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EXPORTING U.S. CORPORATE GOVERNANCE STANDARDS THROUGH THE SARBANES-OXLEY ACT: UNILATERALISM OR COOPERATION?

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INTRODUCTION

The United States's assertion of prescriptive (or legislative)[1] extraterritorial jurisdiction has been the subject of ample criticism.[2] Extraterritorial jurisdiction, or simply extraterritoriality, is defined as the operation of a U.S. law so as to encompass activities where (1) the conduct at issue occurs within the U.S., but its effects take place abroad; (2) the conduct occurs abroad, but its effects take place in the U.S.; or (3) both the conduct and its effects occur abroad.[3] Category (1) does not attract criticism as the occurrence of conduct within the U.S. is an internationally acceptable basis for U.S. jurisdiction.[4]

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1. Three types of jurisdiction are recognized in conflict of laws: jurisdiction to prescribe law (legislative or prescriptive jurisdiction), jurisdiction to adjudicate (adjudicative jurisdiction), and jurisdiction to enforce judgments (enforcement jurisdiction). *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES pt. IV, introductory note, at 231 (1987) [hereinafter RESTATEMENT].

2. *See, e.g.*, Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L L. & BUS. 207 (1996); Michael Wallace Gordon, *United States Extraterritorial Subject Matter Jurisdiction in Securities Fraud Litigation*, 10 FLA. J. INT'L L. 487, 510–38 (1996); Note, *Extraterritorial Application of the Export Administration Act of 1979 Under International and American Law*, 81 MICH. L. REV. 1308, 1320 (1983).

3. Andreas Lowenfeld, *International Litigation and the Quest for Reasonableness*, 245 RECUEIL DES COURS 9, 43 (1994-I). This Note deals mainly with assertions of jurisdiction that fall under part (2) or (3) of the above definition.

4. *See infra* note 125 and accompanying text. Moreover, such extraterritoriality is rarely used. U.S. courts and enforcement agencies tend to be reluctant to use taxpayer money to punish conduct that only harms foreigners, as this fails to increase the agency's institutional or political capital. Judge Bork doubted "that an American court should ever assert jurisdiction over domestic conduct that causes loss to foreign investors." Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 32 (D.C. Cir. 1987); s*ee also id*. ("Congress was concerned with extraterritorial

Category (2) also includes an acceptable basis for jurisdiction, provided that the effects of foreign conduct felt in the U.S. are substantial.[5] However, when the foreign conduct that harms U.S. citizens is noncriminal or even encouraged in the foreign country, assertion of U.S. jurisdiction is controversial.[6] It is also problematic to have Congress, which is unaccountable to foreign persons,[7] regulate politically sensitive foreign conduct.[8] Also controversial—yet less

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transactions only if they were part of a plan to harm American investors or markets."); William S. Dodge, *Understanding the Presumption Against Extraterritoriality*, 16 BERKELEY J. INT'L L. 85, 90 (1998) ("[A]cts of Congress should presumptively apply only to conduct that causes *effects* within the United States regardless of where that conduct occurs."). Other commentators, such as Professor Brilmayer, embrace a diametrically opposed view suggesting that in certain cases, conflicts can be most easily resolved if the country where the conduct occurs were the country of unique jurisdiction, while also recognizing that this approach will not work in all contexts. *See, e.g.*, Lea Brilmayer, *Interstate Preemption: The Right to Travel, the Right to Life, and the Right to Die*, 91 MICH. L. REV. 873, 876, 886 (1993) (explaining that in conflicts of law in the abortion law context, "if we are to eliminate concurrent jurisdiction by singling out a unique, constitutionally adequate connecting factor," then territoriality—or the place where the conduct occurs—should trump residence). The conduct approach favors a single, unique jurisdiction because effects tend to occur in multiple countries while significant conduct usually occurs only in one country.

Securities fraud cases have regularly applied the conduct test where substantial acts in furtherance of the fraud occurred in the U.S., "on the theory that Congress did not want 'to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.'" Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983) (quoting IIT v. Vencap, Ltd., 519 F.2d 1001, 1017 (2d Cir. 1975)).

5. *See infra* notes 125–126.

6. For a discussion of the "full-blooded conflicts" on this issue with foreign countries, see Edward T. Swaine, *The Local Law of Global Antitrust*, 43 WM. & MARY L. REV. 627, 643–46 (2001).

7. *See* Mark P. Gibney, *The Extraterritorial Application of U.S. Law: The Perversion of Democratic Governance, the Reversal of Institutional Roles, and the Imperative of Establishing Normative Principles*, 19 B.C. INT'L & COMP. L. REV. 297, 320 (1996) ("Extraterritoriality is an anathema to the . . . democratic system because those who make and enforce the law (us) are not accountable to [foreign] individuals . . . [who are] bound by it . . . .").

8. Unaccountability is potentially one of the main reasons why such broad assertions of jurisdiction to prescribe exist in the first place. Unlike the Office of the President, the Securities and Exchange Commission (SEC), or the New York Stock Exchange (NYSE), Congress does not have to deal in an iterated manner with international law or foreign grievances. As one commentator has remarked, "[i]f the NYSE and the SEC have assiduously avoided imposing governance requirements on foreign issuers, Congress has just done precisely the opposite and imposed sweeping governance reforms on both foreign and domestic issuers that are listed on U.S. markets." John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1825 (2002). Thus it seems that Congress, which has the least contact with foreign firms of all these bodies, is the one body that, lacking any accountability control mechanism, is able to impose objectionable regulations upon foreign firms.

However, this democratic deficit should equally be linked to judicial activism, since courts are the ones who interpret whether Congress intended that American law reach certain foreign

legally interesting—is the assertion of jurisdiction under category (3), as it is unsupported by a legitimate legal claim; by definition, it lacks the required jurisdictional nexus of either conduct or effects within the country claiming jurisdiction.[9]

Therefore, the category that is both controversial and legally interesting is category (2), which refers to assertion of jurisdiction when conduct that occurs abroad has effects within the U.S. Within this category, the extraterritorial reach of U.S. securities laws has provoked less criticism than the reach of U.S. antitrust law,[10] arguably because securities laws target fraudulent conduct that most countries find offensive, while attitudes toward antitrust law vary widely by country.[11] Nonetheless, nontrivial criticism has been expressed about the extraterritorial reach of U.S. securities laws in relation to issues such as insider trading[12] and, more recently, corporate governance,[13] suggesting that cultural attitudes toward the behavior targeted by these laws also vary widely across the globe.

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conduct or effects. Commentators debate the existence of such intent in certain areas such as securities law. *See infra* note 122; *see also* Lea Brilmayer, *The Extraterritorial Application of American Law: A Methodological and Constitutional Appraisal*, 50 LAW & CONTEMP. PROBS. 11, 14 (Summer 1987) ("The most important consideration governing the extraterritorial application of American law is hybrid legislative/judicial construct . . . . At the same time, these presumptions . . . acquire the status of legislation . . . . Presumptions of legislative intent are something of a Frankenstein monster: Easy to create, but hard to control.").

9. Under both U.S. and international law, in the absence of conduct in the U.S., jurisdiction may only be exercised if substantial harmful effects are felt within the U.S. *See, e.g.*, RESTATEMENT, *supra* note 1, § 402.

10. *See, e.g.*, F.A. Mann, *The Doctrine of Jurisdiction in International Law*, 111 RECUEIL DES COURS 9, 102–06 (1964) (suggesting that the leading case applying U.S. antitrust law extraterritorially, *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945) (*ALCOA*), conflicts with international law); *id.* at 102 n.206 (citing critics of *ALCOA*'s objective effects doctrine while noting the impossibility to cite them all because of their sheer number).

11. JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 1235–36 (3d ed. 2001).

12. *See, e.g.*, James A. Kehoe, Note, *Exporting Insider Trading Laws: The Enforcement of U.S. Insider Trading Laws Internationally*, 9 EMORY INT'L L. REV. 345 (1995) (describing criticism of the extraterritorial reach of U.S. insider trading laws).

13. The criticism was especially directed toward the Public Company Accounting Reform and Investor Protection Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in 15 U.S.C.A. §§ 7201–7266 and scattered sections of 11, 18, 28 and 29 U.S.C.A. (West Supp. 2003)), also known as the Sarbanes-Oxley Act of 2002. See *infra* Part I for a brief discussion of the Act; also see *infra* note 33 and accompanying text for a discussion of the Act's criticism.

This Note addresses the recent criticism of the "exportation"[14] of U.S. corporate governance norms under the Sarbanes-Oxley Act[15] (the Act), focusing on the application of (1) the audit committee requirement to foreign issuers from European countries with codetermination laws,[16] and (2) the prohibition of loans to executives with respect to German issuers.[17] In response to such criticism, the Securities and Exchange Commission (SEC) has already granted foreign issuers[18] some limited exemptions from the Act, including an exemption dealing with the audit committee independence requirement,[19] motivated, among other things, by the desire to reattract foreign companies that canceled listings in the U.S. in response to the Act.[20] This Note provides additional legal and economic justifications favoring the exemption of foreign companies from the audit committee and loan prohibition requirements.

Part I of this Note frames the discussion by briefly describing the Sarbanes-Oxley Act and the problems that these two requirements create for foreign issuers. Part II examines legal justifications for

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14. Justice Brennan's dissenting opinion in *United States v. Verdugo-Urquidez*, 494 U.S. 259 (1990), also employs the exportation terminology in describing the problem of extraterritoriality: "The enormous expansion of federal criminal jurisdiction outside our Nation's boundaries has led one commentator to suggest that our country's three largest exports are now 'rock music, blue jeans, and United States law.'" *Id.* at 280–81 (quoting V. Rock Grundman, *The New Imperialism: The Extraterritorial Application of United States Law*, 14 INT'L LAW. 257, 257 (1980)) (citations omitted).

15. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in 15 U.S.C.A. §§ 7201–7266 and scattered sections of 11, 18, 28 and 29 U.S.C.A. (West Supp. 2003).

16. Codetermination refers to the requirement that supervisory boards of companies of a certain size must have an equal number of representatives of shareholders and labor. *See* Thomas J. Andre, Jr., *Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany*, 73 TUL. L. REV. 69, 84 n.79 (1998) (citing GESETZ ÜBER DIE MITBESTIMMUNG DER ARBEITNEHMER [MITBESTG] [Act Concerning Co-Determination of Employees] (1976) (F.R.G.), *reprinted in* BUSINESS TRANSACTIONS IN GERMANY app. 9 (Dr. Bernd Rüster ed., release No. 19 May 1998)).

17. For a description of these provisions, see *infra* notes 22 and 27.

18. The scope of this Note is limited to those foreign issuers who are reporting companies either because they have a listing on U.S. stock exchanges or because they are traded in the form of American Depositary Receipts (ADRs).

19. *See infra* note 48 and accompanying text.

20. *See* Lenore Taylor London, *Sarbanes-Oxley Gives UK an Edge*, AUSTRALIAN FIN. REV., Dec. 24, 2002, at 13 ("[Several large companies such as Benfield, a reinsurance broker, and Porsche, a car maker] have postponed or cancelled listings on the NYSE because of regulatory uncertainty. Companies are very concerned about the [Sarbanes-Oxley] hard rule approach in the U.S." (citations omitted)). The London Stock Exchange capitalized on this problem and aggressively marketed itself as a preferable alternative to U.S. markets. *Id*.

extraterritoriality, arguing that the subject matter test for jurisdiction, the effects test for prescriptive jurisdiction, and comity considerations counsel against an exercise of U.S. jurisdiction. Notably, the audit committee and loan prohibition requirements present a fresh opportunity for debating the most recent pronouncement on the comity issue, derived from the 1993 case of *Hartford Fire Insurance v. California*,[21] under which comity is not to be applied unless a true conflict exists, namely, when U.S. law requires a person to do something which is prohibited under foreign law. The problems created by the two Sarbanes-Oxley requirements suggest that comity may be warranted even in the absence of true conflict, such as when U.S. legislation is unnecessarily burdensome to foreign issuers. Burdens to foreign issuers arise when regulations are duplicative of foreign regulation already in existence (the loan prohibition),[22] or when some of the safeguards provided by the regulation, such as the audit committee requirement,[23] have less value added in foreign countries that have other safeguards in place.[24] Part III questions several economic arguments favoring U.S. regulatory jurisdiction over foreign issuers, such as fairness concerns, the bonding theory, and efficiency arguments premised on the convergence theory. This Part maintains that despite these economic justifications for U.S.

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21. 509 U.S. 764 (1993). Although *Hartford Fire* is an antitrust case, courts premiered extraterritoriality jurisprudence based on the effects theory in an antitrust case, *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945) (*ALCOA*), and subsequently applied it in securities cases, so it is likely that *Hartford Fire*'s reasoning may be extended to securities cases. *See* Lea Brilmayer & Charles Norchi, *Federal Extraterritoriality and Fifth Amendment Due Process*, 105 HARV. L. REV. 1217, 1227 (1992) (noting that "[t]he modern era of federal extraterritoriality" dates from *ALCOA*); Gordon, *supra* note 2, at 510 (explaining that because "[a]ntitrust developments began much earlier than those in the securities field," the history of the development of extraterritorial jurisdiction in "international antitrust litigation is essential to understanding the securities cases" before and after *Hartford Fire*). Justice Holmes articulated an earlier version of the effects test in a case outside the international arena, which involved the extraterritorial application of Michigan law to conduct occurring in Illinois. Strassheim v. Daily, 221 U.S. 280, 284 (1911); *see also* SYMEON C. SYMEONIDES ET AL., CONFLICTS OF LAWS: AMERICAN, COMPARATIVE, INTERNATIONAL 558–59 (1998) (noting that while the leading case on the "effects doctrine" is *ALCOA*, an earlier articulation of the "effects doctrine" was a statement by Justice Holmes in *Strassheim* to the effect that "[a]cts done outside the jurisdiction, but intended to produce and producing detrimental effects within it, justify a state in punishing the cause of harm") (quoting *Strassheim*, 221 U.S. at 284)).

22. *Compare* Sarbanes-Oxley Act of 2002 § 402, 15 U.S.C.A. § 78m(k) (West Supp. 2003), *with* Aktiengesetz § 89 (Hannes Schneider & Martin Heidenhaii eds., 1996) (Series of Legislation in Translation No. 1) (requiring that the supervisory board approve loans to directors when they exceed more than one month's salary).

23. Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C.A. § 78j-1.

24. *See infra* notes 169–171 and accompanying text.

jurisdiction, unilateral assertion of jurisdiction by the U.S.[25] would antagonize foreign countries, undermining the ability of the U.S. to enforce the Act abroad. The Note concludes that in a world still dominated by sovereignty concerns, cooperation between U.S. and foreign regulators better addresses the need for regulation of foreign issuers listed in the U.S. than the unilateral assertion of U.S. jurisdiction.

I. THE SARBANES-OXLEY ACT AND FOREIGN ISSUERS

The Sarbanes-Oxley Act, enacted as a response to the Enron, WorldCom, and other corporate scandals,[26] enhanced the regulatory protections offered to U.S. investors by adding an audit committee requirement,[27] expanding disclosure requirements,[28] adding a certification requirement,[29] strengthening auditor independence,[30]

25. For the purposes of this Note, unilateral assertion of jurisdiction by the U.S. refers to a decision by the U.S. to apply its laws extraterritorially without consultation or cooperation with foreign countries. In this Note, unilateralism is not employed with its conflict of laws connotations.

26. *See, e.g.*, Lawrence Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 917 (2003) ("Pressured by a parade of accounting and corporate governance scandals from Enron Corp. to WorldCom Inc. at the dawn of the new millennium, Congress possessed that rare political and institutional capacity to address deep causes and systemic dysfunction. Congress used this episodic power opportunity to pass the Sarbanes-Oxley Act." (citations omitted)).

27. Under section 301 of the Sarbanes-Oxley Act of 2002, 15 U.S.C.A. § 78j-1 (West Supp. 2003), and Rule 10A-3 of the Exchange Act adopted thereunder, 17 C.F.R. § 240.10A-3 (2003), securities exchanges and association must delist securities not meeting the norms with respect to the duties and composition of audit committees, including the requirements that (1) members must be independent, 17 C.F.R. § 240.10A-3(b)(1); (2) the audit committee must be directly responsible for the appointment, compensation and oversight of the independent auditor, *id.* § 240.10A-3(b)(2); (3) the audit committee may engage independent counsel and other advisors to assist in carrying out its duties, *id.* § 240.10A-3(b)(4); (4) the audit committee must establish procedures for the treatment of complaints regarding accounting, internal controls or auditing matters, *id.* § 240.10A-3(b)(3); and (5) the issuer must provide appropriate funding for the audit committee's administrative expenses and for compensating the independent auditor, *id.* § 240.10A-3(b)(5).

28. Section 401 of the Sarbanes-Oxley Act requires, among other things, enhanced disclosure in the Management's Discussion and Analysis regarding (a) material correcting adjustments to an issuer's financial statements identified by the external auditors, 15 U.S.C.A. § 78m(i), and (b) off-balance sheet arrangements and contractual obligations, 15 U.S.C.A. § 78m(j).

29. Under section 302 of the Sarbanes-Oxley Act, the principal executive officer and principal financial officer of an issuer must certify, among other things, to the accuracy and completeness of the statements contained in each quarterly and annual report submitted under sections 13(a) or 15(d) of the Securities Exchange Act of 1934 (Exchange Act), ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78 (2000)). 15 U.S.C.A. § 7241. Under section 906 of

prohibiting loans to executives,[31] and strengthening criminal and civil penalties for violations of securities laws.[32]

The Act was criticized for being made applicable to all foreign issuers listed on a U.S. exchange, even though some of the behavior the Act targeted was either a non-issue in foreign countries or was already efficiently regulated.[33] This broad extraterritorial scope is especially problematic given that the SEC has encouraged foreign issuers to enter U.S. capital markets by providing them with several accommodations to foreign practices and polices not inconsistent with the protection of U.S. investors.[34] Foreign companies argue that, as of the end of 2001, more than 1300 foreign issuers had entered U.S.

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the Sarbanes-Oxley Act, the chief executive officers (CEOs) and chief financial officers (CFOs) must include in each periodic financial report a certification that the periodic report fully complies with the requirements of sections 13(a) or 15(d) of the Exchange Act, and that the financial report and statements fairly present the financial condition and results of operations of the issuer as of the date of the report. 18 U.S.C.A. § 1350(a)–(b). Those who knowingly violate this provision may face criminal penalties. 18 U.S.C.A. § 1350(c).

30. Section 201 of the Sarbanes-Oxley Act prohibits auditors from providing certain nonaudit services to audit clients. 15 U.S.C.A. § 78j-1(g). Sections 202 and 203 require that the audit committee approve in advance any audit or permitted nonaudit service provided by the auditor, 15 U.S.C.A. § 78j-1(h)–(i), and that audit partners rotate every five years. 15 U.S.C. § 78j-1 (g).

31. Section 402 of the Sarbanes-Oxley Act, 15 U.S.C.A. § 78m(k), prohibits loans to directors and executives.

32. Section 802 of the Sarbanes-Oxley Act institutes a new crime for the destruction, alteration or falsification of records in federal investigations and the destruction of corporate audit records. 18 U.S.C.A. §§ 1519, 1520. Section 804 extends the statute of limitations for securities fraud claims. 28 U.S.C.A. § 1658(b). Section 903 increases the term of imprisonment for mail and wire fraud from five years to twenty years. 18 U.S.C.A. §§ 1341, 1343.

33. *See* Ian Fraser, *Witch-Hunt on Wall Street*, SUNDAY HERALD (Scotland), Oct. 13, 2002, at 5, *available at* 2002 WL 101044253 (“[N]on-U.S. companies complain that the Act is unwarranted, time-consuming and a costly interference in their affairs when they believe there are adequate investor safeguards in place already.”).

34. *See* Simplification of Registration and Reporting Requirements for Foreign Companies, 59 Fed. Reg. 21,644 (Apr. 19, 1994) (codified at 17 C.F.R. pts. 229–30, 239, 249 (2003)) (adopting various accommodations). These accommodations include, among others: (a) interim reporting on the basis of home country and stock exchange practice rather than mandated quarterly reports; (b) aggregate executive compensation disclosure rather than individual disclosure, if so permitted in an issuer’s home country; (c) offering document financial statements that are required to be updated principally on a semiannual, rather than quarterly, basis; (d) use of home country accounting principles with a reconciliation to U.S. generally accepted accounting principles; (e) exemption from the proxy rules and the insider reporting and short swing profit; and (f) acceptance of cash-flow international accounting standards. 17 C.F.R. pts. 229–30, 239, 249 (2003); s*ee also* Roberta S. Karmel, *Living with U.S. Regulations: Complying with the Rules and Avoiding Litigation*, 17 FORDHAM INT’L L.J. S152, S152 (1994) (discussing regulations applicable to foreign issuers, including accommodations).

capital markets and became "reporting companies[35] *in reliance* on the SEC's accommodations."[36]

Not all of the Sarbanes-Oxley provisions are controversial for foreign issuers, however. Provisions consistent with foreign regulation and which do not impose additional burdens on foreign issuers, such as the executive certification requirement,[37] have not raised much publicity.[38] At the same time, provisions attempting to impose additional burdens in areas in which foreign issuers are already regulated by their country of incorporation have attracted more criticism.[39]

Among the provisions imposing additional burdens on foreign issuers,[40] the most debated one is the provision requiring an independent audit committee.[41] As explained more fully below, issuers incorporated under civil law regimes dislike this provision because it indirectly strengthens labor's bargaining power by giving labor representatives on the audit committee substantive responsibilities and access to sensitive information. Civil law codes often require a two-tier board, with the lower or "managing board" having no independent directors and the upper or "supervisory board" containing a combination of independent directors and employee representatives.[42] Because employee representatives serve

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35. An annually updated list of these companies is available at the SEC's Corporate Finance Division website at http://www.sec.gov/divisions/corpfin/internatl/alphabetical.htm (last visited Nov. 22, 2003).

36. Letter from Todd M. Malan, Executive Director, Organization for International Investment, to Jonathan G. Katz, Secretary, SEC 2 (Aug. 19, 2002) (on file with the *Duke Law Journal*) (emphasis added).

37. This requirement, imposed by sections 302 and 906 of the Sarbanes-Oxley Act, is described *supra* at note 29.

38. For instance, the financial reports certification requirement was not disputed because many corporate executives have already been certifying their financial reports as required by foreign norms. *See* Andrew Parker, *U.S. Fraud Law 'Should Not Hit FTSE 100 Groups*,' FIN. TIMES (London), Aug. 19, 2002, at 2 ("UK boards are already required as a matter of law to present accounts that show a true and fair view, and to sign the accounts accordingly.").

39. *See supra* note 33 and accompanying text.

40. *See* Coffee, *supra* note 8, at 1824 n.279 (explaining that "[a]mong the principal provisions of the . . . [Sarbanes-Oxley] Act . . . that would impose new requirements on foreign issuers are" sections 301, 302, 303, 304, 306, 307 and 402).

41. *See id.* at 1825–26 (illustrating foreign concerns with the audit committee requirement). For a discussion of the audit committee requirement, see *supra* note 27.

42. *See* Coffee, *supra* note 8, at 1825 n.281 ("[U]nder German law, for example, the supervisory board . . . is expected to appoint and, if necessary, remove the corporation's managing board . . . , which consists of its principal executive officers, but the supervisory board does not make or review most business decisions.").

on the supervisory board, civil law corporations have generally resisted giving the supervisory board significant substantive responsibilities.[43] Under the Act, however, labor representatives would be given substantive responsibilities,[44] because the audit committee must be staffed with members of the supervisory committee,[45] including labor representatives.[46]

The audit committee provision was also criticized for making it impossible for civil law companies to comply with both the codetermination requirement imposed by their country of incorporation and the independence requirement imposed by the Sarbanes-Oxley Act. Most members of the supervisory board required under codetermination are not deemed independent under U.S. law: they either control the company (concentrated shareholders) or are controlled by it (employees).[47] This problem was alleviated by the SEC's regulations which provide that foreign

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43. *See id.* (reporting criticism that the supervisory board is weak and not a serious monitoring mechanism inside the firm and that shareholders do not wish to delegate enhanced powers to the supervisory board because to do so would only strengthen labor's voice and authority inside the firm).

44. Members of the audit committee have substantive responsibilities, discussed in note 27, *supra*.

45. As the members of the managing board, who are executives of the company, are not independent, only members of the supervisory board can serve on the audit committee. Executive officers are not independent because they accept a "compensatory fee" from the company. 17 C.F.R. § 240.10A-3(b)(1)(ii)(A) (2004), WL 17 C.F.R § 240.10A-3(b)(1)(ii)(A).

46. *See* Coffee, *supra* note 8, at 1825–26 (explaining that "the Sarbanes-Oxley Act is particularly threatening to many European firms" because the audit committee requirement results in "a mismatch for civil law corporations [in that] [m]embers of the managing board are barred from service on the audit committees, and members of the supervisory board, who may also be conflicted, are given powers that few civil law corporations would willingly entrust to them").

47. Under 17 C.F.R. § 240.10A-3(b)(1), an affiliate of the company is not independent for audit committee purposes. An affiliate is defined as someone that "controls, or is controlled by, or is under common control with" the company. Standards Relating to Listed Company Audit Committees, Securities Act Release No. 33-8220; Exchange Act Release No. 47654, 68 Fed. Reg. 18788, 18793 (Apr. 16, 2003) (to be codified at 17 C.F.R. pts. 228, 229, 240, 249, and 274). For the purposes of this provision, the SEC also defined the term "control" consistent with prior definitions under the Exchange Act as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." *Id.* As a company's concentrated shareholders by definition own a large percentage of a company's voting securities, concentrated shareholders are likely to be considered by the SEC as possessing the power to direct the management and policies of the company. Hence, many members of the audit committee who represent concentrated shareholders are potentially not independent. Nor are employee representatives independent, because they receive a "compensatory fee" from the company. 17 C.F.R. § 240.10A-3(b)(1)(ii)(A).

employee representatives sitting on the supervisory board are allowed to be part of the audit committee, even if they are not technically independent of the company's executives.[48] However, this SEC exemption does not fully eliminate the concerns about the audit committee provision; foreign companies are still apprehensive about increasing labor's bargaining power and allowing the labor representatives on this committee to have access to sensitive financial information.[49]

Several other provisions of the Act, although not in direct conflict with foreign regulation, also raise concerns and additional burdens for foreign issuers. For instance, in Germany, the Stock Corporation Law already regulates loans to insiders by requiring that extensions of credit to members of the board of managers be approved by the supervisory board as to amount, interest rate, and repayment terms.[50] Since this German regulation already minimizes the problem targeted by the Act,[51] it would be unnecessary and inefficient for the U.S. to impose its own corporate governance regulations on this matter.[52] Additionally, it is costlier for the foreign

48. 17 C.F.R. § 240.10A-3(b)(1)(iv).

49. *See supra* notes 41–46 and accompanying text. An increase in labor's bargaining power is problematic because increases in labor's compensation are translated into decreases in the profits left to the shareholders.

50. *See supra* note 22.

51. This Note starts from the presumption that developed countries like Germany have sufficient resources to enforce their existing laws, and as such, the German securities laws should be able to minimize the harms of exorbitant and unpoliced loans to insiders, even if such enforcement is not perfect. No country would be able to deserve proper recognition of its law if perfect enforcement were the standard—even the U.S.'s enforcement record is not perfect, as demonstrated by the SEC's failure to review Enron's filings. For these reasons, the scope of this Note is limited to the criticism of extraterritoriality in cases of duplicative regulation where the country of incorporation is developed (and not known for rampant abuses in its justice system). This is unlike the approach employed by the Food and Drug Administration, which takes into consideration regulations of foreign countries only if they offer greater protection. *See* William DuBois, Note, *New Drug Research, the Extraterritorial Application of FDA Regulations, and the Need for International Cooperation*, 36 VAND. J. TRANSNAT'L L. 161, 201 (2003) (explaining that the regulations do not differentiate between European countries and less regulated countries like Nigeria, which are also more susceptible to corruption, and noting that the "greater protection" exemption is problematic because difficulties could arise if the European Union imposed a similar requirement and also believed that its regulation imposed more protection).

52. Certainly, the reverse is also true: For foreign issuers incorporated in countries where no regulation or practice effectively addresses the problems targeted by the Sarbanes-Oxley Act, the Act should apply so as to protect U.S. investors. Such an approach diminishes the concern of U.S. securities regulators who feel that Congress wanted to respond to corporate governance problems as they exist everywhere in the world. Harvey Pitt, while in office, denied that through the Sarbanes-Oxley Act, America is forcing other countries to adopt a U.S.

firm to comply with two duplicative sets of rules. The next two Parts explore these issues from a legal and economic perspective, respectively.

II. ANALYSIS OF JURISDICTION TO PRESCRIBE

Congress is entitled to regulate disclosures made by foreign companies that are listed on U.S. exchanges or that file reports with the SEC because their shares are traded in the U.S.—these trades constitute sales and offers to sell securities in interstate commerce which have "effects" on U.S. investors.[53] However, U.S. jurisdiction over these companies arguably extends only to matters having a non-attenuated nexus to securities regulation. Thus, a U.S. listing does not give the U.S. a charter to regulate foreign issuers in all aspects; for instance, it could not regulate labor and employment relations of these companies,[54] even if such companies purposefully availed themselves to U.S. regulation. This is so not only because of international law, which places what are arguably flexible external limits on congressional power,[55] but more importantly because of internal limits on Congress's power to legislate. The notion of "internal limits" represents the concept that if "Congress attempts to utilize a specific enumerated power to reach a subject matter beyond the scope of that power, the [Supreme] Court will strike it down as exceeding that power's internal limits."[56] Notably, after *United States v. Lopez*,[57] regulation of guns in school zones is known to be beyond

response to a *domestic* problem and stated: "I don't think it is solely a U.S. problem. We may be feeling the brunt right now but I think many of the same underlying problems exist elsewhere in the world." Fraser, *supra* note 33.

53. This power is derived from the Commerce Clause, U.S. CONST. art. I, § 8, cl. 3. *See also* Tanja Santucci, Note, *Extending Fair Disclosure to Foreign Issuers: Corporate Governance and Finance Implications for German Companies*, 2002 COLUM. BUS. L. REV. 499, 530 n.129 (noting that in deciding to suggest application of a new disclosure requirement to foreign issuers, the SEC reasoned that "the vast majority of these issuers have subjected themselves to such reporting requirements by their election to access U.S. markets").

54. *See infra* note 118.

55. For a discussion of these limits, see *infra* note 69 and accompanying text.

56. George D. Brown, *Should Federalism Shield Corruption?—Mail Fraud, State Law and Post-*Lopez *Analysis*, 82 CORNELL L. REV. 225, 226 n.17 (1997); *see also* GEOFFREY R. STONE ET AL., CONSTITUTIONAL LAW 139 (2d ed. 1991) (discussing differences between internal and external limits).

57. 514 U.S. 549 (1995).

the scope of the commerce power, because the relation between gun regulation and commerce is too attenuated.[58]

Similarly, an argument can be made that the relation between corporate governance and securities laws is too attenuated (and outside the legitimate sphere of securities regulation) in certain circumstances, as not all matters of corporate governance law are meant to shape behavior with respect to offers and sales of securities. For instance, the prohibition of loans to directors does not concern disclosure and is not directly related to securities law. Unlike insider trading, loans to executives are not bad in themselves: That some directors of a company receive small loans is hardly endangering the disclosure of the company's financial information to U.S. investors.[59] Only an attenuated link to disclosure could be made, however, by arguing that some large loans create incentives for directors to engineer company financials to camouflage these loans, which would negatively affect disclosure to investors.

Moreover, federal regulation of corporate governance infringes upon the traditional power of both foreign and U.S. states to regulate companies chartered within their territory.[60] While some level of

58. *Id.* at 561–62, 567. However, the statute in *Lopez* might have been saved if it had contained a jurisdictional element to ensure, "through case-by-case inquiry," that possession of the firearm had any concrete tie to interstate commerce. *Id.* at 561.

59. One commentator also identifies the audit committee and loan prohibition requirements as the most disconnected from securities laws. *See* Kenji Taneda, Note, *Sarbanes-Oxley, Foreign Issuers and United States Securities Regulation*, 2003 COLUM. BUS. L. REV. 715, 756–59 (arguing that in order to ensure greater consistency and certainty, the SEC should be prepared to make wholesale exemptions with respect to provisions that deal with the "particular corporate governance problems prevalent in the United States," because "[w]hile information laws are focused on the consumer of the information, thus favoring a common 'language,' corporate governance laws focus on the company, and should be tailored to the specific corporate environment").

Taneda also highlights a central concept employed throughout this Note, namely, that "measures intended to solve agency problems associated with the particular corporate culture prevalent in the U.S. are unlikely to have as much effect when transposed on a different corporate culture." *Id.* at 758. This Note's analysis of jurisdiction to prescribe provides additional reasons why these two requirements should not be applied to some foreign companies, arguing that both the effects test and the comity test suggest that such jurisdiction is unwarranted precisely because measures intended to solve agency problems in U.S. corporate law are unlikely to have much effect in different foreign corporate structures. *See infra* Part II.D.

60. Foreign countries have a right under international law to regulate the corporate governance of companies chartered or having their principal place of business on the foreign countries' territories. Under the RESTATEMENT, *supra* note 1, § 213, a state of incorporation has jurisdiction over corporate governance issues. Under European and international law,

infringement is inescapable and permissible under the Commerce Clause,[61] concerns akin to competitive federalism suggest that U.S. and foreign states should not relinquish all power over corporate governance issues.[62] Accordingly, the critical question is how much can Congress regulate corporate governance without exceeding the scope of its power to regulate offers and sales of securities in interstate commerce.

This Section discusses whether the U.S.'s assertion of extraterritorial jurisdiction with respect to corporate governance goes too far by examining the tests that U.S. courts have used in dealing with the question of extraterritoriality, namely, the subject matter and

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jurisdiction over corporate governance issues is also afforded to the country where a company's main base of operations are located. *Id.* § 213 cmt. c, reporters' notes 5, 6.

61. Congress's power to regulate the sale and offer for sale of any security in interstate commerce is derived from the Commerce Clause, U.S. CONST. art. I, § 8, cl. 3. Incident to the power to regulate sales and offers for sale of securities is the power to regulate the disclosures that securities issuers make to prospective buyers, so as to avoid misrepresentation and fraud. Because the audit committee verifies that the information in such disclosures is accurate, Congress is probably entitled to regulate the independence of audit committee members in order to insure the accuracy of such disclosures. A similar argument can be made to support most securities regulations that have corporate governance implications, although, as with this argument, several inferential steps are probably necessary.

62. By "competitive federalism," this Note means a model under which states compete for residents and investments by offering more appealing taxation, legal regimes, and government services. This competition is beneficial because it leads to the protection of liberty: "If I dislike the laws of my home state enough and feel tyrannized by them enough, I always can preserve my freedom by moving to a different state with less tyrannous laws." Stephen Calabresi, *"A Government of Limited and Enumerated Powers": In Defense of* United States v. Lopez, 94 MICH. L. REV. 752, 776 (1996). If Congress makes a law preempting state law, the benefits of competitive federalism in that area of law cannot be realized, because no matter where one would move, it would be impossible to hide from federal law. Recent models of competitive federalism suggest that, as a matter of efficiency, the federal government should only regulate activities having spillover effects among the states. *See, e.g.*, Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom-Rationale" for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210, 1222 (1992) (citing the "presence of interstate externalities" as a "powerful reason for intervention at the federal level").

Competitive federalism in corporate law refers to the competition among states for corporate charters. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 14–24 (1993). Scholars debate, however, the extent to which it is desirable in the area of corporate governance, as it may result in a race to the bottom, in which states will follow the example of the state offering the lowest level of protections to shareholders so as to attract companies. *See generally* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 212–27 (1991); Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974). Notwithstanding the possibility of a race to the bottom, it is unclear whether the benefit of eliminating lax standards via congressional regulation outweighs the associated cost of stifled regulatory innovation by the states.

the prescriptive tests. It then argues that these tests indicate that some of the Sarbanes-Oxley provisions should not apply to foreign companies.[63]

A. Jurisdiction

Jurisdiction is "[t]he power of a sovereign to affect the rights of persons, whether by legislation, by executive decree, or by the judgment of a court."[64] Accordingly, a "State has the right to exercise jurisdiction within the limits of its sovereignty, but is not entitled to encroach upon the sovereignty of other States."[65] At the same time, travel, commerce, and dual nationality can subject physical or juridical persons to the concurrent jurisdiction of several states.[66] Such cases of concurrent jurisdiction fall under international law, which governs relations between states.[67] International law imposes limits on the ability of states to encroach on the sovereignty of other states by delineating the acceptable bases for asserting jurisdiction.[68] These acceptable bases are the territoriality, nationality, protective, universality, and passive personality principles.[69] Of these principles,

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63. While these tests have traditionally applied to the U.S.'s power to assert criminal or tort jurisdiction, these should equally be applicable to matters of U.S.'s power to assert regulatory jurisdiction. For instance, category (3) extraterritoriality, under which conduct neither occurs nor has effects within the U.S., cannot justify an assertion of regulatory jurisdiction any more that it can justify an assertion of criminal jurisdiction. *See supra* note 9 and accompanying text.

64. Joseph H. Beale, *The Jurisdiction of a Sovereign State*, 36 HARV. L. REV. 241, 241 (1923).

65. F. A. Mann, *The Doctrine of International Jurisdiction Revisited*, 186 HAGUE RECUEIL 9, 20 (1984), *quoted in* James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200, 1240 n.130 (1999).

66. *See infra* note 176 and accompanying text.

67. *See* Hersch Lauterpacht, *The So-Called Anglo-American and Continental Schools of Thought in International Law*, 12 BRIT. Y.B. INT'L L. 31 (1931) ("International law is not concerned with matters of municipal law; it is concerned with relations between States.").

68. *See* R.Y. Jennings, *Extraterritorial Jurisdiction and the United States Antitrust Laws*, 33 BRIT. Y.B. INT'L L. 146, 150 (1957):

> Are we to conclude then that extraterritorial jurisdiction is a matter left within the discretion of each sovereign State; that it is not governed by international law? The practice of States leans against such a conclusion. For the fact is that States do not give themselves unlimited discretion in the matter.

Professor Jennings views states as limiting their own discretion through their municipal laws, which contain principles of jurisdiction such as the nationality principle, the protective principle, the universality principle and the like. *Id*.

69. *See* RESTATEMENT, *supra* note 1, § 402 cmts. c–g. These five theories of jurisdiction were first outlined in a Harvard study done in 1935. *See* Research in International Law Under Auspices of the Faculty of the Harvard Law School, *Jurisdiction with Respect to Crime*, 29 AM.

only the territoriality principle confers the U.S. prescriptive jurisdiction in matters of securities regulation,[70] provided that substantial and harmful effects of foreign conduct are felt on U.S. markets and commerce.[71]

These jurisdictional limitations set by international law are not binding on Congress in matters of domestic affairs.[72] The law of

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J. INT'L L. 435, 445 (Supp. 1935) ("disclos[ing] five general principles on . . . which penal jurisdiction is claimed by States at the present time"); *see also* BARRY E. CARTER & PHILLIP R. TRIMBLE, INTERNATIONAL LAW 725–89 (2d ed. 1995) (analyzing the five bases of prescriptive jurisdiction); WILLIAM R. SLOMANSON, FUNDAMENTAL PERSPECTIVES ON INTERNATIONAL LAW 198–205 (2d ed. 1995) (same).

70. *See* Cox, *supra* note 65, at 1240 n.120 ("Territorial jurisdiction does permit the extraterritorial application and enforcement of U.S. law to foreign-based conduct, provided sufficient effects of that conduct occur within the U.S."). Some cases have also advanced the protective principle as a basis for jurisdiction, but this principle is not used in regulatory matters: it is only applicable in cases relating to a vital national security or economic interest. *Id.*; RESTATEMENT, *supra* note 1, § 403:

> [Application of the protective principle is] limited to serious and universally condemned offenses, such as treason or traffic in narcotics, and to offenses by or against military forces. In such cases the state in whose territory the act occurs is not likely to object to regulation by the state concerned.

See also United States v. King, 552 F.2d 833, 850 (9th Cir. 1976) (recognizing the nationality principle in addition to the protective and territorial principles for jurisdiction over unlawful distribution in Japan of heroin intended for importation into the United States); United States v. Pizzarusso, 388 F.2d 8, 10 (2d Cir. 1968) (applying the protective principle in the case of a false statement made by a prospective immigrant to a United States consul in Canada); Rocha v. United States, 288 F.2d 545, 548–49 (9th Cir. 1961) (using the protective principle as a basis for jurisdiction over sham marriage ceremonies to secure preferential immigration visas). The passive personality principle is very controversial as well. *See* IAN BROWNLIE, PRINCIPLES OF INTERNATIONAL LAW 296 (2d ed. 1973) (citing passive personality as the "least justifiable" of all bases). Section 402(3) of RESTATEMENT, *supra* note 1, allows the use of passive personality jurisdiction when a criminal act is committed outside a state's territory by a non-national against a victim who is a national. This principle is accepted most often when applied to terrorism or other organized attacks on a state's nationals by reason of their nationality, or to assassination of a state's diplomatic representatives, *id.* § 402 cmt. g, reporters' note 3, and thus it is inapplicable here.

71. *See infra* Part II.C.1. The territoriality principle has not always included the effects test, rather, it strictly based jurisdiction on conduct occurring on the territory of the state. However, sovereignty concerns suggest that exceptions to the territoriality principle (such as the effects test) are to be narrowly interpreted, as customary practice among states confirms. *See* Note, *supra* note 2, at 1320 ("Although a state's right to territorial jurisdiction is frequently phrased in exclusive terms, some exceptions have evolved . . . . [b]ut . . . the evolution of these exceptions has provoked serious controversy, and the accepted scope of the exceptions remains rather limited.").

72. "Congress has broad power under Article I, § 8, cl. 3, '[t]o regulate Commerce with foreign Nations,' and this Court has repeatedly upheld its power to make laws applicable to persons or activities beyond our territorial boundaries where United States interests are affected." Hartford Fire Ins. Co. v. California, 509 U.S. 764, 813–14 (1993) (Scalia, J., dissenting) (alteration in original); *see also* Am. Baptist Churches v. Meese, 712 F. Supp. 756, 771 (N.D. Cal.

nations[73] is part of federal common law,[74] but it can be overruled by statute or treaty.[75] Nonetheless, Congress cannot legislate in violation of international law without suffering any repercussions. For instance, if the U.S. violates the international law of prescriptive jurisdiction, it may be liable to foreign states if sued.[76] This liability arises because international law sets the rights and duties of states, and violations of such duties give rise to a cause of action for the states that are adversely affected.[77]

In addition to the limitations set by international law, U.S. courts themselves have imposed internal limitations on their jurisdiction in order to avoid unnecessary confrontation with other nations or opening the floodgates of litigation to foreign plaintiffs. These limitations—the subject matter and the prescriptive tests for jurisdiction—are discussed below.

1989) ("Congress is not constitutionally bound to abide by precepts of international law, and may therefore promulgate valid legislation that conflicts with or preempts customary international law.").

73. The law of nations is commonly viewed as embodied in customary international law. *See, e.g.*, Filartiga v. Pena-Irala, 630 F.2d 876, 884 (2d Cir. 1980).

74. *See* The Paquete Habana, 175 U.S. 677, 700 (1900) ("International law is part of our law, and must be ascertained and administered by the courts of justice of appropriate jurisdiction.").

75. *See id.* (stating that international law controls only "where there is no treaty, and no controlling executive or legislative act or judicial decision"). However, courts may still use international law as a tool of statutory construction when congressional intent is ambiguous, presuming that Congress will not legislate in violation of international law. *See* Murray v. Schooner Charming Betsy, 6 U.S. (2 Cranch) 64, 118 (1804) ("[A]n act of Congress ought never to be construed to violate the law of nations if any other possible construction remains.").

76. *See* Note, *supra* note 2, at 1319–20 (1983):

> Territorial jurisdiction is closely related to the concepts of territorial integrity and nonintervention. While territorial jurisdiction gives the state the *right* to prescribe or enforce a rule of law within its territory, the latter concepts impose a *duty* on other states to refrain generally from any act that infringes on the territorial supremacy of a state, including any action that interferes with the domestic relations or international intercourse of another nation. A state's attempts to enforce its laws extraterritorially may violate this duty, and *give rise to a cause of action for the states adversely affected.*

(last emphasis added).

77. *See* LOUIS HENKIN ET AL., INTERNATIONAL LAW 556 (1980) ("If a state by its act or omission breaches an international obligation, it incurs international responsibility. If the consequence is an injury to another state, the delinquent state is responsible to make reparation or give satisfaction for the breach to the injured state."). *See generally* 5 MARJORIE M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 6–7 ("For every right there is a correlative duty, and for every wrong there should be a remedy."). For an argument that the Export Administration Act of 1979, 50 U.S.C. §§ 2401–2420 (2000), violated this duty of nonintervention, see generally Note, *supra* note 2, at 1319–21.

B. Subject Matter Jurisdiction

The "subject matter test" for U.S. extraterritorial jurisdiction is actually composed of two presumptions. The first presumption, that acts of Congress are not to be construed in violation of international law,[78] was imposed at an early date by the U.S. Supreme Court. This presumption, referred to as the "*Charming Betsy* presumption," recognizes the potential for international discord engendered by violations of international law and is usually utilized to discern murky congressional intent; when, however, such intent is clear, international law "bends to the will of Congress."[79] The second presumption, looking at the question of congressional intent, is imposed by a separate but related canon of construction, which says that "legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."[80] This Note refers to this presumption as the *Foley Bros.* presumption, although *Foley Bros. v. Filardo* was not the first case invoking it.[81]

To determine how either of these presumptions apply to the Sarbanes-Oxley Act, it must be discerned whether Congress intended either the Securities Exchange Act of 1934 (the "Exchange Act")[82] or the Sarbanes-Oxley Act itself to apply to foreign companies.[83]

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78. *See Charming Betsy*, 6 U.S. (2 Cranch) at 118.

79. The Over the Top, 5 F.2d 838, 842 (D. Conn. 1925); *see also supra* note 75 and accompanying text.

80. Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949) (explaining that this presumption "is based on the assumption that Congress is primarily concerned with domestic conditions"); *see also* EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991) (*Aramco*) ("It is our task to determine whether Congress intended the protections of Title VII to apply to United States citizens employed by American employers outside of the United States.").

Dodge, *supra* note 4, at 91 n.44, notes that the *Charming Betsy* presumption is separate from the *Foley Bros.* presumption against extraterritoriality. Some scholars argue that the *Charming Betsy* presumption has actually been transformed into the test for subject matter jurisdiction identified in *Foley Bros*. *See, e.g.*, Jonathan Turley, *"When in Rome": Multinational Misconduct and the Presumption Against Extraterritoriality*, 84 NW. U. L. REV. 598, 607 (1990) ("With *Foley Bros.* the presumption against extraterritorial application became ensconced as a canon of statutory construction. What began in *American Banana* as a prohibition against the perceived violation of international law through extraterritorial regulation became simply a legal test for subject matter jurisdiction.").

81. *Foley Bros.*, 336 U.S. at 285 (citing Blackmer v. United States, 284 U.S. 421, 437 (1932)).

82. Securities Exchange Act of 1934, 15 U.S.C. § 78 (2000).

83. Even if international application of an act would violate international law, manifest congressional intent that such act apply extraterritorially would rebut the *Charming Betsy* presumption, and as such, it is reasonable to inquire about congressional intent first when

Although the Exchange Act was found to apply extraterritorially in *Schoenbaum v. Firstbrook*,[84] this finding of intent has little textual support.[85] Rather, it is based on a purposive interpretation of the statute: Congress's goal to protect consumers and market integrity would be undermined if foreign acts were allowed to significantly and harmfully disrupt U.S. markets.[86]

In contrast to this purposive interpretation, a comprehensive test for congressional intent was articulated by the Supreme Court in *Foley Bros.*[87] The plaintiff in *Foley Bros.* was an American cook employed to feed construction workers in Iran and Iraq, who was denied overtime compensation as required by the Eight Hour Law.[88] The Supreme Court held that the Eight Hour Law did not apply extraterritorially, as legislation of Congress, "unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."[89] To discern congressional intent, the *Foley Bros.* Court relied upon three factors (the *Foley Bros.* test): (1) the absence of an expressed intent that the statute apply to foreign companies, (2) the legislative history of the statute, and (3) administrative decisions.[90]

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applying the *Charming Betsy* and the *Foley Bros*. presumptions. *See The Over the Top*, 5 F.2d at 842 (explaining that when congressional intent is clear, international law "bends to the will of Congress"); *see also* Tag v. Rogers, 267 F.2d 664, 666 (D.C. Cir. 1959) ("There is no power in this Court to declare null and void a statute adopted by Congress or a declaration included in a treaty merely on the ground that such provision violates a principle of international law."), *cert. denied*, 362 U.S. 904 (1960).

84. 405 F.2d 200 (2d Cir. 1968); *see id.* at 206 (establishing the effects test under federal securities law and explaining that "Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges").

85. *See* MGC, Inc. v. Great W. Energy Corp., 896 F.2d 170, 173 (5th Cir. 1990) ("When Congress drafted the securities laws, it did not consider the issue of extraterritorial applicability, [which requires] that the federal courts fill the void."); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir. 1975) ("Our conclusions rest on case law and commentary concerning the application of the securities laws and other statutes to situations with foreign elements and on our best judgment as to what Congress would have wished if these problems had occurred to it . . . .").

86. *See Bersch*, 519 F.2d at 987 ("Congress did not mean the United States to be used as a base for fraudulent securities schemes even when the victims are foreigners, at least in the context of suits by the SEC . . . .").

87. 336 U.S. 281, 285–90 (1949).

88. 40 U.S.C. § 324 (1958) (repealed 1962). The current version of the code section considered by the Court is codified at 40 U.S.C. § 328 (2000).

89. *Foley Bros.*, 336 U.S. at 285 (citing Blackmer v. United States, 284 U.S. 421, 437 (1932)).

90. *See id.* at 285–90:

The *Foley Bros*. presumption was not applied again until its revitalization forty years later in *EEOC v. Arabian American Oil Co.* (*Aramco*).[91] *Aramco*, a case under Title VII of the Civil Rights Act of 1964,[92] reaffirmed the first prong (express congressional intent) of the *Foley Bros.* test, explaining that overcoming the presumption required "the affirmative intention of the Congress clearly expressed."[93] Moreover, Chief Justice Rehnquist's opinion indirectly suggested that the first prong predominates over the two other prongs (legislative history and administrative decisions) by not addressing the legislative history of the statute,[94] rejecting arguments based on boilerplate language[95] and administrative interpretations,[96] and suggesting "that he was looking for a clear statement from Congress in the language of the statute itself that Title VII applied extraterritorially."[97]

> *First* [factor]. The canon of construction which teaches that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States, is a valid approach whereby unexpressed congressional intent may be ascertained. It is based on the assumption that Congress is primarily concerned with domestic conditions.
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> . . . .
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> *Second* [factor]. The legislative history of the Eight Hour Law reveals that concern with domestic labor conditions led Congress to limit hours of work.
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> . . . .
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> *Third* [factor]. The administrative interpretations of the Eight Hour Law in its various phases of development afford no touchstone by which its geographic scope can be determined.

(citations omitted).

91. 499 U.S. 244 (1991); *see also* Dodge, *supra* note 4, at 91 (noting that *Aramco* "breathed new life into the presumption").

92. 42 U.S.C. §§ 2000e–2000e-17 (2000).

93. *Aramco*, 499 U.S. at 248 (citation omitted). *Aramco*'s holding that Congress did not intend Title VII to apply abroad was superceded by section 109 of the Civil Rights Act of 1991, Pub. L. 102-166, 105 Stat. 1071 (1991) (codified at 42 U.S.C. §§ 2000e(f), 2000e-1(b)-(c)), which redefined the term "employee" as used in Title VII to include certain United States citizens working in foreign countries for United States employers. *Aramco's* use of the *Foley Bros*. presumption as a principle of judicial interpretation is still good law, though.

94. *Id.* (failing to address what effect legislative history had on the presumption, thus implicitly rejecting the dissenters' argument that the presumption against extraterritoriality is not a clear statement rule and that the Court must look at the legislative history of the statute); *cf. id.* at 262–64 (Marshall, J., dissenting) (citing several cases which indicated that the presumption is not a clear statement rule).

95. *Id.* at 251.

96. *Id.* at 256–57.

97. Dodge, *supra* note 4, at 93.

However, the purely textualist "clear statement" interpretation was arguably rejected by later Supreme Court[98] and lower court decisions[99] that utilized the second prong of the *Foley Bros.* test (legislative history).[100] At the same time, these decisions confirmed that boilerplate language alone does not overcome the presumption.[101] Also, the autonomy and exceptional power the SEC enjoys in granting exemptions[102] suggest that the third prong (administrative interpretations) of the *Foley Bros.* test should not be disregarded in discerning congressional intent.[103] Congress's intent to give broad exemptive power to the SEC suggests that it did not create an Act that applies equally to all issuers, but rather that Congress envisioned that certain categories of issuers, including foreign issuers, may need exceptions. These considerations of SEC autonomy, together with the post-*Aramco* decisions, suggest that the *Foley Bros.* test, rather than the clear statement test, should be applied to determine congressional intent.

The application of the *Foley Bros*. test suggests that the *Schoenbaum* purposive interpretation of the Exchange Act cannot be extended to the Sarbanes-Oxley Act. First, there is no express or

98. *See* Sale v. Haitian Ctrs. Council, Inc., 509 U.S. 155, 174–79 (1993) (examining legislative history); Smith v. United States, 507 U.S. 197, 204 (1993) (using legislative purpose to strengthen the presumption against extraterritoriality).

99. *See, e.g.*, Kollias v. D & G Marine Maint., 29 F.3d 67, 74 (2d Cir. 1994) (examining legislative history); Gushi Bros. v. Bank of Guam, 28 F.3d 1535, 1542 (9th Cir. 1994) (looking for an "express statement of Congressional intent . . . in 'the Act itself . . . or in its legislative history'" to overcome the presumption against extraterritoriality (quoting Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949))).

100. *See* Dodge, *supra* note 4, at 97, 110 (arguing that *Smith* and *Sale* indicate that the Supreme Court does not view the presumption as a clear statement rule and will examine other available evidence of congressional intent, and that lower courts have reached a similar conclusion).

101. *See id.* at 111–12:

> [C]ourts seem to be in agreement that general, boilerplate language in a statute is insufficient to rebut the presumption against extraterritoriality. In addition, they agree that a court may look . . . to the text of other provisions in the statute, as well as to its *legislative history* . . . . These decisions are consistent with the Supreme Court's decisions since *Aramco*, which demonstrate that the Supreme Court does not view the presumption as a clear statement rule and that it will examine "all available evidence" of congressional intent.

(footnotes omitted) (emphasis added) (quoting *Sale*, 509 U.S. at 177).

102. 15 U.S.C. §§ 77s, 77z-3 (2000) (outlining special powers of the commission and granting general exemptive authority).

103. *See* Dodge, *supra* note 4, at 123 ("[S]ince the ultimate purpose of the presumption is to aid in determining congressional intent, all other evidence of that intent should be considered . . . . Administrative agencies' interpretations of a statute should be given the same deference in this context that they are in any other.").

affirmative indication in the text of the Sarbanes-Oxley Act that Congress intended it to extend beyond the territorial jurisdiction of the U.S. No geographical terms are used to describe the coverage of the Act. This situation is different from that in *Vermilya-Brown Co. v. Connell*,[104] where the Supreme Court held that "by specifically declaring that the Act covered 'possessions' of the United States, Congress directed that the Fair Labor Standards Act applied beyond those areas over which the United States has sovereignty."[105] Thus, it is unlikely that the "boilerplate language" that the Act applies to every reporting company[106] can be considered an expression of congressional intent favoring extraterritoriality.[107]

Second, Congress most likely did not intend that the Act apply to foreign companies, given that the Act was a response to two domestic crises: Enron and WorldCom.[108] The legislative history of the Act provides some additional support for the argument that the Sarbanes-Oxley was mainly concerned with domestic problems.[109] Third, cases such as *Schoenbaum*, which find that Congress intended that the Exchange Act apply extraterritorially,[110] deal with securities fraud and are distinguishable from cases dealing with corporate governance

104. 335 U.S. 377 (1948).

105. Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949) (summarizing the Court's previous holding in *Vermilya-Brown Co.*).

106. The Act imposes the requirements discussed in Part I on all reporting companies, without differentiating between U.S. and foreign issuers. *See, e.g.*, Coffee, *supra* note 8, at 1824 (noting the requirements "[i]mposed sweeping governance reforms on both foreign and domestic issuers that are listed on U.S. markets").

107. "Words having universal scope, such as 'Every contract in restraint of trade,' 'Every person who shall monopolize,' etc., will be taken as a matter of course to mean only every one subject to such legislation, not all that the legislator subsequently may be able to catch." Am. Banana Co. v. United Fruit Co., 213 U.S. 347, 357 (1909), *quoted in Foley Bros.*, 336 U.S. at 287 n.3.

108. *See supra* note 26 and accompanying text.

109. *See* 148 CONG. REC. S7350-04 (daily ed. July 25, 2002) (statement of Sen. Enzi):

> In addition, I believe we need to be clear with respect to the area of foreign issuers and their coverage under the bill's broad definitions. While foreign issuers can be listed and traded in the U.S. if they agree to conform to GAAP and [NYSE] rules, the SEC historically has permitted the home country of the issuer to implement corporate governance standards. Foreign issuers are not part of the current problems being seen in the U.S. capital markets, and I do not believe it was the intent of the conferees *to export U.S. standards* disregarding the sovereignty of other countrie*s* as well as their regulators.

(emphasis added).

110. *See* Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968) (finding "Congress intended the Exchange Act to have extraterritorial application"); *see also supra* notes 84–85 (listing several cases which found that Congress intended that the Exchange Act apply extraterritorially).

issues. As a further distinguishing factor, foreign companies are also traditionally exempt from some disclosure or corporate governance provisions through administrative decisions of the SEC.[111] These administrative exemptions, the third prong of the *Foley Bros.* test for congressional intent,[112] strongly indicate that the U.S. securities laws were not intended to apply indiscriminately to foreign companies listed in the U.S.

An argument can be made, however, that this analysis may not apply to the Sarbanes-Oxley Act as courts have applied the presumption against extraterritoriality predominantly, if not exclusively, in labor and employment cases, and almost never in antitrust or securities cases.[113] Professor Turley suggests that this discrepancy can best be explained on the basis of economic principles.[114] In his view, courts have kept this presumption in "non-market" cases (labor and employment cases), but disfavored it in "market" cases (antitrust and securities matters), in which courts are concerned with protecting the integrity of U.S. markets,[115] because the impact of a single employment case on the U.S. economy is slight when compared to the potentially gigantic impact of a fraud case, such as Enron.[116]

This explanation is contradicted, however, by the various administrative exemptions granted to foreign issuers by the SEC. If indeed Congress thought that U.S. markets could be protected only if all U.S. securities laws and regulations apply extraterritorially, then the SEC would not have awarded these "dangerous" exemptions[117] in some cases in which the U.S. markets could have clearly been impacted. Accordingly, at least some other strategic factors, such as

111. *See* Coffee, *supra* note 8, at 1821 (explaining that it is a longstanding position of the U.S. exchanges and the SEC not to require foreign firms to satisfy the same listing requirements as domestic firms, which allows foreign firms to obtain "both greater liquidity and lower governance requirements"); *see also supra* note 34 (describing several accommodations).

112. *See supra* note 90 and accompanying text.

113. *See* Turley, *supra* note 80, at 608, 663–64 (pointing to this difference and arguing that the presumption against extraterritoriality is an archaic relic of legal realism that discourages multinational corporations from promoting corporate responsibility).

114. *Id.*

115. *Id.*

116. *Id. But see* Gibney, *supra* note 7, at 304 ("Rather than promoting some general principle such as the free market, as Turley suggests . . . U.S. law has been applied extraterritorially when that has served the national interest . . . and it has been given a territorial application when a restrictive interpretation would serve those same ends.").

117. For a listing of these exemptions, see *supra* note 34.

attracting foreign business or fear of potential foreign retaliation, may play into consideration when deciding whether or not foreign conduct should be regulated.

Moreover, the discrepancy between securities and labor cases involving extraterritoriality can also be explained by the fact that courts may feel that greater potential for international discord exists in the extraterritoriality of labor laws than in the extraterritoriality of securities laws. Labor and employment matters are sensitive political issues in which other states are presumed to have jurisdiction based on international law,[118] while market extraterritoriality is less invasive on the sovereignty of foreign states.[119] As the Supreme Court explained in *Foley Bros.*, "labor conditions . . . are the *primary* concern of a foreign country,"[120] thus interference with a country's

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118. American statutes are interpreted to apply "only to areas and transactions in which *American law would be considered operative under prevalent doctrines of international law*." Hartford Fire Ins. Co. v. California, 509 U.S. 764, 816 (1993) (Scalia, J., dissenting) (quoting Lauritzen v. Larsen, 345 U.S. 571, 577 (1953)). As the Supreme Court explained, "labor conditions . . . are the *primary* concern of a foreign country," Foley Bros. v. Filardo, 336 U.S. 281, 286 (1949), and thus American law would not be considered operative with respect to foreign conduct relating to labor conditions regulations.

119. Extraterritoriality is less invasive in market cases, because most states recognize, like the Supreme Court, that in an era of expanding world trade and commerce, "[w]e cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts." The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972).

In addition, most states usually declare fraud to be illegal, and as such their policies are not undermined when another state prosecutes frauds extraterritorially. As fraud is illegal in both the country of prosecution and the country where conduct occurred, there is also no true conflict between the laws of the two countries. The RESTATEMENT, *supra* note 1, § 416, reports that virtually no conflicts with other states occurred with respect to securities fraud cases.

120. *Foley Bros*., 336 U.S. at 285. For an argument why interfering with this primary concern would constitute an infringement upon German sovereignty, see *infra* note 176 and accompanying text.

Arguably, this could also be an intervention in the internal affairs of Germany. Intervention is usually understood as "dictatorial interference by a State in the affairs of another State for the purpose of maintaining the actual condition of things." LASSA FRANCIS LAWRENCE OPPENHEIM, INTERNATIONAL LAW 305 (Hersch Lauterpacht ed., 8th ed. 1955). Intervention can also be defined negatively as the breach of the duty of nonintervention: it is the duty of a state under international law not to interfere with the internal and external affairs of another state. *See* 5 M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 321–22 (1965) (describing the doctrine of nonintervention as "the duty . . . to refrain from the performance of any act which would violate the internal autonomy or the external independence of another state").

Extraterritorial actions are unlawful if they interfere with the duty of nonintervention. IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 309 (3d ed. 1979). Thus, a breach of this duty gives states a right to an international cause of action. *See supra* notes 76–77 and accompanying text. However, the duty of nonintervention is narrowly construed in light of

regulation of its labor conditions may raise significant nonintervention issues. These considerations counsel against the application of the audit committee requirement to foreign companies in countries that have codetermination, given that it increases labor's bargaining power.[121]

C. Prescriptive Jurisdiction

The prescriptive test for U.S. jurisdiction is an additional requirement that U.S. courts impose when deciding jurisdiction. This test, commonly known as the "effects test,"[122] is actually two-pronged: the first prong is the effects test itself and the second prong is a comity analysis.[123] Although the test for prescriptive jurisdiction is

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the impact of globalization, in spite of several U.N. General Assembly resolutions proscribing interference with domestic affairs. *See Declaration on the Inadmissibility of Intervention*, G.A. Res. 2131, U.N. GAOR, 20th Sess., 1408th plen. mtg. at 9, U.N. Doc. A/6220 (1965) (prohibiting, among others, the use by a state of economic, political, or other measures to coerce another state into subordinating the exercise of its sovereign rights or otherwise secure advantages from it); *see also* U.N. CHARTER art. 2, para. 7 (barring intervention by the United Nations into the domestic affairs of states); Tom J. Farer, *Political and Economic Coercion in Contemporary International Law*, 79 AM. J. INT'L L. 405, 413 (1985) (arguing that economic coercion constitutes aggression "only when . . . the *objective* of the coercion is to liquidate an existing state or to reduce that state to the position of a satellite"), *cited in* Sarah H. Cleveland, *Norm Internalization and U.S. Economic Sanctions*, 26 YALE J. INT'L L. 1, 53 n.308 (2001) (supporting the view that the duty of nonintervention tends to be narrowly interpreted).

121. *See supra* notes 41–46 and accompanying text.

122. The first case applying securities law extraterritorially was Schoenbaum v. First Brook, 405 F.2d 200 (2d Cir. 1968). The effects test is now the applicable test for extraterritorial jurisdiction in securities law. *See, e.g.*, Consol. Gold Fields PLC v. Minorco, S.A., 871 F.2d 252, 261–63 (2d Cir. 1989) ("The anti-fraud laws of the United States may be given extraterritorial reach whenever a predominantly foreign transaction has substantial effects within the United States."); *see also* Russell E. Brooks, *The Extraterritorial Reach of the Securities Exchange Act*, 24 SEC. REG. L.J. 306, 310–11 (1996) ("A . . . test under which federal courts may assert jurisdiction is the effects test."); John D. Kelly, *Let There Be Fraud (Abroad): A Proposal for a New U.S. Jurisprudence with Regard to the Extraterritorial Application of the Anti-Fraud Provisions of the 1933 and 1934 Securities Acts*, 28 LAW & POL'Y INT'L BUS. 477, 481–82 (1997) ("[A]nti-fraud provisions were to have 'extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities.'"); Louis Loss, *Extra-Territoriality in the Federal Securities Code*, 20 HARV. INT'L L.J. 305, 313–19 (1979) (stressing that the Securities Act of 1933 governs conduct that occurs outside the United States if it causes a substantial effect in the United States); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 556–63 (1976) (identifying "the existence of a substantial and foreseeable effect in the forum-country arising from conduct occurring outside its boundaries" as a basis for extraterritorial jurisdiction).

123. *See* RESTATEMENT, *supra* note 1, §§ 402–03 (identifying conduct that produces or was intended to produce a substantial effect within a territory as a basis for extraterritorial jurisdiction if the exercise of such jurisdiction is reasonable).

different from the test for subject matter jurisdiction discussed above, courts have often incorporated the prescriptive test in the subject matter test, presuming that Congress would not have wanted to apply a law abroad without some territorial effect on the U.S.[124] This Note treats the tests as different, however, in order to facilitate analysis. Thus, in order to satisfy U.S. jurisdiction, a law must satisfy not only the subject matter test for jurisdiction, but also the conduct targeted by that law must satisfy the test for prescriptive jurisdiction: a certain level of effects must exist so as to trigger jurisdiction, and the comity analysis must suggest that U.S. jurisdiction is not unwarranted. The rest of this Section applies this test to the Sarbanes-Oxley Act and argues that both the effects test and the comity analysis counsel against U.S. jurisdiction.

1. *The Effects Test under Restatement Sections 402, 416.* The U.S. effects test is derived from the objective territoriality principle in international law, which recognizes the right of a nation to exercise extraterritorial jurisdiction over a person abroad who willfully puts in motion a force that causes local harm.[125] Under the U.S. version of the effects test for securities transactions, the U.S. "may generally exercise jurisdiction to prescribe with respect to . . . conduct, regardless of where it occurs, significantly related to a transaction . . . if the conduct has, or is intended to have, a *substantial* effect" in the U.S.[126]

Interestingly, the U.S. test omits the international law requirement that the effects be harmful—they need only be

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124. *See* Turley, *supra* note 80, at 632:

> The effects and conduct tests . . . are tests of prescriptive jurisdiction used to resolve conflicts between the laws of the United States and the laws of other nations. In the extraterritoriality cases, these conflicts tests are used, by incorporation, as tests for subject matter jurisdiction. Thus, a court will presume that Congress would not want to apply a law abroad without some territorial effect or conduct or, alternatively, some clear expression of intent to the contrary.

See also, e.g., Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949) ("[L]egislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.").

125. *See* BROWNLIE, *supra* note 70, at 304 ("[T]he doctrine that territorial jurisdiction over conduct which has occurred wholly outside the territory of the State claiming jurisdiction may be justified because of the resulting economic 'effects' of such conduct within the territory of that State."). The principle was introduced by the Permanent Court of International Justice in the *Lotus* case, S.S. Lotus (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No. 9 (Sept. 7). *See id.* at 23–24 (holding that Turkey could apply its criminal laws to any foreigner who committed an offense outside of Turkey which harmed Turkey or its subjects).

126. RESTATEMENT, *supra* note 1, § 416 (emphasis added).

substantial. This change could be justified if U.S. courts were to argue that foreign activities with substantial positive effects on U.S. markets also have the potential of producing harmful effects if they are subverted, thus justifying a preemptive exercise of U.S. jurisdiction. However, under this theory, few limits to U.S. jurisdiction would remain. The better view is that the requirement that effects be harmful is implied in U.S. law, as the areas in which U.S. courts most readily have asserted extraterritorial jurisdiction involve activities which have substantial harmful effects on U.S. markets, such as antitrust, securities fraud and disclosure. Foreign securities fraud may harm U.S. investors and market integrity, nondisclosure increases information costs for U.S. investors and helps facilitate fraud, and conspiracies in restraint of trade harm U.S. consumers by increasing prices. Furthermore, a prudential concern suggests that the harm requirement be implied, as the U.S. would find it hard to justify internationally the regulation of activities that do not have harmful effects on the U.S. or its citizens.

Under either the U.S. or international version of the effects test, listing in the U.S. provides a basis for assertion of U.S. jurisdiction to prescribe disclosure requirements and prohibit conduct such as insider trading because both nondisclosure and insider trading negatively affect U.S. investors.[127] However, the Sarbanes-Oxley Act goes beyond prescribing disclosure requirements and prohibiting conduct that negatively affects U.S. investors;[128] rather, in cases where the harmful effects targeted by the Act are already minimized by foreign regulation, the Act arguably attempts to regulate conduct that does not have *substantial* harmful effects on U.S. investors. For instance, while the harmful effects of a German issuer's

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127. *See supra* note 53 and accompanying text.

128. In other words, a genuine link or jurisdictional nexus may be missing for some of the Sarbanes-Oxley regulations. *See* David Massey, Note, *How the American Law Institute Influences Customary Law: The Reasonableness Requirement of the Restatement of Foreign Relations Law*, 22 YALE J. INT'L L. 419, 429 (1997) (citing 58 A.L.I. PROC. 262 (1981) (comments of Louis Henkin)) (arguing that foreign countries have made objections to extravagant or exorbitant assertions of U.S. jurisdiction based not on the reasonableness principle, but rather "as a matter of interpretation of the 'effects principle'"). Massey argues that these objections "reflect a view as to how the traditional jurisdictional links should be interpreted—that they should not be interpreted to permit jurisdiction when the links between the regulating state and the regulated conduct are de minimis." *Id.* Although it may seem that the difference between the reasonableness test and the genuine link test may be no more than semantic, Massey argues that the two are distinct: although all exorbitant acts are unreasonable, not all unreasonable acts are exorbitant. *Id*. Massey also indicates that the U.S. government interprets the rules of prescriptive jurisdiction as requiring a genuine link. *Id*.

noncompliance with the provision prohibiting loans to executives[129] would be *substantial* absent German regulation, in reality, these effects are likely to be less significant given that German regulation already minimizes opportunistic behavior with respect to loans.[130] Similarly, in the case of the audit committee requirement, the effects of noncompliance with this requirement are likely insignificant given that the harmful effect targeted by the Act (that of unaccountable managers) is already minimized by German corporate structure: Managers in Germany are controlled by the concentrated shareholders,[131] thus being less likely to "cook the books."

This is not to say the foreign countries do not experience corporate scandals despite the existence of such safeguards:[132] No law will be able to deter certain aberrational individuals. The conduct of such foreign individuals will harm U.S. investors, which may prompt courts to find jurisdiction based on the substantial and harmful effects of that particular conduct. Such a finding would be unwarranted, however, because it is the noncompliance with the foreign safeguard, rather than with the Sarbanes-Oxley provision, which causes harm to U.S. and foreign investors. In other words, the Sarbanes-Oxley Act is no better able to deter aberrational individuals than are foreign

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129. Sarbanes-Oxley Act of 2002 § 402, 15 U.S.C.A. § 78m(k) (West Supp. 2003).

130. *See supra* notes 17, 22, 50–51 and accompanying text.

131. *See* Coffee, *supra* note 8, at 1826 n.286 ("The real deficiency in the extension of the audit committee to most European firms is that the audit committee was designed to monitor management . . . . Yet, in the system of concentrated ownership that characterizes most civil law jurisdictions, controlling shareholders naturally perform that function."). Instead, a system of concentrated ownership needs "an organ that can monitor the controlling shareholders." *Id.*

132. For a discussion of recent foreign corporate scandals, see Lawrence Cunningham, *From Convergence to Comity in Corporate Law: Lessons from the Inauspicious Case of SOX*, 2 INT'L J. DISCLOSURE & GOVERNANCE (forthcoming Jan. 2004). Professor Cunningham describes these scandals to criticize the "no-scandal here" attack on Sarbanes-Oxley, which maintains that the Sarbanes-Oxley Act addressed uniquely U.S. problems. Rather, Professor Cunningham argues that foreign scandals exist, but they have local flavors. As such, the solutions given by the Sarbanes-Oxley are unable to correct the local flavors of foreign scandals. This issue, among others, enables Professor Cunningham to argue that foreign issuers who undergo adequate regulatory supervision in their home countries should be exempt from the Sarbanes-Oxley Act. Candidates for exemption would be issuers from Canada, Germany, France, the U.K., Japan, Australia, the Netherlands, and perhaps Israel. Although any approach based on the concept of "adequate" supervision would run into definitional problems, the country examples provided by Professor Cunningham coincide with countries that have a comprehensive system of securities regulation and no history of widespread corruption or an overly lenient enforcement of securities laws. This approach for defining "adequate" foreign safeguards is similar to that employed in this Note. *See supra* note 51.

safeguards.[133] Naturally, the reverse is also true: When significant harmful effects exist, as with companies from countries in which harm-minimizing foreign regulation is nonexistent, or not enforced, the Sarbanes-Oxley Act should be applied extraterritorially.

2. *The Comity Analysis.* An early definition of comity articulated by the Supreme Court viewed it as "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws."[134] Although comity under this traditional definition is merely a matter of discretionary "recognition" of the legislative acts of another nation,[135] the American Law Institute (ALI) has made comity the second component of the test for prescriptive jurisdiction, equating it with interest balancing, also known as the reasonableness test.[136] ALI's introduction of this reasonableness test attracted vehement disapproval,[137] which culminated with the demise of interest balancing in *Hartford Fire Insurance v. California*.[138]

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133. Additionally, such aberrational individuals can be punished in their home countries for the violation of their home country safeguards, reducing the need for the Sarbanes-Oxley Act to apply so as to provide a remedy to harmed investors.

134. Hilton v. Guyot, 159 U.S. 113, 163–64 (1895). Comity has an even earlier tradition though, being traceable to Roman law and commercial law in the middle ages. *See* Joel R. Paul, *Comity in International Law*, 32 HARV. INT'L L.J. 1, 12–24 (1991) (discussing the judicial and intellectual history of the concept).

135. *See* Jake S. Tyshow, *Informal Foreign Affairs Formalism: The Act of State Doctrine and the Reinterpretation of International Comity*, 43 VA. J. INT'L L. 275, 288–89 (2002) (characterizing comity as a legal matter short of an "absolute obligation" but greater than a "mere courtesy and good will").

136. *See* RESTATEMENT, *supra* note 1, § 403 (identifying factors that test the reasonableness of a state exercising extraterritorial jurisdiction even when an acceptable basis for extraterritoriality exists). Interest balancing has been widely criticized, both by judges and courts. *See* Societe Nationale Industrielle Aerospatiale v. United States Dist. Court 482 U.S. 522, 553 (Blackmun, J., concurring in part and dissenting in part) (arguing that interest balancing is more appropriately considered by the Executive and Congress because judges lack experience with foreign legal systems, misapprehend foreign procedural rules, inaccurately assess foreign responses to particular acts, and are likely to exhibit a pro-forum bias). For an excellent academic critique of interest balancing, see generally Maier, *infra* note 153.

137. *See, e.g.*, Massey, supra note 128, at 428–37 (arguing that the ALI's reasonableness test misstated the customary international law rules of jurisdiction); *id.* at 423 n.24 (citing numerous critics of the reasonableness test).

138. 509 U.S. 764 (1993).

Hartford Fire involved a conspiracy of London coinsurance companies to limit the coverage of several pollution damage claims.[139] The London companies argued that section 1 of the Sherman Act[140] should not apply because comity suggested that U.K. law should apply, and the U.K. has developed a comprehensive regulatory system that permitted their conduct.[141] The five-Justice majority in *Hartford Fire* disagreed, holding that "comity is not a consideration in the exercise of public law jurisdiction until a 'true conflict' exists between the U.S. law and a foreign law."[142] Further, this "true conflict" exists for comity purposes only when U.S. law requires a person to do something which is prohibited under foreign law; comity considerations did not apply since British law did not require something which U.S. law prohibited.[143]

The *Harford Fire* opinion was somewhat shocking, as it seems to have equated comity with the doctrine of foreign sovereign compulsion.[144] The latter provides that when U.S. law requires a person to do something which is prohibited under foreign law, that person is not required to comply with U.S. law.[145] However, if the two concepts were indeed identical, there would have been little need for international law to use both.[146]

German issuers would probably be exempt from the audit committee requirement, under either *Hartford Fire* or the defense of foreign sovereign compulsion, given that there is a "true conflict" with German regulation: the Sarbanes-Oxley Act requires German

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139. *Id.* at 794–95.

140. 15 U.S.C. § 1 (2000).

141. *Hartford Fire*, 509 U.S. at 798–99.

142. Philip J. McConnaughay, *Reviving the "Public Law Taboo" in International Conflict of Laws*, 35 STAN. J. INT'L L. 255, 291 n.80 (1999).

143. *Hartford Fire*, 509 U.S. at 799 (1993).

144. *See* Andreas F. Lowenfeld, *Conflict, Balancing of Interests, and the Exercise of Jurisdiction to Prescribe: Reflections on the Insurance Antitrust Case*, 89 AM. J. INT'L L. 42, 46 (1995) (noting that foreign compulsion obviates the need to perform a comity analysis for extraterritorial jurisdiction); Swaine, *supra* note 6, at 680.

145. The doctrine of foreign sovereign compulsion is codified by the *Restatement*. *See* RESTATEMENT, *supra* note 1, § 441.

146. *See also* Lowenfeld, *supra* note 144, at 46 (footnote omitted)):

> Justice Souter's opinion seems to equate "conflict" with "foreign compulsion." For conflict, that is for inconsistent interests of states, *Timberlane* taught that one should evaluate or balance; for foreign compulsion, in contrast, we had understood since the *Nylon* and *Light Bulb* cartel cases of the early 1950s that no person would be required to do an act in another state that is prohibited by the law of that state or would be prohibited from doing an act in another state that is required by the law of that state; in other words, that the territorial preference would make balancing unnecessary.

issuers to do an act which is impossible to perform under German law.[147] But *Hartford Fire*'s true conflict test is not helpful in alleviating all the extraterritoriality issues presented by the Act; *Hartford Fire* would require German firms listed in the U.S. to comply with U.S. law on the loans to executives restriction because German law does not require something which the U.S. law forbids, even if German law places several safeguards on loans to executives.[148]

The existence of duplicative burdens from German and U.S. loan regulation support the view that the *Hartford Fire* majority misread the true conflict requirement.[149] *Hartford Fire* found it easy to decline the application of comity because the conduct at issue in *Harford Fire* was not regulated at all by foreign law, and thus the concept of a "true conflict" was an easy solution. However, the universe of possibilities is not split between "true conflict" and "no conflict" cases. *Hartford Fire* failed to imagine the existence of cases where two nonconflicting systems of regulation efficiently attempt to minimize the same problem.[150] Comity considerations in such cases may be applied to avoid unnecessary and duplicative regulations.

Thus, although the *Hartford Fire* majority was right that true conflict warrants the application of comity and is always a defense to extraterritoriality on grounds of foreign sovereign compulsion, the application of comity should not be limited to cases of true conflict, especially in commercial contexts such as the one here. Rather, in commercial contexts, the Supreme Court has recognized a more expansive view of comity, explaining that in an era of expanding world trade and commerce, "[w]e cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts."[151]

Thus, if one starts from the premise that transnational commercial activity is desirable because of the efficiency brought to U.S. investors and foreign issuers by market integration, then several U.S. Supreme Court cases suggest that comity should be applied in order to encourage the formation of a rule that facilitates such

147. For a discussion of the impossibility of compliance, see *supra* notes 129–131 and accompanying text.

148. See *supra* note 22 for a discussion of these safeguards.

149. *See supra* notes 144–146 and accompanying text.

150. *See supra* notes 22, 33 and accompanying text; *see also infra* notes 169–174 and accompanying text.

151. The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972).

commercial activity. Professor Maier analyzed these cases[152] and summarized them as follows:

> In every instance the court weighed the immediate interest of the United States in applying its own local law against its national interest in contributing to the development of an effective international system reflecting pragmatic functional values. Those systemic values mentioned include preservation of stability and order through decisions contributing to *predictability* for business planners in determining the applicable law, adoption of law selection principles that consistently identify which nation's policies are likely to be applied in similar cases regardless of forum, . . . deference to the need to facilitate the flow of goods and persons in transnational commercial intercourse, and continued concern for fairness to parties by respecting their legitimate *expectations* and thus encouraging useful transnational activity.[153]

The principle derived from these cases, favoring the protection of the *expectations of the parties*, suggests that where foreign corporate governance provisions already minimize the specific problem targeted by the Act, foreign issuers should only be subject to corporate governance law within their country of incorporation, because their expectations were that most corporate governance decisions are to be decided by the country of nationality. Such a rule also encourages *predictability*: Foreign issuers will be able to predict that they will be subject only to regulations that are not already in place in their country of incorporation, expecting that if conflicts arise, they will either be exempted or the SEC will negotiate a solution with affected foreign countries.[154]

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152. The cases discussed by Professor Maier include the following: *Lauritzen v. Larsen*, 345 U.S. 571 (1953); *Romero v. Int'l Terminal Operating Co.*, 358 U.S. 354 (1959); *Benz v. Compania Naviera Hildago*, 353 U.S. 138 (1957); *McCulloch v. Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10 (1963); *Windward Shipping v. American Radio Ass'n*, 415 U.S. 104 (1974); and choice-of-forum cases such as *Scherk v. Alberto-Culver*, 417 U.S. 506 (1974)).

153. Harold Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection Between Public and Private International Law*, 76 AM. J. INT'L L. 280, 315 (1982) (emphases added).

154. The granting of exemptions by the SEC, either unilaterally or in cooperation with foreign countries, is in itself a form a comity, known as regulatory comity. Some commentators suggest that regulatory comity should be the preferable form of comity, arguing that courts should abstain from resolving extraterritorial problems through comity: not only are courts ill-equipped to solve extraterritorial problems, but also such conflicts facilitate international negotiation and cooperation between the regulatory and executive bodies that are better able to solve these problems. *See, e.g.*, William S. Dodge, *Extraterritoriality and Conflict-of-Laws Theory: An Argument for Judicial Unilateralism*, 39 HARV. INT'L L.J. 101, 166 (1998). However, international agreements by regulatory and executive bodies do not solve all the problems of

Another reason for applying comity is the desire not to burden U.S. firms with similar duplicative regulations abroad. Professor Maier pointed out that the central theme in the above cases was the Court's recognition that "any decision applying municipal law to a transnational transaction will create legitimate reciprocal expectations about the applicability of foreign law to activities with similar relationships to foreign forums, and that this realization signaled restraint in applying United States legislation.[155] For instance, such restraint may be warranted to discourage foreign countries where U.S. issuers have a secondary listing from imposing corporate governance requirements that are different from, but target the same problems as, U.S. regulations.

III. ECONOMIC JUSTIFICATIONS FOR U.S. JURISDICTION

Even if the legal justifications discussed above suggest that some of the Sarbanes-Oxley provisions should not apply to foreign issuers, exporting corporate governance standards through securities regulations may be desirable from an economic efficiency standpoint. The rest of this Part analyzes three common economic justifications for asserting U.S. jurisdiction—fairness, bonding, and convergence—and concludes that these justifications do not support the extraterritoriality of the Sarbanes-Oxley audit committee and loan prohibition requirements.

A. Fairness

The first argument for U.S. regulatory jurisdiction over foreign issuers is that fairness requires that these companies be subject to U.S. securities regulations because they listed in the U.S. in order to

extraterritoriality, as they tend to bind only U.S. federal regulatory bodies, not private parties or U.S. states. *See, e.g.*, Swaine, *supra* note 6, at 661–62 ("But private parties go almost unmentioned in the bilateral agreements. The resulting gap in regulatory comity has been noted, however, in academic appraisals of *Hartford Fire*, and has resulted in calls for a legislative resolution . . . ."). Additionally, it is unclear whether application of judicial comity would have inhibited international regulatory cooperation, despite the fact that nonapplication of judicial comity has been correlated with increased cooperation. Such correlation may be spurious. Furthermore, judicial comity is not as pernicious as usually portrayed, since nothing stops Congress from amending an act to expressly provide that the act applies extraterritorially even in those case in which the courts may have previously found that an application of comity was warranted.

155. Maier, *supra* note 153, at 314–15.

profit from the superiority of U.S. markets.[156] However, this argument sees only half of the picture. The big, multinational companies only have a secondary listing in the U.S., and have a number of additional reasons for listing in the U.S. that have nothing to do with the superiority of the U.S. markets.[157] They could be listing in the U.S. in order to accommodate U.S. investors who wish to diversify their portfolios with foreign stock. In the absence of a U.S. listing, such investors would incur higher transaction costs, as they would have to purchase foreign stock in London or Frankfurt.[158] Also, these companies could be offering securities outside of their own country in order to hedge their exposure to their domestic market in cases of economic crises. A company looking to hedge domestic market exposure is probably indifferent to the choice of the foreign country it uses for hedging.[159] Given this indifference, some of these companies might have chosen New York over London relying on the special exemptions offered by the U.S. market.[160] Thus, such U.S. listings could be simply realizing market integration via New York rather than via London or Frankfurt.[161] In light of these concerns, in issues of

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156. This argument was made, for instance, by the SEC in attempting to justify imposing Regulation Full Disclosure (FD) on foreign issuers. *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,597 (proposed Dec. 28, 1999) (codified at 17 C.F.R. pts. 230, 240, 243, 249 (2003) ("[T]he vast majority of these issuers have subjected themselves to such reporting requirements by their election to access U.S. markets."). Regulation FD addresses the practice of "selective disclosure" whereby issuers selectively disclose "material, nonpublic information to analysts, institutional investors, and others, but not to the public at large." *Id.* at 72,591.

157. Of course, this may not be the case for many other less-established companies who probably list in the U.S. in order to benefit from the liquidity and lower costs of capital offered by U.S. capital markets.

158. U.S. investors could actually force these companies to become reporting companies under section 12(g)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(d) (2000), by having more than 500 U.S. investors buy securities of a company listed and traded on a foreign exchange. Hence a company that was forced against its will to become a reporting company may decide that since it is already paying the costs of reporting, it should at least reap the benefits of listing.

159. Unless, of course, European companies feel that European stock markets are interdependent, and as such hedging could only be done by having a secondary listing in the U.S. The general view is, however, that corporations are indifferent over where they raise money, with the location being selected based on price considerations such as interest rates and transaction costs. *See generally* Richard G. Ketchum, *The Role of the Securities and Exchange Commission in Regulating International Securities Trading: Looking to the Future*, 4 B.U. INT'L L.J. 33 (1986).

160. See *supra* note 34 for a description of these exemptions.

161. A survey of German corporations whose shares were traded internationally suggests that only 40 percent of the surveyed companies cited purely financial considerations as a motivation for cross-listing. Santucci, *supra* note 53, at 531. These considerations include the

corporate governance, fairness seems to also favor the foreign company relying on corporate governance exemptions, not only U.S. investors.

B. Bonding

The second argument advanced by economic-based approaches favoring the expansion of the traditional reach of U.S. security regulation is that foreign companies should not be given exemptions because they do not want such exemptions.[162] According to this argument, foreign companies decided to list in the U.S. precisely because they wanted more disclosure and restrictions than those imposed in their home countries, so as to reduce the discount investors were placing on their less transparent foreign securities.[163] This process is labeled bonding, and has been described as "a credible and binding commitment by the issuer not to exploit whatever discretion it enjoys under foreign law to overreach the minority investor"; in other words, "the issuer ties its own hands by subjecting itself to the mandatory requirements of U.S. law in order to induce minority shareholders to invest in it."[164]

This jurisdictional approach based on the bonding theory is problematic. Certainly, foreign firms must have expected to be subject to U.S. corporate governance requirements with respect to issues on which the country of incorporation remained silent. However, it is debatable whether these companies were agreeing to be subject, without exemption, to regulations about their corporate governance in matters in which their country of nationality already had established effective regulations that protect investors. After all,

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desire to increase the shareholder base and reduce capital expenses, as well as to give "*institutional investors in foreign markets access to German shares*." *Id.* (emphasis added).

162. This argument was discussed by Tanja Santucci in the context of exemptions from Regulation FD, 17 C.F.R. pts. 230, 240, 243, 249 (2003). Santucci, *supra* note 53, at 530–33. Regulation FD "address[es] the practice of 'selective disclosure' whereby issuers selectively disclose material, nonpublic information to analysts, institutional investors, and others, but not to the public at large." *Id.*

163. *See* James D. Cox, *Regulatory Competition in Securities Markets: An Approach for Reconciling Japanese and United States Disclosure Philosophies*, 16 HASTINGS INT'L & COMP. L. REV. 149, 159 (1993) (explaining investor discount as based on the magnitude of risk in a market and noting that "if a true equilibrium disclosure condition existed across all nations, [the investor] would demand higher returns to invest in the lower disclosure state than in the higher disclosure state").

164. John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence and Its Implications*, 93 NW. U. L. REV. 641, 691 (1999).

the discount placed by investors is based on the regulations to which these issuers are not subject, not those which already exist in their country of incorporation. Moreover, to the extent that the costs imposed by added U.S. corporate governance regulation outweigh the benefits derived from bonding, these companies, as rational actors, would probably not prefer bonding.[165]

C. Convergence

The third argument that can be made in favor of extraterritoriality is that changes in foreign corporate governance induced by U.S. law could be desirable because a country's corporate code often includes concessions to interest groups (such as labor) that make the country, as a whole, worse off.[166] However, such exportation of American norms is problematic if it prompts a backlash against the perceived "American imperialism," a scenario likely to materialize if this century were experiencing a "clash of civilizations" rather than convergence of norms and structures towards an American legal model,[167] a convergence also referred to as the end of history.[168]

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165. For a similar argument, under which foreign issuers are subject to higher costs in the corporate governance context than in the disclosure context, see Taneda, *supra* note 59, at 757–58. Taneda argues that, with respect to disclosure requirements, the benefits of the regulation are as likely to apply to foreign issuers as to domestic issuers, but that regulations that are designed to cure corporate governance failures are likely to have far fewer benefits and more substantial costs due to the different agency structure in foreign countries. *Id.* Additionally, it is costlier for foreign issuers to comply with such regulations because they come from a different starting point. *Id.*

166. This argument was advanced, for instance, by Harvey Pitt, who argued that the problems of the U.S. corporate system exist everywhere in the world. *See supra* note 52.

167. *Compare* SAMUEL P. HUNTINGTON, THE CLASH OF CIVILIZATIONS AND THE REMAKING OF WORLD ORDER 31 (1996) (predicting a clash of civilizations rather than the triumph of one idea), *with* Francis Fukuyama, *The End of History?*, NAT'L INT., Summer 1989, at 3 ("The triumph of the West, of the Western *idea*, is evident first of all in the total exhaustion of viable systematic alternatives to Western liberalism."), *and* Francis Fukuyama, THE END OF HISTORY AND THE LAST MAN (1992) (predicting a worldwide movement to liberal democracy). The Huntington-Fukuyama debate is fundamental enough to be depicted in most introductory textbooks in international relations. *See also* Antonio F. Perez, *International Antitrust at the Crossroads: The End of Antitrust History or the Clash of Competition Policy Civilizations*?, 33 LAW & POL'Y INT'L BUS. 527, 542 (2002):

> Under [Fukuyama's] vision, the core principles of democratic capitalism, which have largely reached their clearest expression in the sociopolitical order of the United States, have triumphed over all other competing models. . . . As post-Communist brushfires erupted over the globe and a new competition emerged between the United States and rising forces in East Asia and the Middle East, Huntington advanced a vision that saw no final victory for Western democratic capitalism, but rather, imagined an emerging, yet unavoidable, conflict between the great civilizations of the world, each defined in terms of fundamental views of man, society, and the state.

Convergence theorists argue that the U.S. corporate governance based on the separation of ownership and capital will eventually predominate in the world, because it is the most efficient one.[169] As a

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For another response to Fukuyama, see for example, BRUCE ACKERMAN, THE FUTURE OF LIBERAL REVOLUTION 122 (1992).

In the context of corporate governance, several authors have argued the triumph of the U.S. corporate governance model over all others. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 443 (2001) ("[W]e are witnessing rapid convergence on the standard shareholder-oriented model."); *see also infra* note 169 (listing scholarship predicting convergence). Like in other disciplines, the idea of an end of history is widely disputed. *See* Douglas Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321, 330–36 (2001) (arguing that convergence is not taking place and that the world might be experiencing several backlashes against the prospect of a Lex Americana). Professor Branson makes several excellent observations why such an end of history is a myth, despite his vehement tone in attacking the alleged chauvinism of the convergence theorists. *Id.*

168. Although authors attribute the "end of history" idea to Fukuyama, the idea is not new and has been prematurely proclaimed before. Robert N. Strassfeld, *If . . .: Counterfactuals in the Law*, 60 GEO. WASH. L. REV. 339, 344 n.25 (1992):

> [P]roclamations of the end of particular ideas, ideologies, methods, or theories often prove to be embarrassingly premature. In the late 1950s, Daniel Bell and Seymour Martin Lipset announced the "end of ideology" and the "exhaustion of political ideas." Events quickly showed their claim to be unprescient, although recently we have heard it echoed in the proclamation of the end of history.

(citations omitted) (quoting DANIEL BELL, THE END OF IDEOLOGY: ON THE EXHAUSTION OF POLITICAL IDEAS IN THE FIFTIES, 17, 409 (1988 ed.); SEYMOUR M. LIPSET, THE POLITICAL MAN: THE SOCIAL BASES OF POLITICS, 403–17 (1960)). The concept of "end of history" can be traced back to Hegel, whom Fukuyama arguably misreads:

> It is also common to assume that since Hegel speaks about the "end of history" and posits that the modern constitutional state developed because it resolved certain contradictions existing in more "primitive" societies, that Hegel believes the modern state is a final resolution. Once again, this is a misconception. As Hegel famously states in the preface to The Philosophy of Right, speculative philosophy, as he understands it, is a retroactive, not a prospective, study.

Jeanne L. Schroeder, *The Stumbling Block: Freedom, Rationality, and Legal Scholarship*, 44 WM. & MARY L. REV. 263, 324 (2002); *see id.* at 324 n.239 (specifically criticizing Fukuyama's interpretation).

169. *See* Coffee, *supra* note 164, at 705–07 (1999) ("Those firms seeking to grow in size to a global scale are likely to elect into the "higher" governance standards already largely observed in the United States, and such bonding should minimize the social friction and even unrest that formal convergence could cause . . . . "). Professor Coffee predicts that "just as securities regulation has over the last thirty years dominated substantive corporate law in the United States, so too may the law of securities markets effectively overshadow local substantive law on a global basis, at least in the case of the largest public corporations." *Id.* According to him, there are both normative and efficiency arguments for convergence, including (1) substantial savings in transaction costs and increased comparability of issuers, (2) reduced agency costs and increased ability of foreign firms to sell their shares in public markets, and (3) longer-term and higher-risk investments, which translate into higher economic growth. *Id.* Moreover, he argues, "facilitating dispersed ownership would produce desirable social and political consequences" as in the absence of "legal protections for the minority shareholders, investors depend on relationships, not law." *Id.*

corollary, the agency problems inherent in the separation of ownership and control[170] must exist everywhere, and this invites arguments such as that advanced by the former SEC Chairman Harvey Pitt, while in office, that Sarbanes-Oxley should apply to foreign companies because the corporate problems faced by the U.S. are present everywhere in the world.[171]

This convergence-based argument fails to recognize that the corporate problems faced by the U.S. may be specific to a model premised on the separation of ownership and control, and as such, the problems faced by U.S. companies are not present in countries lacking this separation of ownership and control. Additionally, even in countries that have a corporate model based on the separation of

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For further arguments predicting convergence, see Brian R. Cheffins, *Current Trends in Corporate Governance: Going from London to Milan via Toronto*, 10 DUKE J. COMP. & INT'L L. 5, 6 (1999) ("Movement towards a worldwide capital market could in turn have a substantial impact on corporate governance in individual countries."); Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1145–46 (1999) ("[C]ountries have sought to improve their corporate governance structures by implementing the best policies from around the world."); Jeffrey N. Gordon, *Pathways to Corporate Convergence? Two Steps on the Road to Shareholder Capitalism in Germany*, 5 COLUM. J. EUR. L. 219 (1999) (referencing the ongoing debate about whether the Anglo-American corporate model will triumph through convergence); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 453 (2001) (identifying efficiency, competition, interest group pressure, imitation, the need for compatibility, cross-border harmonization, and corporate charter competition as forces driving convergence); Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L.Q. 367, 388 (1996) (championing competition among international corporate governance structures). In contrast, other commentators believe that path dependence may be an obstacle to convergence. *See* Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 135–36 (1999) (noting that forces exist to spur convergence but have been unable to overcome the historically developed, and differing, corporate governance structures).

170. The problems inherent in the separation of ownership (shareholders) and control (managers) were popularized by the pioneering work of Berle and Means. *See* ADOLPH BERLE & GARDNER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 6–7 (rev. ed. 1968) (predicting that large corporations will almost inevitably experience separation of ownership and control). Managers have little incentive to act in the most economically efficient way because they do not always reap the profits of such actions. *Id.* at 115 (citing corporate misdeeds of managers of various railroads in the first decade of the twentieth century as evidence that management has interests conflicting with those of the shareholders and would pursue personal profit even at cost of bankrupting a corporation). Although competition and regulation help better align the interests of managers and shareholders, the agency problems deriving from separation of ownership and control cannot be fully eliminated, as demonstrated by the recent corporate scandals that prompted the enacted of the Sarbanes-Oxley Act.

171. *See supra* note 52.

ownership and control, culture or social norms may play a role in reducing opportunistic behavior.[172]

Most importantly, the convergence-inspired approach that Harvey Pitt advocates glosses over the possibility that although the problems targeted by the Sarbanes-Oxley might exist abroad, foreign countries are already efficiently regulating them, as in the case of German restrictions on loans to executives.[173] Although the SEC could argue that regulations of these issues in developed countries may not be as effective as U.S. regulations, adopting an approach under which U.S. law must be applied because it is overwhelmingly more effective than its foreign counterpart demeans "the standards of justice elsewhere in the world, and unnecessarily exalts the primacy of United States law over the laws of other countries."[174] Accordingly, end of history or not,[175] excessive extraterritoriality can still be viewed as objectionable because it infringes upon the sovereignty[176] of the foreign regulator.

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172. *See* Rock, *supra* note 169, at 388 (concluding that "[a]s a general matter, product and labor markets and social norms seem to trump corporate governance structures in determining success or failure by a wide margin").

173. *See supra* note 22 (describing the German provisions).

174. Scherk v. Alberto-Culver, 417 U.S. 506, 517 n.11 (1974).

175. If the world were indeed experiencing an end of history, there would be little need for this Note, because the exportation of American standards would be controversial only in the short run. In the medium and long run, such exportation would be harmless as it would merely help speed up the harmonization of legislation. However, despite the attractiveness of an end-of-history argument in terms of efficiency (harmonization of laws decreases transaction and compliance costs for cross-listed companies) and understanding (on the lines of the argument that democracies do not fight each other), the triumph of one model or ideology can be problematic. On the dangers inherent in the triumph of one model or ideology, see THEODORE ADORNO, NEGATIVE DIALECTICS 334–65 (E. B. Ashton trans., Continuum 1999) (1973).

176. Excessive extraterritorial assertions of jurisdictions over physical or juridical persons of a foreign nationality for conduct undertaken on the foreign sovereign's territory represent an encroachment on the sovereignty of the foreign state because the foreign state's jurisdiction to prescribe rules for the conduct on its territory is viewed as an attribute of its sovereignty. *See supra* notes 76–120 and accompanying text. This is because sovereignty is used to describe the "whole body of rights and attributes which a state possesses in its territory, to the *exclusion* of all other states, and also in its relations with other states." The Corfu Channel Case (U.K. v. Alb.), 1949 I.C.J. 39, 43 (Apr. 9) (separate opinion of Judge Alvarez) (emphasis added). For similar definition of sovereignty, see JARROD WIENER, GLOBALIZATION AND THE HARMONIZATION OF LAW 8 (1999) (defining the power "to exercise supreme authority over a territory carved on the physical map of the world" as a primary aspect of sovereignty). However, international law recognizes several situations where such an encroachment on sovereignty is legal. *See supra* notes 68–69 and accompanying text.

D. The Need for Cooperation

Finally, even if the economic justifications for U.S. jurisdiction (fairness, bonding, and convergence) supported the extraterritoriality of the Sarbanes-Oxley Act, cooperation with foreign states would achieve the outcomes envisioned by the Act at fewer costs. Although the need for cooperation has always been evident as "[w]e cannot have commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts,"[177] several developments make the call for cooperation imperative. These developments include the growing competition from foreign exchanges with more lax requirements and the need to obtain foreign information and documents in order to implement extraterritorial regulatory measures.[178]

It is also unlikely that foreign states would permit regulatory improvements via United States's unilateral assertions of regulatory jurisdiction. Even if U.S. regulation promoted overall economic efficiency, foreign states are unlikely to allow the U.S. to unilaterally export its corporate governance norms. Rather, sovereignty concerns are likely paramount to efficiency concerns, given that states tend to maximize relative gains rather than absolute gains in the absence of an institutionalized cooperation regime.[179] Thus, when deciding whether or not to retaliate against extraterritorial foreign regulation, states would look at relative gains (here, a relative loss in sovereignty because the change would come unilaterally from the U.S.) and not at

177. The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972).

178. *See* Amir N. Licht, *Games Commissions Play: 2x2 Games of International Securities Regulation*, 24 YALE J. INT'L L. 61, 67 nn.17–18 (1999). The SEC has itself announced that it would prefer cooperative measures to unilateral ones. Regulation of International Securities Markets—Policy Statement of the U.S. Securities and Exchange Commission, Securities Act Release No. 33,6807, [1988–1989 transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 84,341, at 89,576 (Nov. 14, 1988). For a discussion of this document, see Paul G. Mahoney, *Securities Regulation by Enforcement: An International Perspective*, 7 YALE J. ON REG. 305, 310–20 (1990).

179. As states are believed to maximize relative gains rather than absolute gains, higher absolute economic welfare matters less than a possible decrease in security resulting from a rival state's higher increase in economic power. *See generally* Joseph Grieco, *The Relative Gains Problem for International Cooperation*, 87 AM. POL. SCI. REV. 729 (1993); Michael Mastanduno, *Do Relative Gains Matter? America's Response to Japanese Industrial Policy*, 16 INT'L SEC. 73 (1991); Duncan Snidal, *Relative Gains and the Pattern of International Cooperation*, 85 AM. POL. SCI. REV. 701 (1991). International institutions facilitate cooperation. *See* Licht, *supra* note 178, at 99 ("[O]rganizations like IOSCO may still facilitate cooperation by offering opportunities for issue linkage and by helping the smaller player to save face domestically. Thus, it may be considered more respectable to yield to IOSCO than to the SEC.").

absolute gains (here, an absolute increase in efficiency). For this reason, the proliferation of unilateral assertion of jurisdiction by the U.S. has led to conflict with other states, who, feeling that their sovereignty has been violated,[180] have enacted various "antidote" laws in response.[181] For instance, bank secrecy laws and blocking laws have hindered unilateral enforcement of U.S. securities laws.[182] Thus, the combined effect of the unilateral extraterritorial offensives and the antidote laws bears resemblance to a legislative "arms race,"[183] a result that is—as in military races—suboptimal: it either helps foreign

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180. Although international law recognizes a state's right to criminalize conduct that occurs outside its borders if such conduct has effects in the state in question, foreign states may have felt that the U.S. went beyond the traditional bases for extraterritorial jurisdiction, either because the effects in the U.S. were not substantial or because the U.S. laws conflicted directly with the laws and policies the other sovereigns were promoting.

181. *See, e.g.*, Jorge F. Pérez-López & Matias F. Travieso-Diaz, *The Helms-Burton Law and Its Antidotes: A Classic Standoff*, 7 SW. J.L. & TRADE AM. 95, 155 (2002) (discussing various antidote laws to the Helms-Burton Act that were introduced by Canada (October 1996), Mexico (October 1996), the European Union (November 1996), and Argentina (September 1997) and concluding that antidotes have the effect of forcing cooperation, not unilateralism: "[t]he antidote laws enacted by other nations may have . . . [made] the Clinton Administration more amenable to reach a compromise that minimizes the risk of multiple, inconsistent court adjudications and administrative actions"). Similarly, in the antitrust area, foreign countries have enacted blocking and clawback statutes. Blocking statutes prohibit compliance with foreign discovery orders. RESTATEMENT, *supra* note 1, § 442 reporters' note 4 (describing several blocking statutes). Clawback statutes permit foreign defendants to bring suits against the original plaintiff to recover the noncompensatory portion of damage awards from the original plaintiff. *See, e.g.*, Dodge, *supra* note 154, at 164–65 (describing the British Protection of Trading Interests Act as one of the most prominent clawback statutes and explaining that this British statute also permits "the British Secretary of State to prohibit compliance with the extraterritorial application of another country's substantive law that would 'damage the trading interests of the United Kingdom'").

182. *See* Kehoe, *supra* note 12, at 359–69 ("Since the most useful evidence in the investigation of violations of securities laws often is located in financial documents and records of money transfers, [some foreign] laws significantly restrict access to information which can be critical to investigations of securities violations."). Bank secrecy laws prohibit foreign banks from "disclosing information regarding customers' transactions," and blocking laws "prohibit these banks from providing certain information to foreign investigators." *Id.*

183. *See, e.g.*, Licht, *supra* note 178, at 64–65 (pointing out, in the context of international securities regulations, that "cooperative efforts . . . are the exception to the rule, while the general situation is one characterized by fierce competition and lack of cooperation").

The result of regulatory competition in areas that do not involve retaliation can be described by another race, a "race to the bottom," in the sense of a legislative trend toward the lowest common denominator. *See id.* (citing Joseph A. Grundfest, *Internationalization of the World's Securities Markets: Causes and Regulatory Consequences*, 1990 J. FIN. SERVICES. RES. 349; Joel P. Trachtman, *International Regulatory Competition*, *Externalization, and Jurisdiction*, 34 HARV. INT'L L.J. 47 (1993)).

individuals or corporations to avoid U.S. laws altogether[184] or it overregulates bona fide companies.

Given this concern with a perceived loss of sovereignty resulting from unilateral imposition of U.S. legislation, states will more likely make corporate governance changes via cooperation, as cooperative endeavors entail a consensual, rather than nonconsensual, loss of jurisdiction. Indeed, the U.S. has succeeded to impose its view on insider trading via treaties and agreements,[185] rather than via unilateral assertions of jurisdiction.[186]

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184. *See, e.g.*, James R. Doty, *The Role of the Securities and Exchange Commission in an Internationalized Marketplace*, 60 FORDHAM L. REV. S77, S83 (1992) ("One of the greatest difficulties of investigating illegal cross-border conduct is gathering evidence [abroad]."). Thus, retaliatory provisions such as clawback statutes in discovery disputes favor delinquents, undermining the very assertion of jurisdiction.

185. *See* Licht, *supra* note 178, at 125 ("Within the analytical framework suggested here, we can say that the United States has realized that it cannot exert hegemonic power, in the traditional sense, to induce countries to curb insider trading . . . ."). Professor Licht argues that the U.S. saw itself as an ideological hegemon and "utilized IOSCO to achieve the same result." *Id.* ("For all its members, IOSCO served the classic role assigned to a weak organization like itself. First, by giving its imprimatur, it helped the members save face. Second, by providing the text of a model [Memorandum of Understanding ("MOU")], it strengthened the cooperational focal point."); s*ee also* Kehoe, *supra* note 12, at 359–69 ("Early attempts at enforcement of cross-border insider trading violations were heavy-handed unilateral efforts aimed at the extraterritorial application of U.S. securities laws. Though some of these attempts were effective, foreign countries viewed many as infringements upon their sovereignty."). In contrast, the U.S. presently enforces insider trading laws "through a variety of methods," including the "Memoranda of Understanding as well as mutual legal assistance treaties to assist [the U.S.'s] enforcement efforts." *Id*. at 358. For a discussion of MOUs, see *id*. at 359–62.

Professor Licht also argues that states would be more willing to enact and enforce anti-insider trading laws if they "could be assured that their progressive (hostile) stance against insider trading will not be exploited by their competing rivals." Licht, *supra* note 178, at 118 n.197. To ensure other countries that it prefers cooperation, the U.S. used signaling mechanisms in addition to MOUs. *Id.* (suggesting that the Insider Trading and Securities Fraud Act of 1988 (ITSFEA) and the International Securities Enforcement Cooperation Act of 1990 (ISECA) complement the MOU system and give the SEC more license in cooperating with fellow authorities, thus functioning as a "signaling mechanism—a unilateral assurance on behalf of the United States that it is willing to pursue cooperative paths").

186. Of course, an argument can be made that the U.S. has been able to convince other states to sign MOUs or treaties on insider trading precisely because of its power to assert extraterritorial jurisdiction. This power is based on the fact that many companies have assets in or contacts with the United States. Accordingly, weak states could have realized that if they cannot beat the U.S., they would better join it. However, the efficacy of clawback statutes and other antidote laws in deterring the extraterritorial application of U.S. law suggests that such an argument does not explain why some countries opposed (successfully) unilateral U.S. action, but were willing to compromise in treaties. *See supra* note 185. Rather, the theory that sovereignty is paramount is better able to explain this phenomenon.

CONCLUSION

This Note argued that it is hard to justify U.S. regulatory jurisdiction under the effects test in cases where foreign regulation already minimizes the effects of foreign conduct on U.S. markets. Moreover, comity considerations, in the sense of abstention from jurisdiction based upon a desire of "progress toward the goal of establishing the rule of law among nations,"[187] also counsel against unilateral assertion of extraterritorial jurisdiction in corporate governance issues. Application of comity would render a faster and more sustainable rule of law among nations because it would foster predictability in international transactions and protect the expectation of foreign issuers.

Even if these legal justifications suggest that some of the Sarbanes-Oxley provisions should not apply to foreign issuers, exporting corporate governance standards via securities regulations may be desirable if convergence theorists are right that foreign corporate systems are moving toward the U.S. model. This Note suggested, however, that this economic-driven view of international interaction fails to take into account sovereignty considerations. Corporate governance codes may embody fundamental compromises that people make about their communities, and the relinquishment of rights to regulate these choices, in favor of choices that the U.S. has made, would be found unacceptably intrusive and would thus attract retaliation. This would result in a suboptimal solution because the U.S. may find itself unable to police foreign conduct that Congress *may* have wanted to regulate. As such, this Note concludes that both legal and economic justifications suggest that cooperation would render a faster and more sustainable rule of law among nations than does unilateral exportation of American norms.

187. Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 437 (1964).