Rule 10b-5 and Transnational Bankruptcies: Whose Law Should Apply?

Lauren D. Rosenthal

Recommended Citation

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Law Review by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.
RULE 10b-5 AND TRANSNATIONAL BANKRUPTCIES: WHOSE LAW SHOULD APPLY?

LAUREN D. ROSENTHAL

INTRODUCTION

Since the enactment of Rule 10b-5 fifty years ago, commercial activity has extended beyond national boundaries, resulting in transnational corporations with assets and business activities scattered throughout the world. The disintegration of national commercial borders,\(^1\) and the global securities market\(^2\) which has consequently emerged, could not have been fully anticipated when the Securities Exchange Commission drafted this provision. Accordingly, globalization has raised questions concerning the extraterritorial application of Rule 10b-5. This issue has been the subject of frequent litigation, as well as the focal point of intense scholarly debate. Although these questions have yet to be resolved fully and satisfactorily, the courts adjudicating these issues have established general guidelines toward this goal.

To complicate this issue further, however, many of these transnational corporations have undergone bankruptcy proceedings in recent years. This occurrence has, in turn, raised questions concerning the extraterritorial application of United States bankruptcy laws. Once again, the courts have developed flexible and malleable guidelines to address this issue. Yet, as this Note will show, the guidelines addressing transnational bankruptcies conflict with those addressing transnational securities fraud. This conflict presents yet another challenge to the courts in circumstances where transnational bankrupt companies are accused of Rule 10b-5 violations. This Note discusses the challenge that the courts face, in attempting to reconcile this conflict.

At the outset, an understanding of this globalization process is helpful. A combination of factors is responsible for this surge of international activity.\(^3\) Technological advances in computer and telecommunication

---

1. See David L. Goelzer & Anne Sullivan, *Obtaining Evidence for the International Enforcement of the United States Securities Laws*, 16 Brook. J. Int'l L. 145 (1990). "In the world market the average investor, both in the United States and abroad, is increasingly likely to own an interest in business entities outside his or her own country . . . ." *Id.* at 145; see also *Foreign Investment in U.S. Exceeds American Investment Abroad Last Year*, 21 Sec. Reg. & L. Rep. (BNA) No. 40, at 1638 (Nov. 3, 1989) [hereinafter *Foreign Investment in U.S.*] (In 1988, "foreign direct investment [defined as at least 10% ownership of a United States asset] in the United States totaled $328.9 billion" and Americans invested $326.9 billion overseas.).

2. See Goelzer & Sullivan, supra note 1, at 145 (citing Terry M. Chuppe et al., *The Securities Market in the 1980's: A Global Perspective* (1989)). "The internationalization of the world's securities markets has become a fact: capital investments worldwide have increased threefold this decade, while world stock market capitalization rose from 2.5 trillion dollars in 1980 to 8.2 trillion dollars in 1988." *Id.*

3. See infra notes 4-14 and accompanying text. Although these factors have accompanied the emergence of the international securities market, it is difficult to ascertain

S321
systems provide businesses with around-the-clock access to foreign markets. This access has facilitated the mobility and liquidity of investments, thus reducing risks to investors. Increased mobility and liquidity has encouraged investors to pursue investment opportunities without regard to national boundaries. For example, increased access to foreign investors has facilitated the recent privatization of major industries in several countries. Equity offerings, too large to be satisfied by national markets alone, can now be sold in multinational markets.

Political changes and shifting economic strategies have significantly affected investment decisions. For example, the recent fall of communism in the former Soviet Union has led to an influx of foreign investments in the untapped markets of several countries. Similarly, German reunification has been met with equally receptive and eager investors. In fact, “the process of deregulation . . . has facilitated market access and attracted new investors” in many of the advanced economies. Another phenomenon that attracted foreign investors in the 1980s was the increased demand for funds in the United States resulting from an abundance of corporate mergers and acquisitions.

Investors utilize international portfolio management as an insurance policy to reduce exposure to depressed local market conditions and to stabilize volatile exchange rates, interest rates, and equity prices. This strategy has been used more frequently as investors have become more familiar with non-domestic issuers.

Finally, innovative financial instruments have been designed to “simplify” investment and attract new investors. For example, the Eurodollar and Eurobond markets were created in response to United States taxpayers’ needs.

The preceding factors have contributed toward the emerging global
securities market. Because this evolution has not been accompanied by uniform regulatory structures, however, globalization has enabled American investors to avoid United States regulations by permitting trading beyond its borders.\(^\text{15}\) This opportunity has been especially enticing to United States investors because United States securities laws are more stringent than comparable laws of other countries.\(^\text{16}\)

Thus, in order to maintain control over trading activity that is deemed illegal according to United States standards, international application of United States securities laws is essential. To this end, United States courts have permitted an expansive application of its securities laws.

The new integrated market will likely result in a large number of bankruptcies as a result of both risky experimentation and interdependence of markets worldwide.\(^\text{17}\) However, traditional domestic safety nets, established to prevent a bankruptcy from causing a national disaster, are not available once transactions move across national borders. Therefore, as investors continue to pursue international investment opportunities, transnational bankruptcies will become more commonplace. Because courts continue to permit an expansive application of United States securities laws, Rule 10b-5 claims will inevitably arise in the context of these transnational bankruptcies. Yet, there are no uniform regulations guiding international insolvency proceedings.\(^\text{18}\)

In 1978, Congress enacted section 304 of the Bankruptcy Act to deal with transnational bankruptcies. This provision encourages United States courts to defer to foreign law in appropriate situations and presumes that foreign insolvency proceedings are fair.\(^\text{19}\) This is in conflict with the approach taken by the courts in international securities cases.\(^\text{20}\)

This Note discusses Rule 10b-5 claims that are brought within the context of an international bankruptcy. Part I describes the broad extraterritorial application of United States securities laws in Rule 10b-5 cases. Part I also compares and contrasts extraterritorial application in Rule 10b-5 cases with the more limited extraterritorial application of United States bankruptcy laws. Part II discusses the importance of the extraterritorial doctrine in an integrated global market in which conflicting regulations exist. Part III addresses the conflict that arises when securities claims are brought within the context of a transnational bankruptcy. This Note concludes that strong United States public policy against securities fraud mandates that the more expansive extraterritorial approach generally applied in Rule 10b-5 actions be followed in situations

\(^\text{15. See infra notes 134-40 and accompanying text.}\)
\(^\text{16. See infra notes 132-40 and accompanying text.}\)
\(^\text{17. See infra part II.}\)
\(^\text{18. See infra notes 63-69 and accompanying text.}\)
\(^\text{19. See infra notes 108-27 and accompanying text.}\)
\(^\text{20. See infra part I and accompanying text.}\)
where the securities claim arises in the context of a transnational bankruptcy proceeding.

I. Extraterritorial Doctrine

A. Rule 10b-5

Pursuant to the Securities Exchange Act of 1934 (the “1934 Act”), the United States imposed a centralized regulatory system on secondary trading of public securities. This regulation requires corporate securities issuers to disclose certain information to investors. The Securities and Exchange Commission (the “SEC”) is charged with enforcing these disclosure laws, and has done so primarily through the implementation of rules.

Rule 10b-5, promulgated under section 10(b) of the 1934 Act, was established to eliminate securities fraud. It prohibits:

any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,
(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Under Rule 10b-5, courts have defined an insider trading offense as follows:

(1) a nondisclosure
(2) of material, nonpublic information;
(3) made with scienter . . .
(4) in breach of a fiduciary duty.

22. See id.
Because securities markets have become international, the SEC frequently needs to obtain "evidence from, or [assert] jurisdiction over, persons located outside the United States" in order to enforce Rule 10b-5 regulations. As a result, federal courts have become concerned with the application of United States securities laws in cases involving foreign activity with an American nexus. While many commentators question whether the SEC can assert jurisdiction in transnational cases, a related and more critical issue is which country's laws should be applied once jurisdiction is asserted. This latter issue will often determine the ultimate result of a Rule 10b-5 case because the United States securities laws, which have "developed almost entirely out of the general anti-fraud provisions of federal statutes," are unique as compared to the laws of other nations. This choice-of-law determination becomes problematic when dealing with multinational investors and markets.

Another problem is that United States securities laws are silent as to their extraterritorial reach. In fact, United States courts have found little guidance in either the language or legislative history of the 1934 Act.

27. Goelzer & Sullivan, supra note 1, at 146.

28. This concern applies equally to all potential permutations, including transactions in which the following occur: (1) a foreigner trades United States securities, (2) a United States citizen trades foreign securities, and (3) a United States citizen trades United States securities from abroad. For a comprehensive discussion of cases discussing the extraterritorial reach of Rule 10b-5, see generally James J. Finnerty, Note, The 'Mother Court' and the Foreign Plaintiff: Does Rule 10b-5 Reach Far Enough?, in Annual Survey of Financial Institutions and Regulation, Happy Birthday 10b-5: Fifty Years of Antifraud Regulations, 61 Fordham L. Rev. S287 (1993) (arguing for a limited extension of Rule 10b-5 across international borders).

29. The cases considering the extraterritorial application of Rule 10b-5 often blur the distinction between jurisdiction and choice of law to be applied. See Donald C. Langevoort, Insider Trading Regulation § 14.03, at 14-9 (1989). These cases presume that when a United States court is deemed to have jurisdiction over a particular matter, that court will apply United States securities laws to the dispute. In theory, however, these are two separate, though related, issues. As such, a United States court could, in appropriate circumstances, choose to apply foreign securities laws, rather than United States securities laws. But see id. (asserting that some recent cases have addressed this distinction and, consequently, have refused to apply "American law even where the threshold tests are met").

30. Bornstein & Dugger, supra note 26, at 379.


The provisions 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.

Id. (emphasis added). However, the phrase "without the jurisdiction of the United States" has been a source of controversy among the courts. Most courts have initially read "jurisdiction" in the territorial sense, thereby limiting the rule's applicability to all persons transacting business in securities inside the territory of the United States. In recent years, however, courts have expanded the meaning of "jurisdiction" to include prescriptive jurisdiction—i.e., jurisdiction extending far beyond the territory of the United States. See Comment, The Transnational Reach of Rule 10b-5, 121 U. Pa. L. Rev.
In addition, while the SEC and Congress have attempted to clarify the extent to which specific sections of the securities laws apply in transnational settings, they have not set limits on the extraterritorial reach of Rule 10b-5.

Given the lack of established guidelines for controlling application in the international context, courts have been forced to look elsewhere for guidance. United States courts have relied upon principles of international law and have commonly referred to the Restatement (Second) of Foreign Relations Law of the United States (the "Restatement (Second)") to justify and support their conclusions. Pursuant to the guidelines set forth in the Restatement (Second), United States courts have developed several broad tests for determining the extraterritorial reach of Rule 10b-5.

The first of these tests—the "conduct" test—entitles a state to prescribe rules governing conduct within its own territory. The Second

1363, 1390-91 (1973). This expansion has been in response to increasing transnational transactions. See infra Part II.

32. "The legislative history indicates little more about § 10(b) of the Act than that it was intended as an antifraud catchall." Note, American Adjudication of Transnational Securities Fraud, 89 Harv. L. Rev. 553, 553 n.4 (1976) [hereinafter American Adjudication] (citing Hearings on Stock Exchange Regulation Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 115 (1934)). According to Judge Robert Bork, "'[i]f the text of the 1934 Act is relatively barren, even more so is the legislative history.'" Margaret V. Sachs, The International Reach of Rule 10b-5: The Myth of Congressional Silence, 28 Colum. J. Transnat'l L. 677, 687 (1990) (quoting Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 30 (D.C. Cir. 1987)).

33. For a brief outline of areas in which the SEC has addressed the transnational applicability of the securities laws, see Comment, supra note 31, at 1364 & n.2.

34. See American Adjudication, supra note 32, at 553 n.7 (asserting that the SEC has generally prosecuted in cases of transnational securities fraud, thereby expanding judicial interpretation of the rule).

35. Restatement (Second) of Foreign Relations Law of the United States (1965) [hereinafter Restatement (Second)].

36. See, e.g., SEC v. Kasser, 548 F.2d 109, 113 n.12 (3d Cir. 1977) (relying upon Judge Weis' interpretation of § 17(a) of the Restatement (Second) in concluding that conduct in this country, standing alone, is enough for jurisdiction to attach under the federal securities laws); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 985 (2d Cir.) ("We have no doubt that the activities within the United States, detailed in the judge's thorough factual findings, were sufficient to authorize the United States to impose a rule with respect to consequences flowing from them wherever they might appear, under the principle stated in Restatement (2d) ... § 17..."), cert. denied, 423 U.S. 1018 (1975); IIT v. Vencap, Ltd., 519 F.2d 1001, 1016 (2d Cir. 1975) ("Although the United States has power to prescribe the conduct of its nationals everywhere in the world, see Restatement (2d) ... Congress does not often do so and courts are forced to interpret the statute at issue in the particular case."); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334 (2d Cir. 1972) ("The instant case deals ... with the problem considered in the Restatement[ ] [Second]'s § 17, 'Jurisdiction to Prescribe with Respect to Conduct, Thing, Status, or other Interest within Territory.'").

37. See Restatement (Second), supra note 35, §§ 10(a), 17(a); see also IIT v. Cornfeld, 619 F.2d 909, 932 (2d Cir. 1980) (concluding that, absent specific effects on American exchanges or American investors, substantial fraudulent conduct must occur in the United States for a United States court to assert jurisdiction over a predominantly foreign securities fraud claim); Bersch, 519 F.2d at 992 ("While merely preparatory activities in
Circuit established this test in *Leasco Data Processing Equip. Corp. v. Maxwell*, which concerned a foreign defendant who allegedly made "substantial misrepresentations" in order to defraud an American corporation. The court held that misrepresentations made in the United States constituted sufficient conduct within its territory, even though it was understood at the outset that the remainder of activities would transpire abroad. Thus, the court found that United States securities laws applied.

A second test, of far greater scope than the "conduct" test, is the "effects" test. This test provides that the United States may regulate conduct which occurs outside its territory if that conduct produces a substantial and foreseeable effect within its territory. In devising this test, the Second Circuit gave an expansive interpretation of section 18 of the *Restatement (Second)*. The court stated that violations of the 1934 Act are within the subject matter jurisdiction of United States courts regardless of where the violations occur, "at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors."

A third test for determining the reach of Rule 10b-5 is based upon the nationality principle, which provides that a state has jurisdiction over the conduct of its citizens regardless of whether that conduct occurs outside its boundaries. Members of the international community have universally accepted this principle, although the extent to which they have applied it has varied widely. In contrast, United States courts have generally disfavored this approach.

The *Restatement (Third) of Foreign Relations Law of the United States*
(the “Restatement (Third)”)
proposes still another analytical approach
to determine the choice of law question. Section 416 of the Restatement (Third) identifies five specific situations in which the application of United States securities laws is presumed reasonable. Additionally, it specifies factors by which to determine the reasonableness of United States securities laws in other circumstances. At least one commentator has labeled this approach the “reasonableness test.” Courts and commentators, however, have asserted that this approach is counterproductive.

47. The Restatement (Third) reads, in pertinent part as follows:
   (1) The United States may generally exercise jurisdiction to prescribe with re-pect to
   (a) (i) any transaction in securities carried out in the United States to which
       a national or resident of the United States is a party, or
       (ii) any offer to enter into a securities transaction, made in the United
           States by or to a national or resident of the United States;
   (b) any transaction in securities
       (i) carried out, or intended to be carried out, on an organized securities
           market in the United States, or
       (ii) carried out, or intended to be carried out, predominantly in the
           United States, although not on an organized securities market;
   (c) conduct, regardless of where it occurs, significantly related to a transac-
       tion described in Subsection (1)(b), if the conduct has, or is intended to
       have, a substantial effect in the United States;
   (d) 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; or
   (e) investment advice or solicitation of proxies or of consents with respect to
       securities, carried out predominantly in the United States.

48. The Restatement (Third) § 416(2) specifies the following factors:
   (2) Whether the United States may exercise jurisdiction to prescribe with re-
       spect to transactions or conduct other than those addressed in Subsection (1)
       depends on whether such exercise of jurisdiction is reasonable in the light of
       § 403, in particular
       (a) whether the transaction or conduct has, or can reasonably be expected to
           have, a substantial effect on a securities market in the United States for secur-
           ities of the same issuer or on holdings in such securities by United States
           nationals or residents;
       (b) whether representations are made or negotiations are conducted in the
           United States;
       (c) whether the party sought to be subjected to the jurisdiction of the United
           States is a United States national or resident, or the persons sought to be
           protected are United States nationals or residents.

49. Sachs, supra note 32, at 684.
50. See Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 32 n.2 (D.C. Cir. 1987)
   criticizing balancing test set forth in Restatement (Second) § 403(2)); Goelzer et al.,
   supra note 45, at 450 (asserting that this approach “would require a more detailed analy-
   sis and a greater expenditure of judicial resources than under current law or under the
   Code”); David Michaels, Note, Subject Matter Jurisdiction Over Transnational Securities
   Fraud: A Suggested Roadmap to the New Standard of Reasonableness, 71 Cornell L. Rev.
   919, 930-31 (1986) (suggesting that this approach is not judicially manageable).
Although the approaches set forth in the Restatements provide guidelines for Congress in promulgating securities regulations, technically, Congress is constrained only by the Constitution. In fact, Congress may extend application beyond the principles of international law, provided that such extension comports with the Due Process Clause of the Fifth Amendment.\footnote{51} Thus, in interpreting these statutes and in applying them to transnational disputes, courts have a duty to comply with congressional intent. Such compliance has been problematic, however, because the 1934 Act, like many other federal statutes, is silent on the issue of extraterritoriality.\footnote{52} As an alternative, United States courts have applied the guidelines set forth in the Restatement (Second) as an outer limit on extraterritorial application of securities laws.\footnote{53} Relying on these guidelines, courts have continually expanded the reach of Rule 10b-5.

Because the Restatement (Second) is subject to varying interpretations, judges have wide discretion in determining the international reach of Rule 10b-5. Yet, courts have found it difficult to conform their interpretations to one of the existing tests for extraterritorial reach. For example, they have struggled to define “conduct” under the “conduct” test. Further, their efforts to determine whether an “effect” is “substantial and foreseeable” under the “effects” test have been, for the most part, fruitless.\footnote{54} In explaining its decision to apply the “effects” test in Schoenbaum v. Firstbrook,\footnote{55} the court stated, “[w]e believe that Congress intended the [1934 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 . . . .”

Yet, “[s]ince most publicly-owned companies are likely to have some American shareholders, an expansive interpretation of Schoenbaum would bring securities transactions throughout the world within the ambit of Rule 10b-5.”

Recognizing this problem, Judge Friendly attempted to limit the scope of Rule 10b-5 in *Leasco Data Processing Equip. Corp. v. Maxwell*, by incorporating restrictions into the dicta of his opinions. Although he continued this practice in subsequent opinions, his attempts were virtually fruitless because he continually asserted subject matter jurisdiction.

In fact, the United States courts have been overwhelmingly receptive toward plaintiffs claiming 10b-5 violations and have continued to extend its application across international borders with increasing frequency.

On the other hand, United States courts have been more reluctant to extend application of other United States laws to extraterritorial disputes.

**B. United States Bankruptcy Laws**

There is currently no consistent or reliable procedure for resolving disputes between debtors and creditors who are from different nations. Many commentators have argued that the most effective solution would be an international bankruptcy treaty. These commentators, however, generally concede that, judging from past attempts, negotiating such a treaty would prove frustrating and inconclusive. This path to international bankruptcy cooperation is obstructed by the varying customs and

---

56. *Schoenbaum*, 405 F.2d at 206.
58. 468 F.2d 1326 (2d Cir. 1972).
59. See *id.* at 1334. He stated, “[T]he language of § 10(b) of the Securities Exchange Act is much too inconclusive to lead us to believe that Congress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security.” *Id.* He further stated: “[I]t would be . . . erroneous to assume that the legislature always means to go to the full extent permitted. This is a question of the interpretation of the particular statute . . . .” *Id.*
60. See *American Adjudication*, supra note 32, at 557 (citing Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975), and IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975), as examples of cases where the Second Circuit attempted “to restrict the scope of Schoenbaum’s effects test,” yet, ultimately asserted subject matter jurisdiction).
61. See, e.g., Sachs, *supra* note 32, at 679 n.10 (citing cases allowing foreign traders to sue under Rule 10b-5).
62. See *infra* part I. B.
policies followed by each country, which are reflected in their differing attitudes toward bankruptcy.\(^6\) For example, some countries encourage "rehabilitation of the debtor,"\(^6\) while others support liquidation of the debtor's property.\(^6\) Moreover, some countries, such as Brazil, only recognize a limited number of entities as eligible for bankruptcy,\(^6\) while other countries, such as the United States, recognize "the vast majority of persons and entities [as] eligible for bankruptcy proceedings."\(^6\)

These conflicting approaches are summed up in two doctrines: the territoriality theory and the universality theory.\(^7\) Under the territoriality doctrine, separate bankruptcy proceedings take place concurrently in the jurisdiction where the debtor is located and in the jurisdiction or jurisdictions where the debtor's assets are located.\(^7\) Extraterritorial recognition is not given to either proceeding.\(^7\) In contrast, under the universality doctrine, there is only one bankruptcy adjudication. This proceeding takes place in the jurisdiction of the debtor's domicile, even when assets throughout the world are included in the estate, and the court's judgment is recognized everywhere.\(^7\) Although the universality approach requires creditors to submit to foreign laws, thereby subjecting them to inconvenience, its underlying premise is that creditors in similar positions will receive equal treatment.\(^7\)

At first glance, the universality approach appears to be ideal. Realistically, however, this approach is meaningless unless all countries agree to enforce the judgments of other jurisdictions. Such an agreement would require the existence of a treaty, and, as mentioned above, "treaties governing transnational bankruptcies are rare."\(^7\) Thus, by default, the territoriality approach has been applied by the majority of courts, thereby resulting in multiple bankruptcy proceedings and conflicting national

\(^{65}\) See Gitlin & Flaschen, supra note 64, at 308.

\(^{66}\) Id. In the United States, for example, "there is an express Congressional policy in favor of rehabilitating debtors and maintaining the equity in their property." Id. at 308 n.4 (quoting In re Hollanger, 15 B.R. 35, 48 (Bankr. W.D. La. 1981)).

\(^{67}\) See id. at 308. In countries that favor liquidation, reorganization is very rare. Less than one percent of West German debtors have been able to successfully reorganize and approximately only 10 debtors in the past two decades have been able to do so in Mexico. See id. at 308 n.5.

\(^{68}\) See id. at 308 (citing Timothy E. Powers & Rona R. Mears, Protecting a U.S. Debtor's Assets in International Bankruptcy: A Survey and Proposal for Reciprocity, 10 N.C.J. Int'l L. & Com. Reg. 303, 309-10 (1985)).

\(^{69}\) Gitlin & Flaschen, supra note 64, at 308 (referring to 11 U.S.C. § 109 (1982)).


\(^{71}\) See Huber, supra note 70, at 744.

\(^{72}\) See id.

\(^{73}\) See id.

\(^{74}\) "Because every creditor's claim is subject to one body of law . . . , the universality doctrine equalizes creditors' rights." Id.

\(^{75}\) Id. at 745.
preferences. Historically, United States bankruptcy laws have been hostile toward
claims asserted by foreign trustees in bankruptcy against estate property
located in the United States. In fact, early in our history, the Supreme
Court established that “[t]he bankrupt law of a foreign country is incap-
able of operating a legal transfer of property in the United States.”
Accordingly, at least one commentator has accused the United States of
being one of the least cooperative of the major trading states when faced
with a foreign bankruptcy.

The Bankruptcy Code of 1898 did not authorize foreign representa-
tives to initiate bankruptcy proceedings against United States debtors in
United States courts. In fact, prior to the enactment of the Bankruptcy
Reform Act of 1978, there was little statutory guidance regarding inter-
national bankruptcies. Therefore, until 1978, the courts based their de-
cisions upon the vague doctrine of comity, as proposed in the landmark
case of Hilton v. Guyot. During this time period, “the foreign representa-
tive’s only hope... was for the court to recognize the representative’s
claims as a matter of comity and then defer to the foreign administration
of the estate.”

The vague concept of comity is neither easily defined nor easily com-
prehended, but the Hilton Court attempted the following explanation:

“Comity,” in the legal sense is neither a matter of absolute obligation,
on the one hand, nor of mere courtesy and good will, upon the other.
But it is the recognition which one nation allows within its territory to
the legislative, executive or judicial acts of another nation, having due
regard both to international duty and convenience, and to the rights of
its own citizens or of other persons who are under the protections of its
laws.

Under the concept of comity, courts are allowed, but not required, to

76. See John D. Honsberger, Conflict of Laws and the Bankruptcy Reform Act of
Sabena, Belgian World Airlines, 731 F.2d 909 (D.C. Cir. 1984) (holding that parallel
proceedings on the same in personam claim should ordinarily be allowed to proceed si-
multaneously, at least until one court reaches a decision).

77. See In re Toga Mfg. Ltd., 28 B.R. 165, 167 (Bankr. E.D. Mich. 1983); see also
Unger, supra note 70, at 1153 (“The United States has traditionally not treated foreign
creditors favorably, especially when conflicting claims of United States creditors were
involved.”).

79. See Gitlin & Flaschen, supra note 64, at 314.
80. See Morales & Deutsch, supra note 63, at 1575-76.
81. 159 U.S. 113 (1895). Notably, Hilton was not a bankruptcy case. The Court
intended that the doctrine of comity be applied generally in the recognition of foreign
judgments. Consequently, this doctrine is not limited to bankruptcy issues.
82. Anne Norby Nielsen, Section 304 of the Bankruptcy Code: Has it Fostered the
Development of an “International Bankruptcy System”, 22 Colum. J. Transnat’l L. 541,
83. Hilton, 159 U.S. at 163-64.
recognize foreign laws, judgments, or proceedings. The courts must balance the interests of international responsibility and the protection of local citizens on a case-by-case approach. Factors supporting recognition of foreign laws include "increased international cooperation through reciprocal recognition, economic and efficient use of judicial resources, and avoidance of multiple proceedings against the same debtor." Factors opposing recognition of foreign proceedings include "the desire to protect local creditors, the inconvenience U.S. creditors would suffer in being forced to assert their claims abroad, and differences in bankruptcy laws which may violate basic principles of fairness according to U.S. standards." These factors, among others, must be weighed on a case-by-case basis in order to determine whether foreign proceedings should be recognized under the principles of comity.

Initially, the post-*Hilton* cases relied upon comity as a license to adopt a protectionist stance; the courts generally concluded that local citizens' interests would be prejudiced and that public policy would be violated if they were to recognize foreign proceedings. Nevertheless, an analysis of more modern cases reveals a shift from this initial emphasis. Rather than basing decisions upon "an overt nationalistic bias favoring American creditors," the courts began to focus more on the equitable distribution of assets among creditors. Yet, although comity was

84. See Unger, *supra* note 70, at 1159. This permission, of course, assumes that each proceeding or judgment sought to be recognized is jurisdictionally proper. See *id.* at 1159 n.25 (citing *Hilton*, 159 U.S. at 166).
85. Id. at 1160.
86. Id.
87. See *id.* The court in *Hilton* ultimately denied recognition of a French judgment by considering an additional requirement—reciprocity. The court expressly stated that United States courts should not give full credit and conclusive effect to foreign judgments rendered in countries which themselves refused to give conclusive effect to similar United States judgments. See *Hilton*, 159 U.S. at 227-28. This factor has been ignored, or criticized, by virtually every court. It has been rejected by the courts of New York. See, e.g., *Cunard Steamship Co. v. Salen Reefer Services AB*, 773 F.2d 452, 460 (2d Cir. 1985) (quoting Judge Learned Hand's opinion in *Disconto-Gesellschaft v. United States Steel Corp.*, 300 F. 741, 747 (S.D.N.Y. 1924), aff'd, 267 U.S. 22 (1925), which concluded that the Supreme Court in *Hilton* "certainly did not mean to hold that an American court was to recognize no obligations or duties arising elsewhere until it appeared that the sovereign of the locus reciprocally recognized similar obligations existing here"). It has also been rejected by other courts. See, e.g., *Somportex Ltd. v. Philadelphia Chewing Gum Corp.*, 453 F.2d 435, 440 n.8 (3d Cir. 1971) (acknowledging that "the doctrine [of reciprocity] has received no more than desultory acknowledgment," and, further, that it has been completely rejected by the New York courts), cert. denied, 405 U.S. 1017 (1972). Similarly, reciprocity has been rejected by statute in some states, such as California. See *id.* at 440 n.8 (citing Willis L.M. Reese, *The Status in this Country of Judgments Rendered Abroad*, 50 Colum. L. Rev. 783, 790-93 (1950)).
88. See, e.g., *Disconto Gesellschaft v. Umbreit*, 208 U.S. 570 (1908) (concluding that the discretionary nature of comity entitles Wisconsin to favor its local creditors as a matter of public policy).
90. See *Clarkson Co. v. Shaheen*, 544 F.2d 624, 630 (2d Cir. 1976); see also *Somportex*, 453 F.2d at 440 (concluding that "[c]omity should be withheld only when its acceptance would be contrary or prejudicial to the interest of the nation called upon to
consistently the principal basis for decisions during this time period, the doctrine did not serve to render consistent decisions or adequate protection.91

The bankruptcy proceedings that arose from the 1974 failure of Bankhaus I.D. Herstatt Kommanditgesellschaft auf Aktien ("Herstatt"), a major West German commercial bank, clearly demonstrate the inadequacy of United States law in the 1970s respecting foreign insolvency proceedings.92 Although Herstatt did not conduct business in the United States, it maintained over $150 million in assets at Chase Manhattan Bank of New York. Upon hearing of the bankruptcy, international creditors from around the world “raced” to the courthouse to attach the funds held by Chase,93 and those responding first reaped the largest proportionate distributions.94 Moreover, the foreign representative appointed to liquidate the Herstatt estate chose not to participate in the United States proceedings for fear of subjecting the entire estate to United States jurisdiction.95 Eventually, the uncertainty created by the complexity of the problems and the lengthy time period anticipated for final determination motivated all of the parties to settle their claims out of court.96 The disorder resulting from the Herstatt bankruptcy “highlighted the inability of American law to provide satisfactory guidance in this international context.”97

The Second Circuit attempted to correct this inadequacy in two subsequent decisions: Israel-British Bank (London) Ltd. v. FDIC98 and Banque de Financement v. First National Bank of Boston.99 In Israel-British Bank, the representative of a foreign bankrupt debtor (“IBB”)—a London bank which conducted no business in the United States—sought to recover assets held by New York correspondent banks. In contrast to Herstatt, IBB chose to compete with United States creditors by participating in United States courts. Noting that “[t]he road to equity is not a race course for the swiftest,”100 the court ordered the assets returned to the London receiver so they could be equitably distributed pursuant to the London proceeding.101 Significantly, the Second Circuit acknowledged IBB’s right to initiate a voluntary proceeding in the United States.

91. See Morales & Deutsch, supra note 63, at 1574.
92. See Unger, supra note 70, at 1163-64; see also Gitlin & Flaschen, supra note 64, at 314-15 (discussing the Herstatt affair).
93. See Unger, supra note 70, at 1164.
94. See Nielsen, supra note 82, at 548 (citing Joseph D. Becker, International Insolvency: The Case of Herstatt, 62 A.B.A. J. 1290, 1294 (1976)).
95. See Unger, supra note 70, at 1164.
96. See id. at 1165.
97. Id.
98. 536 F.2d 509 (2d Cir.); cert. denied, 429 U.S. 978 (1976).
99. 568 F.2d 911 (2d Cir. 1977).
100. Israel-British Bank, 536 F.2d at 513.
101. See id. at 511-15.
Further, it recognized this claim despite the potential for resulting harm to United States creditors.102

Similarly, in *Banque de Financement v. First National Bank of Boston*, the Second Circuit stressed equal distribution among creditors in the international context.103 In this case, a Swiss bank undergoing reorganization under Swiss Law initiated a parallel United States bankruptcy proceeding to release its assets deposited in New York banks from attachments by New York creditors. Both the bankruptcy and the trial court held that United States creditors should be given preferential treatment. The district court specifically focused on prejudice to American creditors resulting from participation in Swiss bankruptcy procedures—procedures which significantly differ from our own. In particular, the court expressed concern over the Swiss bank secrecy laws.104 But, in reversing the lower courts, the Second Circuit, relying upon *Israel-British Bank*, interpreted the existing Bankruptcy Code105 as being primarily concerned with the equality of similarly situated creditors (regardless of their nationality) and the economy of judicial resources.106

These two decisions marked a significant departure from the initial protectionist interpretations of comity. In light of the Herstatt affair, which so clearly demonstrated the inadequacies of our existing laws and the consequent need for reformation, the decisions came as no surprise. In fact, the judicial branch was not alone in its expression of dissatisfaction; in 1970, Congress created the Commission on the Bankruptcy Laws of the United States to amend and revise the old laws. In 1973, the Commission proposed a draft of a new Bankruptcy Code which distinctly reflected the two Second Circuit decisions.107

The Herstatt disaster, coupled with the inconsistent United States case law regarding international insolvency, prompted Congress to enact section 304 of the Bankruptcy Reform Act of 1978 (the “Bankruptcy

103. 568 F.2d 911, 918 (2d Cir. 1977).
104. See id. at 921.
107. See Unger, *supra* note 70, at 1167.

In a note in the 1973 draft of the Code prepared by the Commission on the Bankruptcy Laws of the United States, it was stated that “recognition accorded a foreign trustee . . . should enhance the likelihood that a trustee of an estate appointed or elected in this country will be accorded respect when he sues to recover property located abroad.”

Id. at 1167 n.51 (alteration in original) (citing Bankruptcy Act Revisions: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Const. Rights of the House Comm. of the Judiciary, 94th Cong., 2d Sess. 1443 (1976)).
Section 304 and its related provisions\(^{109}\) (hereinafter "section 304") provide a foreign representative\(^{110}\) with a number of protections and opportunities that are similarly afforded to domestic creditors. Pursuant to section 304(a), a foreign representative has the option to file a case ancillary to a foreign proceeding\(^{111}\) for the limited purpose of pursuing certain specified remedies, without exposing himself to the jurisdiction of any other United States court.\(^{112}\) This provision addresses the concerns of liquidators involved in Herstatt-like bankruptcies regarding exposure to jurisdiction. Section 304(b) provides a foreign trustee with two specific types of relief: first, the court may enjoin the commencement, continuation, or enforcement of any United States action, judgment, or lien against a debtor with respect to property or assets involved in the foreign proceeding;\(^{113}\) second, the court may order that the property in question be turned over to the representative for distribution in the foreign proceeding.\(^{114}\) Additionally, section 304(b) contains a flexible catchall provision which empowers the court to order "other appropriate relief"\(^{115}\) under certain circumstances.

Section 304(c) enumerates specific factors which the bankruptcy courts are required to consider in determining whether to grant the relief requested by the foreign representative. The preamble of section 304(c) clearly favors a universal approach to foreign bankruptcies,\(^{116}\) demonstrating Congress' intent to depart from pre-code treatment of foreign bankruptcies and to shift focus away from biased protection of local interests: "[i]n determining whether to grant relief . . . the court shall be guided by what will best assure an economical and expeditious administration of such estate."\(^{117}\) Furthermore, section 304(c) enumerates six policy principles which a court should consider, and which, together, conclusively manifest a congressional intent to expand upon and clarify the prior law (which was governed solely by comity). These six factors include the following:


\(^{109}\) See 11 U.S.C. §§ 303(k), 305(b), and 306 (1988) (referring, in part or in whole, to the foreign trustee).


\(^{111}\) A "case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative." 11 U.S.C. § 304(a) (1988).


\(^{114}\) See id. § 304(b)(2) (1988).

\(^{115}\) Id. § 304(b)(3) (1988).

\(^{116}\) See Huber, supra note 70, at 746-48.

(1) just treatment of all holders of claims against or interests in such estate;
(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
(3) prevention of preferential or fraudulent dispositions of property of such estate;
(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
(5) comity; and
(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns. 118

In order to alleviate the tensions between nationally-oriented and internationally-oriented policies, the drafters of the Bankruptcy Act applied a balancing approach. As a result, the Act embodies both the universalist and territorialist theories of bankruptcy jurisdiction. 119 In addition, as evidenced by the legislative history, Congress did not intend courts to be bound by these factors; rather, the factors should serve as guidelines "designed to give the court maximum flexibility." 120 Principles of international comity, including respect for the judgments and laws of other nations, suggest that the court be permitted to make the appropriate orders on a case-by-case basis, rather than being provided with inflexible rules.

In addition to the six factors enumerated in the Bankruptcy Act, one commentator has suggested other factors to consider when determining whether to grant bankruptcy relief to a foreign representative, including the following:

1) [whether] the failure to grant an order in an ancillary proceeding will require a local bankruptcy to protect local assets, necessitating concurrent bankruptcies and higher administrative costs;
2) [whether] the foreign bankruptcy law is similar to that of the United States;
3) [whether] the relative ease of access to the foreign country and relative ease of communications with the foreign creditors facilitates a convenient proceeding; 121 and
4) [whether] more creditors and a greater part of the estate of the

118. Id.
119. While some commentators have criticized § 304(c) for providing "a morass of internally inconsistent and redundant principles" which have resulted in an unworkable standard upon which to determine requests for relief, see Nielsen, supra note 82, at 554-60, others have praised the flexibility these factors provide. See, e.g., Honsberger, supra note 76, at 670 ("It is not the extent of the congressional action that is significant, but the spirit implicit in its innovations."); Donald T. Trautman, Foreign Creditors in American Bankruptcy Proceedings, 29 Harv. Int'l L.J. 49, 49 (1988) ("[T]he statutory additions of 1978 represent a significant statement by our legislature of a spirit of international cooperation in bankruptcy.").
121. "[O]n these grounds alone it would seem that all things being equal, a court's
debtor are located in the foreign country.\footnote{Id.}

Following the enactment of section 304 of the Bankruptcy Code, courts deciding transnational cases became more receptive to foreign laws. For example, the bankruptcy court in \textit{In re Culmer}\footnote{25 B.R. 621 (S.D.N.Y. 1982).} granted the liquidators' petition to transfer all assets located in the United States to the foreign court for distribution, holding that “[o]ne who invests in a foreign corporation subjects his investment to foreign law and may not seek to obtain greater rights than his co-creditors by suing in an American court.”\footnote{Id. at 632; accord Cunard Steamship Co. v. Salen Reefer Servs. AB, 773 F.2d 452 (2d Cir. 1985) (Second Circuit deferred to Swedish bankruptcy proceedings, vacating English corporation's attachment of Swedish entity's assets located in the United States); Kenner Prods. v. Societe Fonciere et Financiere Agache-Willot, 532 F. Supp. 478 (S.D.N.Y. 1982) (New York court deferred to French bankruptcy proceeding); Cornfeld v. Investors Overseas Servs., Ltd., 471 F. Supp. 1255 (S.D.N.Y.) (New York court deferred to Canadian bankruptcy proceeding), aff'd, 614 F.2d 1286 (2d Cir. 1979). \textit{But see In re Toga Mfg. Ltd.,} 28 B.R. 165 (Bankr. E.D. Mich. 1983) (bankruptcy court held that comity required claim of American lien creditor against Canadian debtor be litigated in United States court, rather than permitting deferral to Canadian bankruptcy proceedings).}

In addition, although more recent decisions still rely upon the doctrine of comity, the meaning of the term “comity” has been turned virtually on its head. Prior to the enactment of the Code, bankruptcy courts relied upon comity to protect local interests and refused to defer to foreign proceedings whenever local interests were even slightly prejudiced.\footnote{See Gitlin & Flaschen, supra note 64, at 314.} Subsequent to the enactment, many courts shifted their interpretation of comity, holding that it generally requires courts to recognize foreign proceedings.\footnote{See Unger, supra note 70, at 1183.} In fact, following the enactment of section 304, “New York courts . . . narrowly construe[d] exceptions to the comity doctrine, stating that ‘foreign-based rights should be enforced unless the judicial enforcement of such a [right] would be the approval of a transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense.’ ”\footnote{Kenner Prods. v. Societe Fonciere et Financiere, 532 F. Supp. 478, 479 (S.D.N.Y. 1982) (second alteration in original) (citing Intercontinental Hotels Corp. v. Golden, 203 N.E.2d 210, 212 (N.Y. 1924)).}

\section*{II. The Effect of Globalization on the Extraterritorial Doctrine}

Part I of this Note explained the concept of the extraterritorial doctrine and explored its application to the substantive areas of securities fraud and bankruptcy. This Section will expand upon that discussion,
specifically addressing why concern about the application of the extraterritorial doctrine intensifies as the global market evolves.

First, while an integrated global securities market undoubtedly provides substantial benefits to all parties involved, a number of problems have ensued. Currently, "there is no cohesive supervision of the global securities market[]." This fragmentation of supervision, both at national and agency levels, makes policing transnational securities transactions difficult, if not impossible. Thus, as trading has expanded, the ability of nations to detect, investigate, and prosecute violations of their securities laws has become attenuated, and, consequently, the opportunity for widespread abuse of these laws has multiplied dramatically.

Second, United States securities laws are not only unique, but are also more inclusive and comprehensive in scope than comparable laws of other countries. Accordingly, activity that the United States considers illegal may be deemed permissible in other countries. Some American nationals have exploited this by unlawfully trading American securities through the use of foreign brokers and institutions. These investors usually trade "on the assumption that such trading activity will unlikely be of interest to the foreign authorities and that much more difficult to detect by American regulators." Moreover, they are further induced to conduct illegal trading in foreign countries, such as the Bahamas, which apply foreign secrecy and blocking laws to maintain their confidentiality.

For example, Dennis Levine, a United States citizen convicted of securities fraud, utilized bank accounts established in the Bahamas to conduct illegal trading.

128. See Gruson, supra note 3, at 306.
129. Id. at 307.
130. See Bornstein & Dugger, supra note 26, at 376.
131. See House Committee Report Critical of SEC's International Enforcement, 20 Sec. Reg. & L. Rep. (BNA) 1551 (Oct. 14, 1988) [hereinafter House Committee Report] ("The report . . . found that of 229 market surveillance reports containing suspicious foreign trades that were reported to the SEC during 1986 and 1987, the commission failed to pursue the foreign trades in 168—73 percent.").
133. See id. at S338; see also Andrew N. Grass Jr., Internationalization of the Securities Trading Markets, 9 Houston J. Int'l L. 17, 49 (1986) (concluding that the scope of insider trading is far more developed in the United States than in foreign securities markets).
134. Langevoort, supra note 29, § 14.01.
135. For example, the Cayman Islands responded to a flood of subpoenas served on American tax dodgers by the Internal Revenue Service by enacting the Confidential Relationships Preservation Law. This made it a crime for banks or local officials to disclose information to "nosy foreign governments" or investigitors. Steve Lohr, Where the Money Washes Up, N.Y. Times, Mar. 29, 1992, § 6 (Magazine), at 27, 46; see also House Committee Report, supra note 131, at 1551 ("[T]he Securities and Exchange Commission has not enforced vigorously U.S. securities laws against suspicious trades originating from . . . countries with bank secrecy and 'blocking' statutes.").
136. See Langevoort, supra note 29, § 14.01; see also Wall Street Rogues: Where are
Third, problems may arise even when neither of the two parties involved in the trade deliberately seek to evade stringent laws. This occurs because different laws will likely govern a transaction across international borders; hence, neither party can be certain of the legality of the transaction.\footnote{137}

Fourth, the regulation of international trade is further complicated by the electronic linkages among exchanges worldwide. In addition to the linkages established by the marketplaces themselves, a number of private systems now provide parties with the capability to trade by computer.\footnote{138} These linkages/systems permit transactions to be electronically routed through several exchanges before settling at its final destination, making the origin of the transaction difficult to trace.\footnote{139} Also, authorities have


\footnotetext[138]{See Grass, supra note 133, at 40. For example, Instinet, which was developed by the Reuters Monitor System, provides an electronic marketplace for traders. “These and other technological advances have been seized upon by global markets . . . . Freely operating securities markets will be created, which may not conform to perceptions held in the United States of firm and orderly markets, but which will decidedly have direct impacts on U.S. markets . . . .” \textit{Id.}}

\footnotetext[139]{See Lohr, supra note 135.}

In their efforts to monitor the global movement of funds through money havens, the United States has signed tax-information exchange agreements with several offshore countries and territories in the Caribbean, including Barbados, Jamaica, Bermuda and Grenada. In exchange for their cooperation, Washington has said it will encourage American investment in those places. \textit{Id.} at 52. “However, . . . ‘the key secrecy jurisdictions like the Cayman Islands and the Bahamas refused to lift the veil.’” \textit{Id.} (quoting Bruce Zagaris, a Washington lawyer who is an expert on international criminal law).

The difficulty of tracing funds routed through foreign banks presents problems in investigating many crimes. \textit{See, e.g.,} Sara Fritz & Robert C. Jackson, \textit{Federal Authorities Expect Additional Arrests in Trade Center Bombing}, L.A. Times, Mar. 13, 1993, at A16 (criticizing the laissez-faire attitude of German authorities toward policing terrorist abuses of banks: “‘The Germans are very remiss on policing the corporations and banks and their misuse by terrorist groups’. . . . ‘On several incidents over the years, the trails go through Germany.’”); Jim McGee, \textit{Authorities Trace Source of Bomb Suspects’ Money}, Wash. Post, Mar. 12, 1993, at A1 (quoting the New York Police Commissioner Raymond W. Kelly regarding the difficulty of discerning financial transactions and locating the source of funds when such funds have been routed through several locations).
lost a substantial amount of control over trading because of these linkages/systems. For example, the SEC has complained that the effectiveness of an order to halt trading in one jurisdiction may be impaired if trading in the same securities is possible in a different jurisdiction through another exchange.\textsuperscript{140}

In sum, although progress has stimulated a global economy, similar accomplishments have not yet been made toward its regulation. This inability to regulate the growing number of international transactions has caused a loss of control over the securities markets. Furthermore, when certain cross-border transactions are deemed beyond the reach of the United States legal system and are governed, instead, by less stringent foreign laws, the integrity of the United States securities market is undermined. Thus, the extraterritorial doctrine is of great concern in the evolving global market.\textsuperscript{141}

A much more serious concern than that of impracticable supervision, however, is the devastating effect that one failure in this unified global market could have on the entire system.\textsuperscript{142} In other words, because of the interdependence between members of a global market, such a failure could cause a domino-theory collapse that might have global impacts. To this end, a minor domestic bankruptcy could be transformed into a world-wide catastrophe. This threat of collapse is exacerbated in a global market, as opposed to a national market, because international investors are more likely to overextend themselves in risky transactions and, consequently, to become bankrupt. Moreover, these risks are magnified in global transactions because volatile exchange rates, which are often utilized to diversify risk,\textsuperscript{143} simultaneously create a potential for loss,\textsuperscript{144} and international players do not have access to government help in the event that this loss is realized.\textsuperscript{145}

In contrast, our national system has designed “safety nets” upon which domestic players\textsuperscript{146} may rely in certain emergencies. For example, where a lack of financing may result in far-reaching repercussions, central banks can step in as lenders of last resort in order to prevent a national disaster.\textsuperscript{147} Furthermore, the United States Bankruptcy Code

\textsuperscript{140} See Bornstein & Dugger, supra note 26, at 376.
\textsuperscript{141} See Kenneth W. Dam, Economic and Political Aspects of Extraterritoriality, 19 Int'l Law. 887, 888 (1985); see also Finnerty, supra note 28, at pt. II (arguing for a limited extension of extraterritorial application of Rule 10b-5).
\textsuperscript{142} See Gruson, supra note 3, at 307-08.
\textsuperscript{143} See id. at 305.
\textsuperscript{144} See Bernard, supra note 137, at 326. In addition, these fluctuations create a risk of non-performance when they occur during the period between the trade and the settlement. See id.
\textsuperscript{145} See id. While commercial banks may be protected to some extent, investment banks in international markets do not have any such cushion. See Gruson, supra note 3, at 308.
\textsuperscript{146} Once financial players cross international borders, however, they may no longer rely upon this protection.
\textsuperscript{147} See Gruson, supra note 3, at 308.
includes provisions designed to alleviate the confusion resulting from a domestic crisis. Specifically, section 365\(^{148}\) addresses the issue of executory contracts and what happens if a party to a transaction becomes bankrupt during the settlement period.\(^{149}\) Still another domestic safety net, which is of no avail once transactions move across international borders, includes the accessibility of clearing corporations and depositories which protect creditors from the nonperformance of a bankrupt party. Finally, the Securities Investor Protection Corporation protects investors from their brokers' insolvency.\(^{150}\)

As indicated above, a new integrated market will result in novel innovations, but will simultaneously be accompanied by a greater number of failures. Moreover, because of many interrelated causes, including riskier ventures, uncertainty, volatile exchange rates, and unprecedented opportunities to engage in illegal trading, the high number of bankruptcies can be expected to continue into the future.\(^{151}\)

United States investors of insolvent companies often react to a declaration of bankruptcy by claiming there was a material error in either disclosure or omission which induced the investment and, hence, their loss. Absent the enactment of uniform regulations of securities traded worldwide, an event which is unlikely to occur,\(^{152}\) transnational companies will continue to commit fraud (as defined by the United States). United States investors of these companies will likely respond to a declaration of bankruptcy by claiming violations of Rule 10b-5. Therefore, the likelihood of a Rule 10b-5 action arising in the context of a transnational bankruptcy case has risen dramatically.

This prospect is problematic because the emerging trend for applying United States laws extraterritorially in transnational securities fraud cases directly opposes the emerging trend for applying United States laws in transnational bankruptcy cases.\(^ {153}\) While United States courts have continued to extend extraterritorial application of Rule 10b-5,\(^ {154}\) they


\(^{149}\) See Bernard, supra note 137, at 325.

\(^{150}\) See id.

\(^{151}\) This trend coincides with the recent abrupt end of a decade of rapid development. During the 1980s, remarkable advances occurred in the area of international finance. For example, investment multiplied significantly, in part through investors' willingness to over-leverage. In addition, the 1980s were marked by an unprecedented number of mergers and acquisitions, and there appeared to be an endless supply of money.

Yet, the current downturn in the economy has had a chilling effect on the advances of the 1980s, and the consequences of this downturn are now being realized. Moreover, this decade of international prosperity culminated in "[t]he B.C.C.I. scandal, [which] highlighted, and left unresolved the 'least common denominator aspect' of international finance—that is, money flows to the places that regulate least." Lohr, supra note 135, at 28-32 (quoting E. Gerald Corrigan, President of the Federal Reserve Bank of New York and head of The Bank of International Settlement's committee on global banking supervision in Basel, Switzerland, testifying before the House Banking Committee last fall).

\(^{152}\) See supra notes 63-69 and accompanying text.

\(^{153}\) See supra part I.

\(^{154}\) See supra part I. A.
have restricted the extraterritorial application of United States bankruptcy laws. In fact, these two trends are headed on a collision course. Thus, an issue of critical concern is which approach courts should apply when faced with this situation.

III. DOMESTIC PUBLIC POLICY SHOULD PROVOKE APPLICATION OF EXTRATERRITORIAL DOCTRINE WHEN RULE 10b-5 ARISES IN AN INTERNATIONAL BANKRUPTCY PROCEEDING

Part I of this Note discussed the willingness of the United States courts to apply United States securities laws expansively to extraterritorial disputes. The United States courts have been overwhelmingly receptive toward plaintiffs claiming violations of Rule 10b-5, and have often premised application of United States securities laws on minimal contacts with the United States. For example, when United States shareholders of foreign corporations allege Rule 10b-5 violations, United States courts traditionally exercise considerable discretion in asserting subject matter jurisdiction and in applying United States securities laws, even where the defendant does not necessarily intend to link the fraud to the United States.

As stated in Part I of this Note, the United States courts have been reluctant to apply United States bankruptcy laws to extraterritorial disputes. The courts have been disinclined to adjudicate claims brought against foreign debtors, even when deferring to foreign bankruptcy proceedings will leave a United States creditor with less protection than the United States Bankruptcy Code would afford. A conflict thus arises when a shareholder alleges securities fraud claims against an international corporation which is concurrently undergoing foreign bankruptcy proceedings. The question that arises is whether the United States courts should assert jurisdiction and adjudicate the Rule 10b-5 claims or, alternatively, dismiss the action in deference to the related foreign bankruptcy proceedings.

The recurrence of this conflict is an inevitable byproduct of globalization. The increasing number of multinational corporations, and the

155. See supra part I. B.
156. See supra part I. A.
157. See supra part I. A.
158. See, e.g., Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 980 (2d Cir.) (defendant Investors Bank Limited of Nassau, the Bahamas, issued a prospectus which specifically stated that the shares being offered "are not being offered in the United States of America . . . or any area subject to its jurisdiction"), cert. denied, 423 U.S. 1018 (1975).
159. See supra part I. B.
160. See, e.g., In re Koreag, Controle et Revision S.A., 130 B.R. 705, 713-14 (Bankr. S.D.N.Y. 1991) (holding that creditor holding secured claim under New York law and United States Bankruptcy Code, but relegated to status of unsecured creditor under Swiss law, could not preclude turnover of assets to Swiss bankruptcy proceeding; the test is whether proceedings in the foreign country comport with fundamental notions of fairness, not whether Swiss law mirrors American law), vacated on other grounds, 961 F.2d 341 (2d Cir.), cert. denied, 113 S. Ct. 188 (1992).
question of their relationships "to the home and the host nation," have raised several issues concerning both the external activities of these corporations and the reach of the regulatory authority of the various nations involved in areas such as antitrust, anti-corruption, bankruptcy, environmental protection, foreign exchange, labor, securities regulation, and tax. The doctrine of extraterritoriality has developed independently within each area of substantive law. Accordingly, the doctrine applied in securities law is contrary to that applied in bankruptcy proceedings. Regardless of whether this is a positive or negative circumstance that the extraterritorial doctrine accounts for the substantive law, in practicality, it is inevitable. A broad, overgeneralized rule would result in numerous exceptions, thus rendering any such rule ineffective.

The recent insolvency proceedings of Polly Peck International exemplify the need for a uniform approach to this dilemma. Polly Peck is a publicly held, multinational conglomerate organized under the laws of the United Kingdom. The company is currently undergoing reorganization pursuant to an administration order issued by an English court. This administration order has triggered a stay on the commencement or continuation of all judicial and other proceedings against Polly Peck and its property. In the midst of this complex administration, a shareholder, Nathan Zeidenberg, filed suit in the United States against Polly Peck claiming violations of the Securities Exchange Act of 1934, Rule 10b-5, and common law fraud. Polly Peck contended that an effective defense of this action would have required the administrators to expend an immense amount of time and incur tremendous costs. Thus, it

162. See id. at 93-94.
163. See, e.g., Bruce A. Rosenfeld, Extraterritorial Application of U.S. Laws: A Conflict of Laws Approach, 28 Stan. L. Rev. 1005, 1028 (1976) (arguing that the ad hoc approach is more likely to serve justice between the parties in each case).
164. See, e.g., Note, Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction, 98 Harv. L. Rev. 1310, 1318-19 (1985) (referring to the divergence among the tests, the author comments: "Given the muddle of current doctrine, it is hardly surprising that courts have decided questions of extraterritoriality in an inconsistent and confusing fashion.").
165. See In re Polly Peck Int'l PlC, No. 009296 of 1990 in the High Court of Justice, Chancery Division, Companies Court, Order dated October 25, 1990.
166. The Polly Peck insolvency proceedings are estimated to be the largest in the history of the United Kingdom. Polly Peck has approximately 2000 creditors (not including shareholders), with claims currently amounting to approximately $2.3 billion. See Zeidenberg v. Polly Peck, No. 91 Civ. 3246, 1992 WL 178626 (S.D.N.Y. July 16, 1992).
167. Specifically, the Companies Court of England and Wales in the Chancery Division of the High Court of Justice issued the order.
168. This stay is similar to the automatic stay triggered by the filing of a Chapter 11 petition under the United States Bankruptcy Code.
169. Plaintiff purports to represent a class of purchasers of Polly Peck Ordinary Stock, or American Depositary Receipts, who acquired their securities in the United States between January 2, 1989, and October 16, 1990. However, plaintiff has made no motion to obtain class certification.
made a motion to dismiss the suit on the grounds of comity and forum non conveniens.

The Southern District of New York, in dismissing both Zeidenberg's suit and a second securities fraud suit against Polly Peck, concluded that the comity regularly accorded to bankruptcy proceedings in common law jurisdictions abroad supported dismissal of the two claims. The court asserted that the procedures under the United Kingdom Insolvency Act, although not identical, are comparable to those under the United States Bankruptcy Code in that they abide by standards of fundamental fairness. The court's conclusion, however, was based upon an erroneous interpretation of the Third Circuit's holding in Kohn v. American Metal Climax, Inc.

In Kohn, American shareholders of a Zambian mining corporation claimed that the corporation obtained shareholder approval of a proposed amalgamation by violating United States securities laws. The Third Circuit ruled that the fairness of the corporate amalgamation could not be challenged in the United States because it had already been decided by a Zambian court. On the other hand, the court distinguished the Rule 10b-5 claim and held that it could properly be heard by the district court. Consequently, the American shareholders were entitled to bring the Rule 10b-5 action notwithstanding the Third Circuit's decision to defer to the foreign bankruptcy proceedings.

The court in Zeidenberg relied upon Kohn in concluding that "deference may be given to foreign bankruptcy proceedings where the American suit is based on United States securities laws." Although this interpretation of Kohn is accurate, it does not support the dismissal of the Rule 10b-5 claims against Polly Peck. The shareholders in Kohn were entitled, nonetheless, to bring their Rule 10b-5 claims. In fact, the Third Circuit concluded that it was obligated to provide the shareholders with a remedy. Therefore, the Southern District of New York errone-
ously relied upon Kohn to dismiss the Rule 10b-5 claims brought against Polly Peck.

A number of cases decided subsequent to Kohn have found that while comity may be applicable to securities claims, "the [Kohn] opinion reflects a legitimate concern that claimants asserting federally protected rights not be made to depend on the vagaries of another country's law which might not protect them as fully as our own."179 In fact, in Pogostin v. Pato Consolidated Gold Dredging, Ltd.,180 a New York court, which relied principally on Kohn, similarly found an obligation to provide a remedy for a plaintiff who has proven violations of the United States securities laws, even when a foreign defendant is the party who violated the laws.181 The New York court reasoned that "[o]therwise the Congressional policy implicit in federal securities regulation in this country would be seriously frustrated."182

The policy argument asserted in Kohn and Pogostin has been applied to foreign conflicts of law in other substantive areas.183 For example, courts have held that some areas of law—e.g., those areas which present universal goals—may be treated with substantial consistency, regardless of the nation imposing regulations. Consistent with this premise is the assertion that "the lack of a shared goal does not [automatically] imply the existence of an opposing goal";184 often, cognizable foreign interests are not harmed by the United States imposing more stringent regulations than those enacted by the foreign jurisdiction. Certain aspects of foreign laws, however, are designed in a manner which prevent implementation

United States Courts have exclusive jurisdiction under the Securities Exchange Act and defendants [had] not asserted that any similar law exists in Zambia. Accordingly, no finding, especially one that is merely implicit in the High Court's finding of fairness, could bind this Court, at least as to plaintiffs' Securities Exchange Act claims.


181. See id. at 90,699 (shareholder of a Bermuda corporation claimed the corporation violated United States securities laws by freezing-out public shareholders of the corporation at an unfair price).


183. See, e.g., Michael P. Bigelow, Case Comment, Public Policy Concerns Prevent Application of Comity to Foreign Bankruptcy Proceedings that Discriminate Against Tax Obligations Owed to the United States Government, 24 Vand. J. Transnat'l L. 571, 585 (1991) (arguing that a public policy approach is most appropriate to uphold strong public policy regarding tax obligations). Public policy has also been an issue of concern in litigation involving antitrust concerns and pre-dispute arbitration agreements.

of United States goals. In these areas, courts should focus more heavily on United States public policy.

Recent antitrust cases concerning conflicting foreign laws clearly demonstrate the need to analyze United States public policy. In addition, many commentators agree that a public policy approach to choice of law questions is more appropriate than an international comity approach. These commentators have questioned whether the courts are competent to balance international interests effectively, and whether a court may rely upon principles of international comity to dismiss, for lack of jurisdiction, an otherwise congressionally authorized cause of action.

One case, for example, which addressed these concerns is *Laker Airways Ltd. v. Sabena Belgian World Airlines*. In *Laker*, the D.C. Circuit acknowledged that courts are ill-equipped to engage in balancing foreign and domestic interests, and that any such attempt would, therefore, be inappropriate. According to the *Laker* court, a balancing approach was deficient for several reasons. First, in most cases, a court has already evaluated many of the factors set forth in a balancing test during its initial determination of prescriptive jurisdiction. Second, the contacts which "provide a basis for distinguishing between competing bases

---

185. See, e.g., *id.* at 1299 (asserting that foreign antitrust laws "may be designed precisely to prevent implementation of . . . United States [antitrust] law[s]").

186. Pursuant to *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597 (9th Cir. 1976), early antitrust cases applied a balancing test in granting extraterritorial effect to antitrust laws. However, this balancing test was not uniform throughout the courts. Compare *Timberlane*, 549 F.2d at 614 (proposing seven-factor test) and *Mannington Mills, Inc. v. Congoleum Corp.*, 595 F.2d 1287, 1297-98 (3d Cir. 1979) (proposing 10-factor test) with *Laker Airways Ltd. v. Sabena Belgian World Airlines*, 731 F.2d 909, 948 (D.C. Cir. 1984) (challenging the usefulness of a balancing approach). However, more recent cases suggest that "[t]he U.S. judiciary seeks foremost to protect the marketplace by effectively enforcing American antitrust policies." James M. Grippando, *Declining to Exercise Extraterritorial Antitrust Jurisdiction on Grounds of International Comity: An Illegitimate Extension of the Judicial Abstention Doctrine*, 23 Va. J. Int'l L., 395, 396 (1983).


189. 731 F.2d 909 (D.C. Cir. 1984).

190. See *id.* at 948.
of jurisdiction... generally incorporate purely political factors which the court is neither qualified to evaluate comparatively nor capable of properly balancing.” The Laker court thus conceded that it was "ill-equipped to 'balance the vital national interests of the United States and [a foreign government] to determine which interests predominate.'" 192

However, the Laker court further concluded that "[a]n... American court cannot refuse to enforce a law its political branches have already determined is desirable and necessary." 193 Specifically, the Laker court was referring to antitrust laws. Many commentators have concluded that the availability of treble damages demonstrates the firm opposition to monopolistic practices in the United States. Because such behavior may be overlooked, or even actively encouraged, by foreign governments, the court was concerned that declining to assert extraterritorial antitrust jurisdiction on grounds of international comity, would likely leave a plaintiff without an adequate remedy. 194 To preclude such an unfair result, United States courts adjudicating international antitrust cases often allow domestic public policy concerns to override international comity.

Similar to the antitrust laws, the United States securities laws provide numerous alternatives for pursuing securities fraud claims, including the opportunity for a plaintiff to impose multiple damages. 195 This availability demonstrates that, in this country, opposition to securities fraud is comparable with opposition to monopolistic practices. Moreover, such behavior may also be overlooked, or even actively encouraged, by foreign governments. Thus, United States courts adjudicating securities fraud claims that are brought within the context of an international bankruptcy case should follow the lead established in the antitrust arena.

Some critics maintain that such a policy is unnecessary because no country would sanction securities fraud. 196 Yet, blocking and secrecy

191. Id. at 949. These factors include “the degree to which the desirability of such regulation . . . is generally accepted,” “the existence of justified expectations that might be protected or hurt by the regulation in question,” and “the importance of regulation to the regulating state.” Id. (citation omitted).

192. Id. at 950 (quoting In re Uranium Antitrust Litig., 480 F. Supp. 1138, 1148 (N.D. Ill. 1979)). The applicable time constraints also placed an inherent limitation on the court's ability to balance competing interests. See id.

Although the Laker opinion concerned extraterritorial application of United States antitrust laws, the same arguments are applicable in the context of United States securities laws. The United States has imposed stringent legislation in both of these substantive areas of law, thereby revealing strong public sentiment.

193. 731 F.2d 909, 949 (D.C. Cir. 1984) (emphasis omitted). “Although the flash point of the controversy has been the antisuit injunctions, the real powder keg is the strongly mandated legislative policies which each national court is bound to implement.” Id. at 916.

194. See Grippando, supra note 186, at 420.


196. See Stewart, supra note 184, at 1305; see also IIT v. Cornfeld, 619 F.2d 909, 921 (2d Cir. 1980):

The problem of conflict between our laws and that of a foreign government is
laws do appear to have this effect. Furthermore, the term "securities fraud" has not been defined uniformly across international borders; each country defines its own standards under which activities are deemed either permissible or fraudulent. Thus, in light of these problems and the inadequate remedies currently provided by foreign nations in the adjudication of securities fraud actions, United States courts should focus on the strong public policy embodied in the United States securities laws, rather than resort to international comity.

**CONCLUSION**

In transnational securities fraud cases, United States courts have found an overwhelming need to apply United States law. Responding to this need, the courts have grasped to find even the most minimal links necessary to derive authority for applying United States law. Yet, in transnational bankruptcy cases, United States courts have been overwhelmingly receptive toward applying foreign law. One question that arises as a result of changes in today's global market is how the courts will handle securities fraud claims that arise in the context of a transnational bankruptcy.

The United States securities laws reflect a firm opposition in the United States toward fraudulent practices. Rule 10b-5 was designed to protect investors by preventing such behavior. To realize this goal fully, and because of the inadequacy of comparable foreign laws, United States courts should adopt a protectionist treatment and apply United States securities laws, regardless of whether the 10b-5 fraud claim arises in a transnational bankruptcy.

much less when the issue is the enforcement of the anti-fraud sections of the securities laws than with such provisions as those requiring registration of persons or securities. The primary interest of Luxembourg is in the righting of a wrong done to an entity created by it. If our anti-fraud laws are stricter than Luxembourg's, that country will surely not be offended by their application. If they are weaker . . . , the [plaintiffs] made their choice, doubtless at least in part because of difficulty in securing personal jurisdiction in Luxembourg . . . ;

Edward A. Taylor, Note, *Expanding the Jurisdictional Basis for Transnational Securities Fraud Cases: A Minimal Conduct Approach*, 6 Fordham Int'l L.J. 308, 328 (1983) (asserting that extraterritorial application of antifraud provisions is less offensive to foreign countries than extraterritorial application of registration and margin requirements because antifraud provisions do not interfere with foreign economic policies).