International Law and the Ramifications of the Sarbanes-Oxley Act of 2002

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Abstract: This Note examines the international implications of the Sarbanes-Oxley Act of 2002 (SOX). First, it identifies the relevant provisions of SOX and its impact on securities regulation generally. Second, it discusses how SOX impacts foreign companies that list securities on U.S. exchanges. Third, it analyzes how SOX is different from other U.S. securities regulations and discusses the consequences of its extraterritorial application.

INTRODUCTION

The Sarbanes-Oxley Act of 2002 (SOX), signed into law on July 30, 2002, was a response by U.S. legislators to a string of scandals that revealed corruption in corporate America and the securities markets. Initially, the collapse of Enron in late 2001 prompted the Securities and Exchange Commission (SEC) to propose rule changes to federal securities law. However, the subsequent disclosure of accounting irregularities and management deception at corporations such as Global Crossing, Adelphia, and WorldCom revealed systemic problems in the legal framework of securities regulation that required Congressional legislative action.

The speed with which SOX became law was startling. Many observers were troubled by the apparent lack of consideration for SOX’s impact abroad. A number of SOX’s provisions place foreign corporations in the unenviable position of having to comply with U.S. laws

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5 Cunningham, supra note 2, at 1.
that directly conflict with their own domestic regulations. This Note explores the nature of these conflicts and how SOX fits within the extraterritorial framework of U.S. securities regulation. Part I provides a brief summary of the context in which SOX was enacted and its implications for corporate governance and securities markets in the United States. Part II examines the different ways SOX conflicts with foreign corporate governance laws. It also explores the territorial reach of U.S. securities law before SOX. Part III analyzes the extraterritorial nature of SOX and how its provisions diverge from traditional securities regulations. This Note concludes that although SOX does not expand the territorial scope of securities law, its regulation of corporate governance does raise comity concerns. Nevertheless, these concerns will not have a lasting impact on the desire of foreign issuers to enter U.S. capital markets.

I. BACKGROUND

A. The Context of SOX

In many respects, SOX is a strict response to the specific accounting and governance problems that were at the root of the corporate scandals in 2001 and 2002. A brief review of these scandals provides context to SOX and its legislative intent.

1. The Collapse of Enron and Its Ilk

In the fall of 2001 and spring of 2002, revelations of management deception and abuse at Fortune 500 companies reached a feverish pace. In October 2001, the Enron Corporation disclosed that it had lost $1.01 billion due to failed investments. By December, it had filed a Chapter 11 petition for bankruptcy that reported $13.15 billion in debts. Enron’s petition represented the largest bankruptcy in U.S. history at the time. An investigation by an Enron special committee later revealed that the company had used special purpose entities (SPEs) to conceal another $27 billion in liabilities and operating

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6 See id. at 9–10.
7 See BLOOMENTHAL, supra note 3, § 1.
8 See id.
9 Id.
10 Id.
11 Id.
losses from the market.\textsuperscript{12} These losses were mostly linked to the private limited investment partnerships that, according to the SEC, were used to misappropriate millions of dollars of undisclosed fees.\textsuperscript{13}

As events at Enron were unfolding, other seemingly stable and respected U.S. corporations began to crumble.\textsuperscript{14} In December 2001, Global Crossing, Inc. disclosed that it was experiencing financial troubles.\textsuperscript{15} Global Crossing had staked its fortune in the late 1990s on the risky proposition that a world-wide fiber optic network was required to support the vast sums of data being exchanged around the world through the Internet.\textsuperscript{16} By 2000, Global Crossing had grown rapidly and boasted a market capitalization of $48 billion and revenue of $3.3 billion.\textsuperscript{17} In mid-December 2001, however, the company announced it would halt dividend payments and refuse to honor loan agreements totaling $400 million.\textsuperscript{18} Global Crossing filed for Chapter 11 bankruptcy in January 2002, listing assets of $22.4 billion and liabilities of $12.4 billion.\textsuperscript{19} Although the bankruptcy petition gave the appearance of $10 billion in surplus assets, most of it was related to essentially worthless intangible goodwill.\textsuperscript{20}

The rapid revenue growth that fueled Global Crossing's stock valuation was a mere illusion.\textsuperscript{21} The company boosted its revenues by using transactions known within the industry as "swaps."\textsuperscript{22} In these transactions, Global Crossing sold its network capacity to other telecommunications operators.\textsuperscript{23} At the same time, however, it purchased an equal amount of network capacity from those operators.\textsuperscript{24} Hence, these "swaps" were cashless transactions that had no real economic

\textsuperscript{12} Bloomenthal, \textit{supra} note 3, \S\ 1.
\textsuperscript{13} Id.
\textsuperscript{14} Dennis K. Berman et al., \textit{Global Crossing Ltd. Files for Bankruptcy}, \textit{Wall St. J.}, Jan. 29, 2002, at A3 [hereinafter Global Crossing Article].
\textsuperscript{15} Id.
\textsuperscript{17} Dennis K. Berman, \textit{Andersen’s ‘Swaps’ Method Draws Scrutiny}, \textit{Wall St. J.}, Mar. 19, 2002, at A3 [hereinafter Andersen’s ‘Swaps’ Article].
\textsuperscript{18} Global Crossing Article, \textit{supra} note 14.
\textsuperscript{19} Id.
\textsuperscript{20} Kessler, \textit{supra} note 16. Goodwill represents "[a] business’s reputation, patronage, and other intangible assets that are considered when appraising the business, esp. for purchase," \textit{Black's Law Dictionary} 557 (7th ed. abr. 2000).
\textsuperscript{21} See Andersen’s ‘Swaps’ Article, \textit{supra} note 17.
\textsuperscript{22} Id.
\textsuperscript{23} Id.
\textsuperscript{24} Id.
value. Nonetheless, the company immediately reported its “sale” as revenue and wrote off the “purchase” as an expense. This accounting maneuver gave Global Crossing’s operating results, a key indicator on Wall Street, the appearance of rising revenues without any corresponding liabilities.

Troubling disclosures by other companies in the spring of 2002 also highlighted deep conflicts of interest in corporate boardrooms. For example, Adelphia, Inc., a leading U.S. cable company, was one of the largest cases of insider dealing ever in a public company. It announced in the spring of 2002 that $2.3 billion in debt related to partnerships owned by the Rigas family, the company’s founder, had not been disclosed on the company’s balance sheet. Although, like Enron, Adelphia used these partnerships to hide debt from its balance sheet, it did so to serve a different end. Federal prosecutors and auditors uncovered a vast network of business relationships between the company and the Rigas family as well as a complex corporate cash management system that functioned like the family’s personal bank. The company made cash advances and guaranteed loans for the family’s other business ventures, which included a golf course, timber investment, hockey franchise, furniture store, and an independently produced film. The nine member board, consisting of four outside directors, claimed that it was aware of the family’s borrowing arrangements, but that it had never been informed of the other business transactions.

In June 2002, WorldCom, one of the nation’s largest telecommunications companies, announced that it had overstated its income in 2001 and the first quarter of 2002 by $3.8 billion. The company also disclosed that an additional $3.3 billion had been improperly recorded as earnings in 2000 and 1999 and that the company’s goodwill and

25 Id.
26 Andersen’s ‘Swaps’ Article, supra note 17.
27 Id.
29 Id.
31 See Vast Network Article, supra note 28.
32 Id.
33 Id.
34 Id.
35 BLOOMENTHAL, supra note 3, § 6.
other intangible assets had declined by $50.6 billion.\textsuperscript{36} Despite the staggering amount of money involved, WorldCom executives perpetrated the fraud with relative ease.\textsuperscript{37} By classifying operating expenses as capital expenditures, the executives made WorldCom's balance sheet appear to have far fewer liabilities than assets.\textsuperscript{38} Thus, the balance sheet greatly overstated the company's actual value.\textsuperscript{39} On July 21, 2002, WorldCom filed a bankruptcy petition that listed debt of $41 billion, which surpassed Enron as the largest bankruptcy petition in history.\textsuperscript{40}

2. The Creation of Sarbanes-Oxley

The Bush Administration pushed for a tough regulatory response in the wake of Enron's collapse.\textsuperscript{41} Harvey Pitt, then Chairman of the SEC, proposed the creation of a public accounting board that would provide oversight of accountants practicing before the SEC.\textsuperscript{42} In addition, Pitt asked Congress for legislation to extend the SEC's authority, where necessary, to better patrol the securities markets.\textsuperscript{43} A legislative response to the crisis in investor confidence developed quickly. By March 8, 2002, over thirty "Enron-inspired" bills had been introduced in Congress.\textsuperscript{44} After WorldCom's disclosure on June 25, 2002, the arrays of competing bills were quickly reconciled.\textsuperscript{45} By July 24, 2002, a final bill was crafted by the Conference Committee of the House and Senate and passed by Congress the following day.\textsuperscript{46} The Act was signed by President Bush five days later.\textsuperscript{47}

B. An Overview of the Sarbanes-Oxley Act

SOX addresses a range of corporate governance, accounting, and securities issues.\textsuperscript{48} It impacts corporate law in five major respects: (1)
accounting oversight (through the Public Company Accounting Oversight Board); (2) auditor independence; (3) corporate governance; (4) disclosure requirements; and (5) criminal penalties. Each of these categories is examined below.

1. Accounting Oversight

Before SOX, the auditing profession was mostly self-regulated: it policed the audit process, set private auditing and accounting standards, and conducted private disciplinary measures. These self-regulating functions, however, were funded through voluntary fees paid by the auditing firms. Therefore, true independent auditor oversight did not exist under this regime because funding could be withheld by the very constituents that had a stake in the outcome of the process.

Title I of SOX establishes the Public Company Accounting Oversight Board (PCAOB), which has the authority to regulate auditors of public companies, set auditing standards, and investigate violations. The board is independent from the industry. For example, funding for PCAOB is derived from mandatory fees paid by the auditing companies. This is a significant change from the voluntary fee arrangement because the effectiveness of the board’s oversight is not dependent on the industry’s willing cooperation. Moreover, board members must have limited contacts with the profession—only two members of the board may be certified public accountants and all members must serve full-time and have no other employment.

The PCAOB’s authority also extends to foreign accounting firms. Foreign accounting firms that prepare or furnish audit reports concerning an issuer are deemed by SOX to have consented to producing their audit work papers and being subject to federal court

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49 See Hamilton & Trautmann, supra note 4, at 13–14. This Note does not attempt to discuss all aspects of the Act but merely mentions its most significant elements.
50 Id. at 14.
51 Id.
52 Id. at 27–28 (citing testimony of former SEC Chief Accountant Michael Sutton before the Senate Committee).
54 See id. § 101.
55 Id. § 109.
56 Hamilton & Trautmann, supra note 4, at 14.
57 Sarbanes-Oxley Act § 101.
58 Id. § 106.
59 “Issuer” is defined by the Act as a company that has registered securities on U.S. exchange. Id. § 2.
jurisdiction for enforcement of any request to produce those papers. While foreign accounting firms already must comply with U.S. accounting rules and securities laws, SOX subjects them to PCAOB inspection every three years to assess their "degree of compliance" with SOX itself, PCAOB rules, SEC rules, professional standards, and the firms' quality control policies.

2. Auditor Independence

Auditors are paid by the companies they audit. Thus, an implicit conflict in the relationship between the auditor and the audit client exists. Nevertheless, because the nature of the audit relationship makes it unavoidable, this conflict of interest is tolerated.

The degree of this conflict in the auditor-client relationship, however, changed dramatically in the 1990s as auditing firms began providing management consulting services. This change was due to the fact that management consulting services generated far greater fees than auditing. As a consequence, to continue the lucrative management consulting projects, auditors needed to maintain good relations with their clients. This tension naturally eroded the auditor's independence because a critical audit would only dampen that relationship. As one commentator noted, "an accountant finds it very difficult to sound off about a client's financial shenanigans if he needs the client's far more lucrative consulting business." Moreover, by auditing the same companies for which they provided consulting, auditors placed themselves in the awkward position of auditing their own work. Hence, their objectivity was also sacrificed.

SOX attempts to correct the balance in the auditor-client relationship by prohibiting an auditor for a public company from provid-
ing a variety of services contemporaneously with the audit. 72 Such prohibited services include: (1) bookkeeping; (2) design and implementation of financial information systems; (3) appraisal or valuation services; (4) actuarial services; (5) management functions or human resources; (6) investment adviser or investment banking services; and (7) legal services and expert services related to the audit. 73

Moreover, SOX requires that auditing firms rotate the lead auditing partners in charge of a respective corporate client every five years. 74 This measure ensures that "fresh and skeptical eyes" evaluate the company on a periodic basis. 75 SOX also requires that the General Accounting Office conduct a study to determine whether companies should be required to rotate audit firms after a certain number of years. 76 Thus, even more stringent rotation requirements may still be forthcoming from the SEC. 77

3. Corporate Governance

Corporate governance refers to the important legal relationship that exists between shareholders, management, auditors, and the board of directors. 78 A company's management governs the company under the supervision of the board of directors and for the benefit of its shareholders. 79 Auditors ensure that the management complies with accounting standards, thereby providing shareholders and prospective investors with an accurate understanding of the company's financial health. 80

One factor that contributed to the breakdown of the auditing process in the last few years was auditors' misperception that their main responsibility was to serve company management rather than the board of directors, which acts as trustees of the company's shareholders. 81 Consequently, SOX takes a two-step approach to reestablish the proper dynamic between an auditor and its client and to sever

73 Id.
74 Id. § 203.
75 HAMILTON & TRAUTMANN, supra note 4, at 52.
76 Sarbanes-Oxley Act § 207.
77 See id.
79 See id.
80 See HAMILTON & TRAUTMANN, supra note 4, at 47.
81 See id. at 56.
management's overt influence over auditing functions. First, SOX requires that a company's audit committee, which is established by the board of directors, be solely responsible for appointing, compensating, and overseeing the work of the auditing firm. Moreover, the audit firm must report directly to the audit committee. Second, the auditing committee must consist of independent members of the board of directors who accept no consulting fees and have no affiliations with the company or its subsidiaries.

To further ensure investor confidence in financial statements, SOX requires CEOs and CFOs to attest to the accuracy of quarterly financial disclosures. Such certifications represent an acknowledgment by the executives that the quarterly financial disclosure fairly presents, in all material respects, the financial condition and results of operations of the company for the period reported. Criminal penalties of up to $5 million and twenty years imprisonment result from a willful violation of this requirement.

SOX also regulates attorney conduct and professional responsibility by requiring an attorney to report evidence of corporate misconduct to either the chief legal counsel or the CEO. If, after reporting the misconduct, neither executive officer acts to rectify the conduct, the lawyer is obligated to report the misconduct directly to the board of directors. However, the scope of this requirement is somewhat limited in its reach. For example, a lawyer must only report evidence of a material violation of the law, i.e., a violation that would require disclosure to a reasonable investor. Moreover, once the violation is reported, SOX does not specify how the CEO or chief counsel should act to rectify the problem.

82 See Sarbanes-Oxley Act § 301.
83 Id.
84 Id. § 204.
85 Id. § 301.
86 Id. § 302.
87 Sarbanes-Oxley Act § 302.
88 Id. § 906.
89 Id. § 307.
90 Id.
91 See id.
92 HAMILTON & TRAUTMANN, supra note 4, at 61.
93 Id.
4. Disclosure Requirements

SOX addresses four key areas of financial reporting that were heavily exploited by Enron and other companies. First, to allow investors to better understand and gauge a company’s financial performance, companies reporting pro forma (or expected) financial results must simultaneously reconcile those results to comparable financial data calculated according to generally accepted accounting principles (GAAP). Second, to close a loophole that came to light through the Enron investigation, companies must disclose all material transactions with entities that are not included in the calculation of their balance sheet and that may have a material effect on their financial condition. Third, to limit loan abuses and hidden compensation that caused the collapse of companies like Adelphia, companies are barred from making loans to their executives. Finally, to significantly increase investor awareness of insider activities, insider transactions by directors, officers, and ten percent shareholders must be reported to the SEC by the end of the second day following the transaction.

5. Criminal Penalties

SOX amends a number of criminal laws related to corporate governance malfeasance and securities fraud. For example, one provision of SOX makes it unlawful to knowingly execute or attempt to execute a “scheme or artifice ... to defraud any person in connection with any security of an issuer.” In contrast, under the SEC’s longstanding 10b-5 anti-fraud provision, a violation only occurs if it is “in connection with the purchase or sale of any security.” Thus, SOX’s new “scheme

94 See Sarbanes-Oxley Act §§ 401–403
95 Pro forma results are often described to be “as if” results, i.e., they reflect a company’s hypothetical performance had certain actual one-time events and expenses not occurred. Pro forma results do not conform to generally accepted accounting principles (GAAP). See Securities and Exchange Commission, Cautionary Advice Regarding the Use of “Pro Forma” Financial Information in Earnings Releases, at http://www.sec.gov/rules/other/33-8039.htm (last visited Apr. 29, 2004).
97 Sarbanes-Oxley Act § 401.
98 Id. § 402.
99 Id. § 403.
100 See id. § 807.
101 Id.
or artifice" crime may make it easier for prosecutors to prove securities fraud because a purchase or sale of a security is not required.\textsuperscript{103}

SOX also establishes two new criminal statutes that clarify penalties for destroying audit records.\textsuperscript{104} First, the destruction or creation of evidence with the intent to obstruct a federal investigation carries a maximum penalty of twenty years imprisonment.\textsuperscript{105} Second, a willful failure to preserve, for a minimum of five years, audit or review work papers of companies that issue securities carries a maximum penalty of ten years imprisonment.\textsuperscript{106}

Furthermore, SOX lengthens the time period under which individuals can sue for securities fraud.\textsuperscript{107} Actions may now be brought either five years from the date of the fraud or two years from the date of its discovery, whichever is earlier.\textsuperscript{108} Judgments and settlements based on securities law violations have also been made nondischargeable under the bankruptcy code.\textsuperscript{109}

\section*{II. Discussion}

\subsection*{A. The Impact of SOX Abroad}

Although U.S. legislators were responding to domestic corporate corruption when they enacted SOX, its impact is global.\textsuperscript{110} More than 1300 foreign corporations that list securities on U.S. exchanges are affected.\textsuperscript{111} Moreover, the Act's extraterritorial reach creates a complicated regulatory environment for foreign corporations.\textsuperscript{112} Listed below are some examples of SOX's impact abroad.

1. Germany and Japan

SOX emphasizes principles of independence and individual accountability in corporate governance.\textsuperscript{113} These principles conflict

\begin{footnotesize}
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\item \textsuperscript{103} See Hamilton & Trautmann, supra note 4, at 81.
\item \textsuperscript{104} See Sarbanes-Oxley Act § 802.
\item \textsuperscript{105} Id.
\item \textsuperscript{106} Id.
\item \textsuperscript{107} See id. § 804.
\item \textsuperscript{108} Id.
\item \textsuperscript{109} Sarbanes-Oxley Act § 803.
\item \textsuperscript{110} See Cunningham, supra note 2, at 4.
\item \textsuperscript{112} See Tamara Loomis, Sarbanes-Oxley Act, NEW YORK LAW JOURNAL, Jan. 2, 2003, at 5.
\item \textsuperscript{113} See Sarbanes-Oxley Act §§ 301–302.
\end{itemize}
\end{footnotesize}
most notably with German and Japanese corporations, where corporate governance is rooted in a collective decision-making structure.\textsuperscript{114}

Thirty-one German corporations list securities on U.S. exchanges, aggregating $287 billion in market capitalization.\textsuperscript{115} This places Germany near the top of the list of European countries with foreign SEC registrants.\textsuperscript{116} Furthermore, Germany’s direct foreign investment in the United States is estimated at $35 billion.\textsuperscript{117} Yet, among European countries, Germany’s corporate governance laws appear the least amenable to the imposition of enhanced U.S. regulation.\textsuperscript{118} One obvious example is Germany’s two-tiered corporate board structure.\textsuperscript{119} The board of management is in charge of the day-to-day operations, while the supervisory board, which by law must seat a minimum number of employee representatives, oversees the board of management.\textsuperscript{120}

This board structure conflicts with SOX because of the differing nature of accountability that exists in U.S. and German corporate governance systems.\textsuperscript{121} First, SOX requires that a corporation’s board of directors establish an audit committee staffed by independent board members.\textsuperscript{122} SOX defines an independent board member as being an individual who is not employed by the company as either an employee or consultant.\textsuperscript{123} Both boards of a German corporation, however, are populated by employees and managers of the company.\textsuperscript{124} Moreover, under German law, either of the two boards can perform the audit function.\textsuperscript{125} Thus, German corporations have a board structure that does not easily accommodate the auditing process as mandated by SOX.\textsuperscript{126} Second, SOX requires a company’s CEO and CFO to certify the company’s financial results.\textsuperscript{127} Under German law, however, both boards of a corporation must certify the financial

\begin{footnotes}
\item[114] See Cunningham, \textit{supra} note 2, at 8, 13.
\item[115] See id. at 5 n.9.
\item[116] See id.
\item[118] See Cunningham, \textit{supra} note 2, at 8.
\item[120] Id.
\item[121] See Cunningham, \textit{supra} note 2, at 11.
\item[123] Id.
\item[124] Birk, \textit{supra} note 119, at 58–60.
\item[125] See Cunningham, \textit{supra} note 2, at 8 n.30.
\item[126] See id. at 8.
\item[127] Sarbanes-Oxley Act § 302.
\end{footnotes}
Although this second conflict appears superficial, it does reflect a tension between the United States' emphasis on individual accountability and Germany's emphasis on collective accountability.\textsuperscript{129} Japanese corporations also have a significant presence in U.S. securities markets.\textsuperscript{130} Thirty Japanese public corporations have U.S. listed securities, aggregating $420 billion in market capitalization.\textsuperscript{131} Like Germany, the Japanese corporate structure does not easily accommodate SOX requirements because it too emphasizes collective responsibility.\textsuperscript{132} One problem is that SOX applies terms that simply have no equivalent in Japan.\textsuperscript{133} For example, SOX often uses the term "officers" to refer to the management of the company.\textsuperscript{134} In Japan, corporations are run by boards of directors that are divided into complex hierarchies of committees.\textsuperscript{135} These committees, in turn, govern the corporation through collective decision-making.\textsuperscript{136} Thus, those who would be considered officers in the United States are really board members in Japan who operate through a committee.\textsuperscript{137}

Moreover, the auditing function in Japan is performed in a markedly different fashion.\textsuperscript{138} Whereas SOX requires independent board members to appoint and supervise an outside auditing firm, Japan's Commercial Code not only allows the auditing function to be performed by non-independent committee members, but it requires that the shareholders select the outside auditors.\textsuperscript{139} Like Germany, this conflict with SOX may be more superficial than real, but it reflects Japan's very different approach to corporate governance than that envisioned by SOX.\textsuperscript{140}

\textsuperscript{129} See Cunningham, supra note 2, at 11.
\textsuperscript{130} See id. at 5 n.10.
\textsuperscript{131} Id.
\textsuperscript{132} See id. at 9.
\textsuperscript{133} Id. at 13.
\textsuperscript{135} Cunningham, supra note 2, at 13.
\textsuperscript{136} Id. at 9.
\textsuperscript{137} Id.
\textsuperscript{140} See Senechal, supra note 138, at 544.
2. The Fiduciary Duty and Auditor Rotation

The translation of SOX abroad also presents more generalized difficulties.\textsuperscript{141} For example, the notion of a fiduciary duty of care is a relatively novel concept in many civil law countries.\textsuperscript{142} The duty of care refers to the level of attentiveness and prudence that managers must take in performing their decision-making and supervisory functions.\textsuperscript{143} This duty has been refined in the United States through common law to protect investors in a variety of corporate events, e.g., proxy contests, mergers, and hostile takeovers.\textsuperscript{144}

Civil law countries, however, have not so finely developed the duty of care because they have other means to police management.\textsuperscript{145} In France, for instance, the state has traditionally taken a controlling interest in large corporations.\textsuperscript{146} This control enables the state to ensure that management is attentive and prudent without having to resort to the courts.\textsuperscript{147}

This variation in the definition of the duty of care will inevitably lead to confusion.\textsuperscript{148} For instance, SOX requires attorneys to report evidence of corporate misconduct.\textsuperscript{149} If that misconduct occurs in a French corporation and it relates to the duty of care, what standard of the duty of care is the attorney to use? The standard honed through U.S. law or that of French law? Such difficult questions have no answer as of yet.\textsuperscript{150}

Moreover, rotating auditors every five years, as is required under SOX, poses a significant problem for companies in developing countries where accountants are scarce.\textsuperscript{151} In China, for example, there is approximately one certified public accountant per 13,000 persons.\textsuperscript{152} This compares to one certified public accountant per 1000 persons in the United States.\textsuperscript{153} Therefore, finding a replacement auditor that

\textsuperscript{141} See Loomis, supra note 112.
\textsuperscript{142} Id.
\textsuperscript{143} LEWIS D. SOLOMON & ALAN R. PALMITER, CORPORATIONS 195 (3d ed. 1999).
\textsuperscript{144} James A. Fanto, France, in THE LEGAL BASIS OF CORPORATE GOVERNANCE, supra note 119, at 22.
\textsuperscript{145} Id. at 23.
\textsuperscript{146} Id. at 7.
\textsuperscript{147} See id. at 23.
\textsuperscript{148} See Loomis, supra note 112.
\textsuperscript{150} See Loomis, supra note 142.
\textsuperscript{151} Id.
\textsuperscript{152} Id.
\textsuperscript{153} Id.
can competently address a corporation's needs may be a practical impossibility in such regions.154

B. The Territorial Application of U.S. Securities Law Before SOX

The imposition of SOX on foreign corporations has prompted objections from all corners of the world even from countries whose laws do not outwardly conflict with SOX.155 However, the fact that U.S. securities laws apply to corporations outside the United States is neither a radical nor recent development.156 To understand how SOX fits into the U.S. securities regulatory regime and why it is so controversial abroad, it is important to explore the territoriality of U.S. securities law before SOX and understand how comity157 shaped its boundaries.158

A dichotomy existed in the extraterritorial application of securities regulation before SOX.159 Whereas the SEC limited the territorial reach of registration requirements, U.S. courts crafted jurisdictional tests for the anti-fraud provisions that allowed for their broad extraterritorial application.160 Although SOX does not disturb this territorial framework, it does raise other comity concerns.161

1. Securities Registration

Initially, the territorial reach of U.S. securities registration requirements was not an important issue in foreign capital markets.162 Once a global marketplace emerged, however, the SEC took steps to clarify when foreign securities issuers fell within the United States' jurisdiction.163

Section 5 of the Securities Act of 1933 requires a company issuing securities to register the securities with the SEC any time the instru-

154 See id.
155 See Cunningham, supra note 2, at 12.
157 Comity is defined as the informal and nonmandatory courtesy sometimes referred to as a set of rules to which the courts of one sovereignty often defer in determining questions where the laws and interests of another sovereignty are involved. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 455 (Philip B. Grove ed., 1986).
158 See Testy, supra note 156, at 932–58.
159 See id.
160 See id.
162 See Testy, supra note 156, at 928.
mentalties of interstate commerce are directly or indirectly used to offer or to sell those securities.\textsuperscript{164} The term "interstate commerce" in this context is defined to mean not only commerce among states but commerce between a state and a foreign country.\textsuperscript{165} This language could be broadly construed to apply to foreign securities transactions that have only the barest relationship (like a single telephone transaction) to the United States.\textsuperscript{166}

Until recently, the SEC had provided only minimal guidance on the territorial reach of Section 5.\textsuperscript{167} As a result, foreign issuers were often reluctant to allow U.S. investors to participate in offerings for fear that the securities would then be subject to the burdensome U.S. registration requirements.\textsuperscript{168} Consequently, U.S. investors found it difficult to access foreign securities offerings, a problem that became more prevalent as foreign issuances increased in the 1970s and 1980s.\textsuperscript{169}

Before 1990, foreign and domestic companies had to rely on SEC Release 4708 and an extensive body of no-action letters (which are non-binding statements from the SEC) to determine whether their security offerings were subject to U.S. registration requirements.\textsuperscript{170} Release 4708, issued by the SEC in 1964, indicated that the Commission would not take enforcement action against a domestic issuer who failed to register securities sold to foreign nationals provided that the securities "[came] to rest" abroad.\textsuperscript{171} The guiding principle behind this Release was to guard against unregistered securities sold abroad from flowing back to the United States and into the hands of unprotected U.S. investors.\textsuperscript{172} Furthermore, subsequent interpretive letters made it clear that the SEC viewed its registration requirements as having extraterritorial reach so as to protect U.S. investors, regardless of their physical location.\textsuperscript{173}

Release 4708, however, did not define the requirement of a security coming to rest abroad.\textsuperscript{174} Thus, foreign issuers were given little guidance as to what circumstances would require their securities to be

\textsuperscript{164} Id.
\textsuperscript{165} Id. § 77b(a)(7).
\textsuperscript{166} Testy, supra note 156, at 939.
\textsuperscript{167} See id.
\textsuperscript{168} Id. at 940–41.
\textsuperscript{169} Id.
\textsuperscript{170} Id. at 939.
\textsuperscript{171} Testy, supra note 156, at 940.
\textsuperscript{172} Id.
\textsuperscript{173} Id.
\textsuperscript{174} Id.
registered in the United States.\textsuperscript{175} Their concern focused in particular on how and when securities sold in an offering to non-U.S. nationals could be resold to either a person in the United States or a U.S. national outside the United States.\textsuperscript{176}

In 1985, the SEC issued a no-action letter regarding InfraRed Associates that reflected an understanding that the globalization of financial markets required that Section 5 be constrained so as not to interfere with the laws of other nations.\textsuperscript{177} Specifically, the letter approved the resale of non-U.S. registered securities to U.S. investors on a foreign stock exchange but only after the expiration of a specified restriction period.\textsuperscript{178} As U.S. investor demand for access to global markets increased in the late 1980s, the SEC took further steps to clarify the territorial reach of Section 5.\textsuperscript{179} These steps ultimately resulted in the adoption of Regulation S in 1990.\textsuperscript{180}

Regulation S codified the territorial reach of Section 5 and provided specific guidelines for offshore offerings to be exempt from registration requirements, thereby making compliance by issuers more certain.\textsuperscript{181} In particular, Regulation S set forth two conditions for the issuance and resale of unregistered securities: (1) the offer or sale must be made in an "offshore transaction," and (2) no "directed selling efforts" could be made in the United States.\textsuperscript{182} An "offshore transaction" occurred when the offer was not made to a person in the United States and either the buyer was outside the United States\textsuperscript{183} or the transaction was executed on an established foreign securities exchange.\textsuperscript{184}

"Directed selling" meant any activity that conditioned the U.S. market for the sale of such securities, including road-shows\textsuperscript{185} and newspaper advertisements in the United States.\textsuperscript{186} Regulation S im-

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{175} Id. at 941.
\item \textsuperscript{176} Testy, supra note 156, at 941.
\item \textsuperscript{177} See id.
\item \textsuperscript{178} Id.
\item \textsuperscript{179} Id.
\item \textsuperscript{180} Id.; Regulation S, 17 C.F.R. § 230.901-230.904 (2002).
\item \textsuperscript{181} Robert B. Robbins & Elizabeth A. Harris, Regulation S Offerings, § Background, July 2002, LEXIS, Scile File (ALL-ABA Course of Study Materials—Securities Law for Nonsecurities Lawyers).
\item \textsuperscript{182} Id. § Operation of Regulation S.
\item \textsuperscript{183} Id.
\item \textsuperscript{184} Id.
\item \textsuperscript{186} Robbins & Harris, supra note 181, § Operation of Regulation S.
\end{itemize}
\end{footnotesize}
posed additional conditions depending on the nature of the issuer and the type of security being offered to further safeguard against the flow back of unregistered securities into the United States.\textsuperscript{187}

Promulgation of Regulation S was an important step for the SEC in soothing international concerns regarding the extraterritorial reach of U.S. securities laws.\textsuperscript{188} It not only gave issuers greater clarity regarding U.S. securities registration requirements, but it constrained application of those requirements from trampling on the sovereignty of other states.\textsuperscript{189}

2. Enforcement of Securities Anti-Fraud Provisions

The SEC was created to enforce the laws contained in the Securities Act of 1933 and the Securities Exchange Act of 1934.\textsuperscript{190} Its primary mission is to promote stability within U.S. capital markets and, more importantly, protect investors through the aggressive enforcement of the Acts' anti-fraud provisions.\textsuperscript{191} As a result of this mandate, the anti-fraud provisions are considered a cornerstone of U.S. securities regulation and their territorial application is quite broad.\textsuperscript{192}

The Securities Exchange Act of 1934 charged the SEC with formulating a rule to protect investors from securities fraud.\textsuperscript{193} As a result, the Commission promulgated and 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."\textsuperscript{194}

At the time of the Rule's enactment, little attention was paid to its expansive territorial language since securities transactions were primarily domestic in nature.\textsuperscript{195} However, beginning in the 1960s, plaintiffs began filing lawsuits that sought to apply U.S. securities anti-fraud provisions, including Rule 10b-5, to international transactions.\textsuperscript{196} Although the SEC and Congress had provided guidance on the territo-

\textsuperscript{187} Id.
\textsuperscript{188} Id. § Background.
\textsuperscript{189} Testy, \textit{supra} note 156, at 955.
\textsuperscript{191} See id.
\textsuperscript{192} See \textsc{David L. Ratner}, \textsc{Securities Regulation in a Nutshell} 127-45 (1998).
\textsuperscript{194} Rule 10b-5, 17 C.F.R. § 240.10b-5 (2002).
\textsuperscript{195} Testy, \textit{supra} note 156, at 928.
\textsuperscript{196} Shoenbaum \textit{v.} Firstbrook, 405 F.2d 200 (2d Cir. 1968) (en banc).
riality of securities registration, they remained silent on the reach of the anti-fraud provisions. As a result, the federal courts were left to craft limits on 10b-5. In doing so, two predominant tests for determining a court's subject matter jurisdiction over transnational transactions emerged: the "effects" test and the "conduct" test.

a. The Effects Test

The "effects" test was first announced in Shoenbaum v. Firstbrook, a case that involved a U.S. shareholder of a Canadian corporation trading on both the U.S. and Toronto Stock Exchanges who alleged fraud against the corporation and its directors. The Second Circuit held that subject matter jurisdiction existed over any case where fraudulent extraterritorial conduct had a substantial impact on the investors or markets of the United States. In reversing the district court, the court reasoned that Section 2 of the Securities Exchange Act indicated Congress' intention for the Act to protect both domestic investors and markets from fraudulent foreign transactions.

Since "substantial impact" is a vague standard determined on a case-by-case basis, this test seems to cast a broad jurisdictional net. Courts, however, have been restrained in using it—in cases where both parties are foreign citizens or entities, subject matter jurisdiction under the effects test has been declined. This limited use of the effects test has been rationalized as reflecting Congress' wish to protect only U.S. entities from securities fraud.

b. The Conduct Test

The extraterritorial application of the Exchange Act most often occurs under the conduct test. Under this test, if significant conduct related to a securities fraud occurred in the United States, then a fed-

198 Testy, supra note 156, at 933.
199 Id.
200 405 F.2d at 204-05.
201 Id. at 208.
202 Fick, supra note 197, at 455.
203 Id.
204 Id.
205 See id. at 456.
206 Id.
eral court's jurisdiction is established regardless of the victim's nationality.\textsuperscript{207} The extraterritorial reach of this test, however, depends on the circuit applying it.\textsuperscript{208} The Second Circuit applies the most rigid interpretation of the test, requiring that the acts done in the United States "directly cause" the losses suffered by investors.\textsuperscript{209} This means that the conduct occurring in the United States must satisfy each element of a 10b-5 cause of action, i.e., "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."\textsuperscript{210} Conversely, acts that are "merely preparatory" to the alleged fraud are insufficient to satisfy the test.\textsuperscript{211} Moreover, when the parties are not U.S. citizens or entities and the securities are not traded on a U.S. exchange, there must be additional factors that tip the scales in favor of jurisdiction.\textsuperscript{212}

Other circuits, including the Third, Eighth, and Ninth, approach the conduct test in a less rigid fashion.\textsuperscript{213} Under their approach, any significant activity undertaken in the United States that furthers a fraudulent scheme can provide the basis for subject matter jurisdiction.\textsuperscript{214} This broader formulation has resulted in subject matter jurisdiction being conferred in cases such as \textit{Grunenthal GmbH v. Hotz},\textsuperscript{215} which involved the sale of foreign securities between West German and Mexican corporations controlled by a Bahamian holding companies and owned by citizens of Switzerland and Mexico.\textsuperscript{216}

In addition to varying formulations of the test, the circuit courts are also divided on whether the inquiry requires consideration of other factors.\textsuperscript{217} 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.\textsuperscript{218}

\begin{itemize}
\item \textsuperscript{207} Testy, \textit{supra} note 156, at 934.
\item \textsuperscript{208} See \textit{id}.
\item \textsuperscript{209} \textit{Id}.
\item \textsuperscript{210} Zoelsch v. Arthur Anderson & Co., 824 F.2d 27, 31 (D.C. Cir. 1987).
\item \textsuperscript{211} Fick, \textit{supra} note 197, at 457.
\item \textsuperscript{212} \textit{Id} at 461.
\item \textsuperscript{213} Testy, \textit{supra} note 156, at 934.
\item \textsuperscript{214} \textit{Id} at 935.
\item \textsuperscript{215} 712 F.2d 421 (9th Cir. 1983).
\item \textsuperscript{216} Fick, \textit{supra} note 197, at 459.
\item \textsuperscript{217} Testy, \textit{supra} note 156, at 935.
\item \textsuperscript{218} \textit{Id}.
\end{itemize}
c. The Restatement (Third) of Foreign Relations Law of the United States

By far the broadest statement of the extraterritorial reach of U.S. securities law is that found in the Restatement (Third) of Foreign Relations Law of the United States (the Third Restatement). Although it has no binding effect on courts, the Third Restatement asserts, in part, that U.S. courts have jurisdiction with respect to conduct occurring predominantly in the United States that is related to a transaction in securities, even if the transaction itself takes place outside the United States. In determining jurisdiction, the Third Restatement also indicates that particular weight should be given to whether representations are made or negotiations are conducted in the United States. Commentators have noted that this articulation of foreign relations law arguably extends the already expansive scope of the conduct and effects tests.

III. Analysis

A. Extraterritoriality and the Efficacy of International Capital Markets

The price of a security reflects, in part, the costs and benefits associated with the capital market on which that security is listed. Consequently, the price of a security will vary according to its capital market. For example, a security may be priced higher when it is listed on a U.S. exchange because the rigorous disclosure requirements raise transactional costs while the broad anti-fraud provisions provide investors and issuers a greater level of protection. That same security, however, may have a lower price on a foreign exchange because the costs involved and protections offered by that capital market are lower. Therefore, in a global securities marketplace, investors and issuers choose their capital markets, and the concomitant regulatory regimes, according to costs and benefits they desire.
Critics suggest that the extraterritorial application of U.S. securities law has a negative impact on the global securities marketplace because it limits the ability of investors and issuers to select the securities regime of their own choosing. When the jurisdiction of U.S. securities law unexpectedly ensnares a foreign transaction, the parties to that transaction lose the benefit of their bargain. The anticipated transactional costs and fraud protections of a foreign transaction are suddenly obscured by the intrusion of the highly developed and complex U.S. regulatory regime. Ultimately, the extraterritorial application of U.S. securities law impedes capital mobility. Foreign issuers fearful of U.S. jurisdiction restrict U.S. investors from participating in their offering. This creates economic inefficiency in two ways: (1) U.S. investors are denied access to attractive foreign investments, and (2) issuers are denied the liquidity that access to U.S. capital markets would provide.

Therefore, Regulation S won praise because it established a level of predictability in the extraterritorial application of U.S. securities registration requirements. By providing clear territorial boundaries, Regulation S allowed investors and issuers to select foreign regulatory regimes without fearing the incursion of additional U.S. registration costs.

The territoriality of U.S. anti-fraud provisions, however, has not been similarly constrained. As most notably demonstrated by the conduct test, enforcement of U.S. anti-fraud laws can extend so far as to ensnare parties that neither reside in the United States nor have securities listed on U.S. exchanges. In addition, the territorial reach of U.S. anti-fraud provisions is made even more unpredictable by the fact that circuit courts are divided on what factors actually establish jurisdiction. As a result, investors and issuers engaging in interna-
tional transactions continue to function in an uncertain regulatory environment with respect to U.S. anti-fraud provisions.\textsuperscript{239}

B. \textit{SOX and the Territorial Framework of U.S. Securities Regulation}

As illustrated above, the territoriality of U.S. securities laws is dichotomous.\textsuperscript{240} Whereas the extraterritorial application of U.S. registration requirements is restricted by Regulation S, the anti-fraud provisions have a tendency to be applied more broadly.\textsuperscript{241} Although SOX radically changes the nature of U.S. securities regulation, as will be discussed below, it does not disrupt this territorial framework.\textsuperscript{242}

SOX applies to an "issuer" of securities on a U.S. exchange and the professionals who interact with that issuer.\textsuperscript{243} SOX defines an "issuer" as any issuer that is already required to register its securities pursuant to the Securities Act of 1933 or the Securities Exchange Act of 1934.\textsuperscript{244} Thus, SOX only applies if and when an issuer becomes subject to U.S. registration requirements.\textsuperscript{245} Regulation S, however, governs when a foreign issuer must register its securities in the United States.\textsuperscript{246} Therefore, the territorial application of SOX is directly limited by Regulation S because its provisions are only effective once the requirements for securities registration under Regulation S are satisfied.\textsuperscript{247}

It is for this reason that SOX does not add further confusion or unpredictability to the extraterritorial application of U.S. securities law.\textsuperscript{248} Since it is not enforceable against corporations that do not deliberately choose to register securities on a U.S. exchange, there is no chance that SOX will unexpectedly ensnare a foreign transaction that would have formerly been free of U.S. jurisdiction before SOX's passage.\textsuperscript{249} Although foreign corporations with securities already listed on U.S. exchanges are having to accommodate SOX, the burden of additional regulation is a risk these corporations accepted when they entered the U.S. capital markets.\textsuperscript{250}

\begin{itemize}
\item \textsuperscript{239} See id.
\item \textsuperscript{240} See id. at 933–58.
\item \textsuperscript{241} See id.
\item \textsuperscript{243} See generally id.
\item \textsuperscript{244} Id. § 2.
\item \textsuperscript{245} See id.
\item \textsuperscript{246} Choi & Guzman, \textit{supra} note 223, at 210.
\item \textsuperscript{247} See Sarbanes-Oxley Act § 2.
\item \textsuperscript{248} See id.
\item \textsuperscript{249} See id.
\item \textsuperscript{250} See Loomis, \textit{supra} note 112.
\end{itemize}
Since SOX does not appear to increase the extraterritorial application of U.S. securities law, one would imagine little opposition to SOX internationally.\textsuperscript{251} This, however, has not been the case.\textsuperscript{252} To understand the controversy surrounding SOX abroad, therefore, it is important to understand how SOX breaks from the norm of securities regulation.\textsuperscript{253}

C. SOX Divergence from Traditional Methods of Securities Regulation

The scandals of 2001 and 2002 demonstrated to Congress that no amount of financial disclosure would protect U.S. capital markets so long as company management continued to be corrupted by conflicts of interest rooted in flawed corporate organizational structures.\textsuperscript{254} Regulating corporate governance, however, has traditionally been the realm of states and professional associations rather than the SEC.\textsuperscript{255} It is for this reason that SOX radically departs from the conventional forms of securities regulation by federalizing areas of law that were once the domains of non-federal organizations.\textsuperscript{256}

1. The Federalization of Corporate Governance

The Securities Act of 1933 and the Securities Exchange Act of 1934 protected U.S. capital markets through two mechanisms: (1) rigorous registration and financial disclosure requirements, and (2) broad anti-fraud provisions.\textsuperscript{257} In contrast, the organization of corporate entities has traditionally been an exclusive function of state law, while the legal and accounting professions have customarily been self-regulated.\textsuperscript{258} However, the implosion of Enron and others revealed the flaws in the organizations and powers of the boards of directors to govern corporations.\textsuperscript{259} These scandals also highlighted the failures of accountants and attorneys to detect and report corporate mismanagement.\textsuperscript{260} The only

\textsuperscript{251} See Sarbanes-Oxley Act § 2.
\textsuperscript{252} See Cunningham, supra note 2, at 11.
\textsuperscript{253} See generally Sarbanes-Oxley Act.
\textsuperscript{254} See Hamilton & Trautmann, supra note 4, at 219 (floor remarks of Sen. John McCain on July 10, 2002).
\textsuperscript{255} See Stephen Gillers, Regulation of Lawyers: Problems of Law and Ethics 2 (2002); Hamilton, supra note 78, at 6–9; Hamilton & Trautmann, supra note 4, at 20.
\textsuperscript{256} See generally Sarbanes-Oxley Act.
\textsuperscript{257} See Ratner, supra note 192, at 32–44, 93–171.
\textsuperscript{258} See Gillers, supra note 255, at 2; Hamilton, supra note 78, at 6–9; Hamilton & Trautmann, supra note 4, at 20.
\textsuperscript{259} See Bloomenthal, supra note 3, § 1.
\textsuperscript{260} See id.
conclusion Congress could draw from such examples was that a base line of principles and practices in corporate governance needed to be established for all public companies.\footnote{See Hamilton & Trautmann, supra note 4, at 206-07.} Only then would financial disclosure become a meaningful indication of a company’s performance and value.\footnote{See id. at 205.} Consequently, by implementing provisions such as board audit committees, auditor services restrictions, and attorney conduct standards, SOX bridged the long standing divide between federal securities regulation, state corporate governance law, and professional self-regulation.\footnote{See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 301, 201, 307, 116 Stat. 745 (2002).}

2. The Shock of SOX Abroad

It is SOX’s regulation of the corporate governance structure that has so enraged the international community.\footnote{See Cunningham, supra note 2, at 11.} Before SOX, access to U.S. capital markets only required a foreign corporation to comply with registration and disclosure provisions.\footnote{See generally Securities Act of 1933, 15 U.S.C. § 77a to z-3 (2002), and Securities and Exchange Act of 1934, 15 U.S.C. § 78a to ff (2002).} Thus, foreign corporations needed only to divulge the cold numbers behind their operations.\footnote{See Securities Act of 1933, 15 U.S.C. § 77a to z-3 (2002), and Securities and Exchange Act of 1934, 15 U.S.C. § 78a to ff (2002).} With the adoption of SOX, however, access to these markets has been further restricted to those foreign corporations willing to reorganize their organizational structure and business practices.\footnote{See Sarbanes-Oxley Act §§ 301-308.} Hence, SOX reaches beyond the registration and disclosure requirements first established by the 1933 and 1934 Acts and forces foreign corporations to conform to a model of corporate governance crafted by the U.S. Congress.\footnote{See id.}

SOX offends the tradition of comity, which emphasizes deference to the laws of other concerned states, by failing to respect the cultural values reflected in the corporate organization of those states.\footnote{See id.} Indeed, the organization of a corporation often reflects a nation’s cultural values.\footnote{See Cunningham, supra note 2, at 14-16.} In Japan, for example, companies are organized in a manner
that reflects that culture’s emphasis on collective decision-making.\textsuperscript{271} The presence of employees on a German company’s supervisory board, meanwhile, reflects that culture’s emphasis on operating companies for the benefit of employees, not just investors.\textsuperscript{272} SOX’s corporate governance model, in contrast, emphasizes independent oversight and individual accountability.\textsuperscript{273} Ultimately, in order to adopt SOX’s corporate governance model, foreign corporations are forced to either compromise or abandon their own cultural values.\textsuperscript{274} This is particularly ironic from the perspective of foreign corporations because the U.S. Congress crafted SOX as a response to corporate scandals that were very much an American phenomenon.\textsuperscript{275}

3. The Potential Effect on U.S. Capital Markets

It is feared that the burdensome provisions of SOX will drive foreign issuers away from U.S. capital markets.\textsuperscript{276} Although this is true in a limited respect, over the long term, SOX will not diminish the appeal of U.S. capital markets abroad.\textsuperscript{277}

There are benefits and drawbacks to increasing the rigor of securities regulation.\textsuperscript{278} Certainly, investors benefit from a regulatory regime that requires comprehensive financial disclosure and honest corporate governance practices.\textsuperscript{279} Such a regime ultimately allows investors to better gauge the true value of corporations and their securities offerings.\textsuperscript{280} The drawback to enhanced securities regulation, however, is the burden of added transactional costs placed on issuers.\textsuperscript{281} Therefore, regulatory regimes must strike a balance that satisfies investors’ needs for transparency against issuers’ desires for manageable transactional costs.\textsuperscript{282} The danger regulatory regimes must avoid, of course, is driving

\begin{footnotesize}
\begin{enumerate}
\item See id. at 13.
\item See Birk, supra note 119, at 67.
\item See Cunningham, supra note 2, at 14–16.
\item See Loomis, supra note 112.
\item See id.
\item See IAN H. GIDDY, GLOBAL FINANCIAL MARKETS 349–50 (1994).
\item See id.
\item See id. at 350.
\item Id.
\item See id.
\end{enumerate}
\end{footnotesize}
issuers away from a capital market with costly and unnecessary regulation.283

One criticism of SOX is that it creates a new tier of transactional costs that will drive foreign issuers away from the United States.284 Thus, in an overzealous effort to rebuild investor confidence, SOX will diminish the appeal of U.S. capital markets abroad by imposing onerous disclosure and corporate governance requirements.285 At the surface level, this criticism appears to be justified—several companies have cited the enactment of SOX as the reason for their decision not to list on a U.S. exchange.286

This criticism, however, is only justified in the short term.287 A closer examination reveals that companies based their decision not to list in the United States largely because the SEC had not yet finalized its rules for SOX.288 Without clear rules that govern how SOX will interact with the laws of other countries, foreign corporations faced an uncertain regulatory environment.289 As one Japanese executive explained in regards to his company’s decision not to enter the U.S. capital markets, “[w]e didn’t know what the rules of the game we’d be playing [would be] . . . [so] we wanted to know what we were getting into” before listing in the United States.290 This reasoning suggests that the impact of SOX in driving away foreign issuers is merely temporary.291 Once the SEC finalizes its rules for SOX, the U.S. regulatory environment will stabilize and the uncertainty driving foreign issuers away will fade.292

The burdensome nature of SOX itself will also have a minimal long-term impact.293 The disclosure rules governing securities in the United States before SOX were already by far the most stringent and costly in the world.294 Indeed, one commentator noted that, compared

283 See GIDDY, supra note 278, at 350.
286 See Mattich, supra note 275 (noting that Porsche AG of Germany and Daiwa Securities Group of Japan recently reversed their plans to list on the New York Stock Exchange as a result of SOX).
288 Id.
289 See id.
290 Id.
291 See id.
292 See Karmin & Kelly, supra note 287.
293 GIDDY, supra note 278, at 349.
294 Id.
to the United States, the disclosure requirements of other markets were “mere child’s play.”\textsuperscript{295} The reward for foreign issuers listing on a U.S. exchange, however, was access to an enormous pool of capital.\textsuperscript{296} Thus, before SOX, foreign issuers entering the U.S. capital markets already had to commit to costly, continuous investor relation programs and the time-consuming personal involvement of their top management.\textsuperscript{297} Although there is no question that SOX is burdensome, when compared to the regulatory burdens that were already present in the United States, it represents only an incremental increase in that burden.\textsuperscript{298} Therefore, because companies were willing to shoulder costly disclosure requirements before SOX in order to reap the benefits of U.S. capital markets, it is unlikely that the incremental burdens imposed by SOX will result in a long-term decrease of foreign issuers on U.S. exchanges.\textsuperscript{299}

**Conclusion**

Unlike traditional securities regulations, SOX seeks to protect U.S. capital markets by regulating the manner in which corporations are governed. Although this approach does not broaden the extraterritorial framework of securities regulation, it does ignore issues of comity with respect to the cultural values reflected in other nations’ corporate organizations. However, despite the anger it has generated abroad, SOX will not diminish the desire of foreign issuers to enter U.S. capital markets because it only poses an incremental increase in the burden of U.S. securities regulation.

\begin{footnotes}
\item[295] Id.
\item[296] See Cunningham, supra note 2, at 5 n.9.
\item[297] Giddy, supra note 278, at 349.
\item[299] See Cunningham, supra note 2, at 5 n.9.
\end{footnotes}