think the SEC's initial inclination is always we can fit every peg into this shaped hole. I think really there's some serious cultural differences between the EU practices and U.S. practices. Going back a few years prior to the listing of Daimler-Benz on the New York Stock Exchange, there was a big debate about whether or not all companies should not be required to make their financial statements according to the United States GAAP, that is generally accepted accounting principles, and I think that there was just an assumption on the part of U.S. regulators that we had the best accounting system in the world and that everybody should be willing to comply with that if they wanted to be traded in the United States market.

To its credit, I think the SEC has loosened up significantly since that time. I suspect that they realized that other markets were becoming serious competitors to the United States market and that to keep significant companies like Daimler-Benz or other large foreign companies from being traded in the United States on the basis of these kinds of restrictions was really kind of shooting yourself in the foot.

So one of the things that companies are able to do--now this really isn't a matter of Sarbanes-Oxley--but rather is a general matter in terms of reporting for SEC purposes, they're permitted to either restate their financial reports in United States terms; that is, according to generally accepted accounting--U.S. generally accepted accounting principles, or explain the difference between whatever system it is that they follow and how the numbers would have been different in particular categories if United States GAAP had been followed.

And I think that's a pretty good compromise. I mean if a company wants to have its shares traded in foreign markets, they ought to be at least willing to go that far and find out what the rules in the foreign jurisdiction are. I mean, after all, when in Rome, do as the Romans do, right? When in New York, do as New Yorkers do.

But there are still I think some lurking issues that will probably play out in multiple ways. For instance, the accounting principles in the EU are general principles based, and I think there's a widely held belief that the United States focus on rules-based accounting as opposed to principles-based accounting is at least in part responsible for the kinds of frauds that we saw at places like Enron and WorldCom. Some people on this side of the pond have also argued that maybe we should be moving more towards principles-based accounting.

But I think that in each individual area, we're seeing lots of convergence in terms of the way things get reported. We have independently in the EU, and the U.S. come to the roughly the same conclusion relating to accounting for executive compensation and those sorts of things. It's been a big issue here, perhaps not such a big issue there. But we kind of came to the same solution anyway.

One issue that's been discussed a little bit is that in many other countries, audit committees tend to include representatives of other constituencies. Whereas, under the

Sarbanes-Oxley Act, it's pretty explicit that the audit committee has to be composed of directors and not only that, directors who are independent and directors who, at least some of them, have particular expertise in the area of finance.

Other countries, and Germany always comes to mind here, I mean they have boards of directors that include all sorts of other constituents and to push that a little bit farther, apparently audit committees that also include non-directors, who have played a very significant role in corporate governance and in other countries. So I think those are some issues that still need to be ironed out.

One issue that I haven't really seen a whole lot said about has to do with the fact that accounting firms in foreign countries tend to be combined with law firms. It strikes me as rather difficult for a law firm to be independent in the same way that we insist that accounting firms be independent here. The United States model is that lawyers are zealous representatives who take your side, and that auditors are a very different kind of animal. And things that will be tolerated among lawyers won't be tolerated among accountants here. So what do you do when you're operating in a jurisdiction where the two are contained in the same firm? I don't know what the answers to those things are.

MR. BEVILACQUA: I guess if it's a foreign private issuer, and they're an Exchange Act reporting company, the auditor is going to have to be a PCAOB registered firm, and my guess is the PCAOB is not going to allow that sort of combined situation with regard to a reporting issuer.

I think Richard made a couple of really good points, a couple I want to follow up on. One is on the international accounting standards. In addition, I guess what the requirements of the Exchange Act are is that the financials be done pursuant to a comprehensive body of accounting standards. I can't find a definition of what that means. So if your home country has a comprehensive body of accounting standards, then you can use your home country GAAP, and then you have to provide a reconciliation to U.S. GAAP.

But what you're seeing is an international standard developing. There's the International Accounting Standards Board, the IASB, which is based in the U.K., and they've come up with the IFRS, which is the International Financial Reporting Standards, and so I think these are reporting standards that are similar to GAAP, but not exactly like U.S. GAAP, and I think these are developing and I think a lot of the foreign private issuers are using IFRS instead of either U.S. GAAP or their home country GAAP, because it gives them financial statements that people can recognize both in the EU and in the U.S. and sort of know what they are and understand them.

Then the other point that I thought was really interesting that Richard made was about how there's a potential conflict between the laws of the foreign country and the U.S. Sarbanes-Oxley or other securities laws, and Germany does come to mind. They have a dual board system there where representatives of labor are required to be on the board of directors or the audit committee. And here in the U.S., under Sarbanes-Oxley, if you're a listed company, then your audit committee has to consist entirely of independent directors, so you can't have any employees, which would screw up the independence.

And I think these are really tough issues that the SEC has had to deal with. I think there may be an exception for that particular case, but there are lots of other examples here. There are foreign laws that conflict with either Sarbanes-Oxley or other securities laws that the SEC and other market participants are dealing with all the time.

MS. GABALDON: That's very interesting, and it suggests a possibly different slant that was taken by one of our listeners, who wrote in with this question. This is a question from David C. Donald: "The type of disclosures regarding securities issues, as originally set forth in the Securities Act of 1933, have become nearly universal in all developed markets, at least with respect to markets such as the European Union, which imposes disclosure requirements that are almost identical to those found in the United States. Shouldn't we be at least discussing the possibility of mutual recognition and home state regulation rather than trying to draw uncertain boundaries of impact with tools such as Regulation S? Given that U.S. issuers tend to use equity financing more than those in most other countries, we would have the most to gain from such mutual recognition." Would you agree or disagree?

MR. BEVILACQUA: Well, I don't know if we're ever going to really accept the disclosure standards and financial standards, et cetera, of foreign countries. I think what might happen is a move toward sort of an international standard like you're seeing with the international accounting rules, the IFRS.

So what hopefully might happen is as our disclosure rules develop and other countries either sort of catch up or develop on similar lines, we'll start to develop some kind of international standard that can be applied.

MR. BOOTH: There are a couple of different trends I think that are going on this area. One place where we might look for experience and a model of cooperation has to do with the system that we've developed between the United States and Canada, the multi-jurisdictional disclosure system, or I think that's roughly what it's called.

Between the United States and Canada, both for purposes of regular old public offerings under S-1 as well as explicitly the exempt offerings under Regulation A, the two countries are treated pretty much as one country at this point.

With respect to most of the rest of the world, at least in the enforcement area, we've been operating bilaterally and attempting to come up with memoranda of understanding for purposes of seeking information in connection with enforcement proceedings and so forth. I think a little bit more effort to come up with a combined regulatory scheme might be worth investigating.

But, with so many countries in the world at different stages of development, the national interests of individual countries in terms of keeping development at home and not seeing businesses travel offshore or seeing the fruits of those businesses being appropriated by foreign nationals, I think there's a rather significant resistance. And I'm thinking here primarily about some recent developments in the People's Republic of China that have really clamped down on venture capital investments. They've made it extremely difficult for people to invest--I know it's easy enough to invest. It's just impossible to get your money back out. That's the only problem. They're perfectly happy to have you invest.

I think national interests can easily get in the way here. And I'm not entirely sure what we're going to end up doing about that. I suspect the United States ought to attempt to be as much of a leader as it can be in terms of uniform standards. But the obstacles are significant.

MS. GABALDON: I don't think we've really addressed squarely the issue of regulatory competition. Do you think that there is a great deal of competition amongst the various regulators of different states trying to devise either the best set of disclosure rules to make its markets more attractive or perhaps the most relaxed to attract issuers? Lou?

MR. BEVILACQUA: I don't know if it's competition, but I think they're sort of each going about their own job developing their own laws suited for their own investors and other market participants in their market that may not necessarily be suited for the U.S. markets.

And I think there are different cultural things that come into play that may make rules in one market more appropriate, and not appropriate in another market. So I don't know that they're sort of competing thinking that if we develop the best securities laws, that we'll get more investors than someone else will. Maybe they are.

MR. BOOTH: I certainly haven't noticed any particular race in laxity, which is what we always talk about in the area of corporate governance, at least the old saw was that Delaware was trying to be as management friendly as it could possibly be so as to attract and keep companies incorporated there. That position has been largely debunked by more rigorous studies that indicate that Delaware is, in fact, a place that treats investors pretty well. And that's what's probably going on is that they're seeking to devise continually revise the best corporation law possible. And oddly enough, I think that's what's going on also in connection with securities regulation.

I do not see, for instance, the rather significant reforms that are being talked about, both in terms of securities regulation and corporate governance in the EU--if anything, seem to be trying to set a higher standard than maybe is even set in the United States. So there's some things that the EU I think would find far too lax in the United States system. I'm thinking here primarily about corporate governance, but the EU seems to be talking seriously about something that would amount to a return to the old par value system among companies that are incorporated there, in an effort to make sure that companies remain, or that they start out remain, adequately capitalized. I think we don't have much faith in that system in this country. But there's a serious move afoot in the EU to beef up those requirements, which is perhaps again a reflection of the more of the creditor orientation there.

But I must say that on balance what I see here is the entire world seems to be really taking securities regulation and corporate governance rather seriously. And regulation is, if anything, increasing and becoming tighter.

MS. GABALDON: Good news for lawyers.

MR. BOOTH: Yes.

MS. GABALDON: Lou, you mentioned earlier the aspect of cultural differences. I read a very interesting paper recently saying that there had been quite a trend in trying to analyze securities markets in terms of whether was a country was civil law or common law, and associating I think relatively more prosperous securities markets with common law tradition. Do you have an insight on that particular issue?

MR. BEVILACQUA: Well, not necessarily on that particular issue, but I do think culture is a big factor in how the laws of any particular jurisdiction are structured. And I think there are good examples that have come out in connection with Sarbanes-Oxley as to how culture can affect securities laws.

For example, in the U.S. we have, under the Sarbanes-Oxley, whistle blower protections, where employees can call up a hotline and report on other employees who are violating, federal securities law, for example, or employment laws.

And in places like Germany and France, they have tougher or broader privacy rules for employees. And so you had a situation with Wal-Mart, for example, in Germany, where Wal-Mart put together a whistle blower hotline and basically the labor representatives sued Wal-Mart saying that the policies under the whistle blower hotline violate German law.

And you had a situation in France, where a division of Exide Technologies did something similar and the French Data Protection Authority tried to prohibit that.

Other examples are in connection with collecting data in order to prepare for your internal control attestation by your auditors or their review of your internal controls for their attestation.

You need to get some information from employees, and there's the Data Protection Act in the EU that requires that you get employees consent before you can start to solicit certain types of information. So that's in conflict with the laws under Sarbanes-Oxley.

MR. BOOTH: Pre-Sarbanes-Oxley, there were worries about the opportunities for international enforcement. The United States securities laws is extremely broad in terms of the ability of both U.S. investors to sue companies that are operating largely overseas, maybe are merely traded in the United States, but otherwise have no operations here. So the United States courts have, at least in theory, virtually worldwide jurisdiction over pretty much any fraud that touches the United States or a United States investor.

By the same token, foreigners have in theory more or less unlimited access to United States courts for frauds that have either some level of conduct that has occurred in the United States. I think there's still a lot to be worked out about where we resolve these disputes. I mean rules are one thing. Litigation is probably another.

I think much of the world has probably attempted to use United States courts in connection with securities fraud. I suspect our securities fraud laws are much more highly developed, at least with respect to private litigation, than they are in many other countries. And maybe that's something that can be traced back to our sort of case and rules-based culture as opposed to the more principles-based standards. It's kind of a parallel to the thing we have going on in the accounting area.

But I think there's still a lot of work to be done in this connection. I don't think that we really yet know--and we probably never will know--where the action in securities regulation will be centered. It probably will have multiple centers.

MS. GABALDON: Do you think that there might be any cultural differences with respect to the definition of fraudulent conduct itself? That is, do different practices strike different constituencies in different ways? Lou?

MR. BEVILACQUA: I think when you get down into what exactly fraud is under a particular law and you get into the details of it, you're going to find differences. But I think fraud is pretty much fraud, and you can smell it--and you can see it--and you know it when you see it.

So I would suspect the laws of every jurisdiction would ban fraud, and so I think that's going to cover most fraudulent activities and I think that the gray area would be kind of small. But I haven't studied this issue.

MR. BOOTH: Most of the world didn't see much of anything wrong with insider trading until about the early 1990s. The United States was really quite aggressive in going after insider trading and we, in a sense, dragged the rest of the world along. And eventually, I think most other jurisdictions became convinced that there was a problem with it. And there have been some interesting studies that indicate that it's not just the law, but it's the actions of the enforcement agency that really make a difference in this connection. So I think there have been examples of what you described, and they're probably likely to come up again in the future.

MS. GABALDON: Well, I'd like to thank you both for the excellent discussion today. I emerge much enlightened.

I'd like to remind the audience that this Fireside Chat is now archived by tape in the Society's virtual museum. The transcript of the chat will be ready soon.

Our last Fireside Chat for 2005 will be broadcast on Tuesday, November 1st, at 3:00 p.m., Eastern Standard Time. Our focus will be on professional responsibility, and our panelists will be Barry Melancon of the American Institute of Certified Public

Accountants and Professor Thomas Morgan of the George Washington University Law School.

Please join us again on November 1st. Thank you for being with us today.