

Managing Regulatory Arbitrage: A Conflict of Laws Approach

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Introduction

American International Group (AIG). The very name of this multinational insurance company screams out its U.S. connections.¹ Yet in 2008,

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1. AIG is incorporated in Delaware and has its principal place of business in New York. DEL. INS. DEP'T, REPORT ON EXAMINATION OF AIG INSURANCE COMPANY 7 (2006), available at <http://delawareinsurance.gov/departments/berg/ExamReports/AIGLIFE2006web.pdf>; Restated Certificate of Incorporation of Am. Int'l Grp., Inc., State of Delaware, 47 CORNELL INT'L L.J. 63 (2014)

when London traders, within an office of a subsidiary of AIG, engaged in trading activities that ultimately drove the parent company to the brink of failure,² the trading conduct in question was largely beyond the reach of U.S. insurance and finance regulators,³ leaving American taxpayers on the hook for \$182 billion.⁴

In the world of financial regulation, national financial regulators confront a global financial system.⁵ Since 2008, regulators have made concerted efforts to address the national regulatory differences that made AIG's trades possible in the first place.⁶ New rules hammered out at multiple G20 summits since 2008 seek to address how these global challenges apply to banks.⁷ How have the markets responded to these rules? Financiers have simply found ways of booking their transactions through non-

ware Secretary of State (July 13, 2011), available at http://www.aig.com/Chartis/internet/US/en/CertificateofIncorporation_tcm3171-440365.pdf. It was, however, started by an American in Shanghai. See *Our History*, AIG, http://www.aig.com/our-90-year-history_3171_437854.html (last visited Sept. 12, 2013).

2. See Congressional Oversight Panel, *AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy* 18, 43-44 (2010), available at <http://www.gpo.gov/fdsys/pkg/CPRT-111JPRT56698/pdf/CPRT-111JPRT56698.pdf>.

3. The Office of Thrift Supervision (OTS) was nominally responsible for overseeing AIG Financial Products through a European Union Directive requiring foreign companies operating in Europe to have a home country "consolidated supervisor"—a responsibility the OTS director at the time later compared to "a gnat on an elephant." See *id.* at 18; Press Release, Office of Thrift Supervision, *OTS Receives EU Equivalency Designation for Supervision of AIG* (Feb. 22, 2007), available at <http://www.occ.gov/static/news-issuances/ots/press-releases/ots-pr-2007-11.pdf>. The Commission Bancaire, the French regulatory body who originally decided that the supervision of AIG by the OTS was sufficient under the EU directive, later denied any regulatory authority over AIG Financial Products. See Matthieu Protard, *AIG/France/Commission bancaire - Contrôle limité à la Banque AIG*, REUTERS (Mar. 30, 2009, 4:02 PM), <http://fr.reuters.com/article/idFRU47902720090330>.

4. CONGRESSIONAL OVERSIGHT PANEL, *supra* note 2, at 2.

5. See, e.g., Chris Brummer, *Post-American Securities Regulation*, 98 CALIF. L. REV. 327, 328 (2010) (discussing SEC attempts to "export its preferred safeguards and reforms" abroad); Stavros Gadinis, *The Politics of Competition in International Financial Regulation*, 49 HARV. INT'L L.J. 447, 449 (2008) ("[C]ountries' financial laws remain characteristically heterogeneous, despite exponential growth in international financial activity. While coordination efforts have succeeded in some regulatory areas, they have stalled in others despite strong efficiency arguments for a coordinated regime."); Eric J. Pan, *Four Challenges to Regulatory Reform*, 55 VILL. L. REV. 743, 744-45 (2010) (noting gaps between national regulatory schemes and problems in international cooperation); Pierre-Hugues Verdier, *Mutual Recognition in International Finance*, 52 HARV. INT'L L.J. 55, 55 (2011) ("The rapid globalization of finance since the 1970s has taken place against the background of a decentralized legal framework shaped primarily by national regulators.");

6. Pan, *supra* note 5, at 750.

7. See, e.g., FINANCIAL STABILITY BOARD (FSB), *FSB Framework for Strengthening Adherence to International Standards* 6-7 (2010); FSB, *Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability: Report of the Financial Stability Board to G20 Leaders* (2010); BASEL COMM. ON BANKING SUPERVISION, *Report and Recommendations of the Cross-Border Banking Resolution Group* (2010). See also Douglas W. Arner, Michael A. Panton & Paul Lejot, *Central Banks and Central Bank Cooperation in the Global Financial System*, 23 PAC. McGEORGE GLOBAL BUS. & DEV. L.J. 1, 37 (2010); Andrew F. Cooper & Colin I. Bradford, *The G20 and the Post-Crisis Economic Order*, CIGI G20 Papers No. 3 (June 2010).

bank institutions, known as the shadow banks, which are not subject to the G20's rules.⁸ The Financial Stability Board not surprisingly has responded by hammering out new rules to govern shadow banks.⁹ And yet before these rules even come into operation, market participants are busy devising new kinds of exceptions.

The ability of financial institutions to act beyond the reach of regulators threatens the sovereignty of nation-states and the well being of national economies.¹⁰ Yet as regulators are well aware, the threat is possible only because of differences in national regulatory regimes.¹¹ For offshore investors, a patchy regulatory landscape is key to the business model; the very purpose of booking the transaction offshore, or through an entity that is not subject to a particular kind of regulation, is to circumvent regulatory authority. This is the problem of so-called regulatory arbitrage.¹²

The prevailing wisdom is that regulatory arbitrage can be counteracted only if the rules across all legal systems are harmonized.¹³ In other words,

8. The shadow banking sector has grown significantly since the financial crisis—with some accounts putting it at three times the size it was in 2008. See Steven L. Schwarcz, *Regulating Shadow Banking*, 31 REV. BANKING & FIN. L. 619, 620 (2012); Philipp Halstrick, *Tighter Bank Rules Give Fillip to Shadow Banks*, REUTERS (Dec. 20, 2011, 4:17 AM), <http://www.reuters.com/article/2011/12/20/uk-regulation-shadow-banking-idUSLNE7BJ00T20111220> (discussing the possibility that tightened international banking regulation would result in increasing movement to shadow banks). See also Sungjoon Cho & Claire R. Kelly, *Promises and Perils of New Global Governance: A Case of the G20*, 12 CHI. J. INT'L L. 491, 532 (2012) (noting that some commenters believe that Basel III will encourage financial firms to flee to shadow banking so as to escape its rigors); Charles K. Whitehead, *Regulating for the Next Financial Crisis*, 24 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 3, 20 (2011) (observing that in the United States, Dodd-Frank may cause a similar flight). For background on shadow banking, see generally ZOLTAN POZSAR ET AL., FED. RESERVE BANK OF N.Y., SHADOW BANKING (2012). The FSB has recently unveiled new proposed regulations targeting shadow banks, using an approach many newspaper stories called “softly-softly.” See Press Release, FSB, FSB Publishes Policy Recommendations to Strengthen Oversight and Regulation of Shadow Banking (Aug. 29, 2013), available at http://www.financialstabilityboard.org/press/pr_130829a.pdf; Huw Jones, ‘Shadow’ Banks Face 2015 Deadline to Comply with First Global Rules, REUTERS (Aug. 29, 2013, 2:55 PM), <http://www.reuters.com/article/2013/08/29/us-g20-shadowbanking-rules-idUSBRE97S0TX20130829>.

9. See FSB, STRENGTHENING OVERSIGHT AND REGULATION OF SHADOW BANKING: AN OVERVIEW OF POLICY RECOMMENDATIONS (2013), available at http://www.financialstabilityboard.org/publications/r_130829a.pdf.

10. See FSB, REDUCING THE MORAL HAZARD POSED BY SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS 2 (2010); GROUP OF THIRTY, FINANCIAL REFORM: A FRAMEWORK FOR FINANCIAL STABILITY 17 (2009).

11. REDUCING THE MORAL HAZARD, *supra* note 10; GROUP OF THIRTY, FINANCIAL REFORM, *supra* note 10.

12. Regulatory arbitrage has been defined as “those financial transactions designed specifically to reduce costs or capture profit opportunities created by different regulations or laws.” Frank Partnoy, *Financial Derivatives and the Costs of Regulatory Arbitrage*, 22 J. CORP. L. 211, 227 (1997).

13. See, e.g., BASEL COMM. ON BANKING SUPERVISION, THE JOINT FORUM, REVIEW OF THE DIFFERENTIATED NATURE AND SCOPE OF FINANCIAL REGULATION: KEY ISSUES AND RECOMMENDATIONS 4 (2010) (“Consistent implementation of international standards is critical to avoid competitive issues and regulatory arbitrage.”); ERKKI LIIKANEN, HIGH-LEVEL EXPERT GROUP ON REFORMING THE STRUCTURE OF THE EU BANKING SECTOR 77 (2012) (stating that diversity in accounting standards leads to regulatory arbitrage); THE DE LAROSIÈRE

regulatory arbitrage opportunities can be eliminated only if the regulatory cost of transacting is identical globally. In practice, however, harmonizing national laws is an extremely contentious and difficult process.¹⁴ Attempts to universalize substantive regulation can quickly devolve into regulatory nationalism as internal political and economic interests clash with international expectations.¹⁵ What is more, the very process of harmonization risks creating new regulatory arbitrage opportunities because the pace of enacting legal change will be different across states.¹⁶

Why have nation-states proven so incapable of addressing regulatory arbitrage? As I explain below, the law has been one step behind financial arbitrage in its ability to grasp functional similarities and differences across national differences, and to coordinate among legal differences. In the cat and mouse game between regulators and financiers, finance has been the more creative partner, always one step ahead analytically. Yet remarkably, the law's most sophisticated tools for addressing this kind of coordination have yet to be deployed in discussions of global financial regulation.

The technical, arcane, legal techniques known in the civil law world as Private International Law or, in the common-law world as the Conflict of Laws ("Conflicts"), is the body of law that determines what law should apply where more than one sovereign can arguably lay claim to exercise sovereignty over an issue.¹⁷ For example, what law governs a contract between a bank in London and another bank in the Cayman Islands concerning assets in Singapore, and executed over the Internet? The answer is found in the Conflict of Laws. Conflicts is a body of law that addresses a question that has been largely ignored in global financial regulatory debates—the question of the *scope* (as opposed to the content) of national, international, and non-state regulation: how far does each regulatory authority extend, and what should be done when these overlap?

Unlike the harmonization paradigm, which pursues legal uniformity, the Conflicts approach accepts that regulatory nationalism is a fact of life, and sets for itself the more modest goal of achieving coordination among

GROUP, THE HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU 27 (2009) (criticizing the lack of harmonization of financial regulation in Europe on grounds that "diversity is bound to lead to competitive distortions among financial institutions and encourage regulatory arbitrage."); Benjamin M. Weadon, *International Regulatory Arbitrage Resulting from Dodd-Frank Derivatives Regulation*, 16 N.C. BANKING INST. 249, 259 (2012) (arguing that the lack of international harmonization in OTC derivatives regulation creates the possibility for "regulatory arbitrage" opportunities that could place U.S.-based banks at a competitive disadvantage and increases risk because of migration to less-regulated jurisdictions.).

14. See, e.g., Eric C. Chaffee, *Contemplating the Endgame: An Evolutionary Model for the Harmonization and Centralization of International Securities Regulation*, 79 U. CIN. L. REV. 587, 589-90 (2010) (acknowledging the serious obstacles to harmonization).

15. See *infra* notes 80-83 and accompanying text.

16. See, e.g., BASEL COMM. ON BANKING SUPERVISION, *supra* note 13, at 4.

17. See Karen Knop, Ralf Michaels & Annelise Riles, *From Multiculturalism to Technique: Feminism, Culture, and the Conflict of Laws Style*, 64 STAN. L. REV. 589, 593 (2012) [hereinafter *Multiculturalism*].

different national regimes.¹⁸ Under the Conflicts approach, the point is not to define one set of rules that apply for all, as is the case in public international law¹⁹—the law of international organizations such as the UN or the WTO. Rather, the point is to define under what circumstance a particular dispute or problem shall be subject to one state’s law or another. This alternative approach to international regulatory coordination has been developed over many centuries, beginning with efforts to coordinate transnational trade relations after the fall of the Roman Empire;²⁰ it stands ready to serve us once again today.

The advantage of this approach is that it provides a far more nuanced, sophisticated, and nevertheless manageable approach to answering practical questions such as, “when should so-called host regulators of a global systemically important financial institution defer to so-called home regulators, and vice versa?” A further advantage is that it requires no new legislation, no new agreements to be hammered out at global conferences of regulators, nothing but the more forceful and creative application of laws that are already part of the legal systems of all of the nations in which major financial centers are found.²¹

Accordingly, this Article proposes a Conflict of Laws approach to managing regulatory arbitrage.²² Thinking in terms of the Conflict of Laws encourages us to examine more carefully how we allocate authority across existing regulatory regimes. It changes the debate over global financial regulation because it raises a crucial question that is largely ignored at forums such as the G20—namely, how far does each regulatory authority extend, and what should be done when these overlap?

This Article proceeds as follows: In Part I, I analyze the problem of regulatory arbitrage in order to understand more precisely what we hope to achieve when we seek to eliminate it. I explain the financial logic of regulatory arbitrage in order to understand why harmonization is not a sufficient solution. In Part II, building on this analysis, I critique the prevailing wisdom—the harmonization approach to addressing regulatory arbitrage. If regulatory harmonization has failed us, I argue, national courts have also failed to step in to fill the regulatory gap. I focus here on the limitations of the U.S. Supreme Court’s approach in *United States v. Morrison* and the responses it has generated in the American legal academy. In Part III, I

18. JOSEPH STORY, COMMENTARIES ON THE CONFLICT OF LAWS, FOREIGN AND DOMESTIC 1–2 (1846).

19. See Lan Cao, *Toward a New Sensibility for International Economic Development*, 32 TEX. INT’L L.J. 209, 227, 231, (1997).

20. See Simona Grossi, *Rethinking the Harmonization of Jurisdictional Law*, 86 TUL. L. REV. 633, 634 (2012).

21. See Karen Knop, Ralf Michaels & Annelise Riles, *International Law in Domestic Courts: A Conflict of Laws Approach*, 103 AM. SOC. INT. L. PROC. 269 (2010).

22. I build here upon two key sources: an earlier article, co-authored with Ralf Michaels and Karen Knop on the uses of Conflicts in the human rights sector (see *Multiculturalism*, *supra* note 17, at 593) and my own ethnographic research on the uses of legal technicalities like Conflicts by private actors in the financial markets to create their own global private law regime (see ANNELISE RILES, *COLLATERAL KNOWLEDGE: LEGAL REASONING IN THE GLOBAL FINANCIAL MARKETS* (2011)).

introduce the Conflicts approach. After a short introduction to the Conflict of Laws, I describe how regulatory arbitrage might be approached from a Conflicts perspective. In Part IV, I explain how a Conflicts approach might work in practice with the help of an example adapted from a recent civil suit by the SEC under the anti-fraud provisions of the Exchange Act. The Article concludes by focusing on the wider stakes of such an approach, from the point of view of regulatory theory.

I. Regulatory Arbitrage and the Law: Explaining the Failure of Global Financial Regulation

The legal literature on regulatory arbitrage is surprisingly thin. The chorus of commentators often decries this or that regulatory initiative as “leading to regulatory arbitrage,” and commentators cite regulatory arbitrage as an obvious problem and an obvious rationale for legal harmonization.²³ Proponents of deregulation argue that regulatory arbitrage will inevitably disadvantage domestic financial firms because business will immediately move offshore if regulators should be so brash as to attempt to raise regulatory standards.²⁴ Yet there is almost no substantive analysis of what regulatory arbitrage is, what exactly is wrong with it, and what are the range of options for addressing it.

Likewise, the response of national regulators to the threat of regulatory arbitrage has been to focus on eliminating the differences that make

23. See, e.g., Brett McDonnell & Daniel Schwarcz, *Adaptation and Resiliency in Legal Systems: Regulatory Contrarians*, 89 N.C. L. REV. 1629, 1641 (2011) (“The multisector nature of American financial regulation makes such regulatory arbitrage a constant risk.”); Saule T. Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 416 (2011) (“Given the complexity and global nature of the modern financial market, any government’s attempt to regulate it in a purely unilateral command-and-control manner will inevitably encounter the fundamental problem of regulatory arbitrage, whereby financial institutions find new ways to get around government rules, thus creating a never-ending spiral of rulemaking and rule evading.”).

24. See John C. Coffee, Jr., *Systematic Risk After Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies Beyond Oversight*, 111 COLUM. L. REV. 795, 819 (2011) (“Regulatory arbitrage, in the sense of one nation actively seeking to lure firms from other more regulated countries, did not drive this process of deregulation. But regulatory disparities did enable the U.S. financial industry to insist on maintaining the deregulation of OTC derivatives and the limited oversight of investment bank leverage by giving them a powerful argument: Increase regulation, they claimed, and our bank will be forced to shift its operations abroad.”). For examples of this argument, see, e.g., WORLD BANK GLOBAL FINANCIAL DEVELOPMENT REPORT 2013, RETHINKING THE ROLE OF THE STATE IN FINANCE 65–66 (2012) (“The trend toward regulating more and the growing complexity of regulation distorts incentives by facilitating regulatory arbitrage”); Robert A. Jarrow, *A Critique of Revised Basel II*, 32 J. FIN. SERV. RES. 1, 15 (2007) (“Last, the differences in the horizons, the confidence level, and the scale factors in the computation of the credit risk VaR versus the market risk VaR are problematic. Indeed, these differences could result in ‘regulatory arbitrage’ if these differences imply different levels of capital and some credit risky investments (e.g. loans) can be categorized as falling under either the credit risk or the market risk requirements.”).

arbitrage possible.²⁵ The implicit—though largely unexamined—rationale is that if substantive legal rules are harmonized, then arbitrage should not be possible because arbitrage is about exploiting formal differences, despite the functional similarity of products across different markets owing to the interrelationship of markets.

For the regulators and academics thinking about regulatory arbitrage problems, the notion that harmonization is the answer is largely taken for granted.²⁶ The problem is just how to achieve it. And here, too, there is a standard and almost universally accepted view of the path forward. The harmonization response turns on a public international law model of global consensus-making through high-level negotiations among nation-states.²⁷ The concept is international rulemaking through a global international institution—perhaps on the model of the WTO, for the present on the more limited scale of the Financial Stability Board and the G20²⁸—promulgating international rules that apply uniformly and are ultimately nationally enforceable in each jurisdiction.

25. See, e.g., FSB, OTC DERIVATIVES MARKET REFORMS: THIRD PROGRESS REPORT ON IMPLEMENTATION 2 (2012) (“Full and consistent implementation by all FSB members is important to reduce systemic risk and the risk of regulatory arbitrage that could arise if there are significant gaps in implementation.”); FSB, IMPROVING FINANCIAL REGULATION: REPORT OF THE FINANCIAL STABILITY BOARD TO G20 LEADERS 10 (2009) (“To guard against regulatory arbitrage, it is imperative that initiatives to expand the perimeter of regulation [of the financial system] are effectively and consistently implemented across key jurisdictions.”); OTC DERIVATIVES REGULATORS GROUP, REPORT TO THE G20 MEETING OF FINANCE MINISTERS AND CENTRAL BANK GOVERNORS OF 18–19 APRIL 2013 1 (2013) (a group of authorities with responsibility for the regulation of the over-the-counter (OTC) derivatives markets in Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, Switzerland and the United States, the Group wrote that “[t]he principals recognise that the OTC derivatives market is a global market and firmly support the adoption and enforcement of robust and consistent standards in and across jurisdictions. This will help further the G-20 regulatory reform agenda for OTC derivatives markets to mitigate risk, improve transparency and protect against market abuse, and to prevent regulatory gaps, reduce the potential for arbitrage opportunities, and foster a level playing field for market participants, intermediaries and infrastructures.” They did note, however, that complete harmonization would likely prove “difficult.”); Press Release, European Commission, Financial Services: Commission Sets Out Future Actions to Strengthen the Safety of Derivatives Markets (Oct. 20, 2009), available at http://europa.eu/rapid/press-release_IP-09-1546_en.htm?locale=en (announcing proposals for derivatives regulation in line with G20 objectives, and affirming that “[t]he Commission intends to further develop the technical details in cooperation with its G20 partners in order to ensure a coherent implementation of these policies across the globe and thus avoid regulatory arbitrage.”); see also Annelise Riles, *Is New Governance the Ideal Architecture for Global Financial Regulation?* 18–20 (Inst. for Monetary & Econ. Stud., Discussion Paper Series 2013-E-1, 2013) [hereinafter Riles, *New Governance*], available at <http://www.imes.boj.or.jp/research/abstracts/english/13-E-01.html>.

26. Riles, *New Governance*, *supra* note 25, at 14.

27. *Id.* at 55–56.

28. See Robert Hockett, *Bretton Woods 1.0: A Constructive Retrieval for Sustainable Finance*, 16 N.Y.U. J. LEGIS. & PUB. POL’Y 401, 404–06 (2013) (arguing for an updated version of Keynes’s International Clearing Union—something that would function like a “world central bank.”).

Yet before one can decide how best to approach regulatory arbitrage, one needs to understand clearly what exactly are the problems with regulatory arbitrage and how regulatory arbitrage opportunities emerge.

Despite the negative connotations of the term “regulatory arbitrage,” the cat and mouse game between national regulators and financiers is somewhat more complicated than an old-fashioned game of good guys versus bad guys or lawmakers versus law-evaders. Arbitrage—“a trading strategy that takes advantage of two or more securities being mispriced relative to each other”²⁹—is a longstanding and economically valuable practice, in which value is created by seeking out and eliminating arbitrary differences between functionally equivalent assets.³⁰ The reasoning behind arbitrage is one of the great singular achievements of economic thought.³¹ In arbitrage, traders seek out hidden functional similarities across what look on the surface like differences: a basket of stocks and an index, or the rules of one legal system and those of another.³² This practice increases the efficiency of markets because it eliminates price differences and links markets to each other.

From the perspective of financial theory, the investment strategy in regulatory arbitrage is exactly the same as in other kinds of arbitrage: the arbitrageur seeks to profit from a discrepancy in the price of the investment in two different markets by buying or producing the product in the market of lowest regulatory cost.³³ For example, a certain kind of financial transaction might be outright prohibited in one jurisdiction, yet permitted in another, or a certain transaction might be prohibited in two jurisdictions but the penalties, or the odds of facing civil lawsuits or prosecution, might differ from one jurisdiction to another. In such a scenario, the arbitrageur will engage in the conduct in the jurisdiction of lowest cost, and yet sell the resulting product to investors in jurisdictions where the costs would be higher, thus profiting on the price differential.³⁴

A simple example is the case of an offshore non-bank entity that provides the same investment services to U.S. investors as an investment bank, and yet is not subject to G20-mandated capital adequacy requirements. These capital adequacy requirements are intended to cushion the bank against the risk of failure, but the offshore non-bank entity is not subject to them—both because it is located offshore and because it is not a bank according to the G20’s definitions. This offshore non-bank entity pockets the substantial savings it incurs, relative to regulated banks, from not having to hold so much capital on reserve in order to sell its investment services to U.S. investors.

29. JOHN C. HULL, *OPTIONS, FUTURES, & OTHER DERIVATIVES* 658 (4th ed. 2000).

30. *See id.* at 14.

31. *See generally* HIROKAZU MIYAZAKI, *ARBITRAGING JAPAN: DREAMS OF CAPITALISM AT THE END OF FINANCE* (2013).

32. *See id.* at 34; HULL *supra* note 29, at 14 (“Arbitrage involves locking in a profit by simultaneously entering into transactions in two or more markets.”).

33. *See* HULL, *supra* note 29, at 14; *see* MIYAZAKI, *supra* note 31, at 36.

34. *See* HULL, *supra* note 29, at 14; *see also* MIYAZAKI, *supra* note 31, at 36.

Note that in this example the non-bank is actually engaging in two distinct kinds of regulatory arbitrage—what we might term jurisdictional and categorical arbitrage. Jurisdictional arbitrage is, as the name suggests, a matter of profiting from differences in the laws of different jurisdictions. Categorical arbitrage, in contrast, involves profiting from a legal discrepancy between the treatment of two forms of conduct that are functionally the same—in this example, the creation of an entity that is not a bank in legal terms but functionally offers the same services as a bank. The problem of categorical arbitrage is a longstanding subject of debate, albeit in another vocabulary, among legal scholars interested in the problem of legal “loop-holes” and the relative value of rules versus standards,³⁵ and it also is discussed by domestic financial regulation experts interested in the relative merits and demerits of systems of multiple regulatory authorities versus systems of singular regulatory authorities for financial markets.³⁶ Regulatory arbitrage, in contrast, is typically understood in terms of the problem of transnational regulation—of the “offshore.”³⁷ To date, legal scholars have not adequately recognized, as have the offshore non-banks, that these problems are one and the same.

In brief, an arbitrage opportunity consists of two elements:

- (1) a functional (or economic) similarity among products such that one can substitute for another, and
- (2) a (relatively) stable formal difference of some kind that accounts for a difference in price among functionally equivalent products. This difference must be great enough that, once the arbitrageur subtracts the cost of arbitrage itself, buying in one market and selling in another yields a profit.

Imagine, for example, that one is arbitraging the cost of oil in one country versus another. One is buying oil where the price is low and selling it where the price is high. Doing so depends on (1) a functional similarity between oil sold in both countries—the fact that oil is more or less the same thing wherever it is found, and (2) the fact that there is a stable price for oil in both markets that is different in the two markets. Or to be more precise, the price must be different enough that even when one fac-

35. See, e.g., Frederick Schauer, *The Convergence of Rules and Standards* (Ctr. for Bus. & Gov't, John F. Kennedy Sch. of Gov't, Harv. Univ., Regulatory Policy Program Working Paper RPP-2001-07, 2001); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1687 (1976); Saul Levmore, *Double Blind Lawmaking and Other Comments on Formalism in the Tax Law*, 66 U. CHI. L. REV. 915, 915 (1999); Symposium, *Formalism Revisited*, 66 U. CHI. L. REV. 527 (1999); David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 860-62 (1999) (discussing “anti-abuse rules” (standards) in tax law, and arguing that “standards prevent the tax law from being too complex.”); see also Rachelle Y. Holmes, *Deconstructing the Rules of Corporate Tax*, 25 AKRON TAX J. 1, 2-7 (2010) (arguing that moving to “principles-based” tax rules would help close loopholes, as well as allowing “the corporate tax rules to be more adaptable in an evolving and complex global market” and “facilitate the ability of the United States to coordinate rules and policies with other jurisdictions.”).

36. See, e.g., GROUP OF THIRTY, *THE STRUCTURE OF FINANCIAL SUPERVISION: APPROACHES AND CHALLENGES IN A GLOBAL MARKETPLACE* (2008).

37. See, e.g., Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 243 (2010).

tors in the cost of shipping the oil from one market to another, one can still sell the oil at a profit.

So arbitrage is an “art of association”³⁸ of two things—a similarity, and a difference. I want to pause here for just a moment to appreciate how remarkably sophisticated arbitrage is as a mode of thinking.³⁹ Arbitrage is a tool for appreciating both similarities and differences, all at once. The economic genius of arbitrage is that the similarity and the difference can be of virtually any kind.⁴⁰ Indeed, the more unthinkable the connection, the more likely that arbitrage opportunities can be found and exploited.

What distinguishes regulatory arbitrage is simply that all the relevant differences are differences of law or regulatory practice.⁴¹ Concretely, regulatory arbitrage requires:

(1) An interrelationship of financial markets resulting in a functional *similarity* among financial products across different financial markets. For example, it makes no functional difference to an investor if a swap is “booked” through the New York office of the investment bank or the Dubai office. The swap has the same functional value to the investor, wherever it “is.” Note that this interrelationship of financial markets, giving rise to functional equivalence, is itself the product of prior financial engineering and arbitrage of other kinds.

(2) A relatively stable formal *difference* in the laws governing particular financial markets. The laws of New York and Dubai must be clearly ascertainable, relatively stable, and if there is a difference that affords some tax or regulatory advantage to our investor, she must be able count on the fact that this advantage probably will not disappear overnight. It must be worth her while to pay the *cost* of arbitrage—for example, of finding an investment advisor with an office in Dubai in order to reap the regulatory advantage of booking the transaction offshore.

We will come to the important question of what makes for a relatively stable difference in law in Part II. What is immediately obvious from this definition is that regulatory arbitrage depends on a rich ecosystem of diverse regimes and types of law, which are not organized into any clear, coherent, hierarchical whole. International law and state law, state law and non-state law, and differing bodies of national law, such as insurance law and banking law, all contribute to blind spots and overlap between pieces of regulatory authority—the fact that both New York and Dubai may have a legitimate stake in regulating the transaction and may have the means to enforce their regulations. Regulatory arbitrage profits on these gaps and overlaps in regulation.

38. Daniel Buenza & David Stark, *Tools of the Trade: The Socio-Technology of Arbitrage in a Wall Street Trading Room*, 13 *INDUS. & CORP. CHANGE* 369, 374 (2004).

39. I am indebted to Hirokazu Miyazaki for making me appreciate this point. See generally MIYAZAKI *supra* note 31. See also Roberta Romano, *Against Financial Regulation Harmonization: A Comment* 19 (Yale Law & Econ., Working Paper No. 414, 2010), available at <http://ssrn.com/abstract=1697348> (“[R]egulatory arbitrage is a key driver of financial innovation.”).

40. See MIYAZAKI, *supra* note 31, at 49; Beunza & Stark, *supra* note 38, at 375.

41. See Fleischer, *supra* note 37, at 243.

Regulatory arbitrage also depends on a global market for legal expertise, in which lawyers in Dubai are linked, through institutions such as global law firms with branch offices around the world, and through disciplinary training, to lawyers in New York, such that it is possible to get good legal advice on the similarities and differences between national legal regimes.⁴² While regulators plod along, offering few new alternatives for thinking about this messy mix, arbitrageurs flanked by their lawyers charge ahead in their own register of comparative legal thinking, seeing arbitrage opportunities in regulators' confusion.

What exactly is wrong with regulatory arbitrage? The simple answer is that investment activity that has profound effects in a given state or market is placed beyond that state's regulatory reach.⁴³ Commentators have surmised that this can create a race to the bottom effect as investors choose the most favorable rules simply by framing their transactions in terms of one locality or one legal form or another.⁴⁴ Moreover, the rules that industry insiders prefer are often not even the rules of any particular nation-state.⁴⁵ They are rules created by market participants themselves, the private market associations such as the International Swaps and Derivatives Association, and enshrined in contracts—which are then deemed enforceable by nation-states, even though the rules created by market participants are arguably not socially optimal for any of the nation-states that enforce the contracts.⁴⁶ The impact of arbitrage in such a scenario is to eliminate the difference between national rules and other non-state rules, in functional terms.⁴⁷

Yet, the extent to which we accept that regulatory arbitrage is a problem depends on the extent to which we agree that legal differences are inherently a problem.⁴⁸ In fact, not all differences among legal regimes are inherently worth fighting for.⁴⁹ Assume, for example, that regulators were

42. See generally YVES DEZALAY & BRYANT G. GARTH, *THE INTERNATIONALIZATION OF PALACE WARS* (2002) (examining the export and global circulation of legal expertise through the lens of local "palace wars.").

43. Joel F. Houston et al., *Regulatory Arbitrage and International Bank Flows*, 67 J. FIN. 1845, 1893 (2012).

44. See, e.g., *id.*

45. See Nils Jansen & Ralf Michaels, *Beyond the State? Rethinking Private Law*, 56 AM. J. COMP. L. 527 (2008).

46. See RILES, *COLLATERAL KNOWLEDGE*, *supra* note 22, at 32-34.

47. See HULL, *supra* note 29, at 14 ("Arbitrage opportunities . . . cannot last for long . . . Very quickly, the two prices will become equivalent at the current exchange rate.").

48. Cf. Romano *supra* note 39, at 2 ("[R]egulatory arbitrage is not a source of grave concern, in the absence of data to the contrary regarding specific products, entities or markets.").

49. Cf. Alan S. Blinder, *It's Broke, Let's Fix It: Rethinking Financial Regulation*, 6 INT'L J. CENT. BANKING 277, 278, (2010) ("Before you set out to do something—such as revamping the entire financial system—it is always a good idea to figure out *why* you are doing it and *what* you are trying to accomplish.") (emphasis in original). Blinder usefully sets out four broad reasons for financial regulation: consumer protection, taxpayer protection, financial stability, and macroeconomic stability. See *id.* at 279-80. Interestingly, from a Conflicts point of view, the first two of these reasons are purely domestic in nature—what concerns the regulator is domestic consumers and taxpayers—while the

seeking to eliminate a difference among regulatory systems that was rooted in historical practice, and nothing more, but that created inefficiencies by impeding connections among markets. An example of such a difference might be certain differences in accounting practices used by accountants in different national systems—differences that are rooted in historical traditions and difficult to change due to the entrenchment of expert communities in each jurisdiction, that have relatively little impact on national sovereignty, that do not reflect strong differences of policy, and yet impede linkages among markets. If financial traders, through regulatory arbitrage, were able to synthetically eliminate this difference, such regulatory arbitrage would benefit rather than harm transnational market stability.⁵⁰

A more appropriate understanding of arbitrage therefore would begin with the proposition that some forms of legal pluralism are very much worth defending, but others are not, and hence that some forms of arbitrage are very much worth opposing, but others are not.⁵¹ Thus, our theory of regulatory arbitrage depends on our theory of legal pluralism.

Such an understanding would also begin with an appreciation of how arbitrage is a private tool for regulatory harmonization, because its

second two are transnational in nature—the regulator is concerned about financial stability and spillover effects from the financial markets onto the real economy everywhere).

50. See Romano, *supra* note 39.

51. The scholarship on financial regulation has largely missed this point. In much of this literature the mere existence of difference between legal regimes appears to be seen as presumptively bad. See, e.g., Fariborz Moshirian, *The Future and Dynamics of Global Systemically Important Banks*, 36 J. BANKING & FIN. 2675, 2678 (2012) (“Despite the globalisation of the world of finance and the highly interdependent global financial markets, the main decision-making bodies remain national governments. This means the pace of international financial reform will be either slow or less uniform. One of the consequences of this deficiency is continuous regulatory arbitrage and less effective implementation of even some of the key international financial rules and laws.”); Fariborz Moshirian, *The Global Financial Crisis and the Evolution of Markets, Institutions and Regulation*, 35 J. BANKING & FIN. 502, 503 (2011) (“[T]he introduction of national regulatory rules, in the absence of an integrated global framework, have often encouraged market participants to bypass these rules through more financial innovations and other means such as cross border regulatory arbitrage.”); Jack Boorman, *The Current Financial Crisis: Its Origins, Its Impact, and the Needed Policy Response*, 1 GLOBAL J. EMERGING MKT. ECON. 127, 128 (2009) (noting that the recent financial crisis had its origins, at least partially, “in the international fragmentation and lack of harmonisation of financial supervision and regulation in the face of rapid innovation in the financial markets—a phenomenon that gave rise to regulatory arbitrage by the global financial institutions.”); Joshua Aizenman, *On the Paradox of Prudential Regulations in the Globalized Economy: International Reserves and the Crisis a Reassessment 2* (Nat’l Bureau of Econ. Research, Working Paper No. 14779, 2009), available at <http://www.nber.org/papers/w14779> (arguing for coordinated globalized prudential regulation to reduce regulatory arbitrage). For a slightly more nuanced approach, see Houston et al., *supra* note 43, at 1893 (“[O]ur results reinforce the need for global coordination in banking regulations. We hasten to add that our results do not necessarily suggest that there should always be complete coordination in banking regulations. One can certainly argue that cross-country differences in regulations can promote innovation. Moreover, other differences in the economic, legal, and institutional environment may imply that one size does not fit all when it comes to banking regulation. In practice, real-world political considerations often limit regulators’ ability to coordinate effective regulations.”).

repeated operation eliminates functional differences, and hence that arbitrage and state-based regulatory harmonization are analogs of a kind. The drive for substantive legal harmonization also seeks to eliminate differences among legal regimes, albeit by different means. State-based harmonization is not an antidote but rather an alternative to arbitrage; it works only by beating the arbitrageur to the punch, and harmonizing the rules first. Hence, many of the disadvantages of regulatory arbitrage will also be disadvantages of regulatory harmonization.

So from this point of view, one problem with regulatory arbitrage—and hence with regulatory harmonization—is that all harmonization has costs.⁵² In situations of financial contagion, regulatory differences can be a “safety valve”⁵³ against spreading financial crisis. For example, in the financial crisis of 2008, nations such as Canada and Japan, which had not fully adopted the North Atlantic approach to financial regulation, fared better than others that had joined the international consensus, precisely because their markets were not so accessible to the kinds of techniques financiers had developed to get around international rules.⁵⁴ Hence, by harmonizing laws (either through state-based negotiations or functionally, through arbitrage), regulators or arbitrageurs may unwittingly be injecting additional risk into the system.

There may also be problems with harmonizing or arbitraging away certain specific differences that are important to a particular political community or market. One-size-fits-all approaches to financial regulation can miss significant problems specific to a particular market that do not fit into

52. See Romano, *supra* note 39, at 2–3 (arguing that the solution to regulatory arbitrage, regulatory harmonization, can itself generate systemic risk to the financial system, which has only recently begun to be appreciated in the ongoing assessment of the factors contributing to the global financial crisis of 2008).

53. See Katharina Pistor, *A Legal Theory of Finance*, 41 J. COMP. ECON. 315, 329 (2013).

54. See, e.g., Romano, *supra* note 39, at 17–29; Virginia Torrie, *Weathering the Global Financial Crisis: An Overview of the Canadian Experience*, 16 LAW & BUS. REV. AM. 25, 26 (2010) (noting that “Canadian financial systems appear to have been remarkably more insulated from the crisis than most,” and discussing key differences in Canadian financial regulation when compared to that of the United States); Uwe Vollmer & Ralf Bebenroth, *The Financial Crisis in Japan: Causes and Policy Reactions by the Bank of Japan*, 9 EUR. J. COMP. ECON. 51, 58, 65–71 (2012), available at <http://eaces.liuc.it/18242979201201/182429792012090103.pdf> (observing that “Japanese banks were only marginally affected by the financial crisis, that is, until the failure of Lehman Brothers, because they neither invested directly in subprime-related products nor conducted the ‘originate-and-distribute’-business with structured financial products, such as credit default swaps, on a large scale,” and exploring lessons learned from the Japanese financial crisis of the 1990’s). See also Julie Dickson, Superintendent, Office of the Superintendent of Fin. Inst. Can. (OSFI), Remarks to the Heyman Center on Corporate Governance: Too Focused on the Rules; The Importance of Supervisory Oversight in Financial Regulation 1 (Mar. 16, 2010) (discussing possible reasons Canada fared better during the crisis). It is also notable that the Islamic banking sector, which is governed by very different principles, fared somewhat better, on the whole, than conventional banks did. See Maher Hasan & Jemma Dridi, *The Effects of the Global Crisis on Islamic and Conventional Banks: A Comparative Study* 6–7 (IMF, Working Paper No. WP/10/201, 2010).

the dominant model.⁵⁵ An example of a problematic one-size-fits-all approach from the domain of market-driven arbitrage is the offshore tax haven, which functionally eliminates the difference between one nation's tax laws and the tax laws of the tax haven, and hence eliminates a difference in laws that is of great importance to the nation involved. An example of a one-size-fits-all approach from the domain of state-based harmonization is the definition of Systemically Important Financial Institutions (SIFIs) laboriously hammered out by national representatives at the Financial Stability Board (FSB).⁵⁶ This definition, and the accompanying list of financial institutions that meet the criteria, has the laudable goal of bringing increased regulatory attention to financial institutions that present a threat to the stability of a financial system, wherever they may be operating.⁵⁷ Yet such categories, developed principally with the financial markets of North Atlantic countries in mind, may not provide much analytical leverage to regulators in domestic contexts that face very different sorts of threats.

What is the difference between arbitrage that works to eliminate archaic and insignificant legal differences that simply create unnecessary transaction costs, and arbitrage that eliminates differences in law and regulation that are important to a particular political community? The difference turns on the local meaning of the regulation at stake—on its significance, in the particular case, to the community whose laws are being arbitrated. Hence, one very salient difference between regulatory arbitrage and other forms of arbitrage—a difference that is meaningless to the arbitrageur and cannot be understood in financial terms—is that regulatory arbitrage, unlike other forms of arbitrage among classes of assets for example, implicates political communities, their right to their particular values, and their sovereignty. We will return to the implications of this insight in our discussion of a Conflicts approach in Part III. We will see that unlike existing approaches, a Conflicts approach allows us to distinguish “good” arbitrage from “bad” precisely because it embodies a method for taking these local political meanings into account.

55. See Hasan & Dridi, *supra* note 54, at 7–10.

56. FSB, REDUCING THE MORAL HAZARD POSED BY SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS 2 (2010), available at http://www.financialstabilityboard.org/publications/r_101111a.pdf.

57. FSB, POLICY MEASURES TO ADDRESS SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS 4 (2011), available at http://www.financialstabilityboard.org/publications/r_111104bb.pdf; FSB, UPDATE OF GROUP OF GLOBAL SYSTEMICALLY IMPORTANT BANKS (G-SIBS) 3 (2012), available at http://www.financialstabilityboard.org/publications/r_121031ac.pdf; FSB, CONSULTATIVE DOCUMENT: EFFECTIVE RESOLUTION OF SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS 7 (2011), available at http://www.financialstabilityboard.org/publications/r_110719.pdf.

II. Existing Approaches

A. The Problems with Substantive Legal Harmonization

In policy debates as in the academic literature, it is largely taken for granted that substantive legal harmonization—indeed, substantive harmonization through international negotiations among nation-states, working through international institutions—is the only solution to the problems associated with regulatory arbitrage.⁵⁸ And yet, as is widely acknowledged even by the champions of transnational regulatory harmonization, substantive legal harmonization presents remarkable practical challenges.

First, there is no global consensus as to what the international rules should be. National regulators, whose mandate is to promote their own national financial industries, have proven to be quite nationalistic in their outlook and unwilling to sacrifice the national interest for the global good.⁵⁹ The classic demonstration of this problem was the debacle surrounding the failure of the U.S. authorities to cooperate with their U.K. counterparts in liquidating Lehman Brothers' U.K. assets, almost all of which were transferred back to the U.S. just before Lehman declared bankruptcy, such that at the moment of bankruptcy, the U.K. authorities had almost no funds remaining in the U.K. entity to meet Lehman's basic obligations.⁶⁰ Despite improvements since 2008,⁶¹ the level of coordination among "home" and "host" countries of Global Systemically Important Financial Institutions still remains inadequate due to conflicting interests of the home jurisdiction, which wishes to promote the growth of national banks overseas, and the host jurisdiction, which seeks to prevent negative effects on the local market of a global bank failure.⁶²

Second, even when agreements are reached among regulators negotiating at international fora, such as the Basel Committee, national legislatures have often proven unwilling to codify these agreements into national law, and regulators have frequently proven unwilling to enforce them through

58. See *supra* note 13, and accompanying text.

59. See Charles A.E. Goodhart & Dimitrios P. Tsomocos, Mayekawa Lecture: The Role of Default in Macroeconomics, 15–17 (Inst. for Mon. & Econ. Stud., Discussion Paper No. 2011-E-23, 2011), available at <http://ideas.repec.org/a/ime/imemes/v29y2011p49-72.html>.

60. See Christopher Whittall, *Live and Let Die*, RISK, Sept. 2010, at 106, 106–07.

61. See BASEL COMM. ON BANKING SUPERVISION, PRINCIPLES FOR THE SUPERVISION OF BANKS' FOREIGN ESTABLISHMENTS (1983); FSB, KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES FOR FINANCIAL INSTITUTIONS (2011).

62. See Simon Johnson, *Too Big to Fail Not Fixed, Despite Dodd-Frank*, BLOOMBERG (Oct. 9, 2011, 8:05 PM), available at <http://www.bloomberg.com/news/2011-10-10/too-big-to-fail-not-fixed-despite-dodd-frank-commentary-by-simon-johnson.html> (noting that countries are reluctant to tie their own hands on issues like SIFI's); Helen Scott et al., Panel, *Corporate Governance in a Global Context*, 8 N.Y.U. J. L. & BUS. 321, 328–32 (2012) (panel discussion on post-2008 financial regulation and its effects both on U.S. companies abroad and foreign companies highlighted the conflicting interests of home and host jurisdictions).

regulatory practice.⁶³ By design, the political process at international institutions is somewhat cut off from domestic political processes.⁶⁴ Regulators who participate in international agreements often come home to confront a great deal of skepticism from domestic politicians and even other domestic regulators who have not been part of the international negotiation process.⁶⁵ The failure of the U.S. to accede to Basel II even before negotiations began on Basel III is an infamous example of this problem.⁶⁶

In theory, global financial law aims to displace national law. Member states commit to revise national law as necessary to bring it into harmonization with new globally defined rules and standards.⁶⁷ In practice, however, global financial law does not displace national law by any means. First, many regulatory issues remain unresolved at the global level, and therefore are left to national law to resolve.⁶⁸ Second, national law often is produced by legislatures or by regulators without concern for how such rules might fit existing or future global financial regulation. For example, domestic antitrust law in practice often applies extraterritorially.⁶⁹ Likewise, domestic bankruptcy law often reaches beyond national borders.⁷⁰ Finally, some financial laws, such as the Dodd-Frank legislation, explicitly

63. Pierre-Hugues Verdier, *US Implementation of Basel II: Lessons for Informal International Lawmaking*, in *INFORMAL INTERNATIONAL LAWMAKING* 437 (Joost Pauwelyn et al. eds., 2012).

64. See Armin von Bogdandy, *General Principles of International Public Authority: Sketching a Research Field*, 9 *GERMAN L.J.* 1909, 1929–30 (2008) (“The capacity to form an independent will is constitutive for an international organization; this entails by necessity some autonomy with respect to the member states.”).

65. I have argued elsewhere that one partial solution to this problem would entail the involvement of a far broader range of national actors in international negotiations. See Riles, *New Governance*, *supra* note 25, at 54–57.

66. See Verdier, *supra* note 63, at 444–52 (detailing the extensive delays and domestic furor involved in the U.S. implementation of Basel II).

67. See, e.g., *The Basel Committee’s Work*, BANK FOR INT’L SETTLEMENTS, http://www.bis.org/bcbs/bcbs_work.htm (last visited Sept. 13, 2013) (“The Committee formulates supervisory standards and guidelines to promote global financial stability. However, these have no legal force. Rather, they are developed and issued by the agreement of members, and in the expectation that individual national authorities will implement them.”).

68. See, e.g., Verdier, *supra* note 67, at 444–52.

69. See Hannah L. Buxbaum, *Territory, Territoriality, and the Resolution of Jurisdictional Conflict*, 57 *AM. J. COMP. L.* 631 (2009); Hannah L. Buxbaum, *The Private Attorney General in a Global Age: Public Interests in Private International Antitrust Litigation*, 26 *YALE J. INT’L L.* 219, 221 (2001); see also Sharon E. Foster, *Systemic Financial Service Institutions and Monopoly Power*, 60 *CATH. U.L. REV.* 357 (2011); see generally HANNAH L. BUXBAUM & GENE R. SHREVE, *Choice of Law in the International Context*, in *A CONFLICT-OF-LAWS ANTHOLOGY* (LexisNexis ed., 2d ed. 2012).

70. For example, Chapter 15 of the United States Bankruptcy Code “applies whenever there is a foreign insolvency proceeding relating to a debtor that is subject to a bankruptcy case of some kind in the United States,” and specifically facilitates cooperation between jurisdictions. Jay Lawrence Westbrook, *Chapter 15 at Last*, 79 *AM. BANKR. L.J.* 713, 715 (2005). For criticism of this “universalist” approach, see Lynn Lopucki, *Global and Out of Control?*, 79 *AM. BANKR. L.J.* 79, 79–80 (2005).

aim to reach conduct beyond national borders.⁷¹ In such cases, national regulation inevitably runs up against other national and international regulations. National regulation thus becomes transnational in practice.

This nexus of problems is not unique to financial regulatory harmonization; the same issues pervade substantive international lawmaking across a wide variety of fields.⁷² More recent attempts to use “soft law” or “new governance” methods of achieving consensus⁷³—informal methods such as a “peer review” system among national regulators of each other’s policies to build an informal network of regulators, or models of regulation drawn more from administrative law than from public international law—have had limited success.⁷⁴

Even where international organizations succeed in reaching a consensus that achieves domestic legitimacy, however, conflicting rules, norms, and approaches taken by public, private, national, international, or transnational institutions⁷⁵—all claiming regulatory authority—create further problems.⁷⁶ At the international level, the Basel Committee, the FSB, the International Monetary Fund, IOSCO, and other organizations are all actively engaged in their own regulatory projects, most of which remain quite poorly coordinated.⁷⁷ In addition, numerous regional organizations,

71. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 722(d), 124 Stat. 1376 (2010) (amending the Commodity Exchange Act); Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013) [hereinafter CFTC Guidance] (interpretive guidance and policy statement on the cross-border application of the swaps provisions added to the CEA by Dodd-Frank).

72. In international environmental law, for example, the Kyoto Protocol is a famous instance of this kind of problem. See, e.g., Fiona Harvey, *The Kyoto Protocol is Not Quite Dead*, GUARDIAN (Nov. 26, 2012, 1:23 PM), <http://www.theguardian.com/environment/2012/nov/26/kyoto-protocol-not-dead> (“The US signed the protocol, but with stiff opposition from both Congress and Senate, never ratified it. Russia refused to ratify for seven years, in effect consigning the treaty to the scrapheap of history until a sudden change of heart in 2004. Canada reneged on its obligations under the treaty and pulled out a year ago. Developing countries complained that the protocol did not go far enough, and failed to provide promised funding for them to cut emissions.”).

73. For work examining these kinds of approaches, see generally ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* (2004) (the “network approach” to international law); John Braithwaite, *Accountability and Governance Under the New Regulatory State*, 58 AUSTRAL. J. PUB. ADMIN. 90 (1999) (institutional design for the “new regulatory state,” focusing on Australia); Charles F. Sabel & Jonathan Zeitlin, *Learning from Difference: The New Architecture of Experimentalist Governance in the EU*, 14 EUR. L.J. 271, 278 (2008) (“new governance” in the European Union).

74. See Robert B. Ahdieh, *Imperfect Alternatives: Networks, Salience, and Institutional Design in Financial Crises*, 79 U. CIN. L. REV. 527, 546-50 (2010); Riles, *New Governance*, *supra* note 25, at 42-52.

75. I am grateful to Minoru Aosaki for this observation.

76. Gregory C. Shaffer & Mark A. Pollack, *Hard vs. Soft Law: Alternatives, Complements, and Antagonists in International Governance*, 94 MINN. L. REV. 706, 737-39 (2010).

77. See, e.g., Basel Comm. on Banking Supervision (BCBS), Charter 1 (2013), available at <http://www.bis.org/bcbs/charter.pdf> (“The BCBS is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.”);

such as the European Union and ASEAN+3, are engaged in transnational rulemaking.⁷⁸ New hybrid institutions, such as the “troika” of the European Commission, the IMF, and the European Central Bank provide additional complexity.⁷⁹ This complexity creates further ambiguity about the relationship between all of the various sources of international regulatory

Overview, FSB, <http://www.financialstabilityboard.org/about/overview.htm> (last visited Sept. 3, 2013) (“The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.”); *What We Do*, INT’L MONETARY FUND, <http://www.imf.org/external/about/whatwedo.htm> (last visited Sept. 3, 2013) (“The IMF provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty.”); *General Information*, INT’L ORG. SEC. COMM’N, <http://www.iosco.org/about/> (last visited Sept. 3, 2013) (“The International Organization of Securities Commissions (IOSCO) . . . is the acknowledged international body that brings together the world’s securities regulators and is recognized as the global standard setter for the securities sector.”). See also Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Cornell International Law Journal Symposium: The Changing Politics of Central Banks (Feb. 22, 2013) (transcript available in the Cornell Law School Library) (“There are some obvious weaknesses with such an assortment of international arrangements, notably the difficulty of coordinating initiatives where more than one group is working on an issue. This kind of coordination challenge can be further complicated by the participation in international discussions of various national officials without domestic authority in a particular area. The sheer proliferation of international arrangements, each with its own staff, has at times also led to a proliferation of studies and initiatives that become burdensome to the national regulators and supervisors who have been overtaxed at home since the onset of the crisis and ensuing domestic reform efforts.”).

78. These organizations all engage in rulemaking or standard setting in the financial services or securities regulation arena. See, e.g., Regulation 648/2012, of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L 201/1); FSB, KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES FOR FINANCIAL INSTITUTIONS (2011); BASEL COMM. ON BANKING SUPERVISION, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS (2010); IOSCO, OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION (2010); IMF, CODE OF GOOD PRACTICES ON TRANSPARENCY IN MONETARY AND FINANCIAL POLICIES: DECLARATION OF PRINCIPLES (1999); *The ASEAN and Plus Standards Scheme*, ASEAN, <http://www.asean.org/news/item/the-asean-and-plus-standards-scheme#> (last visited Sept. 13, 2013). For a helpful overview of international standard-setting bodies, see generally *Who are the Standard-Setting Bodies?*, FSB, <http://www.financialstabilityboard.org/cos/wssb.htm> (last visited Sept. 13, 2013).

79. The “troika” (the European Commission, the IMF, and the European Central Bank) formed during the Greek debt crisis, when EU members like Germany insisted on the participation of the IMF to share the burden of the bailout. Controversial since its inception, recent months have illuminated severe internal fault-lines stemming from problems in inter-institutional cooperation. These fault-lines were particularly noticeable in June of 2013, when an internal IMF report criticizing certain EC actions and inactions during the European crisis triggered a round of angry recriminations—both public and private—among troika members. See *IMF Factsheet: The IMF and Europe*, IMF, 2-3, <https://www.imf.org/external/np/exr/facts/pdf/europe.pdf> (last visited Sept. 3, 2013); Andrew Higgins, *Splits Appear in Policy ‘Troika’ Addressing Europe’s Financial Crisis*, N.Y. TIMES (June 7, 2013) <http://www.nytimes.com/2013/06/08/world/europe/policy-troika-for-europe-financial-crisis-has-splits.html?pagewanted=all&r=0>.

standards. How do such rules interact? When they conflict, where should regulators or market participants look for authority?

There are further problems. International institutions' lawmaking is essentialist by design: it treats nation-states as singular units that speak with one voice.⁸⁰ National regulatory authority over financial markets is usually divided among two or more domestic regulators.⁸¹ This creates confusion at international negotiations; foreign delegations, for example, confess to being perplexed by the sheer number of representatives from different U.S. government branches, departments, and agencies, and by how often they disagree on particular policy issues.⁸² It also creates considerable confusion at the implementation stage, as it is not often clear which agency actually possesses implementation power.⁸³

Finally, the public international law model ignores the role of private transnational organizations, like industry groups, in producing law that goes "beyond the state."⁸⁴ Market participants have developed increasingly complex self-regulation protocols, institutions, and norms that interact with and depend upon national regimes in complex ways.⁸⁵ The norms and practices developed over time by organizations like the International Swaps and Derivatives Association, for example, are now an integral part of the transnational legal culture of the financial markets; these practices cannot be ignored any more than local legal culture could be ignored in domestic lawmaking.⁸⁶ Although private rulemaking authorities and public lawmaking authorities may sometimes serve as alternatives to one

80. See, e.g., 74 AM. JUR. 2D *Treaties* § 1 (2013) ("A treaty is primarily a compact between *independent nations* that ordinarily depends for the enforcement of its provisions on the interest and honor of the governments that are parties to it.") (emphasis added).

81. In the United States, for example, there are eleven different institutions or agencies with federal regulatory authority over aspects of the financial markets. See EDWARD V. MURPHY, CONG. RESEARCH SERV., R43087, WHO REGULATES WHOM AND HOW? 2, 7 (2013), available at <http://www.fas.org/sgp/crs/misc/R43087.pdf>. In addition, insurance, banking, tax, retirement funds, state courts, and even securities regulation all are also subject to state-level regulation. See, e.g., JOHN F. DOBBYN, *INSURANCE LAW IN A NUTSHELL* 470-74 (4th ed. 2003) (state insurance regulation); James A. Wilcox, *The Increasing Integration and Competition of Financial Institutions and of Financial Regulation*, 22 RES. FIN. 215, 222 (2005) (state banking regulation); N.Y. ST. DEP'T OF TAX & FIN., <http://www.tax.ny.gov> (last visited Sept. 3, 2013); *State Securities Regulators*, SEC, <http://www.sec.gov/answers/statesecreg.htm> (last visited Sept. 3, 2013).

82. See GROUP OF THIRTY, FINANCIAL SUPERVISION, *supra* note 36, at 50 (identifying "coordination problems" among national regulators as one challenge to effective global financial regulation).

83. Phillip R. Trimble, *A Revisionist View of Customary International Law*, 33 UCLA L. REV. 665, 701 (1986) (noting the friction in foreign relations that results from conflicting national regulation).

84. See generally Nils Jansen & Ralf Michaels, *Beyond the State? Rethinking Private Law*, 56 AM. J. COMP. L. 527 (2008).

85. See generally ANNEISE RILES, *COLLATERAL KNOWLEDGE*, *supra* note 22.

86. See *id.* at 32-34. This does not mean that the rules developed by the industry must be accepted at face value or cannot be changed, of course. But as in domestic lawmaking that goes against an established social norm, it does require strategic thinking, alliance building, and carefully timed implementation strategies that respond to the status quo.

another, they more often interact competitively or collaboratively to create various kinds of public-private hybrids. Public regulators' widespread reliance on internal risk management models or credit ratings, for example, is an example of a situation in which state-based regulation depends upon private regulatory practice.⁸⁷ International legal scholars now generally recognize that, content of such law aside, its very existence, durability, and functionality give it a certain *de facto* legitimacy in the international financial regulation arena.⁸⁸

Global financial regulation of the kind produced at Basel is only one source of financial regulatory structures and norms. It cannot be understood outside its position among a "coexistence of diverse models of market economy and political systems."⁸⁹ Yet negotiations at international fora give private lawmakers only a marginal role, such as allowing for public comment on proposed rules.⁹⁰

Finally, the recent experience with the public international law model of lawmaking in the financial arena suggests that its focus gravitates far too quickly to rulemaking, primarily at the expense of harmonizing regulatory practices.⁹¹ Supervision is very different from rulemaking, and many of the key regulatory problems that led up to the financial crisis of 2008 had more to do with poor supervision than with inadequate rules.⁹² But rules can easily be gutted, interpreted differently, or ignored altogether, in both the supervision and enforcement process. The rules of Basel II, for example, were essentially gutted in the lead-up to the financial crisis of 2008.⁹³ That organizations like the FSB lack any serious enforcement tools⁹⁴ further detracts from the practical significance of transnational rulemaking.

There is another problem with the public international law approach, one we can trace to Hayek's famous critique of the problem of the temporality of regulation vis-à-vis the temporality of the market.⁹⁵ Hayek argued that regulation is always inherently one step behind market activity;

87. See Jansen & Michaels, *supra* note 84; Annelise Riles, *The Anti-Network: Private Global Governance, Legal Knowledge, and the Legitimacy of the State*, 56 AM. J. COMP. L. 605 (2008).

88. See Kenneth A. Bamberger, *Technologies of Compliance: Risk and Regulation in a Digital Age*, 88 TEX. L. REV. 669, 673 (2010).

89. See COLIN I. BRADFORD & JOHANNES F. LINN, BROOKINGS, IS THE G-20 SUMMIT A STEP TOWARD A NEW GLOBAL ECONOMIC ORDER? 2-3 (2009).

90. See Riles, *New Governance*, *supra* note 25, at 43-44.

91. See Eric J. Pan, *Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks*, 11 CHI. J. INT'L L. 243, 264-65 (2010).

92. See *id.*; Riles, *New Governance*, *supra* note 25, at 15.

93. For example, until December 2007, the U.S. elected to apply Basel II only to its nineteen largest banks—an approach sharply at odds with the European one, which held that Basel II should apply to all banks. See DARRYL E. GETTER, CONG. RESEARCH SERV., R42744, U.S. IMPLEMENTATION OF THE BASEL CAPITAL REGULATORY FRAMEWORK 3 (2012), available at http://assets.opencrs.com/rpts/R42744_20121114.pdf. For a detailed overview of problems with the U.S. implementation of Basel II, see generally Verdier, *supra* note 63.

94. See, e.g., Ahdieh, *supra* note 74, at 545.

95. See FRIEDRICH A. HAYEK, THE COUNTER-REVOLUTION OF SCIENCE (1952).

because it is retrospectively oriented to fixing the last crisis or the last problem, it is thus always necessarily out of date with the activities of market participants, who have by then moved on to other things.⁹⁶ The same can be said about global financial regulation; efforts at regulatory harmonization address problems of regulatory arbitrage after they have occurred. For example, much of current policy debate takes the causes of the collapse of Lehman Brothers as its reference point.⁹⁷ Regulators then laboriously take on the issue through the political process and might even, in the best of conditions, finish by harmonizing their rules. By this time, however, regulatory arbitrageurs have simply moved on to the next arbitrage opportunity, leaving regulators to once again play catch-up.

The problem actually is even worse for regulators. In the cat and mouse game they play with market participants, globally harmonized rules do not necessarily eliminate opportunities for regulatory arbitrage. In fact, these rules may actually become the basis for regulatory arbitrage, as clever financiers take on the rule, and search for loopholes, blind spots, or ways to synthetically produce the financial activity that the rule seeks to avoid without actually running afoul of the rule. Shadow banking's relationship to the Basel Accords is a case in point.⁹⁸

In sum, there are serious reasons to doubt whether the public international law model is an effective approach to addressing regulatory arbitrage problems. Efforts at harmonization often fail, at least in the short to medium term.⁹⁹ The very impossibility of global substantive legal harmonization may not even be entirely negative. As mentioned earlier, regulatory pluralism is in fact a positive dimension of global financial markets; by pursuing substantive legal harmonization, as a tool for eliminating regulatory arbitrage, regulators are substantially limiting the scope of their available actions. Therefore, it stands to reason that if it were possible to reduce opportunities for locally harmful forms of regulatory arbitrage without incurring the costs of substantive legal harmonization, this would be far more preferable.

B. The Role of National Courts

While we wait for regulators to hammer out agreements at the international level, we are left with a patchwork of national laws and regulatory practices. How far the scope of national regulation extends is ultimately left to national courts or to domestic corporate and financial law specialists, who habitually treat the scope of national law as a question of domestic statutory interpretation or domestic policy-making without regard for

96. See *id.*

97. See, e.g., *The Orderly Liquidation of Lehman Brothers Holdings Inc. Under the Dodd-Frank Act*, 5 FDIC Q., no. 2, 2011 at 1, 11-18, available at http://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/lehman.pdf (mapping the liquidation process of Dodd-Frank onto the Lehman collapse).

98. See, e.g., FSB, SHADOW BANKING: SCOPING THE ISSUES 5 (2011).

99. As Keynes once said, "at Cambridge we leave the long run to the undergraduates." See Jane I. Guyer, *Prophecy and the Near Future: Thoughts on Macroeconomic, Evangelical, and Punctuated Time*, 34 AM. ETHNOLOGIST 409, 412 (2007).

the transnational dimensions of the problem. Courts have largely failed to step in and fill the gaps in multijurisdictional thinking.¹⁰⁰

In the U.S., for example, U.S. courts take a territorial view of the scope of national law. The analysis is less about the politics, the equities, or the effects of the conduct itself, and more of a deference to territory as a bright line rule.¹⁰¹ Moreover, the reasons for this rule, in the view of U.S. courts, derive from a reading of the legislator's intent rather than any larger principles of Public or Private International Law.¹⁰²

In its recent decision on the scope of U.S. securities laws, in the context of a suit under the anti-fraud provisions of the Securities Exchange Act of 1934,¹⁰³ the U.S. Supreme Court overturned the long-dominant Second Circuit approach to the extraterritorial application of U.S. securities laws, in favor of a strong presumption against extraterritoriality in private causes of action under U.S. securities laws.¹⁰⁴ In *Morrison v. National Australian Bank*, although the subject of the alleged fraud—the allegedly misrepresented purchase of a U.S. company—occurred in the U.S., because the defrauded shareholders purchased their shares on an Australian stock exchange, the Court concluded that their rights and the bank's duties with respect to the fraud vested outside the U.S. and were not subject to U.S. law.¹⁰⁵ The Court held that: "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States."¹⁰⁶

Although, from one point of view, the *Morrison* decision could be seen to defer to foreign jurisdictions insofar as it limits the transnational reach of U.S. law, in fact, the majority opinion in *Morrison* failed even to consider the transnational dimensions of the question of the extraterritorial scope of U.S. law.¹⁰⁷ At no point did the Court pause to consider what other law might govern the transaction, whether it might be substantially similar to U.S. law, or what the interests of other relevant jurisdictions might be in the matter. For example, if as the Court asserted, the rights vested at the point of the sale of shares on the exchange, then those rights vested in Australia, and hence should be governed by Australian law. From the vantage point of the Court's own formalistic vested rights analysis, it would stand to reason that Australian law could answer the question of whether

100. See, e.g., Hannah L. Buxbaum, *Remedies for Foreign Investors Under U.S. Federal Securities Law*, 75 L. & CONTEMP. PROBS. 161, 165 (2012).

101. See *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2877 (2010).

102. See *id.*

103. Securities Exchange Act of 1934 § 10(b), 5 U.S.C. § 78j (2006).

104. See *Morrison*, 130 S. Ct. at 2877-78.

105. See *id.* at 2888.

106. See *id.*

107. Cf. Ralf Michaels, *Empagran's Empire: International Law and Statutory Interpretation in the U.S. Supreme Court of the Twenty-First Century*, in INTERNATIONAL LAW IN THE U.S. SUPREME COURT 533, 533-34 (David L. Sloss et al. eds., 2012) (making a similar argument about an earlier case).

or not the plaintiffs were entitled to compensation for fraud.¹⁰⁸

Instead, *Morrison* enshrines a textualist, statutory interpretation approach to questions of the scope of American law in which the only question is, what did Congress intend the reach of U.S. law to be?¹⁰⁹ The question was only whether the transaction was within U.S. borders.¹¹⁰ The Court answered this question in turn solely through an analysis of the language of the statute without regard to the transnational context in which the legislation was drafted.¹¹¹ In the Court's analysis, Congress had intended U.S. securities laws to apply only to transactions concluded in the U.S.¹¹²

To be fair, the *Morrison* Court's territorial approach—the idea that where conduct occurred should solely govern what law applies¹¹³—and its focus on legislative intent, to the exclusion of multijurisdictional elements, is not new, nor has it been controversial.¹¹⁴ Many prior appellate and Supreme Court decisions have taken an equally myopic view of the issues, regardless of where they come out on the extraterritorial reach of U.S. law.¹¹⁵

In fact, the unique controversy over *Morrison* stems from its implicit and decidedly uninspired Conflicts analysis. The court's statutory interpretation turned on an implicit and unarticulated choice of law rule—and a very old-fashioned one at that. The Court held that a transaction was a U.S. transaction only if it was concluded in the U.S.—it emphatically insisted that fraudulent conduct within the U.S. leading to the conclusion of the transaction would not be enough. In other words, the last act in the

108. See *infra* Part III.D. See also JOSEPH HENRY BEALE, A TREATISE ON THE CONFLICT OF LAWS 102 (1935) (Every legal dispute is “simply about the proper enforcement of rights. Each right was created at a particular geographical place, the place where it vested. The law of that place was integral to the constitution of the right itself, and hence for another state to apply its law to the adjudication of the right would be to infringe on the sovereignty of the state where the right vested. If a New York court was faced with a dispute concerning a contract created in Maryland, it would have to apply Maryland law to the dispute because that is where the rights at issue in that contract had vested. A state applied another state's law not because of policy-oriented concerns of comity, therefore, but because that application was pre-ordained by the vesting of the right itself.”).

109. See *Morrison*, 130 S. Ct. at 2884.

110. See *id.*

111. See *id.* at 2881–83.

112. See *id.* at 2884.

113. See also *American Banana Co. v. United Fruit Co.*, 29 S.Ct. 511, 512–514 (1909); *EEOC v. Arabian American Oil Co. (Aramco)*, 499 U.S. 244, 244, 246–49 (1991) (holding that Title VII does not apply extraterritorially “to regulate the employment practices of United States employers who employ United States citizens abroad.”).

114. See, e.g., *id.*; *McCulloch v. Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10 (1963) (finding that Congress did not intend to apply the National Labor Relations Act abroad, despite broad language referring to foreign commerce, because there was no specific language reflecting congressional intent to do so); *N.Y. Cent. R.R. v. Chisholm*, 268 U.S. 29, 31 (1925) (holding that statutes that contain broad language in their definitions of “commerce” that expressly refer to “foreign commerce” do not apply abroad).

115. See, e.g., *F. Hoffman-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004); see also Michaels, *supra* note 107.

transaction defined where the transaction “happened” for purposes of determining the applicability of U.S. law.¹¹⁶

Without comment, the Court replaced a jurisprudence based on a more modern view of where a legal event “occurred”—a view based broadly on ascertaining which jurisdiction has the most significant relationship to the event—with a nineteenth century view that legal rights only come into being at their “vesting”¹¹⁷ where “irrevocable liability incurred” through the occurrence of the very last act in the transaction.¹¹⁸ In previous jurisprudence, courts had also thought in domestic and territorial ways about the scope of U.S. law.¹¹⁹ Yet the limitations of this approach were at least tempered by the fact that what was dispositive in determining “where” an event occurred was the place of all of the relevant conduct, not just the very last act, and also the place of the effects of that conduct; the presumption against extraterritoriality was a presumption that U.S. law would not apply if both the conduct and the effects occurred outside U.S. territory. The Second Circuit’s effects test had held that “conduct that was meant to produce and did in fact produce some substantial effect in the United States” is subject to U.S. law regardless of where it occurred.¹²⁰ *Morrison*’s move from a modern to a traditional localizing rule in Conflict of Laws went unmentioned, let alone undefended in the opinion.

Subsequently, the Dodd-Frank legislation, which sought to reverse the holding in *Morrison*¹²¹ and reinstate the Second Circuit’s effects test, at least as it concerns actions brought by the SEC and other government agencies, was equally territorial and nationalistic in its outlook and failed also to consider the global context for its assertion of U.S. authority to regulate extraterritorially.¹²² Among the expert commentators, the debate

116. See *Morrison*, 130 S. Ct. at 2888.

117. See BEALE, *supra* note 108, at 105.

118. See *Morrison*, 130 S. Ct. at 2883-85.

119. See generally *Foley Bros. v. Filardo*, 336 U.S. 281, 285 (1949) (discussing the canon of construction “which teaches that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States . . . is a valid approach whereby unexpressed congressional intent may be ascertained.”).

120. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 796 (1993); see also *Lauritzen v. Larson*, 73 S. Ct. 921 (1953); *Steele v. Bulova Watch Co.*, 73 S. Ct. 252 (1952); *U.S. v. Aluminum Co. of America*, 148 F.2d 416 (1945).

121. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 929P (2010) (codified at 12 U.S.C. §§ 5301 et seq.).

122. See, e.g., 156 Cong. Rec. 5235-37 (2010) (Congressman Paul E. Kanjorski, one of the leaders in the creation of Dodd-Frank, commenting that “the purpose of the language of section 929P(b) of the bill is to make clear that in actions and proceedings brought by the SEC or the Justice Department, the specified provisions of the Securities Act, the Exchange Act and the Investment Advisers Act may have extraterritorial application, and that extraterritorial application is appropriate, irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States, when the conduct within the United States is significant or when conduct outside the United States has a foreseeable substantial effect within the United States.”); see also Michael Greenberger, *The Extraterritorial Provisions of the Dodd-Frank Act Protects U.S. Taxpayers from Worldwide Bailouts*, 80 UMKC L. REV. 965 (2012) (discussing opposition from foreign governments).

that has ensued principally concerns whether *Morrison* should be interpreted narrowly or broadly, whether the meaning of Dodd-Frank should be determined with reference to the language of the statute or the purposes and legislative intent behind the statute, and the functional effects of one interpretation or another.¹²³ A high profile letter to the SEC from forty-two American law professors in the securities field urging the extension of the Dodd-Frank rule to the creation of a private cause of action for fraud with substantial U.S. effects definitively demonstrates that the myopic nationalist approach is not the province of one political faction or another.¹²⁴ The letter takes a purely domestic perspective on securities regulation and fails even to consider multijurisdictional elements and consequences.¹²⁵

C. Conclusion

The result is a collection of national courts and national regulatory authorities, each asserting their own authority in cases of regulatory overlap, and each thinking in myopic national terms about how to address a uniquely transnational problem—the problem of regulatory arbitrage. Ironically, this serves regulatory arbitrageurs just fine: such nationalist thinking produces more formal legal differences and results in more arbitrage opportunities. All of this suggests that far more academic and regulatory attention needs to be paid to the interaction among regulatory regimes in this ecosystem of global financial regulation.¹²⁶

One important aspect of the global context of Dodd-Frank is the prospect of the declining supremacy of U.S. capital markets. Territorialism's advantage is that it matches legal authority to market power. When U.S. capital markets were supreme, a territorial approach drew legitimacy from U.S. economic power. Foreign investors and issuers needed access to U.S. capital markets and were willing to comply with U.S. laws. However, in the current environment, which is far more decentralized, and most likely will only become more so in the coming years, investors have many choices.¹²⁷ As the U.S. takes a territorial approach, it can expect other countries to do

123. See, e.g., Richard W. Painter et al., *When Courts and Congress Don't Say What They Mean: Initial Reactions to Morrison v. National Australia Bank and to the Extraterritorial Jurisdiction Provisions of the Dodd-Frank Act*, 20 MINN. J. INT'L L. 1, 1-4 (2011) (discussing potential confusion, problems, and conflicts arising from *Morrison* and Dodd-Frank). But see John H. Knox, *The Unpredictable Presumption Against Extraterritoriality*, 40 SW. L. REV. 635, 649 (2011) (arguing for a presumption of extrajurisdictionality stemming from the *Charming Betsy* canon: “[u]nder this proposal, courts would look to the international law of legislative jurisdiction to provide guidance as to the scope of federal statutes.”).

124. See Comments by Forty-Two Law Professors in Response to Study on Extraterritorial Private Rights of Action (Feb. 18, 2011), <http://www.sec.gov/comments/4-617/4617-28.pdf>.

125. See *id.*

126. See Shaffer & Pollack, *supra* note 76, at 737-41.

127. See generally Chris Brummer, *How International Financial Law Works (and How It Doesn't)*, 99 GEO. L.J. 257 (2011) (arguing that the power of the U.S. and Europe to impose their rules abroad is weakening while other markets are finding new sources of power in territory).

the same, and hence it can expect that as those countries' markets grow and U.S. investors become more active there, more and more U.S. parties will find their financial obligations subject to foreign law. It would seem to be in the interest of a declining market, therefore, not to take a territorial approach but instead to advocate for a more multi-factored analysis.

More importantly, a territorial approach is highly conducive to regulatory arbitrage. All that the parties to a derivatives contract need to do to escape national law is to book their transaction—that is, the very last act in the chain of actions leading to the creation of the contract—outside of the U.S. Indeed, in some instances it may be possible for the dealer to do this without the buyer/end-user of the derivative even being fully aware of where the transaction is booked and hence what law governs.¹²⁸ This amounts to a kind of delegation of power to private parties who, at relatively little cost, can often rearrange their affairs to circumvent national securities laws.

Again, as discussed in the previous Part, there may be situations in which, as a policy matter, we might be perfectly happy to defer to the parties' intent in this way.¹²⁹ Yet there may be situations in which we might not.¹³⁰ What we need is a methodology that can help us to distinguish good arbitrage from bad.

The very technical quality of Conflicts provides a much-needed vocabulary, a register for moving beyond overt politics in the discussion of inter-

128. SEC, STUDY ON THE CROSS-BORDER SCOPE OF THE PRIVATE RIGHT OF ACTION UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934, 42-45 (2012).

129. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 187-88 (1971). This is the rationale for the strong presumption of party autonomy in Conflict of Laws doctrines.

130. Conflicts doctrine reflects this by deferring to parties' choice of law in some cases and not in others. See, e.g., *id.* § 187:

- (1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.
- (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either
 - (a) *the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or*
 - (b) *application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.*

See also *id.* at cmt. b (“A choice-of-law provision, like any other contractual provision, will not be given effect if the consent of one of the parties to its inclusion in the contract was obtained by improper means, such as by misrepresentation, duress, or undue influence, or by mistake.”); *id.* at cmt. f (“The forum will not apply the chosen law to determine issues the parties could not have determined by explicit agreement directed to the particular issue if the parties had no reasonable basis for choosing this law. The forum will not, for example, apply a foreign law which has been chosen by the parties in the spirit of adventure or to provide mental exercise for the judge.”); *id.* at cmt. g (state “fundamental policy” exception).

national financial regulation. In the next section, we will consider what Conflicts can do in the sphere of financial regulation precisely because it transforms political questions into technical, legal issues that can be managed within the scope of existing national law.

III. The Conflict of Laws Alternative

A. Why Conflicts?

There is an alternative, however, to harmonizing substantive regulation on the one hand and devolving into regulatory nationalism on the other. This alternative approach to international regulatory coordination holds the potential to significantly reduce the problems associated with regulatory arbitrage without incurring the problems associated with harmonization. This approach also has the benefit of not requiring changes to national law that provoke domestic interest group politics such as those seen recently in the United States and elsewhere.

Although Conflicts as a field has hardly featured at all in debates about global financial regulation, it is in fact already in play.¹³¹ When regulators or market participants make a claim about the application of one or another body of law to a given party or transaction, they are already making an implicit claim about what the scope of their national law should be.¹³² Whether they recognize it or not, they are making a Conflicts argument.

For example, when the U.S. Commodity Futures Trading Commission (CFTC) asserts authority to regulate foreign brokers and dealers who enter into transactions with U.S. customers,¹³³ it is making an implicit Conflict of Laws argument that regulatory authority should be allocated according to the domicile of the buyer. Likewise, the choice by some national regulators to make use of “ring fences,” or the sequestration of assets located within national boundaries in the case of the collapse of a global financial institution incorporated and headquartered outside the jurisdiction, is evidence of a failure of global harmonization and a pervasive distrust among regulators as it represents a choice not to cooperate with their counterparts in other jurisdictions in the resolution of the failing institution.¹³⁴ Yet it is also a practical assertion on the part of national regulators of a certain theory about the proper allocation of regulatory authority in a global con-

131. See *infra* Part III.C.

132. See Howell E. Jackson, *Toward a New Regulatory Paradigm for the Trans-Atlantic Financial Market and Beyond: Legal and Economic Perspectives*, in *Global Capital Markets & the U.S. Securities Laws* 1203, 1206 (Nicolas Grabar et al. eds., 2009) (“As students of private international law will recognize, the problem I am discussing is fundamentally a choice-of-law question. Which nation’s regulatory system (or combination of national regulatory systems) should govern cross-border transactions or apply to financial firms doing business on a cross-border basis?”).

133. See CFTC Guidance, *supra* note 71.

134. See David Jetuah, *PwC Readies Report on Lehman Wind-Down*, *ACCOUNTANCY AGE* (Mar. 12, 2009) (defining ring fencing as “the supervisory process of protecting the assets or liquidity of a foreign branch or subsidiary by limiting its exposures or liabilities to the parent bank and banking group.”).

text, in the face of the reality of insufficient substantive agreement on globally harmonized regulatory standards. This practical theory is grounded in legal principles, however loosely and intuitively articulated, about the *scope* of their *legal authority* over certain assets by virtue of the fact that those assets are located physically within their territory.¹³⁵ Likewise, as discussed in Part II, the *Morrison* court's treatment of conduct as "located" where the last act that defines the transaction occurred, for purposes of determining the applicability of U.S. law to the transaction, represents a selection of one set of outdated Conflicts doctrines for determining the location of conduct for jurisdiction-selecting purposes over another.¹³⁶

And it is entirely appropriate that principles of Conflicts should operate in the background of assertions of regulatory authority because before we reach the question of the intent of the legislature concerning the scope of the Securities Acts or the Dodd-Frank legislation, for example, we need to determine what the legitimate boundaries of that scope might be. A statute cannot reach beyond its own legitimate limits regardless of what it may subjectively assert about the scope of its own regulatory authority.¹³⁷

The current U.S. statutory interpretation approach ignores that the application of U.S. law does not occur in a vacuum; rather, it occurs in the context of overlapping potential legal regimes, all of which have some legitimate claim to regulatory authority over the case.¹³⁸ Hence, the question of the proper allocation of regulatory authority among legal regimes is a prior question of Private International Law.¹³⁹ Private International Law has its own received and accumulated body of doctrines and case law on such questions,¹⁴⁰ which together provides detailed guidance about such ques-

135. See Chris Brummer, *Territoriality as a Regulatory Technique: Notes from the Financial Crisis*, 79 U. CIN. L. REV. 499, 501 (2010) ("[T]erritorial' authority in financial regulation—routinely considered both a source and limitation of control over *local* firms—in practice constitutes a diverse array of tactics employed by national authorities to exert authority over mobile market participants. As such, it can facilitate the projection of regulatory power beyond national borders, especially for countries enjoying large capital and customer markets.") (emphasis in original); Hannah L. Buxbaum, *Territory, Territoriality*, *supra* note 69, at 635.

136. See discussion *supra* Part II.B.

137. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 403 (1987) and comments.

138. See Hannah L. Buxbaum, *Territory, Territoriality*, *supra* note 69, at 649.

139. U.S. courts have long recognized that in a clear case of conflict between U.S. domestic law and international law, domestic law trumps. However, U.S. courts make every effort to construe domestic law so that it is not in conflict with international law. See *Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch.) 64, 118 (1804). Hence, to the extent that the scope of U.S. securities laws after Dodd-Frank are less than clear about their scope, the proper legal interpretation is to look to international law to understand the scope of U.S. law.

140. For a summary of such principles, we can look to general principles of Conflict of Laws as embodied, for example, in the Second Restatement of Conflict of Laws and to general principles of international law, as elaborated, for example, in the Third Restatement of Foreign Relations. The latter advocates a multifaceted analysis very close to the Second Restatement of Conflicts analysis. Both emphasize the importance of taking into account a variety of factors including the interests of both states in applying their own law to the dispute. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 187–88 (1971); RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 403 (1987).

tions of scope and whose nearly universal acceptance gives them the status of customary international law.¹⁴¹

B. What is Conflicts?

The Conflict of Laws is the body of law that determines *what* law should apply to a dispute. For example, when a dispute arises about what the London holder of collateral in the form of Japanese government bonds can do with that collateral, through its subsidiary in the Bahamas and pursuant to a contract formed over the telephone by traders in Tokyo and New York, should New York law, U.K. law, Bahamian law or Japanese law apply?

The Conflict of Laws approach to international regulatory coordination has a long and established pedigree. It was developed and legitimized over centuries into a universally recognized body of law in the context of the need for stable trade relations, beginning after the fall of the Roman Empire.¹⁴² It rejects at the outset full international substantive legal harmonization as a utopian pipe dream.¹⁴³ Rather, it accepts that regulatory

“[A] state may not exercise jurisdiction to prescribe law . . . when . . . unreasonable.” Whether exercise of jurisdiction over a person or activity is unreasonable is determined by evaluating all relevant factors, including, where appropriate:

- (a) “the link of the activity” to forum, territory, and effects;
- (b) “the connections” of forum to the plaintiff and defendant;
- (c) “the character of the activity” and importance to forum;
- (d) “justified expectations;”
- (e) “the importance of the regulation to the international . . . system;” “the traditions of the international system;”
- (f) “an interest” of another state in regulating;
- (g) “the likelihood of conflict with regulation by another state.”

RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 403 (1987). Arguably, the fact that the Restatement of Foreign Relations cleaves so closely to Conflicts doctrines suggests a tacit recognition that the subject of Conflict of Laws has the more fully elaborated response to this problem.

141. Most commentators agree that customary international law defines the bases for “legislative jurisdiction”—the scope of national law—although some commentators argue that customary law in general deserves lesser deference than does treaty law because it is not the subject of explicit state to state agreement. For an argument as to how conflicts doctrines could be used to determine the scope of customary international law, see Knop, Michaels & Riles, *International Law in Domestic Courts*, *supra* note 21.

142. See Hessell E. Yntema, *The Historic Bases of Private International Law*, 2 AM. J. COMP. L. 297 (1953); see also JOSEPH H. BEALE, A TREATISE ON THE CONFLICT OF LAWS 18-20 (1916).

143. Indeed, it is with this principle that Joseph Story began his famous treatise on the subject: “[W]e find, that, from the earliest records of authentic history, there has been (as far at least as we can trace them) little uniformity in the laws, usages, policy, and institutions, either of contiguous or of distant nations. The Egyptians, the Medes, the Persians, the Greeks, and the Romans, differed not more in their characters and employments from each other, than in their institutions and laws. They had little desire to learn, or to borrow, from each other; and indifference, if not contempt, was the habitual state of almost every ancient nation in regard to the internal polity of all others. . . . Yet even under such circumstances, from their mutual intercourse with each other, questions must sometimes have arisen, as to the operation of the laws of one nation upon the rights and remedies of parties in the domestic tribunals, especially when they were in any measure dependent upon, or connected with foreign transactions.” STORY, *supra* note 18, §§ 1-2.

pluralism, and even regulatory nationalism are facts of life, and sets for itself the more modest goal of *coordination* among different national regimes.¹⁴⁴ In other words, the approach of this body of law is not to define one set of rules that apply for all, as in the case of public international law, but rather to define under what circumstances a particular dispute or problem shall be subject to one regulatory authority or another. One can think of this as global regulation “in the meantime”¹⁴⁵ before we achieve the utopian ideal of pure international integration.¹⁴⁶

The law of Conflicts is a central piece of the global private law governance regime because it is the switchboard that routes agreements and rights for interpretation and enforcement. Where these rights get enforced is without a doubt central to the nature of the rights themselves. A judge in Tokyo will fill in the blanks in an agreement from the point of view of Japanese law and may even find certain aspects of the agreement unenforceable under Japanese law; a judge in New York will do the same from the standpoint of the very different background rules of New York law.

To put it more precisely, Conflict of Laws is a body of rules and a set of interpretive approaches that help decision-makers to determine whether they can legitimately assert regulatory authority over the issue at hand, or whether some other regulatory authority has a greater claim to the issue.¹⁴⁷ The decision-makers might be judges, charged with determining whether they can adjudicate a particular dispute according to the law of their jurisdiction, or whether they must look to some other body of law.¹⁴⁸ Or the decision-makers might be national or international regulators, faced with the question of whether they can require that certain parties or certain conduct should be subject to the national regulators’ rules or its powers of investigation.¹⁴⁹ Conflicts rules are enshrined in statutes,¹⁵⁰ in

144. See Robert Wai, *Conflicts and Comity in Transnational Governance: Private International Law as Mechanism and Metaphor for Transnational Social Regulation Through Plural Legal Regimes*, in CONSTITUTIONALISM, MULTILEVEL TRADE GOVERNANCE AND INTERNATIONAL ECONOMIC LAW 229, 230, 240 (Christian Joerges & Ernst-Ulrich Petersmann eds., 2011) [hereinafter *Conflicts and Comity*.]

145. See Robin Wiegman, *Feminism’s Apocalyptic Futures*, 31 NEW LITERARY HIST. 805 (2000).

146. As Barney Reynolds, a partner at Shearman & Sterling London who is working in this area, argued in an interview with Risk Magazine: “I don’t think in our lifetimes you’ll get a global insolvency regime, but you might get a global agreement on a ‘conflict of laws and regulation’ rule, so as to determine which country’s insolvency regime takes priority in certain situations.” Whittall, *supra* note 60, at 107.

147. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 1, 6 (1971); see also BRAINERD CURRIE, *SELECTED ESSAYS ON THE CONFLICT OF LAWS* 366 (1963).

148. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971); CURRIE, *supra* note 147, at 366.

149. See CURRIE, *supra* note 147.

150. See, e.g., 15 U.S.C. § 6a (2006) (defining what “conduct involving trade or commerce” with foreign nations falls under the Sherman Act); 42 U.S.C. §§ 2000e(f), 2000e-1 (2006) (extending Title VII of the Civil Rights Act to American employers and employees in foreign countries); Dodd-Frank Act, PUB. L. NO. 111-203 § 929P, 124 Stat. 1862-65 (2010); U.C.C. § 1-301 (choice of law provision); Uniform Money Judgments Act, 13 U.L.A. 419 (1980) (providing that foreign money judgments are enforceable with

constitutions,¹⁵¹ and in bilateral¹⁵² and multilateral treaties.¹⁵³ They are also the subject of an extensive and sophisticated body of case law and associated academic commentary.¹⁵⁴

The American Conflicts doctrine is somewhat unique. Outside the common law world, the subject has a different name, *Private International Law*, and a different set of organizing principles focused on the private rights of individual parties in their relationship with one another.¹⁵⁵ In contrast, Conflict of Laws in the United States has generally been conceptualized as a highly technical and somewhat arcane subfield of Civil Procedure.¹⁵⁶ In the United States, the central question of Conflicts is the allocation of state sovereignty and power: which sovereign's law should apply to the particular dispute at hand?¹⁵⁷ In civil law jurisdictions, in contrast, the central question of Private International Law is the enforcement of privately held rights.¹⁵⁸ In other words, while the subject of this Article is very much in the realm of the public in the U.S., it is private law par excellence in many jurisdictions.

the same full faith and credit as those of other states, this uniform law has been adopted by several states, including New York).

151. See, e.g., U.S. CONST. art. IV, § 1 ("Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state. And the Congress may by general laws prescribe the manner in which such acts, records, and proceedings shall be proved, and the effect thereof"); Australian Constitution s 118 ("Full faith and credit shall be given, throughout the Commonwealth to the laws, the public Acts and records, and the judicial proceedings of every State"); GRUNDGESETZ FÜR DIE BUNDESREPUBLIK DEUTSCHLAND [GRUNDGESETZ] [GG] [BASIC LAW], May 23, 1949 BGBL. I (Ger.) art. 25 (stating primacy of international law over federal law).

152. See, e.g., Agreement Between the Government of the Kingdom of Cambodia and the Government of the People's Republic of China for the Promotion and Protection of Investment, Cambodia-China, art. 9, July 19, 1996, available at http://unctad.org/sections/dite/ia/docs/bits/china_cambodia.pdf (choice of law provision).

153. See, e.g., Consolidated Version of the Treaty on the Functioning of the European Union art. 81, Mar. 30, 2010, 2010 O.J. (C 83) 78 (developing "judicial cooperation in civil matters having cross-border implications"); Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, June 5, 2006, available at <http://www.hcch.net/upload/conventions/txt36en.pdf> [hereinafter Hague Securities Intermediary Convention] (uniform Conflict of Laws rules developed by the Hague Conference on Private International Law).

154. See, e.g., Andreas Lowenfeld, *Public Law in the International Arena: Conflict of Laws, International Law, and Some Suggestions for Their Interaction*, 163 RECUEIL DES COURS 311 (1979); *Multiculturalism*, *supra* note 17; Horatia Muir Watt, *Private International Law Beyond the Schism*, 2 TRANSNAT'L LEGAL THEORY 347 (2011); ARTHUR T. VON MEHRING & DONALD T. TRAUTMAN, *THE LAW OF MULTISTATE PROBLEMS: CASES AND MATERIALS ON CONFLICT OF LAWS* (1965).

155. See, e.g., FRIEDRICH KARL VON SAVIGNY, *A TREATISE ON THE CONFLICT OF LAWS AND THE LIMITS OF THEIR OPERATION IN RESPECT OF PLACE AND TIME* (William Guthrie, trans., 1869).

156. See Annelise Riles, *A New Agenda for the Cultural Study of Law: Taking on the Technicalities*, 53 BUFF. L. REV. 973 (2005).

157. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 10 (1971). See also *Conflict of Laws*, LEGAL INFO. INST. (Aug. 19, 2010, 5:13 PM), http://www.law.cornell.edu/wex/conflict_of_laws.

158. See, e.g., SAVIGNY, *supra* note 155.

Although to date it has not been adequately deployed,¹⁵⁹ Conflicts, as a field, gives us a vocabulary for critically examining, and therefore challenging claims about the scope of national, international, and non-state regulation.¹⁶⁰ Attention to the rules and processes that should govern the allocation of regulatory authority among overlapping sovereigns is not just a second best response to regulatory arbitrage, however. There are many advantages to this approach.

First, the Conflicts approach takes an agnostic view of the very possibility of a singular overarching “right answer” to the question of what the rules of regulation should be.¹⁶¹ The doctrines of Conflict of Laws instruct judges always to be aware that their own perspective is a situated and partial one, and that a judge elsewhere in another jurisdiction could and most likely would think of the dispute at hand in different terms.¹⁶² This pluralistic orientation with its deferential attention to differences in approaches,¹⁶³ speaks directly to a significant weakness in G20-led efforts at global financial regulatory harmonization. Although the G20 has made significant progress in becoming more inclusive, it still remains something of a North Atlantic club, at considerable cost to its own legitimacy.¹⁶⁴ In contrast, the Conflicts approach does not suffer from this kind of legitimacy gap because any assertion that a certain issue falls within the scope of one regulatory jurisdiction claims to be nothing more than it is—one particular possible view of the issue among many.

A second advantage of the Conflicts approach is that it is case-driven, and hence builds coordination from the ground up rather than from the top down.¹⁶⁵ This ground-up approach has the important benefit of allowing for greater participation in the process of generating consensus because litigants define issues for themselves. This addresses a major weakness of the G20 approach, which, as we saw in the last part, still proceeds from the assumption that nation-states speak of one voice and hence that national negotiators adequately represent the national interests—both public and private. Market participants have severely critiqued this model

159. See Watt, *supra* note 154, at 350 “[P]rivate international law remains by and large, if not entirely, absent from the whole global governance scene, at least reluctant to offer any systemic vision, or sense of meaning, to the changes affecting law and authority in a global environment.”)

160. See Robert Wai, *Transnational Private Law and Private Ordering in a Contested Global Society*, 46 HARV. INT’L L.J. 471, 472–73 (2005) [hereinafter *Transnational Private Law*].

161. On the Conflicts approach’s agnostic negotiation of difference, see generally Paul Schiff Berman, *Conflict of Laws and the Legal Negotiation of Difference*, in LAW AND THE STRANGER 141 (Austin Sarat et al. eds., 2010).

162. See *Multiculturalism*, *supra* note 17, at 629–631.

163. See Joel R. Paul, *The Transformation of International Comity*, 71 LAW & CONTEMP. PROBS. 19 (2008).

164. See, e.g., Rolf H. Weber, *The Legitimacy of the G20 as a Global Financial Regulator*, 28 BANK. & FIN. L. REV. 389, 400 (2012); Robert Wade & Jakob Vestergaard, *Overhaul the G20 for the Sake of the G172*, FIN. TIMES, Oct. 21, 2010.

165. See, e.g., Oliver Wendell Holmes, Jr., *Codes, and the Arrangement of the Law*, 5 AM. L. REV. 1, 1 (1870), reprinted in THE COLLECTED WORKS OF JUSTICE HOLMES 212 (Sheldon M. Novick ed., 1995).

for the way it excludes private actors from the negotiating process or fails to recognize the role of private actors in transnational law-making.¹⁶⁶

Third, an advantage is that, in contrast to substantive regulatory standards, there is already considerable agreement on the formal rules of Private International Law or Conflict of Laws.¹⁶⁷ Some difference of philosophy exists between the American approach on one end of the spectrum and the civil law approach on the other.¹⁶⁸ Certainly, there is room for different interpretations of the rules with regard to specific cases. Yet on the whole, the doctrines of all countries in which major financial markets are located already share a great deal. Certainly, there is far more transnational agreement about Conflicts doctrines than there is about key substantive questions of global financial regulation.¹⁶⁹ For this reason, some legal commentators have suggested, in an analogous way, that the Conflict of Laws may serve as a tool of unification within the European Union in areas where substantive unification seems out of reach.¹⁷⁰

Yet as discussed more extensively elsewhere,¹⁷¹ what is perhaps most intriguing about the Conflict of Laws is the most likely reason it has been ignored as a tool of global financial regulation: it is a highly arcane, technical body of law with an intricate and fine grained set of doctrines, arguments, and rules.¹⁷² The people who work most closely with its doctrines are practitioner-oriented teachers—trainers of future lawyers who on the whole eschew “high theory” in favor of an interest in real-world problems.¹⁷³ Conflicts is taught and learned as a series of problem-solv-

166. See Riles, *New Governance*, *supra* note 25. See also Gunther Teubner, *The Two Faces of Janus: Rethinking Legal Pluralism*, 13 *CARDOZO L. REV.* 1443, 1461-62 (1992).

167. This agreement is evident in the many conventions successfully concluded by the Hague Conference on Private International Law. See generally *Conventions, HAGUE CONFERENCE ON PRIVATE INT'L LAW*, http://www.hcch.net/index_en.php?act=conventions.listing (last visited Sept. 6, 2013). See also SYMEON C. SYMEONIDES, *CODIFYING CHOICE OF LAW AROUND THE WORLD: AN INTERNATIONAL COMPARATIVE ANALYSIS* (forthcoming 2014).

168. See generally Ralf Michaels, *The New European Choice-of-Law Revolution*, 82 *TUL. L. REV.* 1607, 1643-44 (2008) (discussing differences in European and American Conflicts traditions).

169. See SYMEONIDES, *supra* note 167 (noting further that this uniformity is increasing rapidly over the last decade).

170. See Christian Joerges, *The Idea of a Three-Dimensional Conflicts Law as Constitutional Form*, in *CONSTITUTIONALISM, MULTILEVEL TRADE GOVERNANCE AND INTERNATIONAL ECONOMIC LAW* 427-39; Christian Joerges, *Unity in Diversity as Europe's Vocation and Conflicts Law as Europe's Constitutional Form* 21-26 (LSE 'Europe in Question' Discussion Paper Series, Paper No. 28/2010, 2013), available at <http://ssrn.com/abstract=1723249>; Christian Joerges, *Rethinking European Law's Supremacy with Comments by Damian Chalmers, Rainer Nickel, Florian Rödl, Robert Wai* (European Univ. Inst. Dep't of Law, Working Paper No. 2005/12, 2005), available at <http://ssrn.com/abstract=838110>.

171. See generally *Multiculturalism*, *supra* note 17; Riles, *A New Agenda for the Cultural Study of Law*, *supra* note 156.

172. *Multiculturalism*, *supra* note 17, at 594-95.

173. See, e.g., Larry Kramer, *More Notes on Methods and Objectives in Conflict of Laws*, 24 *CORNELL INT'L L.J.* 245 (1991); Bruce Posnak, *Choice of Law: Interest Analysis and Its "New Critics"*, 36 *AM. J. COMP. L.* 681, 681-82 (1988); Robert Sedler, *Interest Analysis and Forum Preference in the Conflict of Laws: A Response to the "New Critics"*, 34 *MERCER L.*

ing methods, as opposed to theories, a way of disposing of actual cases.¹⁷⁴ The questions in the casebooks and in the hypotheticals teachers present to students cast the student in the role of the decision-maker, continually faced with the task of coming up with a solution.¹⁷⁵ Thus, from the point of view of its practitioners, the Conflict of Laws is a body of technical and instrumental knowledge, a series of “methods” rather than “theories.”¹⁷⁶ It is knowledge at a step removed from, and yet facilitating day-to-day social practices, and knowledge that does not describe the world, but rather solves the world’s problems.

The technical quality of the field surely makes it intimidating to some and obscures the politics of decision-making from the point of view of others. Yet as Knop, Michaels, and I have argued elsewhere,¹⁷⁷ the technical effect of Conflicts provides a register for moving beyond overt politics in discussions of politically contentious transnational questions. Conflicts treats political questions *as if* they were merely technical ones. It provides a framework, a series of technical pathways for discussion, which obviates and transforms the political questions so experts can approach them anew.¹⁷⁸ The field is populated by a cadre of legal experts, who are cosmopolitan in their outlook and who think more in terms of technical puzzle solving than in terms of political banner-waving.¹⁷⁹ The field’s studied technicality may serve to practical advantage in cases where the more straightforwardly political approaches to harmonization—transnational negotiations at the state level—have failed to produce adequate results.

C. How Conflicts Can Help Manage Regulatory Arbitrage

But a Conflicts approach is not simply a more accurate legal interpretation of the problem of overlapping regulatory authorities. The approach also gives us important additional tools for responding to regulatory arbitrage. In Part I, we saw that regulatory arbitrage depends upon a stable, formal difference between legal regimes. The desire to profit from this difference is behind the growth of regulatory arbitrage, while the impulse to eliminate this difference is behind the push for substantive legal harmonization.¹⁸⁰ Now, let’s explore more closely the matter of what makes for a “formal difference” of law. When, for example, AIG’s traders book trades through a London branch office, they may be taking advantage of a formal

REV. 593, 593-95 (1983); David E. Seidelson, *Interest Analysis: The Quest for Perfection and the Frailties of Man*, 9 DUQ. L. REV. 207, 207 (1981).

174. See generally Russell J. Weintraub, *How Are You Going to Keep Them Down on the Farm After They’ve Seen the Conflict of Laws?*, 27 U. TOL. L. REV. 681 (1996).

175. See e.g., HERMA HILL KAY ET AL., *CONFLICT OF LAWS: CASES, COMMENTS, QUESTIONS* v (9th ed. 2013).

176. See, e.g., ERNST RABEL, *THE CONFLICT OF LAWS: A COMPARATIVE STUDY* VOL. I 49-50 (The Univ. of Mich. Press, 1st ed. 1945).

177. Multiculturalism, *supra* note 17, at 594; Knop, Michaels & Riles, *International Law in Domestic Courts*, *supra* note 21, at 4.

178. For a full elaboration of this point, see generally *Multiculturalism*, *supra* note 17.

179. See Knop, Michaels & Riles, *International Law in Domestic Courts*, *supra* note 21, at 9.

180. See *supra* Part I.

difference between U.K. and U.S. securities, banking, or insurance regulation. But how do they *know* that U.K. law applies to their activity?

If asked the question, these non-lawyers would likely respond forthrightly that U.K. law applies because the transaction took place in London. Without realizing it, they would be invoking an old-fashioned rule in the Conflict of Laws—the same judge made Conflicts rule espoused without commentary by the *Morrison* court—that the law of the place in which a transaction is concluded governs that transaction in the absence of contractual terms dictating otherwise.¹⁸¹ And in fact, the *Morrison* court's formalistic definition of the “place of a transaction” as defined by the last act in a transaction¹⁸² is an arbitrageur's dream because it allows for compliance at a very low cost, by simply booking a transaction in one jurisdiction or another.¹⁸³ Hence, in this example, the formal difference that makes arbitrage possible is quite simply a humdrum, technical, overlooked Conflicts rule—one that is not set in stone but open to multiple interpretations.

Recall that arbitrage requires not simply a stable difference, but a difference that arbitrageurs can overcome at a low enough cost that there is still a profit remaining from the transaction.¹⁸⁴ In Part I, we saw that the formal difference must be great enough that once the arbitrageur subtracts the cost of arbitrage itself, he or she can make a profit. If, in the example in Part I,¹⁸⁵ the cost of procuring or shipping oil from State A to State B goes up too far, we will simply stop buying in A and selling in B because it will no longer be profitable.

The same is true for regulatory arbitrage: if the cost of regulatory arbitrage goes up, the amount of regulatory arbitrage can be expected to decrease, as arbitrageurs decide that the transaction is just not worth their efforts.¹⁸⁶ For example, imagine that the state of Kazakhstan were to enact the world's most favorable financial regulations from global financial custodial banks' point of view. How might a global financial institution take

181. See RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 311. Importantly, the Second Restatement of Conflict of Laws moderates and complexifies this simple rule. It provides that in the absence of specified law in the contract, the contract will be governed by “the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties” The contacts to be considered in this determination include the place of contracting, the place of negotiation, the place of performance, the location of the subject matter, and the location of the parties, among a number of other factors. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 186, 188 (1971). Cf. Pistor, *supra* note 53, at 23, 26 (“Financial markets do not exist outside rules but are constituted by them.”) (“Financial systems are not state or market, private or public, but always and necessarily both.”).

182. Cf. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) (1971).

183. Hannah Buxbaum, *Remedies for Foreign Investors Under US Federal Securities Law*, 75 LAW AND CONTEMP. PROB. 161, 172 (2011) (arguing that “the implication of this approach is that the location of an investment transaction hinges on the location of the final act that gives rise to liability to purchase and sell. Yet that may be manipulable by the parties—or, even more troubling, by one of them.”).

184. See *supra* Part I.

185. See *supra* Part I.

186. See HULL, *supra* note 29, at 14.

advantage of such law? If it were necessary to relocate the headquarters from New York to Kazakhstan, along with all the employees and their families, the cost of regulatory arbitrage would most likely make the operation prohibitive. If, on the other hand, all that is required is for a trader in New York or London is to “book” a trade through a small Kazakhstan office, then the cost of regulatory arbitrage is probably worth the profits incurred.

Much of the talk about offshore jurisdictions that pass laws that encourage this kind of regulatory arbitrage focuses on how such jurisdictions are themselves arbitrageurs of a kind: they profit from bringing the business into their jurisdiction, knowing that the costs of the rogue behavior will be born by other states and markets. But what gets lost in this discussion is this: Whether one must move one’s operations to Kazakhstan to get the benefits of Kazakhstan law, or whether one can simply claim Kazakhstan law by booking trades offshore is ultimately not a question of domestic Kazakhstan law, but a question of the Conflicts law of the jurisdiction where either party might bring any future challenge. In the case of a dispute brought in a New York court between two parties about the terms of a custodial arrangement booked in Kazakhstan, for example, will New York courts interpret New York Conflict of Laws rules to say that Kazakhstan law governs the transaction? Or will those courts determine that U.K. law, New York law, or some other law governs the transaction?

Now, the questions of what laws should apply to the custodial dealings of this bank are in fact not simple legal questions at all, should courts or litigants take time fully to consider them. If, for example, New York subscribed to a territorial definition of the scope of law,¹⁸⁷ the relevant legal question would be, where “is” an asset posted as collateral between two counterparties in different countries through the intermediary of the custodial bank, itself located in numerous jurisdictions around the world, when the collateral consists simply of some numbers in a computer system that stand for a bank account? Is the collateral located at the headquarters of the custodial bank? Is it at the site of the computer server? Or is it somewhere else, such as Kazakhstan, as stipulated in the agreement between the custodial bank and its customers?¹⁸⁸ The point is that in the absence of clear scientific answers to epistemological questions like “where is a security?” lawyers have been busy inventing creative answers rooted in the pragmatics of the implications of those answers for their clients, and for the most part, these are answers that serve the interests of the financial

187. In fact, New York courts have pioneered the development of a more flexible and modern approach to Conflicts. See *Phillips Credit Corp. v. Regent Health Grp., Inc.*, 953 F. Supp. 482, 502 (S.D.N.Y. 1997) (“[u]nder New York’s interest analysis, a court must consider five factors: (1) the place of contracting; (2) the place of the contract negotiations; (3) the place of the performance of the contract; (4) the location of the subject matter of the contract; and (5) the domicile, residence, nationality, places of incorporation, and places of business of the parties”).

188. See Directive 2002/47, of the European Parliament and of the Council of 6 June 2002 on Financial Collateral Arrangements, 2002 O.J. (L168) [hereinafter EU Directive on Financial Collateral]; Hague Securities Intermediary Convention, *supra* note 153, art. 4; Knop, Michaels & Riles, *International Law in Domestic Courts*, *supra* note 21, at 171.

industry.¹⁸⁹

The general Conflicts rule, and the one favored by the financial industry in such cases, is simply to allow the parties to decide among themselves what law should govern the transaction.¹⁹⁰ “Party autonomy” is a principal tenet of Conflicts doctrine, albeit one that is subject to certain exceptions and conditions.¹⁹¹

Yet how far should we go in deferring to the will of the parties when their transaction has serious distributive consequences for domestic taxpayers?¹⁹² If the parties choose Kazakhstan law in the example above, and hence place themselves and their transactions beyond their own national law, is that fair to the markets and nation-states that will have to bail them out if the transaction turns out to be an unwise one? Should party autonomy trump all other values?¹⁹³

Whatever one may think of the arguments for or against the principle of party autonomy, the point is that it is the perception that this particular nugget of doctrine is entirely settled that allows traders to act with confidence that courts will honor their wishes not to be subject to national law. Without the security that unnoticed Conflicts rules provides, regulatory

189. See Knop, Michaels & Riles, *International Law in Domestic Courts*, *supra* note 21, at 49–50, 53–54, 92–94.

190. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

191. See *id.* §§ 187–88; EU Directive on Financial Collateral, *supra* note 188; 16 AM. JUR. 2D *Conflict of Laws* §§ 78–80 (2013); WALTER WHEELER COOK, *THE LOGICAL AND LEGAL BASES OF THE CONFLICT OF LAWS* 412, 418 (1942); Michele Graziadei, *Financial Collateral Arrangements: Directive 2002/47/E and the Many Faces of Reasonableness*, 17 UNIF. L. REV. 497 (2012) (discussing party autonomy under EU Directive on Financial Collateral); Fleur Johns, *Performing Party Autonomy*, 71 L. & CONTEMP. PROBS 243, 249 (2008). See also Yuko Nishitani, *Party Autonomy and Its Restrictions by Mandatory Rules in Japanese Private International Law: Contractual Conflicts Rules*, in *JAPANESE AND EUROPEAN PRIVATE INTERNATIONAL LAW IN COMPARATIVE PERSPECTIVE* 77 (Jürgen Basedow et al. eds., 2008) (discussing exceptions to party autonomy under Japanese law in consumer contracts and other situations of inequalities in bargaining power between parties to a contract, and noting that the U.S. has “traditionally taken a reserved position toward the parties’ discretion to determine the law governing contracts”); Symeon C. Symeonides, *Presentation at the American Society of Comparative Law: Codifying Choice of Law Around the World: The Last Fifty Years* (noting important exceptions).

192. See CFTC Guidance, *supra* note 71, at 45, 293–95 (CFTC final guidance discussing extraterritorial reach of swaps provision of Commodities Exchange Act (as modified by Dodd-Frank’s “direct and significant connection with activities in, or effect on, commerce of the United States” language), and focusing on the potential danger of third-party effects as illustrated by the financial crisis); Cross-Border Security-Based Swap Activities, 78 Fed. Reg. 30968, 30980 (May 23, 2013) (SEC proposed rules on extraterritorial reach of the Securities Exchange Act of 1934 (as modified by Dodd-Frank), noting contagion and spillover problems).

193. See Symeonides, *supra* note 191 (demonstrating that while the latest codifications of Conflicts law in almost all jurisdictions recognize the value of party autonomy, they do so with important caveats and leave room for other public interests to supersede the parties’ intentions in certain contexts). See also Onnig H. Dombalagian *Choice of Law and Capital Markets Regulation*, 82 TUL. L. REV. 1903, 1917–18 (2008) (“A hypothetical sovereign might nevertheless approach the question from a different perspective namely, whether a corporation’s contacts are sufficiently substantial that the sovereign is entitled to set aside the foreign law of incorporation when necessary to advance its public policy.”).

arbitrage would be impossible. To put it another way, if a more sophisticated and contemporary Conflicts analysis took a more careful and nuanced view of the question of legal scope, then arbitrageurs would face less certainty that Kazakhstan law applies, or would have to go to greater lengths to move key elements of the transaction to Kazakhstan, in order to ensure that Kazakhstan law would apply. Or to be more precise, if our analysis of the application of the party autonomy rule incorporated a more robust analysis of the conflicting policies and interests, operating in the framework of the application of the rule or the invocation of exceptions to it, then those specific kinds of arbitrage that are likely to be most harmful to national and international objectives would be less likely to be enforceable. From the arbitrageur's point of view, certain kinds of arbitrage—those most harmful to national and international interests—would then become more costly, and more difficult, as these costs would eat into profits.

Note that this does not mean that we sacrifice all certainty and predictability, or that we embrace legal ambiguity as a vehicle of state power at the expense of private legal arrangements. After all, it is highly predictable and foreseeable from the point of view of financiers that, in a case such as *AIG*, the U.S. taxpayers would have a strong interest in regulating the behavior at hand. What it means is that arbitrageurs will need to take into their investment calculus the externalities of their behavior in ways that the blanket application of the party autonomy rule allows them not to do.

One of the fundamental starting insights of Private International Law is that questions of jurisdiction and questions of choice of law are divisible inquiries.¹⁹⁴ What this means is that simply because a given regime has the *power* to govern a certain issue (just because it has jurisdiction) does not mean that it *should* do so (choice of law). In certain circumstances, it might be more appropriate for it to defer to another regulatory authority and to apply that authority's rules if, for example, the parties have stipulated among themselves that a different law should apply to their transaction and it is appropriate to defer to the will of the parties, or again if another regulatory authority has a greater interest in the matter.¹⁹⁵

A crucial corollary to this point is that *some* law governs every cause of action: just because the forum's own law does not reach a legal issue does not mean that the rights and duties involved fall into some kind of legal black hole. Rather, the very reason the forum's law does not reach the transaction is that some other state law *does* reach the transaction.¹⁹⁶ Therefore, the forum can turn the entire matter over to another state and dismiss the case for *forum non conveniens*,¹⁹⁷ but it can also just as legitimately adjudicate the rights involved with reference to that other law.¹⁹⁸

194. See *Multiculturalism*, supra note 17, at 632.

195. See, e.g., Brainerd Currie, *Married Women's Contracts: A Study in Conflict-of-Law Method*, 25 U. CHI. L. REV. 227, 237-244 (1958) (defining legitimate state interests with respect to the application of law).

196. See, e.g., RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 2 (1971); 16 AM. JUR. 2D CONFLICT OF LAWS § 1.

197. See, e.g., 21 C.J.S. COURTS § 93.

198. See, e.g., 16 AM. JUR. 2D CONFLICT OF LAWS § 3.

This represents a significant step forward in sophistication relative to the current debate about the extraterritorial reach of U.S. securities laws, which focuses only on whether courts have the power to reach transactions outside the United States,¹⁹⁹ and in so doing assumes that the only practical choices facing a court are to apply its own law or treat the issue as beyond any law.

A third and equally fundamental starting insight of this approach is that the answer to such questions turns on issue-specific inquiries.²⁰⁰ What other regulatory authority is involved? How different are the rules and principles of the two possible authorities? Who are the parties? What is the nature of the transaction? What state and private interests are implicated?

Fourth, and perhaps most innovative of all, is the core insight that the scope of regulatory authority varies from one legal issue, and from one set of parties, to the next.²⁰¹ The parties in this dispute might be governed by U.K. law with respect to some elements of their relationship but by U.S. law with respect to others. Conflicts allows the decision-maker to “slice” a dispute into distinct questions of law, each with its own scope of law.²⁰²

A Conflicts approach generates not blanket rules, but issue-by-issue determinations of scope.²⁰³ For example, it would not seek to answer the question of whether U.S. rules regarding derivatives apply to all foreign firms, as the CFTC asks in the context of its rule-making powers under Dodd-Frank, but rather would seek to ask more precise questions concerning particular parties’ and the particular transaction’s precise contacts with the United States, and with other regulatory authorities, and the particular nature of the potential harm to taxpayer interests in the US caused by the transaction.

Notice one key point about the Conflicts approach to regulatory arbitrage: *it does not depend on any change in the substantive law of the U.S., or*

199. See, e.g., Greenberger, *supra* note 122, at 971 (arguing that courts have constitutional authority to reach defendants and that Congress has the constitutional authority to legislate extraterritorially). The question of the power of Congress or the courts in fact is not contested however. It is well-accepted that Congress has the power to act even in contravention of international law should it choose to do so explicitly. Likewise, the issue in Morrison and subsequent cases was not whether the courts have personal jurisdiction over the defendants but whether it is appropriate to apply U.S. law to the dispute. See *Morrison v. Nat’l Austl. Bank*, 130 S. Ct. 2869 (2010).

Dodd-Frank § 929p(b)(1) reads: “The district courts of the United States . . . shall have jurisdiction of an action or proceeding brought or instituted by the [Securities and Exchange] Commission or the United States . . . [under the Securities Act of 1933 governing securities fraud], for alleged violations involving (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”

200. See Currie, *supra* note 195, at 237-244.

201. See Willis L. M. Reese, *Dépeçage: A Common Phenomenon in Choice of Law*, 73 COLUM. L. REV. 58, 58 (1973); CURRIE, *supra* note 147, at 368-71.

202. See *Multiculturalism*, *supra* note 17, at 638.

203. See *id.*

Kazakhstan, or the international community. Those laws remain as they were. Our focus is not on eliminating *difference* (as in the harmonization approach), but on increasing the *cost* of arbitration—the costs of complying with the requirements of the doctrine concerning what constitutes an off-shore transaction where the financial interests of the arbitrageur are at cross-purposes with national regulatory interests. By simply updating our approach to the Conflicts doctrines already operating in the background of these judicial and regulatory assertions of legal scope, we can significantly impact the incidence of regulatory arbitration, therefore, without incurring the equally problematic costs associated with substantive legal harmonization.

D. Why Has the Conflicts Approach Been Ignored?

If Conflicts has so much to offer, why has this toolbox been ignored in global financial regulation? Financial regulation experts know little about the Conflict of Laws, if they are even aware that these doctrines exist.²⁰⁴ For its part, Conflicts as a field has historically confined itself to legal issues classically associated with “private law” and eschewed more public issues that implicated state power and regulation.²⁰⁵ Specialists in the Conflict of Laws traditionally specialized in areas of law such as inheritance, marriage, land disputes, private contracts, and the like because historically those private law issues occurred most frequently as a result of the movement of people and goods across borders, and emerging European states had to determine what law would govern various aspects of these migrants’ lives.²⁰⁶ As Horatia Muir Watt argues, Private International Law has had a kind of “tunnel vision” about the problems that are amenable to its analysis.²⁰⁷ She argues that such a myopic view of the limits of the applicability of Conflicts analysis to questions implicating state regulatory authority results in the failure of the field to address the very “transnational expressions of private power”²⁰⁸ that should most directly concern a field by the name of Private International Law.²⁰⁹

In the United States, where the so-called “Conflicts Revolution”²¹⁰ of the early twentieth century turned on the legal realist insight that all pri-

204. See Watt, *supra* note 154, at 350–52.

205. Hisashi Harata, *An Interim Report on Savigny’s Methodology and His Founding of a Modern Historical Jurisprudence*, 8 U. TOKYO L. REV. 125 (2013); Jansen & Michaels, *supra* note 84; Ralf Michaels, *Public and Private International Law: German Views on Global Issues*, 4 J. PRIVATE INT’L. L. 121 (2008); Ralf Michaels, *Globalizing Savigny? The State in Savigny’s Private International Law and the Challenge from Europeanization and Globalization*, in AKTUELLE FRAGEN ZU POLITISCHER UND RECHTLICHER STEUERUNG IM KONTEXT DER GLOBALISIERUNG 119 (Michael Stolleis & Wolfgang Streeck eds., 2007).

206. See Alex Mills, *The Private History of International Law*, 55 INT’L & COMP. L. Q. 1, 7–10 (2006).

207. Watt, *supra* note 154, at 356.

208. *Id.* at 353.

209. Muir argues that this “pasteurisation” of Private International Law from politics is a recent phenomenon dating only to the nineteenth century. See *id.* at 361.

210. For the background of this term, see Annelise Riles, *A New Agenda for the Cultural Study of Law*, *supra* note 156, at 973, 990 n.53.

vate disputes implicate state power,²¹¹ the reason that Conflicts has not been deployed to its fullest in international regulatory contexts is somewhat different. Since the Conflicts Revolution, Conflicts has been imagined as a more or less domestic field, with limited applicability transnationally.²¹² National courts, which routinely apply Conflicts principles in every case of diversity jurisdiction to determine the applicable law (regardless of the field of law or whether the dispute is “public” or “private” in traditional parlance), rarely think about the uses of Conflicts doctrines when the problems involve the extraterritorial scope of national law.²¹³ The important exception to this is a line of lower court cases in U.S. securities and antitrust law applying a multifaceted approach to the extraterritorial application of U.S. law borrowed implicitly from Conflicts doctrines.²¹⁴ Nevertheless, in international cases, commentators sometimes speak of a “public law taboo” against the idea of a domestic court choosing a foreign body of regulatory law as the governing law of a transaction.

As a doctrinal matter, to think of Conflicts as limited either to certain subjects of law or to domestic disputes is simply an error.²¹⁵ Although courts have not traditionally applied foreign regulatory law, “the public law taboo is weak”²¹⁶—based on insufficient practical or theoretical foundations. Moreover, regulators have already begun to move beyond such judicial taboos in their own sphere of financial law-making through practical institutions such as “substituted compliance” in which, although a domestic regulator might determine that a party or transaction is subject to domestic law, the regulator agrees not to regulate the party or transaction because it is already subject to another analogous foreign regulatory authority. Policies such as substituted compliance are innovative and valu-

211. See Symeon Symeonides, *Revolution and Counter-Revolution in American Conflicts Law: Is There a Middle Ground?*, 46 OHIO ST. L.J. 549, 556-57 (1985).

212. Mathias Reimann, *A New Restatement-For the International Age*, 75 IND. L.J. 575, 575 (2000).

213. See *id.* at 579.

214. See *Timberlane Lumber Co. v. Bank of Am., N.T. & S.A.*, 549 F.2d 597, 608-615 (9th Cir. 1976); *O.N.E. Shipping Ltd. v. Flota Mercante Grancolumbiana, S.A.*, 830 F.2d 449, 451 (2d Cir. 1987).

215. It should be acknowledged that some civilian experts in Conflict of Laws entertain a view of the scope of their discipline that would not allow it to apply, analogically in this way, to regulatory problems. In this view, Private International Law is applicable only to private disputes, that is, disputes in which (in these scholars' view) the state is essentially uninterested, while public law (including all regulatory matters) must be governed purely by public international law's more territorial principles. See Masato Dogauchi, *Four-Step Analysis of Private International Law* (2006).

216. See Hannah Buxbaum, *Remedies for Foreign Investors*, *supra* note 184, at 174. Buxbaum discusses a series of cases in which courts have signaled their willingness to apply foreign regulatory law. See *id.* at 175, nn.86-87 and accompanying text. On the so-called “Public Law Taboo,” see generally William S. Dodge, *Breaking the Public Law Taboo*, 43 HARV. INT'L L.J. 161 (2002); Philip J. McConaughay, *Reviving the “Public Law Taboo” in International Conflict of Laws*, 35 STAN. L. REV. 255 (1999); Felix D. Strebler, *The Enforcement of Foreign Judgments and Foreign Public Law*, 21 LOY. L.A. INT'L & COMP. L.J. 55 (1999).

able precisely because they promote the core Conflicts value of regulatory coordination from the ground up.

Hence the field should be open to doctrinal development in the face of an increasingly global and financially interdependent set of markets and of the expressed desire of governments to coordinate their regulatory activities where cross-border financial transactions are concerned. To fail to deploy Conflicts analyses in this area is to miss a precious opportunity to use time-tested legal tools to address a pressing set of problems that are neither distinctively national nor international,²¹⁷ and neither distinctively private nor public²¹⁸ in nature.

One further reason for the failure to consider Conflicts as a tool of global regulatory coordination may be that we normally think of Conflict of Laws doctrines as doctrines applied by judges to disputes brought by private litigants whereas we imagine that most financial regulation takes place within the realm of government bureaucracies. The judicial application of Conflicts certainly is one possible use of such doctrines, and disputes by private litigants certainly are one venue in which the question of the allocation of regulatory authority might get broached. For example, it is possible to imagine private parties challenging a decision of a national regulator, in that regulator's own courts, on the basis of Private International Law doctrines. This in itself is one of the valuable points of the Private International Law approach: it allows private market participants to partake more actively in global financial governance by framing the issues in the context of legal disputes.

Yet although Conflict of Laws doctrines are normally imagined as techniques judges use in the context of legal disputes,²¹⁹ in fact there is nothing that limits Conflicts thinking to the judicial sphere. Legislatures can and often do make Conflicts rules, as when they write the scope of a law into the text of the law itself.²²⁰ Private parties also make Conflicts

217. See Lowenfeld, *supra* note 154, at 322; Ralph J. Steinhardt, *The Privatization of Public International Law*, 25 GEO. WASH. J. INT'L L. & ECON. 523 (1991).

218. See Joanne Braithwaite, *Private Law and the Public Sector's Central Counterparty Prescription for the Derivatives Markets* 11, (LSE Legal Studies, Working Paper No. 2/2011), available at <http://ssrn.com/abstract=1791740> ("the distinction between private and public actors may be a particularly artificial one in the context of [financial regulation]"); Pistor, *supra* note 53, at 25 ("Financial systems are not state or market, private or public, but always and necessarily both.").

219. See William Tucker Dean, Jr., *The Conflict of Conflict of Laws*, 3 STAN. L. REV. 388, 393 (1951).

220. For example, 15 U.S.C. § 6a describes the extraterritorial reach of the Sherman Act: "Sections 1 to 7 of this title shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless . . . such conduct has a direct, substantial, and reasonably foreseeable effect . . . on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or . . . on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and . . . such effect gives rise to a claim under the provisions of sections 1 to 7 of this title, other than this section . . ." 15 U.S.C. § 6a (2006).

rules, in the context of private agreements.²²¹ And whether they recognize it or not, national financial regulators also regularly make Conflicts decisions.²²² In practice, regulators are constantly making decisions about the legal scope of their regulatory authority, often without access to sophisticated legal tools for making such decisions concerning legal scope.²²³

Hence, Conflicts-style reasoning need not be the province of courts alone. Regulators seeking to answer for themselves the question of what their policy should be regarding the reach of their regulatory authority and its relationship to other regulatory authorities could analogously deploy the same principles.²²⁴

E. Conclusion

In sum, Private International Law is a path to global financial regulation “in the meantime,” while we await the discovery of the holy grail of legal harmonization. But along the way, we may discover that the means available to us here and now are in many ways preferable to those of utopia. The value of a Conflicts approach is that it builds agreement in a highly practical way. Conflicts is a more limited, step-by-step approach to global consensus. It starts from the ground up, beginning from where we are, in the present moment, from diversity of regulatory practice and seeking to define the scope in which we can accommodate diversity. This is the alternative to beginning from a utopian and top-down search for global uniformity.

Through Conflicts, courts or regulators face questions of the scope of national law as they develop, and hence, they can address immediate problems now, rather than wait for long-term harmonization. It therefore focuses first on the problems that seem most pressing, most immediate, to those most interested. Through Conflicts, states and private parties work collectively to knit together a system of coordinated regulation.²²⁵ Unlike international treaty-making, it is an approach that accounts for the way a state may encompass a number of regulatory authorities, a number of jurisdictions, and hence, a number of regulatory philosophies.²²⁶ It is a flexible, multi-nodal approach to building transnational consensus—it accepts that lawmaking can happen in any jurisdiction, and is the responsi-

221. See, e.g., Int’l Swaps and Derivatives Ass’n, 2002 Master Agreement pt. 4(h) (clause allowing parties to choose governing law: “[t]his Agreement will be governed by and construed in accordance with [English law] [the laws of the State of New York (without reference to choice of law doctrine.)]”).

222. See *supra* Part III.C.

223. See Verdier, *Mutual Recognition*, *supra* note 5, at 55.

224. This Article is the second in a three-part series of articles. The first focused on the problems with the most advanced solutions to problems in regulatory harmonization. See Riles, *New Governance*, *supra* note 25. In this second article I focus on the application of the Conflicts Approach by courts. The third article will explore how the Conflicts approach could be used by regulators and policy-makers at the domestic and international levels.

225. See *Conflicts and Comity*, *supra* note 144.

226. See *Transnational Private Law*, *supra* note 160, at 472–73.

bility of a range of state and non-state actors.²²⁷ Finally, the technical quality of Conflicts provides a much-needed vocabulary, a register for moving beyond overt politics in the discussion of international financial regulation.

For all these reasons, a Conflicts approach is a more practical, achievable, and ultimately, more effective and more just approach to regulatory coordination. Yet, it has hardly been attempted, let alone tested. In the next Part, I offer an example of how this approach might be deployed in practice.

IV. The Approach in Practice

So how might a decision-maker think about the scope of regulatory authority using a Conflicts approach? Let's explore this problem using a concrete example. This particular example assumes that the issue is the reach of judicial authority. However, as I will elaborate in the companion piece to this Article, the method is also applicable to the decision-making of regulators, central banks, and administrative agencies.²²⁸

Imagine the following situation: An American investor *P*, domiciled in NY, brings a civil action for fraud against *D*, a French trader formerly working in the U.K. office of a U.S. investment bank, *IB*, accusing him of making material misstatements and omissions in connection with the private sale to *D* of a synthetic collateralized debt obligation ("CDO") that was tied to the performance of subprime residential mortgage-backed securities ("RMBS"). All the negotiations and discussions between *P* and *D* occurred in NY, but the transaction was booked through *IB*'s London office. A choice of law clause in the ISDA master agreement concluded some time before this transaction and governing all future transactions between *P* and *IB* specified that U.K. law applied to all their dealings. Should the court dismiss this action for failure to state a claim upon which relief can be granted?²²⁹

227. See Berman, *supra* note 161, at 170.

228. The terminology and description of the Conflicts method in this section borrows directly from a previous article co-authored with Karen Knop and Ralf Michaels. See *Multiculturalism*, *supra* note 17.

229. This hypothetical is based upon SEC v. Goldman Sachs and Fabrice Tourre (2011), a private SEC enforcement action. That case was filed a few weeks before Dodd-Frank was promulgated, and was based on events prior to Dodd-Frank.

After Dodd-Frank, the question of whether U.S. law applies to a case in which the SEC was the plaintiff would have been an easier one since Congress intended to reverse the holding in *Morrison* and ensure that U.S. securities laws applied to private enforcements by the government where the transaction had "effects" in the U.S. See Dodd-Frank §929P(b)(1) ("The district courts of the United States . . . shall have jurisdiction of an action or proceeding brought or instituted by the [Securities and Exchange] Commission or the United States . . . [under the Securities Act of 1933 governing securities fraud], for alleged violations involving (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States."); Securities and Exchange Commission, Release No. 34-69490; File Nos.S7-02-

We are faced here with a clear case of regulatory arbitrage. The buyer is a U.S. investor and the seller's company is a U.S. investment company. Transactions of this kind, moreover, have consequences for U.S. markets as a whole.²³⁰ However, the seller has used an employee from a foreign branch office, booked the transaction through that foreign office, and specified foreign law in the master agreement governing all trades with the buyer for the purposes of evading U.S. securities laws. The result is that the seller has done "in London" what would violate U.S. law if it were done "here." It has profited on this difference by availing itself of the profits of the transaction without paying the costs associated with any enforcement action or civil lawsuit by the plaintiff.

So how should a court think about the scope of U.S. securities laws—about whether those laws reach this transaction? The usual American analysis would head straight to U.S. securities laws, and treat the scope of the Securities Exchange Act as amended by Dodd-Frank as a question of statutory interpretation.²³¹

A Conflicts approach would instead begin with the question of the scope of the law, taking into account the content of the statute as one among other elements of the analysis.²³² There is a series of standard and well-established steps to such an analysis—the same steps we would undertake in any ordinary tort or contracts case. This analysis is richer and more detailed and hence brings to the table a number of elements missed by the standard approach—elements that have consequences for the ease and cost of regulatory arbitrage.

13; S7-34-10; S7-40-11, Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 17 CFR Parts 240, 242, and 249, at 342-343 (asserting that it interprets Dodd-Frank to give it authority to bring suits for fraud when the conduct or effects involve U.S. markets). Hence in order to make the problem more interesting, we will assume a private cause of action involving a U.S. plaintiff.

It should be noted that this interpretation of the effects of Dodd Frank on the holding in *Morrison* is not accepted by all. At issue is the meaning of the word "jurisdiction" in the statute. § 929 states that courts shall have jurisdiction over (1) conduct within the U.S. and (2) conduct outside the U.S. that has a foreseeable substantial effect within the U.S. Some have argued that Dodd-Frank erroneously used the language of jurisdiction rather than choice of law and hence that while the statute confers jurisdiction over such cases and says nothing about what law should actually apply, i.e., whether U.S. securities laws apply. Proponents of the extraterritorial application of U.S. law respond that the meaning of the term jurisdiction should be read as meaning legislative jurisdiction, or jurisdiction to prescribe, as articulated in sections 401 and 402 of the Restatement of Foreign Relations as this was the clear intent of the legislature, as evidenced by the legislative history.

230. In the actual case, the SEC alleged that "synthetic CDOs contributed to the recent financial crisis by magnifying losses associated with the downturn in the United States housing market." See Amended Complaint at 1, *SEC v. Tourre*, No. 10 Civ. 3229 (S.D.N.Y. June 4, 2013).

231. See *id.*, slip op. at 1. If the Securities Act of 1933 does not apply, the court will dismiss the claim under 12(b)(6). FED. R. CIV. P. 12(b)(6).

232. See KERMIT ROOSEVELT, CONFLICT OF LAWS 1-2, 5 (2010).

A. Pleading and Proving Foreign Law

The first step in any Conflicts analysis is to ask, “Does the defendant allege that another law applies, when he or she alleges that U.S. securities laws do not reach the transaction, or does he or she simply allege that his or her conduct shouldn’t be regulated?” In other words, when the defendants in this case booked their transaction in London, are they asserting that U.K. law should apply? If so, what is the content of U.K. law? Is it in fact materially different in a way that advantages the defendant in this dispute?²³³ The parties will only get to question the scope of domestic law by forcing the question of a potential “conflict” between the law of the forum and a relevant body of foreign law.

From a Conflicts perspective, it is not enough to allege that U.S. law does not apply; the defendant must suggest that some other law applies. This is an important first step to a Conflicts analysis because it lays out a different view of how questions of legal scope should be analyzed. The issue is not the limits of U.S. law *tout court*. The issue is the potential *conflict* between U.S. law and some other law. If there is no conflict, there is no problem with the application of domestic law. Conversely, when the U.S. courts apply U.S. law they should do so with awareness, at least, of the claims of other jurisdictions to apply their own laws.²³⁴

From the outset, then, the problem is one of *coordination* among jurisdictions. This approach to coordination, moreover, looks carefully at the differences between regulatory regimes and hence creates room for pluralism. This is quite different from substantive regulatory harmonization, in which agreements negotiated internationally often reflect a woeful lack of knowledge of local conditions beyond the North Atlantic and hence are all but impossible to implement domestically when they come back down from the international plane.²³⁵ Note that it is the parties that must initiate a Conflicts analysis: the plaintiff or defendant must allege that some foreign law applies to the transaction. Hence, the coordination efforts are driven by the parties, from the ground up, based on their understanding of the specifics of the dispute, rather than led by national regulators. It is a more participatory approach to regulatory coordination.

This first step is also practically important for efforts to address regulatory arbitrage because under this approach it is no longer enough to simply move a transaction anywhere offshore to evade U.S. law. Arbitrageurs will have to have a more principled, substantive reason for their claim that U.S. law does not apply. This also means that they will have to incur addi-

233. In this example, the Plaintiff has chosen the forum and is alleging in the complaint that U.S. securities laws apply. It would be possible for the plaintiff to allege that a different law applies, despite the fact that a U.S. court is the forum. In such a case we would engage in the same line of questioning with regard to the Plaintiff’s proposed choice of law.

234. See, e.g., Currie, *supra* note 195, at 368 (“It is altogether fitting and proper that the existence of such a foreign interest should be a factor in the court’s determination of whether a conflicting American interest exists. Such conflict ought not to be created lightly and unnecessarily. . . .”).

235. See Riles, *New Governance*, *supra* note 25, at 15-16.

tional legal costs as they set up such transactions to investigate whether in fact the proposed offshore jurisdictions do have relevant substantive differences of law such that a future claim to the application of foreign law would make sense. In such an approach, moreover, the burden is on the arbitrageur to initiate a Conflicts analysis by alleging that a foreign body of law applies.

In fact, many cases of regulatory arbitrage would fail this simple initial test.²³⁶ In our example, the defendant would run up against the U.K.'s Misrepresentation Act of 1967, which also provides for a private cause of action for misrepresentations in the context of sales of securities.²³⁷ If the statements in question would be sanctioned by U.K. law as well, it would be pointless for the defendant to argue that U.K. law applies since a U.S. court, applying U.K. law, would reach much the same result as under U.S. securities laws.

B. Statutory Interpretation

So that might be the end of this hypothetical episode of regulatory arbitrage. But let's change the facts in our hypothetical just enough to make the case more favorable to our arbitrageur. Let's imagine now that the investment bank *IB* did not directly sell the CDO to *P*, but rather acted as a broker on behalf of a third party seller. In such a case, the U.K. Misrepresentation Act would not apply and *D* might argue that under U.K. law, *P* is a "sophisticated investor" who is not owed a duty of care by *IB*.²³⁸ Hence, *D* could allege that this dispute is governed by U.K. law, which is more favorable to him.

The next step in a Conflicts analysis is to ask, "Is the scope of domestic law explicitly governed by a statute?"²³⁹ Here is where our analysis incorporates the mainstream securities regulation perspective focusing on the interpretation of the statute. A Conflicts methodology looks to the text of a statute to see whether the legislature has expressly spoken on the multijurisdictional question, even if international law on the matter might contradict the legislature's intent, out of an understanding of the legitimacy of Conflicts analysis as resting on implicitly delegated legislative power and a realist recognition that a more multijurisdictional perspective is always in

236. In the actual case on which this hypothetical is based, for example, the defendant did not allege that any foreign body of law applied; he only alleged that U.S. law did not apply to his conduct. See *SEC v. Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 164-65 (S.D.N.Y. 2011).

237. See Andrew Twigger, *Sophisticated Investors: Do They Have Any Rights?*, 25 *BUTTERWORTHS J. OF INT'L BANKING & FIN. L.*, 515, 516 (2010). See also Directive 2004/39/EC, of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments Amending Council Directives 85/611/EEC and 93/6/EEC; Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, 2004 O.J. (L 145) 1, 29 ("[m]ember States shall require that, when providing investment services and/or, where appropriate, ancillary services to clients, an investment firm act honestly, fairly and professionally in accordance with the best interests of its clients.").

238. See Twigger, *supra* note 237, at 516-17.

239. See *RESTATEMENT (SECOND) OF CONFLICT OF LAWS* § 6(1) (1971).

practical terms subject to local democratic authority.²⁴⁰ If the legislature has not expressly spoken on the matter, then principles of Private International Law apply to fill the gaps.²⁴¹

In our hypothetical case, the choice of law issue remains open. Dodd-Frank sought to overturn the holding in *Morrison* with respect to suits by regulatory authorities, but it refrained from addressing the question of private causes of action.²⁴²

C. Comparative Analysis

Once we have concluded that the matter is not decided by the legislature, the Conflicts methodology requires the decision-maker to conduct a serious inquiry into the nature and purpose of foreign law, and the extent to which those purposes come into play in the current issue. This can be achieved with the assistance of the parties' pleadings, or through the use of court-appointed experts, or even the certification of questions to foreign courts; but in many financial regulation cases such as this one, in which the foreign jurisdiction is not an entirely alien one and the body of secondary sources on foreign law is extensive and accessible to the court, the court can answer this question simply through its own legal research.²⁴³ The defendant has alleged that U.K. law applies. What exactly is the substance of U.K. law on this point? What is the history of this law? What would a U.K. court do in this context?²⁴⁴

In other words, the judge does not just take the defendant's word for it. He or she engages in a substantive comparative analysis and seeks, as much as possible, to understand the foreign law on its own terms.²⁴⁵ This comparative analysis distinguishes the Conflicts approach from current U.S. Supreme Court jurisprudence on the extraterritorial scope of U.S. law, which proceeds as if that scope is determined in a vacuum.²⁴⁶ This difference is crucial to an approach that seeks to produce global regulatory coordination based on respect for regulatory pluralism.²⁴⁷ Comparative analysis works to minimize the danger that our efforts to address regulatory arbitrage end up producing many of the same negative side effects of harmonization through unintentional misunderstanding of regulatory differences.

240. See *id.*; see also Symeon Symeonides, *Revolution and Counter-Revolution in American Conflicts Law*, *supra* note 211, at 549, 556–57.

241. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(2) (1971).

242. See Kara Baquizal, Note, *The Extraterritorial Reach of Section 10(B): Revisiting Morrison in Light of Dodd-Frank*, 34 FORDHAM INT'L L.J. 1544, 1546 (2011).

243. See Mathias Reimann, *Comparative Law and Private International Law*, in THE OXFORD HANDBOOK OF COMPARATIVE LAW 1363, 1381–84 (Mathias Reimann and Reinhard Zimmerman eds., 2006).

244. See generally Annelise Riles, *Cultural Conflicts*, 71 LAW & CONTEMP. PROBS. 273 (2008).

245. See *Multiculturalism*, *supra* note 17, at 629–31.

246. See, e.g., *Morrison v. Nat'l Austl. Bank*, 130 S. Ct. 2869, 2877 (2010); *Am. Banana Co. v. United Fruit Co.*, 213 U.S. 347, 357 (1909).

247. See generally Ralf Michaels, *Global Legal Pluralism*, 5 AN. REV. L. & SOC. SCI. 243 (2009).

D. Relevant Policies and Interests

So let's assume that upon completing its comparative analysis, the decision-maker determines that U.K. law is indeed substantively different from U.S. securities laws in ways that are material to the outcome of this case—that *D*'s common law duties of care under U.K. law would not extend to the misrepresentations he made to *P* in this case, as would U.S. anti-fraud provisions because *P* was a sophisticated investor. On its face, at least, our multijurisdictional analysis has revealed a conflict of applicable laws. What does the decision-maker do next under a Conflicts approach?

There are multiple possible methodologies at this stage,²⁴⁸ but in the United States, most of these incorporate a crucial determination: whether each of these jurisdictions in fact has an interest in seeing its law applied to this case.²⁴⁹ We will do this by first inquiring into the purpose behind both U.S. and U.K. laws in an analogous domestic case. We determine that the relevant law in the U.S. is the Securities Exchange Act, which would allow *P* to recover for fraud.²⁵⁰ Its purpose is to ensure fairness and competitiveness in U.S. financial markets.²⁵¹ We determine that the relevant law in the U.K. is a common law duty of care, which may not apply to sophisticated investors.²⁵² We determine from our reading of the case law and the relevant commentaries that the reasons U.K. courts have declined to impose a duty of care on securities dealers acting as intermediaries between sophisticated investors are to protect investors' and dealers' freedom of action—to preserve their ability to structure their own relations as they see best.²⁵³

248. See Symeon C. Symeonides, *Choice of Law in the American Courts in 2012: Twenty-Sixth Annual Survey*, 61 AM. J. COMP. L. 217, 241–261 (2013) (surveying numerous national approaches).

249. See generally Currie, *supra* note 195 (interest analysis); see also Symeon C. Symeonides, Presentation at the American Society of Comparative Law: Codifying Choice of Law Around the World: The Last Fifty Years (arguing that such concerns are increasingly part of the newly codified conflicts law of many nations around the world).

250. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), makes it unlawful: “for 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 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.” 17 C.F.R. § 240.10b-5.

251. See 15 U.S.C. § 78b (Regulation was necessary to “protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets [in transactions in securities].” *Id.*

252. See Twigger, *supra* note 237, at 517.

253. See, e.g., *J.P. Morgan Chase Bank v. Springwell Navigation Corporation*, [2008] EWHC 1186 (Comm) and [2008] EWHC 1793 (Comm) (relying on signed documentation structuring parties' relationship as one factor in decision not to extend duty of care).

Jurisdiction	Relevant Law	Purpose
US	Securities Exchange Act Violation.	To ensure fairness, competitiveness in markets
UK	Common law duty of care No violation	To protect investors' and dealers' freedom of action

Having now considered the hypothetical analogous domestic case from each jurisdiction's point of view, the next step is to ask whether, given these purposes, each jurisdiction has a legitimate interest in seeing its law applied in this particular multijurisdictional case. We do this by considering the relevant "contacts" with the jurisdiction that would trigger an interest in the application of domestic law.²⁵⁴

The purpose of the U.S. law is to ensure fairness and competitiveness in markets,²⁵⁵ but the U.S. legislature that authored the Securities and Exchange Act can only legitimately profess an interest in the fairness and competitiveness of U.S. markets.²⁵⁶ Moreover, since the purpose is to ensure fairness and competitiveness in U.S. markets, the United States will have a legitimate interest in the application of its laws only if a U.S. plaintiff is treated unfairly, or if the conduct has substantial consequences for the sanctity of U.S. markets.²⁵⁷ For its part, the U.K. law is not legitimately interested in protecting dealers and investors' freedom of action everywhere and always. It is only legitimately interested in protecting the freedom of action of its own constituents—U.K. investors and dealers.

Jurisdiction	Purpose	Relevant Contact
US	To ensure fairness, competitiveness in markets	US Plaintiff harmed, or general effects on fairness and competitiveness of US markets
UK	To protect investors' and dealers' freedom of action	UK dealer or investor

With this more fine-grained analysis of the relevant laws in mind, we can now proceed to think concretely about the Conflict of Laws in this particular case. *P* in this case is a U.S. investor—precisely the sort of person the U.S. laws sought to protect. Hence, the United States is clearly interested in seeing its laws applied to this particular harm. On the other hand, the United Kingdom will only be interested in this case if the defendant dealer is a U.K. national or a U.K. company. *D* in this case is a French citizen employed by the U.K. branch office of a U.S. investment bank. A U.K. branch office is different from a U.K. company or even a U.K. subsidiary²⁵⁸ of a U.S. company. It is an outpost of the U.S. firm. Under U.K. law, and also according to harmonized international banking law recog-

254. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971).

255. See 15 U.S.C. § 78b.

256. See Currie, *supra* note 195, at 252.

257. See Currie, *supra* note 147, at 368-69.

258. See Independent Commission on Banking, Final Report 42 (September 2011) (proposing that U.K. subsidiaries of foreign banking conglomerates that sell products to U.K. retail customers should be subject to U.K. ring-fencing rules).

nized by both the U.S. and U.K.,²⁵⁹ the regulation and supervision of branches is left to the “home” jurisdiction. The particular individual and corporation is of little interest to the United Kingdom, therefore. Another way to think about this is that the U.K.’s interest in protecting freedom of action extends only to protecting *D*’s legitimate expectations to freedom of action. This *D* cannot have a legitimate expectation to be exempt from U.S. securities law because it is a U.S. entity that is already subject to U.S. securities law in many of its dealings.

Jurisdiction	Purpose	Contact	Interest
U.S.: Securities Exchange Act violation	To ensure fairness, competitiveness in markets	Was U.S. investor harmed?	Yes
U.K.: No violation of law	To protect investors’ and dealers’ freedom of action	U.K. Defendant bank	No

From this analysis, we can conclude that although on the surface this case presents a conflict of laws, in fact, only one state—the United States—is legitimately interested in seeing its laws applied to this case. Hence a decision-maker would be justified in applying U.S. law to the dispute and *D*’s motion for dismissal should be rejected.

But what if we determine that the purpose of U.K. law is precisely to provide a safe haven for branches of foreign banks—to attract foreign business by providing a hospitable regulatory environment? In other words, what if the U.K. in this example, is actually the regulatory arbitrageur—seeking to profit from foreign business by offering foreign firms a way to do in London what they cannot do at home? What if this law is part of a package of laws, policies, and incentives designed precisely to make London the global hub for financial trading activities by attracting business away from New York and other financial centers? In fact, regulatory arbitrage depends on the implicit or explicit collusion of regulatory jurisdictions that profit from such offshore status. How does a Conflicts approach deal with such a scenario? It would be tempting to declare such domestic purposes as simply out of bounds. Yet to do so would be to take a step down the slippery slope of harmonization—to assume a utopian world in which everyone can agree that certain forms of regulatory nationalism are always unacceptable—that is not our actual reality. This is counter to the spirit of the Conflicts approach.

Instead, the Conflicts approach recognizes that even regulatory arbitrage is more or less legitimate depending on its local meanings and consequences.²⁶⁰ Those local consequences will differ depending on whether the U.S. regulation that the U.K. allows the defendant in this example to

259. See T.C. Baxter et al., *Two Cheers for Territoriality: An Essay on International Bank Insolvency Law*, 78 AM. BANKR. L.J. 57, 69 (2004) (describing the Basel Committee on Banking Supervision’s allocation of authority between “home” and “host” jurisdictions with respect to subsidiaries and branches).

260. See *supra* Part I.

evade is U.S. bankruptcy law, U.S. supervisory rules such as margin requirements on trades, or anti-fraud provisions of U.S. securities laws.

In our example, the anti-fraud provisions of U.S. securities laws are at stake. Assuming now that the purpose of the U.K. law is precisely to enable regulatory arbitrage, does this change our analysis? It does indeed change our analysis—because the bank was doing precisely what the U.K. regulation hoped it would do—bringing business to the U.K. at the expense of U.S. regulatory interests, while the precise kind of harm the U.S. hoped to avoid—harm to a U.S. investor—came to pass as a result. We have what in Conflicts is called a “true conflict.”

Jurisdiction	Purpose	Contact	Interest
U.S.: Securities Exchange Act violation	To ensure fairness, competitiveness in markets	If harmed U.S. investor	Yes
U.K.: No violation of law	To attract business to local markets by providing a favorable business environment	U.K. based foreign branch	Yes

This brings out two important points. First, as suggested in Part C above, a good Conflicts analysis necessitates a good comparative analysis. If the decision-maker fails to understand the purpose of the foreign law, he or she may reach the wrong result. Second, while in this example the foreign jurisdiction’s acquiescence to regulatory arbitrage produces a true conflict between U.S. and U.K. law, this would not always be the case. Had the plaintiff in this case not been a U.S. investor, for example, the result would be different.

So if we conclude that this case presents a true conflict between U.S. and U.K. law, what should we do next? Conflicts methodologies offer a range of techniques and approaches. Some courts and commentators conclude that in such cases certain traditional rules such as party autonomy should serve as presumptive tie-breakers,²⁶¹ while others conclude that the forum can legitimately regulate the conduct based on its own law.²⁶² This diversity of outcomes is admittedly imperfect, but even if the Conflicts methodology fails to achieve perfect coordination in all cases, it does promote progress in eliminating regulatory arbitrage by identifying a subset of “false conflict” cases in which the most appropriate law is clear.

Given that we are deploying Conflicts analysis as an alternative to negotiated regulatory harmonization, one useful approach to true conflicts cases may be the one pioneered by Professor William Baxter and adopted by the courts of California,²⁶³ known as “comparative impairment.”²⁶⁴

261. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971).

262. See Joseph Singer, *Facing Real Conflicts*, 24 CORNELL INT’L L.J. 197, 198–206 (1991); Sedler, *Interest Analysis and Forum Preference in the Conflict of Laws*, 34 MERCER L. REV. 593, 595 (1983).

263. See, e.g., *Kearney v. Salomon Smith Barney*, 45 Cal. Rptr. 3d. 730 (2006); *Bernhard v. Harrah’s Club*, 16 Cal. 313 (1976); *Offshore Rental Co. v. Continental Oil*, 22 Cal. Rptr. 867 (1978).

264. William Baxter, *Choice of Law and the Federal System*, 16 STAN. L. REV. 1 (1963).

Under this methodology, the decision-maker faced with a true conflict reconsiders the interests of both interested states, imagining a hypothetical rational bargaining scenario between the two states in the context of repeated cases and multiple plays of the game. In this scenario, each state would rationally choose to compromise on cases that are less meaningful than others even though the state is technically interested, recognizing that compromise and coordination benefits everyone in the long run.²⁶⁵

In our example, the result might turn on factually specific inquiries such as how important off-shore arbitrage is to the U.K. economy, but one can assume that in this case it is less important than it is to, say, the Virgin Islands. In fact, the U.K. has at least one other reason for its policy of not regulating domestic branches of foreign subsidiaries that cuts in the exact opposite direction: the purpose is to promote rational regulatory coordination and harmonization through deference to the “home jurisdiction” in accordance with Basel principles. The home jurisdiction in this case is the U.S. and the U.S. seeks to regulate the transaction. Moreover, as discussed above, the U.K. and the U.S. share an interest in eliminating securities fraud because both states are the sites of major financial markets whose legitimacy turns on the elimination of fraud, and the U.K. is home to many securities investors who, next time around, could be the victims of this defendant’s fraudulent action—especially since the branch is located in the U.K. where it presumably caters to U.K. investors.²⁶⁶ Hence, under the comparative impairment approach, a decision-maker would still most likely conclude that U.S. law should apply to this transaction.

E. Conclusion

The Conflicts methodology outlined above is quite different from the approach advocated by commentators with expertise in domestic securities regulation, who suggest permitting the United States to apply its own laws to conduct with “effects” in the United States. First, this approach offers a far more precise analysis, focusing on the specific kinds of effects intended by the statute and whether or not such effects are actually at play in the particular facts of this case. Second, the analysis focuses not simply on the purposes of U.S. law, but on the purposes of the foreign law with which it potentially conflicts. If, for example, the U.K. entity had been a subsidiary rather than a branch of the U.S. investment bank—an independent entity formed under U.K. law and subject to extensive U.K. regulation—then the United Kingdom might have had a legitimate interest in its freedom of action and we would have been faced with a so-called “true conflict” between U.K. and U.S. law requiring further, more sophisticated tie-breaking tools.

The Conflicts approach is also different from a “standard”—an approach in which the decision-maker applies his or her own discretion to

265. See Lawrence Kramer, *Rethinking Choice of Law*, 90 COLUM. L. REV. 277 (1990).

266. See Lawrence Kramer, *More Notes on Methods and Objectives in the Conflict of Laws*, 24 CORNELL INT’L L.J. 245, 271-77 (1991).

determine whether, on balance, local law governs.²⁶⁷ It is in fact preferable to an approach to determining the scope of domestic law that is based on pure “power;”²⁶⁸ unlike such discretionary authority, the Conflicts approach is rule-based. It is just that the rules are more precise, and more accurately tailored to the facts at hand. And while there is room for differing interpretations of various elements of this methodology—the nature of foreign law, the purposes of domestic and foreign law, etc.—the structured methodology nevertheless provides important guidance to the decision-maker.²⁶⁹ The technical quality of Conflicts methodology therefore provides a much-needed register for moving beyond overt politics in the discussion of international financial regulation. Conflicts transforms political questions into technical legal issues that can be managed within the scope of existing national laws. Hence, although arbitrageurs will surely complain that such an approach sacrifices “certainty and predictability”—makes regulatory arbitrage more difficult—in fact a Conflicts approach only sacrifices illegitimate certainty and predictability, the kind of certainty and predictability that makes regulatory arbitrage that is counter to the public interest possible in the first place.

In the U.S., one possible concern about the practicality of this proposal is its relationship to the Supreme Court’s jurisprudence in *Morrison*. As we saw, the Conflicts approach advocated here incorporates statutory interpretation as deployed by the *Morrison* court, but without a presumption against extraterritoriality and as only one prong of its analysis. Unfortunately, *Morrison* has had a chilling effect on the U.S. judiciary’s willingness to entertain disputes involving foreign elements.²⁷⁰ Yet despite the timidity of the judiciary post-*Morrison*, there remains considerable room for judicial innovation in this area. After Dodd-Frank, *Morrison* stands for the premise that where private causes of action are concerned, the Exchange Act applies only to securities traded on a U.S. stock exchange, or other transactions concluded “in the United States.” *Morrison* clearly does not limit lawsuits brought by the government, nor does it claim to apply beyond the anti-fraud provisions of the Exchange Act. Indeed a fundamental and universally accepted tenet of Conflicts jurisprudence is that different statutes may have different scopes.²⁷¹ As concerns

267. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 2 (1971).

268. “Where law is elastic decisions are not predetermined by legal rules but left to the discretion of ‘power wielders.’” Pistor, *supra* note 53, at 30; see also Ruth W. Grant & Robert O. Keohane, *Accountability and Abuses of Power in World Politics*, 99 AM. POL. SCI. REV. 29, 29-31 (2005). Power can thus be defined as the differential relation to law. See Pistor, *supra* note 53, at 30.

269. *Multiculturalism*, *supra* note 17, at 629-631 (arguing that the techniques of Conflicts shape the pathway of the decision-maker’s reasoning although they also provide room for political judgment).

270. See, e.g., Richard D. Bernstein et al., *Closing Time: You Don’t Have to Go Home, But You Can’t Stay Here*, 67 BUS. LAW. 957 (2012); Buxbaum, *Remedies for Foreign Investors*, *supra* note 100.

271. See *F. Hoffman-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004) (advocating a consideration of U.S. interests on a statute-by-statute basis).

all other kinds of lawsuits and regulatory questions, U.S. precedent remains multiple and diverse.

Conclusion

Regulatory arbitrage is best understood as a form of market-based regulatory coordination—coordination through the institution of price. Regulatory arbitrage is a highly sophisticated form of comparative analysis. It often defeats national regulatory intentions precisely because it is more sophisticated in its ability to grasp and coordinate regulatory differences than existing legal approaches. And in the process it has significant consequences—often negative consequences—for legitimate national interests. Simply put, there are some differences that matter, and that deserve to be defended, as a matter of domestic and global politics. And yet, one can't just assert as a matter of regulatory policy that such differences matter—one can't just pass national laws to regulate capital flows for example—because, as we saw in Part I, such clear and strong statements of difference are precisely the enabling condition for regulatory arbitrage. What is needed, therefore, is a more sophisticated toolbox, one equal in sophistication to arbitrage itself.

The Conflicts approach is such a tool. Conflicts is for law what arbitrage is for finance—a set of subtle techniques for thinking about and coordinating regulatory differences. As such, it is ready at hand to serve as what Katharina Pistor has termed a “safety valve”—a device for stopping or slowing inappropriate capital flows.²⁷²

Although a Conflicts approach to regulatory arbitrage may seem at first blush different from and more complex than existing approaches, in fact, a number of important U.S. and foreign market regulation cases have adopted a similar methodology.²⁷³ Hence, another signal strength of this

272. See Pistor, *supra* note 53, at 47. Her example is precisely the German Supreme Court reading a principle of good faith into contracts in order to permit their modification.

273. See, e.g., *Romero v. Int'l Operating Terminal Co.*, 79 S.Ct. 468, 486 (1959) (“[I]n the absence of a contrary congressional direction, we must apply those principles of choice of law that are consonant with . . . due recognition of our self-regarding respect for the relevant interests of foreign nations in the regulation of maritime commerce as part of the legitimate concern of the international community. These principles do not depend upon a mechanical application of a doctrine like that of *lex loci delicti commissi*. The controlling considerations are the interacting interests of the United States and of foreign countries, and in assessing them we must move with the circumspection appropriate when this Court is adjudicating issues inevitably entangled in the conduct of our international relations”); *Lauritzen v. Larsen*, 345 U.S. 571, 582 (1953) (“Maritime law, like our municipal law, has attempted to avoid or resolve conflicts between competing laws by ascertaining and valuing points of contact between the transaction and the states or governments whose competing laws are involved”); *Steele v. Bulova Watch Co.*, 73 S.Ct. 252, 257 (1952) (“Unlawful effects in this country, absent in the posture of the *Banana* case before us, are often decisive Where, as here, there can be no interference with the sovereignty of another nation, the District Court in exercising its equity powers may command persons properly before it to cease or perform acts outside its territorial jurisdiction”); *Timberlane Lumber Co. v. Bank of Am., N.T. & S.A.*, 549 F.2d 597, 611-14 (9th Cir. 1976) (“The effects test by itself is incomplete because it

approach is that it requires no substantial law reform. It simply requires that decision-makers avail themselves of already accessible legal tools—tools that have tremendous legitimacy both in theory and in practice. Since Conflicts doctrine is quite universal, all of the countries which currently have sophisticated financial markets already share a body of Conflicts doctrines enshrined both in statutes and in case law. Decision-makers simply need to appreciate the Conflicts dimension of these cases and then to move to a more contemporary, sophisticated and proactive Conflicts methodology.

The value of this approach, from the perspective of addressing regulatory arbitrage, is that it looks more precisely at the specific parties, conduct and effects, and their relationship to the relevant law. This methodology pinpoints cases in which one or both parties manipulate the legal categories to evade domestic law and differentiates these cases from other cases in which one or both of the parties or other aspects of the transaction bear a real and legitimate relationship to another jurisdiction which would think differently about the issues involved. Hence, under such an approach it becomes far more difficult—far more costly—to arbitrage domestic law in situations in which the domestic or global polity has a strong commitment to the application of that law. Therefore, we can expect that a great deal of regulatory arbitrage that is harmful to domestic regulation or to international regulatory cooperation will be eliminated by such an approach.

This valuable result can be achieved, moreover, with a relatively small sacrifice in certainty and predictability—a matter of considerable concern to the financial industry. Indeed, one of the common criticisms of the kind of Conflicts reasoning deployed in this analysis is that it is somewhat mechanical, that is, not sufficiently open-ended and imaginative about the full range of interests and political dimensions of conflicts problems. This is an important and valid critique. And yet, this technical and mechanistic quality is also arguably a strength in that it protects as much as possible market participants' legitimate interest in predictable legal outcomes. For example, in a regulatory arbitrage situation in which the sole purpose of moving a transaction overseas is to evade regulatory restrictions of national law, where that national law is not a mere formality but the product of an engaged political response to a costly financial crisis, it is as predictable to market participants that courts might find that this interest is relevant to the choice of law question as is a rule that party autonomy or the last act in a transaction determines governing law.

fails to consider other nations' interests. Nor does it expressly take into account the full nature of the relationship between the actors and this country. . . . The elements to be weighed include the degree of conflict with foreign law or policy, the nationality or allegiance of the parties and the locations or principal places of businesses or corporations, the extent to which enforcement by either state can be expected to achieve compliance, the relative significance of effects on the United States as compared with those elsewhere, the extent to which there is explicit purpose to harm or affect American commerce, the foreseeability of such effect, and the relative importance to the violations charged of conduct within the United States as compared with conduct abroad.”).

Moreover, unlike substantive harmonization approaches, the Conflicts approach achieves this result without sacrificing significant differences in local regulation—without sacrificing legal pluralism. Hence, this approach to regulatory coordination from the ground up avoids the significant practical and theoretical problems associated with substantive regulatory harmonization explored in Part III.

The larger point is this: In the debates about global financial regulation, far more sustained attention needs to be paid to the scope²⁷⁴ of the disparate elements of the international financial regulatory system—its interaction with other regulatory regimes from national law to non-state legal norms. Many of the problems of the moment, from the extraterritorial reach of a particular country's financial legislation, to the question of when it is appropriate to use ring fences in financial crises, implicate larger questions of the proper allocation of regulatory authority between regulatory systems. Without agreement about such questions of scope based on principled legal theory, international financial governance will disintegrate in times of crisis (and will slowly erode even in ordinary times) into haphazard national assertions of individual authority. Beginning from the resolution of disagreements over questions of scope (such as the extraterritorial reach of domestic securities laws), rather than from the harmonization of substantive rules (such as capital adequacy requirements), places a premium on coordination from the standpoint of respect and preservation of regulatory diversity, and hence holds out the promise of building an international financial governance architecture that is strong and resilient.

In closing, let me reiterate that I do not mean to suggest that regulatory arbitrage should be left only to private disputes and to courts (although I do wish to suggest that courts and private litigants could play a larger role in addressing this problem). Rather, my point is that regulators, like courts and private parties, might better approach their work by thinking through questions of the scope of national law through a Conflicts methodology. In a companion piece to this Article, I will expand on the analysis here to consider how a national regulator working in a supervisory capacity might adopt this methodology, and how this methodology could be incorporated into international efforts at regulatory coordination.

274. See *Dodd-Frank Derivatives Reform: Challenges Facing U.S. and International Markets: Hearing Before the Subcomm. on Gen. Farm Commodities and Risk Mgmt. of the H. Comm. on Agric.*, 112th Cong. 21 (2012) (statement of Patrick Pearson, European Commission) (“[S]cope’ is the root cause of many cross-border problems that we have identified.”).

