

Comment

**BETWEEN A ROCK AND A HARD PLACE:
THE SARBANES-OXLEY ACT AND ITS GLOBAL IMPACT**

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I. INTRODUCTION

*“What does Sarbanes-Oxley mean? That’s when two members of U.S.
Congress fiddle and half a million accountants in Europe start dancing.”¹*

As U.S. corporations progressively move into international markets, many are confronting foreign regulations, which seem to conflict with those governing operations in the U.S, and the Sarbanes-Oxley Act² (“Sarbanes-Oxley”) is arguably the legislation presenting the most challenges to publicly traded organizations. Sarbanes-Oxley was hurriedly enacted by Congress to restore investor confidence and curb various corporate excesses³ after the blight of accounting irregularities and financial turmoil which shook the U.S. corporate landscape and eventually engulfed industry heavyweights such as Enron⁴,

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¹ See Klaus C. Engelen, *Preventing European “Enronitis,”* INT’L ECON., June 22, 2004, at 40.

² *Sarbanes-Oxley Act of 2002*, 15 U.S.C. § 7201 et seq., PL 107-204, 116 Stat 745 (2002).

³ See Lawrence A. Cunningham, *From Convergence to Comity in Corporate Law: Lessons from the Inauspicious Case of SOX* (Boston Coll. Law Sch., Pub. Law & Legal Research Paper Series, Paper No. 24, 2003), available at <http://ssrn.com/abstract=462142>.

⁴ For authoritative accounts of Enron's accounting schemes, see John Coffee, *What caused Enron? A capsule social and economic history of the 1990s*, 89 CORNELL L. REV. 269, 297-98 (2004); William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002); Brian Kim, *Recent Development: Sarbanes-Oxley Act*, 40 HARV. J. ON LEGIS. 235 (2003).

WorldCom⁵, Global Crossing⁶ or Adelphia⁷. Sarbanes-Oxley was described by President Bush as the “most far-reaching reform of American business practices since the time of Franklin Delano Roosevelt.”⁸ However, others have been less than thrilled with the heavy burdens imposed by the Act⁹ and its extraterritorial impact – that is, when one country imposes its laws on persons operating outside its territory – since this measure is perceived as imposing substantial, and hidden, costs on international commerce and industry, while creating new conflicts between jurisdictions. Although Sarbanes-Oxley was only intended to address domestic concerns, the importance of U.S. capital markets in the global economy unfortunately resulted in the Act possessing international “spill-over” effects.

The extensive range of the Act not only had an impact in corporate America, but also in international securities markets in which the United States is a dominant player. For instance, foreign auditing firms, who audit foreign and U.S. issuers, must register with Sarbanes-Oxley’s Public Company Accounting Oversight Board (“PCAOB”). Likewise, the lack of an express exemption to foreign private issuers in Sarbanes-Oxley had a substantial impact on globalization. Accordingly, the Act applies not only to all corporations and subsidiaries whose securities are listed on a U.S. stock exchange, but also to non U.S. issuers who are required to file annual *Form 20-F*¹⁰ or *Form 40-F*¹¹ reports, as well as to all companies that register their securities for sale in the U.S., including through the use of the *American Depositary Receipt* program.¹² Perhaps the most internationally challenging provision of Sarbanes-Oxley is the requirement for organizations listed on U.S. stock exchanges to establish mechanisms for the “receipt, retention and treatment” of anonymous employee reports regarding fraud in accounting, auditing, and financial reporting¹³ (i.e., “whistleblower hotlines”). As a result, multinational groups listed on U.S. stock exchanges find themselves in an unenviable position: on one hand, they are required to set up specific whistleblowing procedures in their establishments located outside the United States, but on the other hand, they also need to comply with local legislation and be sensitive to cultural differences that may exist. This is no easy feat as there are potential conflicts between Sarbanes-Oxley and foreign law (such as E.U. data protection and privacy legislation).

The extensive range of this legislation and its potential conflicts with existing legal and regulatory systems have caused substantial controversy, especially in Europe. Until the *Parmalat* fiasco¹⁴, both European accountants and regulators were under the belief that

⁵ Harold S. Bloomenthal, *Sarbanes-Oxley Act in Perspective* § 1, at 3 (2002).

⁶ Dennis K. Berman et al., *Global Crossing Ltd. Files for Bankruptcy*, WALL ST. J., Jan. 29, 2002, at A3.

⁷ See Robert Frank & Deborah Solomon, *Adelphia and Rigas Family Had a Vast Network of Business Ties*, WALL ST. J., May 24, 2002, at A1.

⁸ Elisabeth Bumiller, *Bush Signs Bill Aimed at Fraud in Corporations*, N.Y. TIMES, July 31, 2002, at A1.

⁹ See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521 (2005); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. Corp. L. 1 (2002); W. Carson McLean, Note, *The Sarbanes-Oxley Act: A Detriment to Market Globalization & International Securities Regulation*, 33 SYRACUSE J. INT’L L. & COM. 319 (2005); Del Jones, *Sarbanes-Oxley: Dragon or White Knight?*, USA TODAY, Oct. 20, 2003, at 1B.

¹⁰ Registration of securities of foreign private issuers, pursuant to section 12(b) or (g) and annual and transition reports pursuant to sections 13 and 15(d). See 17 C.F.R. § 249.220f.

¹¹ This form is primarily for Canadian issuers. See 17 C.F.R. § 249.240f.

¹² An American Depositary Receipt (“ADR”) is a negotiable certificate issued by a U.S. bank representing a specified number of shares (or one share) in a foreign stock that is traded on a U.S. exchange.

¹³ 15 U.S.C. § 78j-1(m)(4).

¹⁴ The massive accounting scandal at Italian diary giant Parmalat SpA is very similar to the Enron fraud, earning the nickname of “Europe’s Enron”: despite annual losses of 350 to 450 million euros from the 1990s through 2001, Parmalat “cooked the books” to show positive earnings for the years in question. For a detailed

incidents similar to Enron could not take place in Europe¹⁵ and thus dismissed Sarbanes-Oxley as irrelevant in the European context.¹⁶ Some European authorities went a step further and denounced what they perceived as “American legal and economic imperialism” – legislation imposing U.S. centric concepts and standards on the rest of the world.¹⁷ Therefore, the European scandals served as a wake-up call to the world that corporate frauds can occur in any country, whenever control mechanisms are lacking. In addition, the controversy was fueled by the fact that an overwhelming number of lawyers outside the United States were confused about the scope of Sarbanes-Oxley and feared it would ultimately override national regulatory authorities.¹⁸ Although these concerns are certainly legitimate, the fact that U.S. securities laws apply to corporations outside the United States is neither a radical nor a recent development.

This Note examines how Sarbanes-Oxley fits within the extraterritorial framework of U.S. securities regulation. Part I provides a brief summary of the bases of extraterritorial application of Sarbanes-Oxley and U.S. securities law. Part II explores the territorial reach of previous U.S. securities law to determine whether Sarbanes-Oxley’s extraterritorial scope is really a departure from previous regulations or not. Finally, Part III analyzes the extraterritorial nature of Sarbanes-Oxley and how its scope diverge from traditional securities regulations. This paper concludes that Sarbanes-Oxley does not actually expand the territorial scope of securities law, but that its regulation of corporate governance is a significant departure from traditional methods of securities regulation.

II. THE BASES OF EXTRATERRITORIAL APPLICATION OF THE SARBANES-OXLEY ACT AND U.S. SECURITIES LAWS

A. *The Implied Consent to Submit to the Jurisdiction of U.S. Courts*

The United States has consistently been at the forefront of the extraterritorial application of its legislation, and has extensively used this practice in the area of competition/antitrust law,¹⁹ and to a lesser extent, in criminal, environmental, financial and securities law. Nevertheless, despite the various criticism of its laws, the U.S. market has been very successful in attracting foreign companies to be listed on its stock exchanges. In 1981, there were only 173 foreign companies registered with the U.S. Securities and Exchange Commission²⁰ (“SEC”). In 1991, this number rose to 439, whereas there are now over 1300 foreign companies registered,²¹ which is triple the number of listings in 1991. In addition, whereas most of the foreign companies registered with the SEC in the 1980s were from Canada or big companies from Europe, listed companies now come from

summary of the Parmalat scandal, see Gail Edmondson & Laura Cohn, *How Parmalat Went Sour - Here's the Skinny on Europe's Enormous Financial Scandal*, BUS. WK., January 12, 2004, at 46.

¹⁵ *Id.*

¹⁶ Roger Adams, *Enron to Parmalat: Now Europe Needs to Declare War on Fraud*, INT'L HERALD TRIBUNE, January 14, 2004, at 7.

¹⁷ For a representative foreign reaction, see Brigitte Stern, *Les Etats-Unis et le droit impérialiste*, LE MONDE, September 12, 1996, at 12.

¹⁸ See LexisNexis, *Sarbanes-Oxley Disclosure and Confidentiality – Executive Summary*, available at http://www.lexisnexis.com/about/whitepaper/LexisNexis_ExecSummary.pdf.

¹⁹ Paul M. Kaplan, *Extra-Territorial Reach of U.S. Antitrust Laws to Foreign Firms*, N.Y.L.J., June 13, 2006, at 4, col. 4.

²⁰ Hannah Buxbaum et al., *Regulating Corporations: Who's Making the Rules?*, in 97 AM. SOC'Y INT'L L. PROC. 269, 271 (2003).

²¹ *Id.*

all around the world, including Latin America, Asia, Eastern Europe and Africa.²² Out of the 1300 foreign companies registered in the U.S., nearly 500 are Canadian, 108 are British, 86 are Israeli, 41 are Mexican, 41 are Brazilian, 35 are Dutch, 34 are French, 31 are Japanese and the rest come from 47 other countries worldwide.

There are a number of reasons why foreign issuers would like to be listed on U.S. exchange markets. Investor demand for foreign securities is abundant in U.S. markets,²³ which means that “foreign firms can raise funds at lower costs than at home.”²⁴ Financial considerations are involved in the decision process, but also the prestige attached to being traded in the U.S. and the desire to increase the company’s visibility and its shareholder base.²⁵ In addition, “listing on an exchange with [a] stricter disclosure environment than the home country exchange conveys a management's confidence in its future earnings.”²⁶ Sarbanes-Oxley, however, arguably diminishes these benefits in the eyes of foreign issuers, since it affects their ability to enter U.S. markets. Nevertheless, it is also perfectly legitimate for the United States to regulate its financial markets to protect American shareholders, ensure market transparency and integrity and maintain the investing public’s confidence. As a result, the burden imposed by the legislation is merely the counterpart for the significant benefits foreign issuers can hope to reap by being listed on U.S. exchanges.

Accordingly, securities laws are entitled to be applied extraterritorially when foreign issuers have agreed to submit to the jurisdiction of the country where they wish to be listed. Thus, it can be argued that foreign corporations voluntarily chose to comply with U.S. legislation when they requested to be listed on a U.S. stock exchange. The extraterritorial application of a national law would hence result from a voluntary decision made by the foreign corporation. Likewise, non-U.S. auditors can be deemed to have agreed to submit to the jurisdiction of the United States whenever they agree to perform accounting services for companies which are publicly traded in the U.S. This analysis can be found in §106(b) of the Sarbanes-Oxley Act which provides that a :

If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that public foreign accounting firm *shall be deemed to have consented*

- (a) to produce its audit workpapers for the [Public Company Accounting Oversight] Board or the [SEC] Commission in connection with any investigation [...] and
- (b) *to be subject to the jurisdiction of the courts of the United States* for purposes of enforcement of any request for production of such workpapers.²⁷

Therefore, whenever a U.S. accounting firm relies on a foreign public accounting firm's work in the preparation of the U.S. firm's audit report, the foreign public accounting firm is deemed to have consented to submit to the jurisdiction of U.S. courts and to produce its audit workpapers for the PCAOB or the SEC in connection with any future

²² *Id.*

²³ *Id.*

²⁴ Craig Doidge, *Why Are Foreign Firms Listed in the U.S. Worth More?*, 71 J. FIN. ECON. 205, 206 (2004).

²⁵ Christopher Woo, *The Effects of the Sarbanes-Oxley Act on Foreign Private Issuers* (paper prepared for the Harvard Law School International Finance Seminar), available at

http://www.law.harvard.edu/programs/pifs/pdfs/christopher_woo.pdf. See also G. Andrew Karolyi, *Why Do Companies List Shares Abroad? A Survey of the Evidence and Its Managerial Implications*, 7 FIN. MKTS., INST. & INSTRUMENTS 1 (1998).

²⁶ *Id.*

²⁷ 15 U.S.C. § 7216(b)(1) (2002).

investigation.²⁸ In addition, the U.S. public accounting firm is deemed to have secured the agreement of the foreign public accounting firm to the production of those foreign audit workpapers whenever it relies on the opinion of the foreign public accounting firm in rendering its own opinion.²⁹ Consequently, extraterritoriality of U.S. securities laws can be explained by the need to protect American investors and by the implied consent of foreign issuers to submit to the jurisdiction of U.S. courts. However, the question remains whether a country has the power to regulate conduct occurring outside of its territory.

B. *The Bases of Extraterritorial Jurisdiction in Public International Law*

Under international law, “the jurisdiction of a state depends on the interest that state, in view of its nature and purposes, may reasonably have in exercising the particular jurisdiction asserted and on the need to reconcile that interest with the interests of other states in exercising jurisdiction.”³⁰ International law has thus produced general principles where municipal courts may exercise jurisdiction. A state may certainly assert jurisdiction over wrongful conduct which occurs within its territory (the *territorial principle*)³¹ and even, in certain circumstances, over conduct occurring outside its territory. Although the Permanent Court of International Justice stated in the Lotus Case that every state has a “wide measure of discretion”³² to adopt principles of extraterritorial jurisdiction that it regards as “best and the most suitable,”³³ it also recognized limits to such jurisdiction:³⁴

*It does not, however, follow that international law prohibits a State from exercising jurisdiction in its own territory, with respect to any case which relates to acts which have taken place abroad, and in which it cannot rely on some permissive rule of international law. Such a view would only be tenable if international law contained a general prohibition to States to extend the application of their laws and the jurisdiction of their courts to persons, property and acts outside their territory, and if, as an exception to this general prohibition, it allowed States to do so in certain specific cases. But this is certainly not the case under international law as it stands at present. Far from laying down a general prohibition to the effect that States may not extend the application of their laws and the jurisdiction of their courts to persons, property and acts outside their territory, it leaves them in this respect a wide measure of discretion, which is only limited in certain cases by prohibitive rules; as regards other cases, every State remains free to adopt the principle which it regards as best and the most suitable.*³⁵

²⁸ *Id.*

²⁹ 15 U.S.C. § 7216(b)(2) (2002).

³⁰ Lori F. Damrosch et al., *International Law: Cases and Materials*, 1090 (4th ed. 2001). See also S.S. 'Lotus' (Fr. v. Turk.), [1927] P.C.I.J. (ser. A) No. 10, at 4, 18 (setting out the principles of international law regarding normative jurisdiction).

³¹ *Id.*

³² *Id.*

³³ Case of the S.S. 'Lotus', *supra* note 30.

³⁴ See F.A. Mann, *The Doctrine of International Jurisdiction Revisited After Twenty Years*, 186 REC. DES COURS 9, 33 (1984) (arguing that “[e]ven the discredited majority opinion in the Lotus case recognized some limits of a State's legislative jurisdiction”).

³⁵ Lotus, *supra*, note 30.

Accordingly, international law permits extraterritorial jurisdiction. That said, the presumption of jurisdiction set out in the *SS Lotus* case has come under fire and has been challenged by members of the I.C.J. In the *Case Concerning the Legality of the Threat or Use of Nuclear Weapons*³⁶, Judge Bedjaoui stressed that it “would be to exaggerate the importance of that decision of the Permanent Court and to distort its scope were it to be divorced from the particular context, both judicial and temporal, in which it was taken.”³⁷ He further stated that contemporary international society has significantly changed, with the development of globalization and international cooperation. Likewise, in *Democratic Republic of the Congo v. Belgium*, President Guillaume stated in a separate opinion that “the exercise of that jurisdiction is not without its limits”³⁸ and that even the *Lotus Case* expressed some doubt as to whether the presumption of jurisdiction applied in the criminal context, but took the view that it was unnecessary to decide that point. He further adds that the legal landscape has changed drastically and is now “totally different”³⁹: “the adoption of the United Nations Charter proclaiming the sovereign equality of States, and the appearance on the international scene of new States, born of decolonization, have strengthened the territorial principle.”⁴⁰

Regardless of where the allegedly wrongful conduct took place, municipal courts have jurisdiction over persons or things that possess its nationality (the *nationality principle*), and the state also has an interest in punishing acts committed abroad which are harmful to its nationals (the *passive personality principle*).⁴¹ In addition, under the *protective principle*, “a state has an evident interest in protecting itself against acts, even if performed outside of its territory and by persons that owe it no allegiance, that threaten its existence or its proper functioning as a state.”⁴² Finally, the *universal principle* allows municipal courts to exercise jurisdiction over acts where the universal nature of the crime, such as genocide or war crimes,⁴³ justify the repression of such acts as a matter of international public policy. Therefore, the general principle appears to be that States may extend the application of their laws beyond their territory, unless the exercise of such jurisdiction is prohibited.⁴⁴ In this regard, § 402 of the Restatement (Third) of Foreign Relations Law of the U.S. provides:

Subject to § 403, *a state has jurisdiction to prescribe law with respect to:*

- (1) (a) conduct that, wholly or in substantial part, takes place within its territory;
(b) the status of persons, or interests in things, present within its territory;
(c) *conduct outside its territory that has or is intended to have substantial effect within its territory;*
- (2) the activities, interests, status, or relations of its nationals outside as well as within its territory; and

³⁶ *Case Concerning the Legality of the Threat or Use of Nuclear Weapons*, 1996 I.C.J. at 270 (Declaration of President Bedjaoui).

³⁷ *Id.* para. 12.

³⁸ *Case Concerning the Arrest Warrant of 11 April 2000 (Democratic Republic of the Congo v Belgium)*, 2002 I.C.J. 3. (separate opinion of President Guillaume).

³⁹ *Id.* para. 14.

⁴⁰ *Id.* para. 15.

⁴¹ Damrosch, *supra* note 30, at 1090.

⁴² *Id.*

⁴³ *Id.* at 1092.

⁴⁴ See Brigitte Stern, *Quelques observations sur les règles internationales relatives à l'application extra-territoriale du droit*, 32 Ann. Fr. de Dr. Int'l 7, at 239-313 (1992).

- (3) certain conduct outside its territory by persons not its nationals that is directed against the security of the state or against a limited class of other state interests.⁴⁵

The overall restriction laid down by the Restatement is that “a state may exercise jurisdiction based on *effects* in the state, when the effect or intended effect is *substantial* and the exercise of jurisdiction is *reasonable* under § 403.”⁴⁶ In other words, jurisdiction may be claimed over acts which, although committed by foreigners overseas, produced or intended to produce substantial effects within U.S. territory. The Restatement further lists a number of factors to guide courts in determining when the exercise of extraterritorial jurisdiction is fair and reasonable, one of the factors being the “*link of the activity to the territory of the regulating state*, i.e., the extent to which the activity takes place within the territory, or has substantial, direct, and foreseeable effect upon or in the territory.”⁴⁷

Thus, a law may be applied extraterritorially whenever the exercise of jurisdiction is deemed reasonable under international law and when the conduct may adversely impact the interests of the State which enacted the legislation.⁴⁸ This reasonableness requirement comes as a resounding echo of Judge Fitzmaurice's instruction in his *Barcelona Traction* opinion that even in areas lacking “hard and fast” limits to national jurisdiction, international law does entail “an obligation to exercise moderation and restraint as to the extent of the jurisdiction assumed by its courts in cases having a foreign element, and to avoid undue encroachment on a jurisdiction more properly appertaining to, or more appropriately exercisable by, another State.”⁴⁹ The reasonableness of the exercise of jurisdiction should depend not only on the territorial links of a given activity with the United States, but also on the character of the activity to be regulated.⁵⁰ Securities laws appear to meet these requirements since extraterritoriality is primarily meant to protect market integrity and investors from fraud. Consequently, the Restatement (Third) states that the “United States may generally exercise jurisdiction to prescribe with respect to [...] conduct occurring predominantly in the United States that is related to a transaction in securities, even if the transaction takes place outside the United States.”⁵¹ The broad approach taken by the Restatement has met strong criticism. Critics have charged that these provisions are “unsupported by precedent”⁵² and that domestic courts will inevitably tend to have a bias in favor of their own forum,⁵³ thus always finding that the United States have subject matter jurisdiction.

In the years following Sarbanes-Oxley, extraterritorial enforcement by the SEC has expanded thanks to increased cooperation among international securities regulators. To permit the SEC to acquire information abroad during an enforcement investigation through the assistance of its foreign counterparts, which is necessary for the SEC to fully carry out its mandate to enforce U.S. securities laws and efficiently obtain evidence from overseas,

⁴⁵ *Restatement of the Law (Third): The Foreign Relations Law of the United States*, § 402 (1987).

⁴⁶ *Id.*

⁴⁷ *Id.* at § 403.

⁴⁸ See Brigitte Stern, *L'extraterritorialité revisitée: Où il est question des affaires Alvarez-Machain, Pâte de bois et de quelques autres...*, 38 ANN. FR. DE DR. INT'L 239, 268- 88 (1992).

⁴⁹ *Barcelona Traction, Light & Power Co., Ltd. (Belg. v. Spain)*, 1970 I.C.J. 4, 105 (Feb. 5).

⁵⁰ Restatement, *supra* note 45, at § 416(1)(d).

⁵¹ *Id.*

⁵² Mark W. Janis, *An introduction to international law* (1st ed. 1988), at 258-59.

⁵³ Harold G. Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection Between Public and Private International Law*, 76 AM. J. INT'L L. 280, 317 (1982).

the SEC is a signatory to more than thirty bilateral Memoranda of Understanding (“MoU”) with counterparts in other countries and one multilateral MoU that permit the SEC to acquire information abroad during an enforcement investigation through the assistance of its foreign counterparts.⁵⁴ Furthermore, MoUs allow the SEC to conduct investigations at the request of foreign authorities, even if the conduct is not in violation of U.S. law. It is significant to point out that this increased cooperation among international securities regulators took place after Sarbanes-Oxley. Convergence and mutual recognition in these areas are gaining importance from the U.S. perspective, especially since foreign companies increasingly do not want to abide by U.S. rules and want to withdraw from U.S. markets. Nevertheless, it is important to point out that Sarbanes-Oxley does not actually expand the territorial scope of securities law since federal courts have long applied securities laws extraterritorially.

III. THE INTERNATIONAL APPLICATION OF U.S. SECURITIES LAWS

Although Sarbanes-Oxley was intended to be a “domestic” legislation, it also has a significant extraterritorial impact since it applies to all firms listed on U.S. exchanges (NYSE and NASDAQ), including foreign firms. Sarbanes-Oxley also applies to all foreign subsidiaries of listed American firms, as well as to non-U.S. auditors who issue an opinion or perform material services for a registered U.S. accounting firm. However, despite heavy criticism of Sarbanes-Oxley’s extraterritorial reach, the application of U.S. securities laws to foreign corporations is neither a radical nor a recent development.⁵⁵

The first major piece of federal securities legislation, the Securities Act of 1933, is principally concerned with the primary market, in which the issuer of the securities sells them to investors.⁵⁶ The Act defines “interstate commerce” in § 77b(7) as including “trade or commerce in securities [...] between any foreign country and any State, Territory or the District of Columbia.”⁵⁷ Securities transactions between a foreign country and the United States must thus comply with the Securities Act of 1933. Section 5 of the Act⁵⁸ requires a company issuing securities to register these securities with the SEC whenever “instruments of transportation or communication in the interstate commerce” are directly or indirectly used to offer or to sell those securities. Certain Circuit courts have been fairly liberal in interpreting the Act and have granted jurisdiction based solely on a phone call or mail coming into the United States from abroad.⁵⁹ In 1934, Congress enacted a far-reaching

⁵⁴ The SEC has signed MOUs with regulators such as Germany, Portugal, India, Singapore and Japan. It also has signed cooperative agreements with regulators in over 27 countries, as well as the European Community and the members of the International Organization of Securities Commissions (IOSCO). See Michael D. Mann & William P. Barry, *Developments in the Internationalization of Securities Enforcement*, 39 INT’L LAW 667, 674-80 (2005).

⁵⁵ Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927, 932-58 (1994).

⁵⁶ William A. Klein, J. Mark Ramseyer & Stephen M. Bainbridge, *Business Associations*, 413 (6th ed. 2006)

⁵⁷ 5 U.S.C. § 77.

⁵⁸ 15 U.S.C. § 77e.

⁵⁹ See *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 420 n.18 (8th Cir. 1979) (stating that for the purpose of subject matter jurisdiction under the federal securities laws, both “the place of sending and the place of receipt constitute locations in which conduct takes place when the mails or instrumentalities of interstate commerce are use[d]”); *Doll v. James Martin Assocs.*, 600 F. Supp. 510, 520 (E.D. Mich. 1984) (stating that in securities cases “the transmission of the letter [from Bermuda] to Ann Arbor was in and of itself a sufficient act to create subject matter jurisdiction”).

securities legislation, known as the Securities Exchange Act of 1934⁶⁰, designed to regulate secondary market transactions, in which investors trade securities among themselves without any significant participation by the original issuer.⁶¹ Under § 78c(a)(17), the Securities Exchange Act applies whenever there is an “interstate commerce” of securities, which includes “commerce [...] between any foreign country and any State”. Therefore, the express provisions of the securities laws establish a broad basis for jurisdiction based on the “interstate commerce” criterion.⁶²

In order to restrict the scope of Section 5 of the Securities Act of 1933⁶³, the SEC adopted *Regulation S*⁶⁴ which provides specific guidelines for non-US companies to enable them to be exempted from registration requirements under the Securities Act of 1933. Nevertheless, the rules set forth in *Regulation S* are solely limited to Section 5 of the Act and do not apply to the other provisions of the securities laws.⁶⁵ Therefore, as stated in *Consolidated Gold Fields PLC v. Minorco S.A.*, “the antifraud provisions of American securities laws have broader extraterritorial reach than American filing requirements.”⁶⁶ Thus, the extraterritorial reach of the antifraud provisions of the securities laws had to be clearly defined by the federal courts.⁶⁷ In particular, Section 10 of the Securities Exchange Act gave the SEC the power to adopt rules and regulations “in the public interest or for the protection of investors”⁶⁸ and accordingly, the SEC passed Rule 10b-5, which made it unlawful for any person, by the use of interstate commerce, to “employ any device, scheme, or artifice to defraud [...] in connection with the purchase or sale of any security.”⁶⁹ Generally, courts are not to apply domestic statutes to conduct that occurred abroad: this is a recognized *presumption against extraterritoriality*.⁷⁰ Subsequently, legislation from Congress will be applied only within the territorial jurisdiction of the United States, “unless a contrary intent appears.”⁷¹ As federal securities laws establish an extensive jurisdictional basis, the courts have designed two tests to determine their subject-

⁶⁰ 15 U.S.C. § 78.

⁶¹ Klein, Ramseyer & Bainbridge, *supra* note 56.

⁶² The Securities Exchange Act of 1934 contained a provision regarding its extraterritorial application [Section 30(b)], however it charged the SEC to craft rules to prevent any abuse: “*The provision of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.*”

⁶³ 15 U.S.C. 77e.

⁶⁴ 17 C.F.R. § 230.901–904 (Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933).

⁶⁵ Metro. Ins. and Annuity Co., SEC No-Action Letter, 2003 WL 21297271 (June 6, 2003).

⁶⁶ *Consolidated Gold Fields PLC v. Minorco S.A.*, 871 F.2d 252 (2d Cir. 1989), *cert. dismissed*, 492 U.S. 939 (1989).

⁶⁷ Testy, *supra* note 55.

⁶⁸ 15 U.S.C. § 78j.

⁶⁹ *Securities Exchange Act of 1934*, Rule 10(b)(5) “Employment of Manipulative and Deceptive Devices”

⁷⁰ *E.E.O.C. v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991) (stating that there is a “presumption that legislation of Congress is meant to apply only within territorial jurisdiction of the United States”, and in construing legislation it is assumed that Congress legislates against backdrop of that presumption); *Small v. United States*, 544 U.S. 385, 389 (2005) (stating that there is a “*legal presumption* that Congress ordinarily intends its statutes to have domestic, not extraterritorial, application”).

⁷¹ “*It is a longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.*” *Smith v. United States*, 507 U.S. 197, 204 (1993).

matter jurisdiction : the “conduct” test and the “effects” test.⁷² Hence, whenever an operation conducted abroad causes harm in the United States, American securities law will be applicable.⁷³

The “effects” test was first announced in *Shoenbaum v. Firstbrook*.⁷⁴ The Second Circuit Court held in this case that federal securities law may apply to foreign transactions whenever there may be a substantial, adverse impact in the United States or to American investors. The Court inferred from Section 2 of the Securities Exchange Act that Congress’ intent was to protect domestic investors and markets from fraudulent foreign transactions and therefore must have “intended the Exchange Act to have extraterritorial application.”⁷⁵ In other words, whenever a conduct abroad may have a substantial, harmful effect in the United States, the federal courts will have subject-matter jurisdiction. A “substantial” economic effect on the U.S. market will therefore allow a U.S. court to exercise its jurisdiction over a transnational securities transaction. Later decisions have restricted the scope of the “substantial impact” requirement : the effects must be specific and must directly affect a U.S. interest.⁷⁶ Hence, a mere drop in investor confidence will not automatically trigger subject-matter jurisdiction of the federal courts, whereas letters sent to American investors will have to comply with the antifraud provisions of the Exchange Act. Since the concept of “substantial impact” is a vague standard determined on a case-by-case basis, this test has been criticized as being too broad.⁷⁷ However, courts have declined subject matter jurisdiction under the effects test in cases where both parties were foreign citizens or entities on the basis that Congress only intended to protect U.S. entities.⁷⁸

The second test to be set up by courts in order to determine subject matter jurisdiction is “the effects test”, introduced in *Leasco Data Processing Equip. Corp. v. Maxwell*⁷⁹: whenever a significant securities fraud is conducted in the United States, the federal courts will have jurisdiction over the case, regardless of the victim’s nationality. Therefore, protection of securities laws is not limited to American issuers.⁸⁰ Nevertheless, the Second Circuit Court has ruled that the acts committed in the United States must have “directly cause” the losses suffered by investors, and that “merely preparatory” conduct is not sufficient to enable subject-matter jurisdiction.⁸¹ In addition, the conduct must meet

⁷² W. Barton Patterson, Note, *Defining the Reach of the Securities Exchange Act: Extraterritorial Application of the Antifraud Provisions*, 74 FORDHAM L. REV. 213 (2005); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553 (1976).

⁷³ *Churchill Forest Industries (Manitoba), Ltd. v. Securities & Exchange Commission*, 431 U.S. 938 (1977) (stating that the “federal securities laws do grant jurisdiction [...] where at least some activity designed to further a fraudulent scheme occurs within this country.”).

⁷⁴ *Schoenbaum v. Firstbrook*, 405 F.2d 215, 219-20 (2d Cir. 1968).

⁷⁵ *Id.* (stating that “[w]e believe that Congress intended the Exchange Act 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. In our view, neither the usual presumption against extraterritorial application of legislation nor the specific language of Section 30(b) show Congressional intent to preclude application of the Exchange Act to transactions regarding stocks traded in the United States which are effected outside the United States, when extraterritorial application of the Act is necessary to protect American investors.”).

⁷⁶ *Bersch v. Drexel Firestone, Inc.* 519 F.2d 974, 993 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975).

⁷⁷ Katherine J. Fick, Comment, *Such Stuff as Laws Are Made on: Interpreting the Exchange Act to Reach Transnational Fraud*, 2001 U. CHI. LEGAL F. 441, 447-48 (2001).

⁷⁸ *Id.* at 455.

⁷⁹ *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972).

⁸⁰ *SEC v. Berger*, 244 F. Supp. 2d 180,193 (S.D.N.Y. 2001), *aff’d*, 322 F.3d 187 (2d Cir. 2003).

⁸¹ Fick, *supra* note 77, at 455.

the requirements of Rule 10(b)(5): “the fraudulent statements or misrepresentations must originate in the United States, must be made with *scienter* and in connection with the sale or purchase of securities, and must cause the harm to those who claim to be defrauded.”⁸² Other courts, such as the Third, Eighth, and Ninth Circuit Courts, have adopted a less restrictive approach and have held that “any significant activity undertaken in this country—or perhaps any activity at all—that furthers a fraudulent scheme can provide the basis of American jurisdiction.”⁸³ Some courts have indicated that the nationality of the issuer and whether the action is brought by the SEC itself must also be weighed before conferring jurisdiction.⁸⁴ In this regard, it is significant that the Restatement (Third) of Foreign Relations Law of the U.S. states that the U.S. “may generally exercise jurisdiction to prescribe with respect to [...] *conduct occurring predominantly in the United States* that is related to a transaction in securities, *even if the transaction takes place outside the United States.*”⁸⁵ The Restatement further indicates that particular weight should be given to whether representations are made or negotiations are conducted in the United States.⁸⁶ Although the Restatement has no binding effect on courts, it arguably extends the scope of the conduct and effects tests.⁸⁷

In substance, foreign activities can be subject to American jurisdiction in two types of situations: either the foreign activity has a direct and foreseeable effect on U.S. markets and investors, or the securities fraud is conducted in the United States. Whenever an activity fits into one of these two categories, federal courts have subject-matter jurisdiction. The underlying rationale of the U.S. case law is to protect American investors when they are affected by a transaction, even if the transaction takes place outside the United States. Consequently, federal securities laws have had an extraterritorial application long before Sarbanes-Oxley was even enacted. Hence, the extraterritorial reach of Sarbanes-Oxley should come as no surprise at all and one would therefore expect little to no opposition to Sarbanes-Oxley.

IV. THE EXTRATERRITORIAL APPLICATION OF THE SARBANES-OXLEY ACT

Prior to the Sarbanes-Oxley Act, the SEC had an “internationalist” policy: for instance, since 1979, foreign issuers benefited from fairly reduced disclosure requirements (“Form 20-F”). In addition, *Regulation S* restricted the extraterritorial reach of Section 5 of the Securities Act by providing an exemption from registration for offerings and sales of securities occurring outside the U.S. However, since the enactment of Sarbanes-Oxley, the SEC seems to have somewhat changed its policy and adopted a more unilateralist approach.⁸⁸ Foreign issuers are faced with the choice of either applying Sarbanes-Oxley,

⁸² *Zoelsch v. Arthur Anderson & Co*, 824 F.2d 27, 31 (D.C. Cir. 1987); *IIT v. Cornfeld*, 619 F.2d 909, 920-21 (2d Cir. 1980).

⁸³ “Any significant activity undertaken in this country - or perhaps any activity at all - that furthers a fraudulent scheme can provide the basis of American jurisdiction.” *Continental Grain (Australia) Pty Ltd. v. Pacific Oilseeds Inc.*, 592 F.2d 409, 421 (8th Cir 1979); *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977), *Grunenthal GmbH v. Holtz*, 712 F.2d 421 (9th Cir. 1983).

⁸⁴ *Testy*, *supra* note 55, at 935.

⁸⁵ Restatement, *supra* note 45, at § 416(1)(d).

⁸⁶ *Id.* at § 416(2)(b).

⁸⁷ *Testy*, *supra* note 55, at 936.

⁸⁸ Roberta S. Karmel, *The Securities and Exchange Commission Goes Abroad to Regulate Corporate Governance*, STETSON L. REV. 849 (2004).

or to deregister with the SEC and delist from the U.S. markets⁸⁹. Several foreign companies have opted for the latter⁹⁰.

Indeed, in a global securities marketplace, investors and issuers choose their capital markets according to the perceived costs and benefits of registration.⁹¹ It has been argued that many foreign issuers, fearful of U.S. jurisdiction, prefer to restrict U.S. investors from participating in their offerings.⁹² Thus, this results in economic inefficiency since U.S. investors are denied access to attractive foreign investments, while foreign issuers are denied the capital flow that access to U.S. capital markets could have provided them.⁹³ This was the reason why *Regulation S* was widely praised: it not only clarified the applicable law to foreign issuers, but it also allowed foreign issuers to raise capital overseas quickly and inexpensively without having to comply with the full-blown registration process.⁹⁴

Nevertheless, it is crucial to point out that section 2(a)(7) of the Sarbanes-Oxley Act applies to “issuers” of securities on a U.S. exchange, who were already under obligation to comply with the Securities Act of 1933 or the Securities Exchange Act of 1934. As a result, it would be a mistake to assume that the Sarbanes-Oxley Act’s extraterritorial reach is a recent development: as demonstrated previously, the anti-fraud provisions of U.S. securities law were already broadly applied. Additionally, Sarbanes-Oxley only applies if and when an issuer becomes subject to U.S. registration requirements.⁹⁵ *Regulation S*, however, governs when a foreign issuer must register its securities in the United States.⁹⁶ Consequently, Sarbanes-Oxley’s scope is limited by *Regulation S* since its provisions are effective only if the exemptions provided by *Regulation S* are not applicable. For this reason, it is not possible to assert that a foreign corporation who was not previously subject to U.S. securities legislation would unexpectedly be under the grip of Sarbanes-Oxley.

In addition, it is important to keep in mind that many foreign companies still desire to cross-list on U.S. exchanges because of the advantages of such registration: it conveys a positive signal to investors by demonstrating the company’s commitment to minority investor rights and stricter disclosure requirements.⁹⁷ The corporate governance reforms in Sarbanes-Oxley are progressively becoming the benchmark against which financial reporting and corporate governance practices are measured, hence by opting for these new standards, firms enhance their share price and become able to raise additional equity at lower cost.⁹⁸ This signal effect is most valuable for corporations seeking to expand their

⁸⁹ When a company delists, it is no longer required to file various disclosure reports with the SEC or to comply with the SEC rules implementing Sarbanes-Oxley.

⁹⁰ Peter Loftus, *Delistings Surge After Sarbanes-Oxley, Study Finds*, WALL ST. J., Dec. 16, 2004, at B3 (describing a study finding that “most of the companies that deregistered their shares say they did so to escape the steep costs associated with regulatory filings”). See also Stephen Taub, *Vivendi to Delist from U.S. Markets*, CFO MAG., Jan. 17, 2006, available at http://www.cfo.com/article.cfm/5406554/c_5405541?f=TodayInFinance_Inside.

⁹¹ Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 N.W. J. INT’L L. & BUS. 207, 222 (1996).

⁹² *Id.* at 225.

⁹³ *Id.*

⁹⁴ Testy, *supra* note 55, at 955.

⁹⁵ *Sarbanes-Oxley Act of 2002*, 15 U.S.C. § 7201 et seq., PL 107-204, 116 Stat 745 (2002).

⁹⁶ Choi & Guzman, *supra* note 91, at 210.

⁹⁷ 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, 1811 (2002). See also Steven Huddart et al., *Disclosure Requirements and Stock Exchange Listing Choice in an International Context*, 26 J. ACCT. & ECON. 237, 260 (1999).

⁹⁸ *Id.*

business through acquisitions or by raising equity capital. It is thus in the interests of foreign issuers to be cross-registered in the country with a higher standard of corporate governance as this will tend to demonstrate that the firm will protect minority shareholder interests and will not extract private benefits of control.⁹⁹ In addition, the impact of cross-listings and stock market competition should in time produce convergence in regulatory regimes among different capital markets.¹⁰⁰

Much of the controversy surrounding the extraterritorial effect of Sarbanes-Oxley is related to the new rules of corporate governance and accountability. Many authorities describe Sarbanes-Oxley as a significant preemption of state corporate law,¹⁰¹ ushering in “the creeping federalization of corporate law”¹⁰² since the Act goes where the federal government has never gone before in areas of organization of corporate entities and other aspects of business regulation which were traditionally reserved to state law.¹⁰³ Although the legal and accounting professions have traditionally been self-regulated, Sarbanes-Oxley seeks to regulate attorney conduct¹⁰⁴ and establishes an entity to serve as an “auditor of auditors”, the Public Company Accounting Oversight Board¹⁰⁵. In addition, the system which is at the heart of Sarbanes-Oxley – a clear, accurate and adequate disclosure to all relevant constituencies and an adequate control ensuring the integrity of financial reporting and accountability – will affect state law and fiduciary duty requirements. However, Sarbanes-Oxley was swiftly enacted after the wave of accounting irregularities which shook the U.S. corporate landscape and revealed the flaws in the organizations and powers of the boards of directors to govern corporations, and the failure of accountants and attorneys to detect and report corporate mismanagement.¹⁰⁶ Congress thus felt that new corporate governance rules were needed for all public companies to avoid another Enron.¹⁰⁷

When it comes to internal domestic corporate law and governance, the SEC has traditionally respected and deferred to the sovereignty of other nations.¹⁰⁸ However, by going beyond the registration and disclosure requirements first established by the 1933 and 1934 Acts and by establishing for the first time corporate governance rules, Sarbanes-Oxley is in effect forcing foreign corporations to conform to the U.S. model of corporate governance. For example, one of Europe's most authoritative representatives of business, the Union of Industrial and Employers' Confederation of Europe (UNICE), argued that companies with primary listings on European exchanges were already subject to a high

⁹⁹ Michael A. Perino, *American Corporate Reform Abroad: Sarbanes-Oxley and the Foreign Private Issuer*, 4 *EUROP. BUS. ORG. L. REV.* 213, 216 (2003).

¹⁰⁰ *Id.*

¹⁰¹ Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, 26 *REGULATION* 32, 32-39 (Spring 2003).

¹⁰² *Id.*

¹⁰³ See E. Norman Veasey, *State-Federal Tension in Corporate Governance and the Professional Responsibilities of Advisors*, 28 *J. CORP. L.* 441, 443 (2003).

¹⁰⁴ See Jeffrey I. Snyder, Note, *Regulation of Lawyer Conduct Under Sarbanes-Oxley: Minimizing Law-Firm Liability by Encouraging Adoption of Qualified Legal Compliance Committees*, 24 *REV. LITIG.* 223, 245 (2005).

¹⁰⁵ See Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and Its Public/Private Status*, 80 *NOTRE DAME L. REV.* 975 (2005) (arguing that notwithstanding the Public Company Accounting Oversight Board's designation as a nonprofit corporation in the private sector, it should be considered a U.S. government agency for due process purposes).

¹⁰⁶ Bloomenthal, *supra* note 4, § 1.

¹⁰⁷ *Id.*

¹⁰⁸ Corinne A. Falencki, *Sarbanes-Oxley: Ignoring the Presumption Against Extraterritoriality*, 36 *GEO. WASH. INT'L L. REV.* 1211, 1229 (2004).

level of audit standards, and that the additional burdens of Sarbanes-Oxley were unnecessary to achieve the desired results.¹⁰⁹ Another serious criticism is that Sarbanes-Oxley ignores other nations' cultural values and approach to corporate governance,¹¹⁰ while creating transactional costs that will drive foreign issuers away from the U.S.¹¹¹ It appears that Congress failed to give much consideration to the issue in its haste to provide a solution to the corporate scandals. There are no explicit references to foreign issuers in the Act itself, and the legislative history suggests that Congress was primarily concerned with domestic issues, and there was no extensive debate on the scope of the legislation in the global market. Likewise, this may tend to indicate that the SEC has not tried "to understand the difference between corporate governance and disclosure systems in foreign countries and those in the U.S."¹¹² Although this position is strongly supported by a number of critics, the reason Sarbanes-Oxley has such a broad scope is probably that both Congress and the SEC wanted to establish a single, fair and efficient system applicable to all public companies; foreign issuers fall within the scope of Sarbanes-Oxley because "exempting non-US issuers from the Act would create loopholes and be politically unpalatable."¹¹³ This is especially true since a number of foreign countries have also fallen prey to Enron-like scandals. The underlying rationale is that all participants in U.S. markets should be provided with equal treatment and be on a "level playing field," regardless of the country of origin. Such system would eventually provide strong and equal protection to U.S. investors and prevent any form of discrimination,¹¹⁴ whereas implementing different sets of rules depending on the market participant's country of origin would "lead to an incoherent, fragmented market"¹¹⁵ and would probably encourage *forum shopping* as well (corporations moving their place of business for the sole purpose of obtaining an exemption from Sarbanes-Oxley), and this explains why the SEC is "more inclined to a single set of rules for all participants in the U.S. market."¹¹⁶ Due to these public policy considerations, one can understand why the SEC has been so reluctant to grant exemptions to Sarbanes-Oxley, even when confronted with compatibility issues with foreign law.

However, by regulating internal governance matters, Sarbanes-Oxley is in effect setting international standards and entering into the realm of "international relations."¹¹⁷ Globalization is such that capital market regulation in a major country such as the United States will necessarily result in a "domino effect" and have repercussions around the world,

¹⁰⁹ Maria Camilla Cardilli, *Regulation Without Borders: The Impact of Sarbanes-Oxley on European Companies*, 27 *FORDHAM INT'L L.J.* 785, 791-793 (2004); John P. Lucci, *Enron-The Bankruptcy Heard Around the World and the International Ricochet of Sarbanes-Oxley*, 67 *ALB. L. REV.* 211, 212 (2003).

¹¹⁰ Cunningham, *supra* note 2, at 14-16; Larry E. Ribstein, *International Implications of Sarbanes-Oxley: Raising the Rent on US Law*, 3 *J. CORP. L. STUD.* 299 (2003).

¹¹¹ See Jack Grone, *The Davos Debate*, *WALL ST. J.*, Jan. 27, 2003, at A4.

¹¹² James A. Fanto, *The Absence of Cross-Cultural Communication: SEC Mandatory Disclosure and Foreign Corporate Governance*, 17 *NW. J. INT'L L. & BUS.* 119, 158 (1996).

¹¹³ Jay Clayton et al., *US Proves Flexible on Sarbanes-Oxley for Foreigners*, 22 *INT'L FIN. L. REV.* 14 (2003)

¹¹⁴ Roel C. Campos, SEC Comm'r, *Embracing International Business in the Post-Enron Era*, Speech at the Centre for European Policy Studies (June 11, 2003), available at <http://www.sec.gov/news/speech/spch061103rcc.htm> (stating that the SEC "remains committed to a philosophy of providing all participants with a level playing field, discriminating against no issuer, intermediary, exchange or other participant on the basis of their country of origin").

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ Lawrence A. Cunningham, *Sarbanes-Oxley and All That: Impact Beyond America's Shores*, Speech delivered to the Federation of European Securities Exchanges Convention in London (June 12, 2003), at <http://lsr.nellco.org/cgi/viewcontent.cgi?article=1000&context=bc/bclslp>.

since globalization increases interdependence between national economies. The shock caused by Sarbanes-Oxley was the result of the U.S. failure to consult or discuss with foreign regulatory counterparts, especially since the Act is the “most far-reaching reform of American business practices” since the 1930s.¹¹⁸ Nevertheless, the SEC does grant exemptions to foreign issuers on a case-by-case basis, whenever certain provisions of Sarbanes-Oxley clearly conflict with local laws of an issuer's jurisdiction. Some authorities have suggested that U.S. corporate governance and disclosure standards should be reconsidered in light of the corporate fraud scandals that have plagued the United States,¹¹⁹ however the Enron-like scandals which occurred in Europe, such as *Parmalat*¹²⁰ in Italy, *Vivendi*¹²¹ in France, *Royal Dutch Shell*¹²² in the United Kingdom/The Netherlands or *Royal Ahold*¹²³ in The Netherlands, suggest that the problem is not an isolated issue but rather a global one, and also that Europe’s “principles-based” system actually has the same limits as America's “rules-based” culture.¹²⁴ No matter which approach is taken, rules can easily be evaded and principles stretched whenever management is determined to do so.¹²⁵ Perhaps the best solution would be for Europe to establish a single securities regulator, a “European Securities Commission,”¹²⁶ which would represent Europe's interests in multilateral organizations such as the International Organization of Securities Commissions (IOSCO), work closely with the SEC in regulating international markets and go beyond setting mere audit rules by establishing standards which encompass all the different aspects of securities regulation.

Sarbanes-Oxley’s corporate governance model conflicts with other nations’ governance structure and cultural values. A striking example of the major distinctions in corporate governance standards between foreign countries and those in the U.S. is demonstrated by the difficulties encountered by multinational groups when attempting to comply with Section 404 of Sarbanes-Oxley,¹²⁷ which provides that publicly traded companies must have internal policies and controls in place to “protect, document and process information for financial reporting”.¹²⁸ Unfortunately, this section applies to both domestic and foreign private issuers.¹²⁹ Many foreign corporations are thus faced with a

¹¹⁸ Bumiller, *supra* note 8.

¹¹⁹ Corinne A. Falencki, *Sarbanes-Oxley: Ignoring the Presumption Against Extraterritoriality*, 36 GEO. WASH. INT’L L. REV. 1211, 1229 (2004).

¹²⁰ Adams, *supra* note 16.

¹²¹ See SEC Files Settled Civil Fraud Action Against Vivendi Universal, S.A., Its Former CEO, Jean-Marie Messier, and Its Former CFO, Guillaume Hannezo, SEC Litigation Release No. 18,523, 81 SEC Docket 3,043 (Dec. 24, 2003).

¹²² See SEC Settles Securities Fraud Case with Royal Dutch Petroleum Company and the "Shell" Transport and Trading Company, p.l.c. Involving Proved Reserves Overstatement of 4.47 Billion Barrels, Exchange Act Release No. 50,233, 83 SEC Docket 1,881 (Aug. 24, 2004).

¹²³ Brian Hanney, *Ahold: The European Enron?*, ACCOUNTANCY, Apr. 1, 2003, at 42-43.

¹²⁴ Adams, *supra* note 16.

¹²⁵ *Id.*

¹²⁶ Roberta S. Karmel, *The Case For a European Securities Commission*, 38 COLUM. J. TRANSNAT’L L. 9, 11-43 (1999); Eric J. Pan, *Harmonization of U.S.-E.U. Securities Regulation: The Case for a Single European Securities Regulator*, 34 LAW & POL’Y INT’L BUS. 499, 527 (2003); Gérard Hertig & Ruben Lee, *Four Predictions About the Future of EU Securities Regulation*, 3 J. COMP. L. STUD. 359, 363 (2003).

¹²⁷ See 15 U.S.C. § 7262.

¹²⁸ See, e.g., Srikant Datar & Michael Alles, *How Do You Stop the Books from Being Cooked? A Management Control Perspective on Financial Accounting Standard Setting and the Section 404 Requirements of the Sarbanes Oxley Act*, 1 INT’L J. DISCLOSURE & GOVERNANCE 119 (2004).

¹²⁹ *Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reporting*, Exchange Act Release No. 33-8238 (June 5, 2003).

dilemma regarding how to effectively maintain a global compliance program: on the one hand, U.S. law obliges them to implement procedures enabling employees to report misconduct; on the other hand, European law (in particular, E.U. privacy and data protection laws) imposes mandatory restrictions on whistleblowing.¹³⁰ In addition, certain countries such as France have a cultural and social aversion to anonymous whistleblowing as the anonymous denunciations to the police and Gestapo during the Nazi occupation of France to persecute personal enemies has left a significant impact on the French view of anonymous whistleblowing.¹³¹

To make matters worse, the whistleblower protection of the Sarbanes-Oxley Act appears to be more theoretical than real, at least for foreign employees. The First Circuit Court has recently held that the whistleblower protections under the Sarbanes-Oxley Act do not extend to foreign workers employed by the overseas subsidiaries of U.S. companies.¹³² The Court pointed out that Carnero, the employee who was allegedly fired after disclosing to the parent company that its subsidiaries had created false invoices and inflated sales figures, might have been protected had the whistleblowing occurred at a domestic subsidiary over alleged misconduct in the United States. Nevertheless, the Court found that Congress did not intend to apply Section 806 extraterritorially as it was silent in that regard, whereas other sections of the Act, such as Section 1107 regarding criminal penalties for retaliation against anyone giving information to law enforcement officers, expressly provided for application outside of the United States. At first sight, this decision supports a public policy interest by declining to interfere with other countries' processes for protecting domestic employees. However, it is important to point out that the decision was expressly limited to the facts presented – whether the Sarbanes-Oxley whistleblower protections (Section 806) apply to foreign nationals working for foreign subsidiaries of U.S. public companies – and cannot be expanded to the extraterritorial application of the Act's other whistleblowing provisions. Only Section 806, which provides protections for employees against being fired for coming forward with fraud information, is held as not having an international reach. Foreign nationals working for foreign subsidiaries of U.S. public companies thus find themselves in an awkward situation, where they are encouraged to report alleged corporate frauds, yet without being granted protection against retaliation.

Sarbanes-Oxley has also brought about a number of unintended consequences, such as high compliance costs. Companies are making unnecessary expenditures “to meet the bureaucratic demands of new rules”, and even “postpone certain technology purchases to avoid running afoul of new compliance requirements.”¹³³ Adjusting to the new requirements imposed by Sarbanes-Oxley is said to cost the U.S. economy \$5.5 billion each year.¹³⁴ A Financial Executives International (FEI) survey of 217 public companies found that firms with average revenues of \$5 billion spent an average of \$4.36 million

¹³⁰ See Paul Lanois, *How to implement Sarbanes-Oxley's whistleblowing procedures without violating European Union Data Protection Laws*, THE PRACTICAL LAWYER (forthcoming, 2007).

¹³¹ See Laurence de Charrette, *La délation est de plus en plus courante, mais la justice peine à l'organiser*, LE FIGARO, June 20, 2006, available at http://www.lefigaro.fr/debats/20060620.FIG000000069_la_delation_est_de_plus_en_plus_courante_mais_la_justice_peine_a_l_organiser.html.

¹³² Carnero v. Boston Scientific Corp., 433 F.3d 1 (1st Cir. 2006).

¹³³ Kurt Eichenwald, *Reform Effort at Businesses Feels Pressure*, N.Y. TIMES, Jan. 14, 2005, at A1.

¹³⁴ Roland Hefendehl, *Enron, WorldCom, and the Consequences: Business Criminal Law Between Doctrinal Requirements and the Hopes of Crime Policy*, 8 BUFF. CRIM. L. REV. 51, 53 (2004).

during fiscal year 2004¹³⁵ (year one), up 39 % from the \$3.14 million they expected to pay, to implement Section 404 of Sarbanes-Oxley,¹³⁶ which requires auditors of publicly listed companies to verify the effectiveness of the company's internal controls and procedures for financial reporting. Fortunately, compliance cost turned out to be lower in year two of adoption, according to another FEI survey.¹³⁷ The drop in compliance costs demonstrate that although some of these costs were one-time only expenses, most of them do recur year after year. Additionally, small companies have been disproportionately subject to the burdens associated with Section 404 compliance because of their limited resources,¹³⁸ and are seeing their profits shrink, which eventually damages their stock price and puts them at risk of a takeover. Instead of protecting American investors, some authorities have suggested that Sarbanes-Oxley may actually be hurting them,¹³⁹ since they will ultimately be the ones footing the bill for the compliance costs, and some investors may also fall prey to a false sense of security. No matter how tough the regulator is, a management committed to fraud can get away with it if there is no strong sense of ethics throughout corporate organizations, and this is not something that can be imposed by regulators or external auditors.

Last but not least, the number of U.S. companies going private (so-called “going dark”¹⁴⁰) has increased dramatically after the enactment of the Sarbanes-Oxley, with many firms citing it as a principal reason for choosing to do so : in 2003 and 2004, over 300 U.S. companies deregistered their common stock for reasons other than a merger, acquisition, liquidation, registration withdrawal or going-private transaction.¹⁴¹ According to a survey, the number of going private filings in 2004 was nearly double the 2002 filings (only 59 going-private filings in 2002, compared to 114 in 2004).¹⁴² Likewise, large foreign issuers, such as Porsche of Germany¹⁴³, Daiwa and Fuji Photo Film of Japan¹⁴⁴, have cited Sarbanes-Oxley's compliance costs as their reason for abandoning plans to list on U.S. exchanges.¹⁴⁵ Gucci, Creative Technology Ltd. and other prominent foreign issuers have

¹³⁵ Currently, accelerated filers have been required to comply with the requirements of Section 404 since their first fiscal years ending on or after November 15, 2004. The companies that are not accelerated filers, including foreign issuers, must comply with Section 404 for fiscal years ending after July 15, 2006.

¹³⁶ Financial Executives International, *Sarbanes-Oxley compliance costs exceed estimates*, available at http://www.fei.org/download/404_pr_3_21_2005.pdf.

¹³⁷ Financial Executives International, *Sarbanes-Oxley Compliance Costs are Dropping*, available at http://fei.mediaroom.com/index.php?s=press_releases&item=74.

¹³⁸ Kathleen Day, *Smaller Firms Are Paying Big To Comply*, WASHINGTON POST, May 8, 2006, at A10; Stephen Bainbridge, *SOXing It to Small Businesses*, TCS DAILY, April 12, 2005, available at <http://www.tcsdaily.com/article.aspx?id=041205D>.

¹³⁹ Stephen Bainbridge, *Is This What Is Meant By Investor Protection*, TCS DAILY, May 31, 2006, available at <http://www.tcsdaily.com/article.aspx?id=053106F>.

¹⁴⁰ “Going dark” means that a company delists its shares from the exchange on which it is traded. See Claudia H. Deutch, *The Higher Price of Staying Public*, N.Y. TIMES, Jan. 23, 2005.

¹⁴¹ Christian Leuz, Alexander J. Triantis & Tracy Yue Wang, *Why Do Firms Go Dark? Causes and Economic Consequences of Voluntary SEC Deregistrations*, Mar. 2006, available at <http://ssrn.com/abstract=592421>.

¹⁴² William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private"*, Emory Law & Econ. Research Paper Series, Working Paper No. 05-4, 2005, available at <http://papers.ssrn.com/abstract=672761>.

¹⁴³ Craig Karmin, *SEC's Exemption Gets Some Praise*, WALL ST. J., Jan. 13, 2003, at C16 (reporting that “German auto maker Porsche AG announced that it was no longer considering a listing on the New York Stock Exchange, citing conflicts with Sarbanes-Oxley”).

¹⁴⁴ Craig Karmin, *Foreign Firms Lose Urge to Sell Stock in U.S.*, Wall St. J., July 24, 2003, at C1.

¹⁴⁵ See William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private"*, 55 EMORY L.J. 141, 152 (2006).

also chosen to withdraw from the U.S. market because of Sarbanes-Oxley.¹⁴⁶ The NYSE has also reported that in recent years the number of new foreign listings has decreased.¹⁴⁷ Finally, Sarbanes-Oxley is said to be responsible for fewer acquisitions and ADR offerings by foreign issuers.¹⁴⁸ Many companies, including Russian and Chinese companies, have opted for listing on the London Stock Exchange (LSE)¹⁴⁹ or on Euronext to avoid the restructuring costs and increased exposure to liability imposed by Sarbanes-Oxley.¹⁵⁰ This could perhaps in part explain why the Nasdaq increased its holding in the LSE to over 25%¹⁵¹, and why the NYSE and Euronext merged on June 1, 2006.¹⁵² It should be noted in this regard that both the NYSE¹⁵³ and the Nasdaq¹⁵⁴ have admitted that Sarbanes-Oxley (particularly Section 404) had a negative impact on U.S. exchange markets and has hampered the U.S.' ability to attract many foreign corporations.

Fortunately, all is not necessarily doom and gloom for U.S. investors: even though a recent study has established that U.S. exchanges have experienced a significant decrease in the frequency of foreign listing following Sarbanes-Oxley, it seems that the "lost" listings are actually composed of firms that are, on average, smaller and less profitable than the firms that listed on a U.S. exchange after Sarbanes-Oxley.¹⁵⁵ Interestingly, the firms most likely to have opted for listing on a foreign exchange (such as the LSE) after the enactment of Sarbanes-Oxley are "smaller and less profitable than the average firms than (a) the average foreign firm predicted to list in the U.S. absent the impact of Sarbanes-Oxley and (b) the average foreign firm that did actually list in the U.S. following the enactment of Sarbanes-Oxley."¹⁵⁶ The survey also identified a "small set of large, profitable firms from predominantly emerging markets that choose to list on U.S. exchanges following the enactment of Sarbanes-Oxley despite being predicted to list on a UK exchange,"¹⁵⁷ which tends to prove that U.S. listing is still considered to be an important signal effect of the firm's quality. Thus, it may turn out that Sarbanes-Oxley has been quite successful after all if one of its purposes was to screen out marginal foreign firms and attracting high quality foreign firms.

Recent developments tend to indicate that the SEC will soften some of Sarbanes-Oxley rules, in particular Section 404. On April 4, 2007, the SEC announced that its Commissioners have endorsed recommendations for "*improved* Sarbanes-Oxley

¹⁴⁶ *Id.*

¹⁴⁷ Kurt Eichenwald, *Reform Effort at Businesses Feels Pressure*, N.Y. TIMES, Jan. 14, 2005, at A1.

¹⁴⁸ Andrei Postelnicu, *Concern over ADRs Leads SEC to Relax Sarbanes-Oxley Rules*, FIN. TIMES, Apr. 14, 2003, at 25.

¹⁴⁹ London attracted 50 international companies from 15 countries to the main market and AIM over the first six months of 2006. In contrast, during the first five months of 2006, only 15 foreign companies listed on the NYSE and Nasdaq exchanges combined. *Source*: Gary Parkinson, *Record amount raised in London this year as foreigners rush to float*, THE INDEPENDENT, August 9, 2006, available at http://news.independent.co.uk/business/analysis_and_features/article1217877.ece.

¹⁵⁰ Roberta S. Karmel, *NYSE-Euronext Merger: NYSE Is Losing Listings to Foreign Exchanges*, N.Y. L.J., Aug. 17, 2006, at 3.

¹⁵¹ Heather Timmons, *Nasdaq Raises Stake in London Exchange*, THE N.Y. TIMES, May 11, 2006, at C3.

¹⁵² Karmel, *supra* note 105, at 3.

¹⁵³ Anuj Gangahar, *Sox effect hits US exchanges*, FIN. TIMES, November 28, 2006, available at <http://www.ft.com/cms/s/361d4fc2-7e85-11db-84bb-0000779e2340.html>.

¹⁵⁴ Nicholas Neveling, *Nasdaq lobbies for lighter touch to Sarbox rules*, ACCOUNTANCY AGE, May 18, 2006, available at <http://www.accountancyage.com/accountancyage/news/2156340/nasdaq-lobbies-lighter-touch>

¹⁵⁵ Joseph Piotroski & Srinivasan, Suraj, *The Sarbanes-Oxley Act and the Flow of International Listings*, Jan. 2007, available at <http://ssrn.com/abstract=956987>.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

implementation”¹⁵⁸ to make the internal controls provisions of Section 404 more efficient and cost effective, since these “*needed improvements* in the Sarbanes-Oxley process are especially *urgent for smaller companies* who will begin complying with Section 404 this year.”¹⁵⁹ Christopher Cox, Chairman of the SEC, further added that “the result of the new auditing standard, together with the SEC's new guidance to management, should make the internal control review and audit more efficient by *focusing the effort on what truly matters to the integrity of the financial statements.*”¹⁶⁰ The SEC expects to receive new standards from the PCAOB by the end of May or early June, in time for the 2007 financial statement audits.

V. CONCLUSION

This paper set out to examine the extraterritorial effects of U.S. securities laws and in what way federal securities laws have regulated activities or conduct occurring outside the United States prior to the Sarbanes-Oxley Act. Even if the extraterritorial application of U.S. securities laws is neither a radical nor a recent development, Sarbanes-Oxley is undoubtedly a revolution in U.S. securities regulation as it goes well beyond former disclosure requirements by altering the internal organization of corporate entities and aspects of business regulation which were traditionally reserved to state law. With all these changes, it is not surprising that a number of small companies that went public and foreign issuers that entered the U.S. market are now reconsidering their decision. Although this approach does not broaden the extraterritorial framework of securities regulation, it does ignore other nations’ cultural values and approach to corporate governance, which is rather problematic. While some of Sarbanes-Oxley rules may be revisited, it is unlikely to provide significant relief requested by a number of foreign issuers or small firms. Only time will tell whether Sarbanes-Oxley’s intended main purpose (hindering future corporate scandals) has indeed been achieved.

¹⁵⁸ See Press Release, SEC News Release No. 2007-62, *SEC Commissioners Endorse Improved Sarbanes-Oxley Implementation To Ease Smaller Company Burdens, Focusing Effort On 'What Truly Matters'*, April 4, 2007, available at <http://www.sec.gov/news/press/2007/2007-62.htm>.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*