

# CORPORATE GOVERNANCE IN A VIABLE MARKET FOR SECONDARY LISTINGS

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## I. INTRODUCTION

A seminal series of articles has used quantitative methods to scrutinize the legal roots of diverging ownership structures, and varying market depth and liquidity findings around the world.<sup>1</sup> Recent scholarship challenges law and finance literature's purely functionalist explanation, which rests upon the alleged fundamental idiosyncrasies of legal families, at least with respect to the evolution of developed economies within the second half of the last century.<sup>2</sup> Yet, the law's dispositive role within the institutional

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1. E.g., Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998) (presenting a positive correlation between the degree of investor protection, in terms of both legal rules and enforcement, and the robustness of capital markets around the world); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999) (looking at ownership structures in large, publicly-traded firms from the twenty-seven richest countries); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997) (exploring how a country's legal environment affects the size and extent of its capital market); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *What Works in Securities Laws*, 61 J. FIN. 1 (2006) (examining the relationship between the laws governing initial public offerings and various metrics of stock market development).

2. E.g., MARK J. ROE, *POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE* (2003) (explaining the relationship of ownership concentration to the agency cost-increasing effect of "social democratic" polities); Enrico C. Perotti & Ernst-Ludwig von Thadden, *The Political Economy of Corporate Control and Labor Rents*, 114 J. POL. ECON. 145, 168 (2006) (explaining the subsequent restriction of capital markets in central Europe as a

arrangement necessary to establish viable capital markets remains well-substantiated.<sup>3</sup> Even the regulation-hostile position, articulated early by George Stigler<sup>4</sup> and later taken up with regard to disclosure duties, partially relies on the legal system to protect investor interests, but considers the safeguards of general contract and tort law sufficient.<sup>5</sup>

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reaction of the economically and financially pummeled middle class to the Great Depression); Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the 20th Century*, 69 J. FIN. ECON. 5 (2003) (arguing that the key factor is the relative political strength of incumbents opposing or favoring financial development). See also MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994) (linking the development of U.S. capital markets to the statutory elimination of alternative sources of corporate finance).

3. Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 789-99 (2001) (highlighting certain investor protections fundamental to the development of a strong securities market); Andrei Shleifer & Daniel Wolfenzon, *Investor Protection and Equity Markets*, 66 J. FIN. ECON. 3 (2002) (considering the particular choices of a model entrepreneur who took a company public under a weak investor protection regime); Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control* 1-37 (Nat'l Bureau of Econ. Research, Working Paper No. 7203, 1999), available at <http://www.nber.org/papers/w7203> (evaluating the choice between concentrated and dispersed ownership as influenced by the value of private control under different legal frameworks); Allen Ferrell, *The Case for Mandatory Disclosure in Securities Regulation Around the World*, 1-63 (Harvard Ctr. for Law, Econ., and Bus., Discussion Paper No. 492, 2004), available at <http://ssrn.com/abstract=631221> (arguing for stronger mandatory disclosure requirements to reduce inefficient control premiums by reducing agency costs).

4. George J. Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117, 120-24 (1964) (finding no difference in the average returns on new securities issues from 1925-1928 and 1949-1954, respectively). See also Gregg A. Jarrell, *The Economic Effects of Federal Regulation of the Market for New Security Issues*, 24 J.L. & ECON. 613 (1981) (employing the Capital Market Asset Pricing Model (CAPM) to estimate risk-adjusted abnormal returns and finding no difference in the average returns earned prior to and after federal securities regulation); Seha M. Tiniç, *Anatomy of Initial Public Offerings of Common Stock*, 43 J. FIN. 789 (1988) (explaining IPO underpricing as an insurance against prospectus liability under federal securities laws). For indications of the positive effects of U.S. securities laws, see Carol J. Simon, *The Effect of the 1933 Securities Act on Investor Information and the Performance of New Issues*, 79 AM. ECON. REV. 295, 305-6 (1989) (showing that abnormal returns, due to investors' erroneous forecasting of unseasoned, non-NYSE-listed issuers, were significantly lower after the promulgation of the Securities Act).

5. See Sanford J. Grossman & Oliver D. Hart, *Disclosure Laws and Takeover Bids*, 35 J. FIN. 323 (1980) (discussing the effects of requiring positive disclosures in takeover bids, beyond a simple prohibition against making false statements, particularly with regard to disclosures relating to any intention to dilute the rights of shareholders who do not tender). See also Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 673-79 (1984) (showing how a mere rule against fraud could deter unscrupulous managers from habitually overstating corporate prospects and depriving investors of any reasonable method by which to discern actual share values); Sanford J. Grossman, *The Informational Role of Warranties and Private Disclosure About Product Quality*, 24 J.L. & ECON. 461 (1981) (arguing that disclosure incentives, which exist in private business relationships, ensure that sellers disclose the highest possible quality short of overstating); Paul Milgrom & John Roberts, *Relying on the Information of*

The parallel debate, regarding the potential for convergence among standard configurations of governance institutions and securities regulations akin to the current U.S. model,<sup>6</sup> finds variation in a widespread explanation of international cross-listings. If the focus on corporate and securities laws' content, administration, and enforcement as quintessential decoys to attract investors was correct, and if readily available means could subject business entities to a superior legal regime, then issuers could easily avoid cumbersome domestic law reform simply by moving to a system that reduces the firm's capital costs and optimizes its growth prospects. Some commentators have argued that cross-registering shares with U.S. exchanges is the best method to facilitate the above described opt-in scenario with regard to a firm's corporate governance regime. This mechanism is particularly attractive for corporations in search of credible commitment opportunities to promote their equities that their jurisdictions of origin do not provide. This is known as the legal bonding hypothesis.

Although intuitive in its basic propositions, the legal bonding hypothesis does not resolve all doubt in the cross-listing puzzle, and the empirical evidence of its validity is mixed. There are indicators that the success of U.S. exchanges and quotation systems represents a snap-shot of the 1990's, and was superseded by a reversal that advantaged European equity markets in the wake of corporate scandals, such as Enron and Worldcom, and the federal legislature's sweeping response. Moreover, general evidence on investors' appreciation of specific corporate governance regimes does not comport with the legal bonding hypothesis' demanding presumptions about impounding the regulatory framework into equity prices.

This Article argues that precisely-measured bonding premiums are unlikely to exist within relatively similarly-developed corporate governance and disclosure regimes. Alternative corporate governance standards and disclosure regulations governing the world's primary capital markets serve investors primarily as relatively easily observable benchmarks for permissible variations in acceptable behavior of foreign issuers. Disparities in legal details alone would not trigger precise adjustments in law-related risk premiums. Yet, comparative evidence suggests that investors distinguish between marketplaces if they differ palpably with regard to the enforcement of securities laws, which are, on the books, comparably hospitable to shareholder interests.

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*Interested Parties*, 17 RAND J. ECON. 18 (1986) (investigating the factors relevant to information revelation by interested parties attempting to influence a decision maker).

6. For an overview, cf. CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE (Jeffrey N. Gordon & Mark J. Roe eds., 2004) (collecting opinions on the prospects for global convergence to the U.S. system of corporate governance).

Given this rather feeble link between a marketplace's legal regime and the cross-listing firm's costs of capital, even the incentives of foreign issuers in search of bonding opportunities are limited in an important way. It is unlikely that a race to the top will ensue among issuers engaged in a relentless search for a superior legal framework pertaining to the detailed ramifications of specific securities laws. Rather, it is more likely that investors in globally-integrated markets are willing to acquire shares without a noticeable "inferior law" discount for firm-specific reasons, so long as the issuers bond to governance and disclosure standards that investors consider to be equivalent. Therefore, if investors incrementally consider the governance and disclosure rules of major exchanges and quotation systems as equivalent, foreign issuers can buy their tickets to the arena of integrated global equity markets from a plurality of booths without sacrificing bonding-premiums. Consequently, competitive forces do not push towards an absolute peak or formal convergence but, at best, toward distinguishable levels of equivalent investor protection that may exhibit considerable variation in functional detail.

Against this backdrop, the recent success of the London Stock Exchange in attracting foreign issuers does not indicate that its legal regime protects investors as well as U.S. securities laws. The regulatory environment in the U.K. allows issuers to submit to comparably stringent standards of investor protection with regard to black letter law, however, significantly lower enforcement levels account for measurable differences in bonding premiums. Issuers seeking cross-listings in London pursue partly different goals compared to their counterparts who are attracted by New York's exchanges. Hence, the City's success represents evidence for the occurrence of a separating equilibrium in the global market for international cross-listings.

To support these hypotheses, Part II first introduces some observations about the recent and relative success of the U.S. and U.K. stock markets. After introducing the main explanations proffered for international cross-listings in Part III, Part IV relates the data to the diverging regulatory framework governing the pertinent markets and the observed levels of enforcement. These empirical and legal insights will segue into an assessment drawn from a discussion of the extensive economic literature on cross-listings in Part V, and will finally lead to some conclusions and outlooks in Part VI.

## II. INTERNATIONAL CROSS-LISTINGS ON U.S. AND U.K. MARKETS – THE DATA

Beginning in the early 1990's, the world's largest stock exchanges became aware of an increasingly international dimension in their pursuit of

additional listings and increased trading volumes. Consequently, these stock exchanges enhanced their efforts to inspire equity issuers to conduct capital-raising activities on their markets.<sup>7</sup> Previous studies, which scrutinized the pattern of international cross-listings for the period ending around the millennium, found U.S. markets to be the winners of the international competition for listings, at least with regard to their European rivals.<sup>8</sup> A look at the latest years, however, suggests that fortunes may have reversed to grant some European competitors a considerable lead in the quest for listings. In particular, the London Stock Exchange (LSE), with its Alternative Investment Market (AIM), seems to have captured a growing fraction of international cross-listings in recent years. In this section, I examine data provided by the World Federation of Exchanges (WFE) and the exchanges themselves.<sup>9</sup>

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7. Reports in the mid-1990's indicated that U.S. exchanges discovered international cross-listings as a welcome business opportunity. Support for this position also stems from statements made by then-member of the NYSE's executive committee, James L. Cochrane, *Are U.S. Regulatory Requirements for Foreign Firms Appropriate?*, 17 *FORDHAM INT'L L.J.* 58, 59, 61 (1994) (arguing that U.S. markets must relax regulatory requirements for foreign firms to remain competitive with British markets in the critical competition for international listings), and from supportive regulator, William E. Decker, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective*, 17 *FORDHAM INT'L L.J.* 10, 22-23 (1994) (discussing the high degree of international interest in entering the U.S. investment market, and the improving regulatory climate for such entry).

8. Marco Pagano et al., *What Makes Stock Exchanges Succeed? Evidence from Cross-Listing Decisions*, 45 *EUR. ECON. REV.* 770, 773-75 (2001) (identifying factors relevant to firms' selection of international markets for cross-listing, including market size, liquidity, regulatory environment, and market familiarity with their industry); Marco Pagano, Alisa A. Roell & Josef Zechner, *The Geography of Equity Listing: Why Do Companies List Abroad?*, 57 *J. FIN.* 2651, 2660-65 (2002) (reporting a 291% increase in cross-listings of European issuers on U.S. markets compared to a 16% increase in cross-listings within Europe for the 1986-1997 period). Cf. Asher Blass & Yishay Yafeh, *Vagabond Shoes Longing to Stray: Why Foreign Firms List in the United States*, 25 *J. BANKING & FIN.* 555 (2000) (reporting Dutch and Israeli firms choosing NASDAQ); Edward B. Rock, *Greenhorns, Yankees, and Cosmopolitans: Venture Capital, IPOs, Foreign Firms, and U.S. Markets*, 2 *THEORETICAL INQUIRIES IN L.* 711 (2001) (finding Israeli high-tech firms moving to U.S. markets).

9. The WFE's annual market statistics constitute the general data source. World Fed'n of Exchs., Index of Annual Market Statistics (1996-2006), <http://www.world-exchanges.org/WFE/home.asp?action=document&menu=27>. As the WFE does not separate the LSE's main and parallel markets, the data for the LSE's Main Market and AIM is taken from the LSE Main Market fact sheets covering 1999-2006, London Stock Exch., Main Mkt. Fact Sheets, <http://www.londonstockexchange.com/en-gb/about/statistics/factsheets/mmfs.htm> (last visited July 29, 2007), the LSE's Main Market historical statistics, London Stock Exch., Historic Statistics, <http://www.londonstockexchange.com/en-gb/pricesnews/statistics/othermarketstats/historicstats.htm> (last visited July 29, 2007), and the LSE's AIM market statistics, London Stock Exch., AIM Mkt. Statistics, <http://www.londonstockexchange.com/en-gb/about/statistics/factsheets/aimmarketstats.htm>

*A. Proportion of Cross-Listing Firms on the Respective Markets*

Although the percentage of international issuers with shares listed on London's Main Market has remained consistently high (between 19.71% and 20.83%) over the past ten years, AIM, which never saw a percentage of foreign issuers larger than 7.14% from its launch in 1995 until 2002, saw the percentage of companies cross-listing shares on the LSE's parallel market almost triple (from 6.68% to 18.73%) since 2001, marking the largest growth since 2003 (Table 1, Figure 1). Of course, the Main Market represents a long-established market segment in which predominantly mature issuers trade their shares, while AIM remains a rather fledgling trading platform, which caters to younger, high-growth-oriented companies. Each market's development mirrors these strategic differences, with an overall decline in the number of issuers listing shares on the Main Market (from 2534 in 1994 to 1606 in 2006), but a rapid increase in the total number of companies with listings on AIM (Figure 2). With regard to the analysis conducted here, however, this relevant aspect remains unchallenged: AIM seized an incrementally larger portion of international issuers, forcing its number of international listings to grow significantly faster than the domestic ones (Figure 2).

Looking across the Atlantic to U.S. primary equity markets, the New York Stock Exchange (NYSE) and the National Association of Securities Dealers Automated Quotation System (NASDAQ) consistently increased their percentage of international listings during most of the period under scrutiny. The NYSE performed particularly well, nearly doubling its share of foreign issuers trading on its market, up from 10.15% in 1994 to 20.19% in 2003 (Table 1, Figure 1). Nevertheless, the proportion of foreign listings on both markets has stagnated since 2002 and 2003, respectively (Figure 1). This most recent development coincided with equal trends in the overall number of companies listing their shares on NASDAQ and the NYSE, falling from 5556 (1996) and 3025 (2000) to 3133 (2006) and 2270 (2005), respectively (Figure 2, Table 1). Yet, the decline in domestic issuers originated earlier, back in the mid (NASDAQ) or late (NYSE) 1990's, and represents a trend that can also be observed at the other exchanges, with AIM constituting a notable exception (Figures 1 and 2, Table 1). In stark contrast to New York's most prominent exchanges, the American Stock Exchange (AMEX) was able to increase its share of international issuers with shares listed on its market during recent years from 7.7% in 2000 to 16.89% in 2006. Similar to the development at AIM, AMEX's surge originated in 2001, but peaked in 2006 with foreign issuers accounting for more than one-sixth of the listed companies, a proportion

twice as high as in 2001 and the average percentage during preceding years (Figure 1). AMEX doubled the total number of foreign issuers from fifty in 2000 to 100 in 2006 (Table 1, Figure 2). Still, it is important to note that the AMEX hosts by far the smallest portion of international issuers in absolute numbers (Figure 3, Table 1). Moreover, contrary to the development on AIM, in which the proportion of international issuers rose in lockstep with an increase in the number of domestic issuers (domestic growth was outperformed by international growth), the respective parameter at AMEX declined: the number of domestic issuers fell from 599 in 2000 to 492 in 2006 (Figure 2, Table 1). In order to put AMEX's success into perspective, note that the latter instance obviously boosts the relative effect of rather small augmentations on the international side.

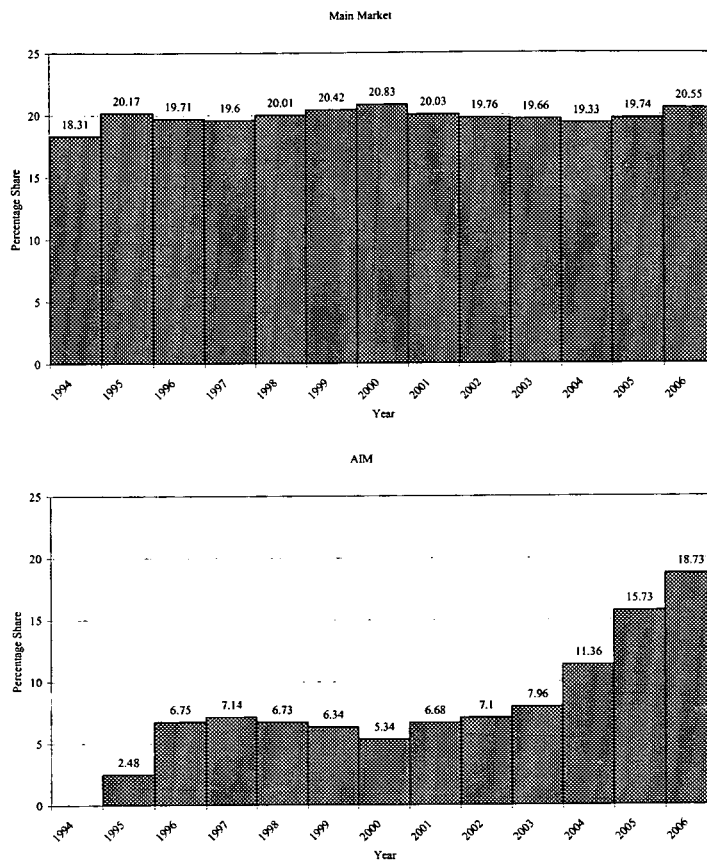
TABLE 1: DOMESTIC AND INTERNATIONAL ISSUERS ON U.K. AND U.S. MARKETS.

This table shows the total number of domestic and foreign issuers on U.K. and U.S. markets for the period between 1994 and 2006, and the proportion of cross-listing issuers relative to their domestic counterparts. Exchange-listed investment funds are excluded from the sample. The data is taken from the annual reports of the World Federation of Exchanges (available at <http://www.world-exchanges.org>) and the LSE's Main Market and AIM fact sheets (available at <http://www.londonstockexchange.com>).

Year	LSE Main Market				LSE AIM				AMEX			
	Dom.	Int'l	Total	Int'l %	Dom.	Int'l	Total	Int'l %	Dom.	Int'l	Total	Int'l %
1994	2070	464	2534	18.31					750	74	824	8.98
1995	2078	525	2603	20.17	118	3	121	2.48	727	64	791	8.09
1996	2171	533	2704	19.71	235	17	252	6.75	688	63	751	8.39
1997	2157	526	2683	19.6	286	22	308	7.14	647	63	710	8.87
1998	2087	522	2609	20.01	291	21	312	6.73	650	61	711	8.58
1999	1945	499	2444	20.42	325	22	347	6.34	589	61	650	9.38
2000	1904	501	2405	20.83	493	31	524	5.92	599	50	649	7.7
2001	1809	453	2262	20.03	587	42	629	6.68	557	48	605	7.93
2002	1701	419	2120	19.76	654	50	704	7.1	523	49	572	8.57
2003	1557	381	1938	19.66	694	60	754	7.96	502	55	557	9.87
2004	1465	351	1816	19.33	905	116	1021	11.36	503	72	575	12.52
2005	1358	334	1692	19.74	1179	220	1399	15.73	495	100	595	16.81
2006	1276	330	1606	20.55	1328	306	1634	18.73	492	100	592	16.89
Year	NASDAQ				NYSE							
	Dom.	Int'l	Total	Int'l %	Dom.	Int'l	Total	Int'l %				
1994	4593	309	4902	6.30	1912	216	2128	10.15				
1995	4717	395	5112	7.73	1996	246	2242	10.97				
1996	5167	389	5556	7.00	2172	304	2476	12.28				
1997	5033	454	5487	8.27	2271	355	2626	13.52				
1998	4627	441	5068	8.70	2278	392	2670	14.68				
1999	4400	429	4829	8.88	2620	405	3025	13.39				
2000	4246	488	4734	10.31	2429	433	2862	15.13				
2001	3681	447	4128	10.83	1939	461	2400	19.21				
2002	3268	381	3649	11.57	1894	472	2366	19.95				
2003	2951	343	3294	10.41	1842	466	2308	20.19				
2004	2889	340	3229	10.53	1834	459	2293	20.02				
2005	2832	332	3164	10.49	1818	452	2270	19.91				
2006	2812	321	3133	10.25	1829	451	2280	19.78				

FIGURE 1: PROPORTION OF INTERNATIONAL ISSUERS LISTED ON U.K. AND U.S. MARKETS.

This figure illustrates the development of the proportion of international issuers listed on U.K. and U.S. markets, relative to domestic issuers over the period between 1994 and 2006.





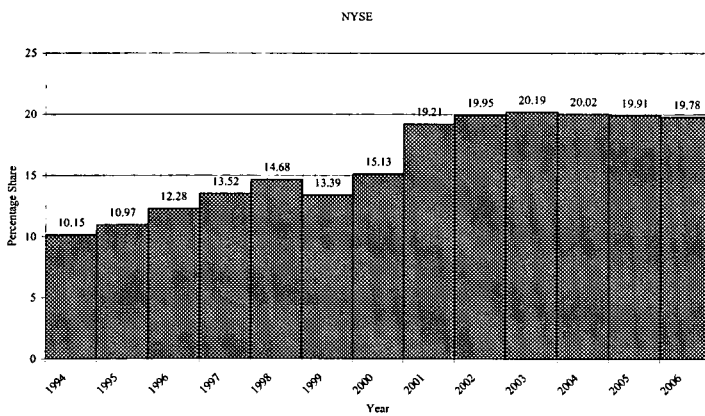
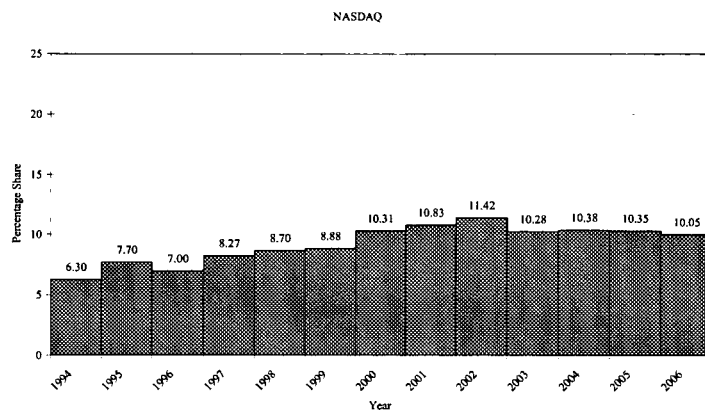
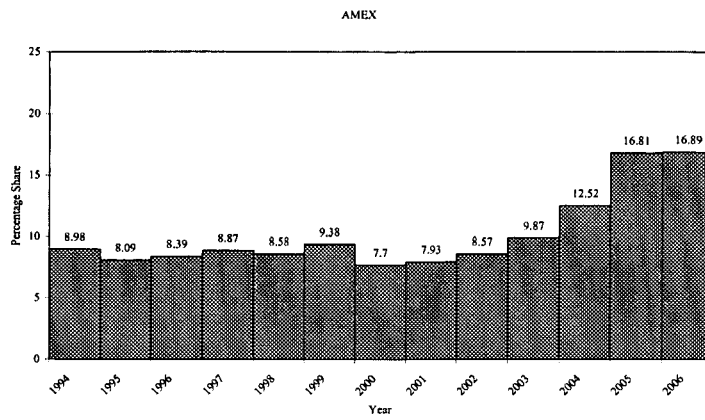
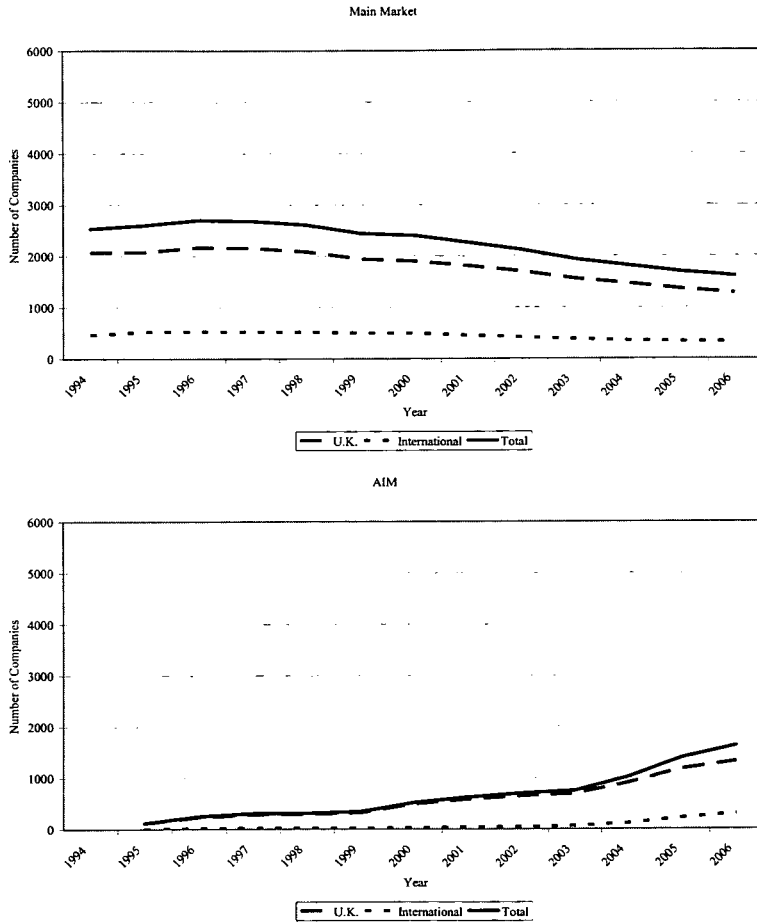
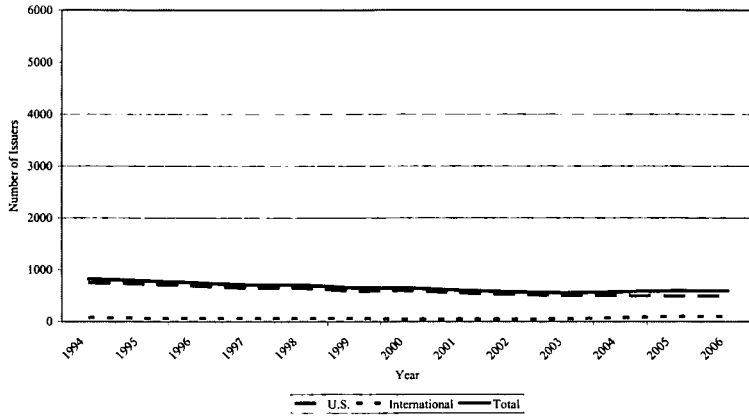


FIGURE 2: NUMBER OF DOMESTIC AND INTERNATIONAL ISSUERS LISTED ON U.K. AND U.S. MARKETS.

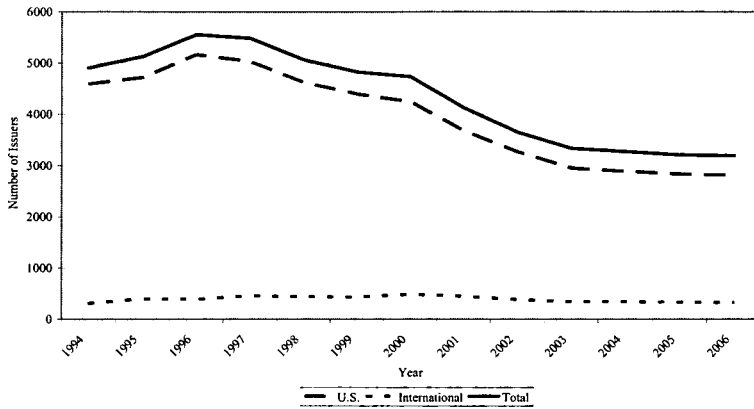
This figure visualizes the development of the total number of international issuers listed on U.K. and U.S. markets relative to domestic issuers over the period between 1994 and 2006.



AMEX



NASDAQ



NYSE

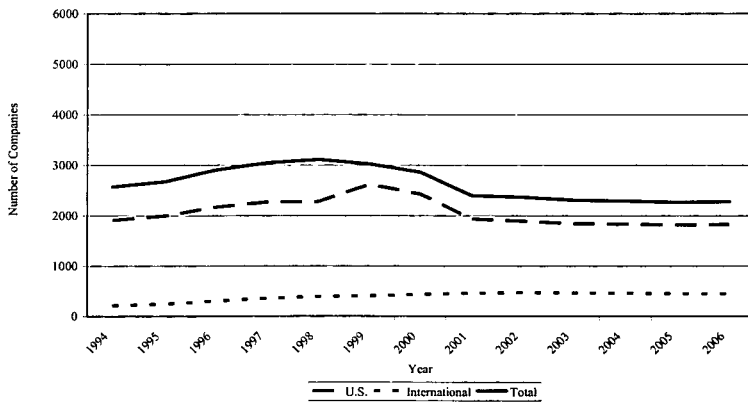
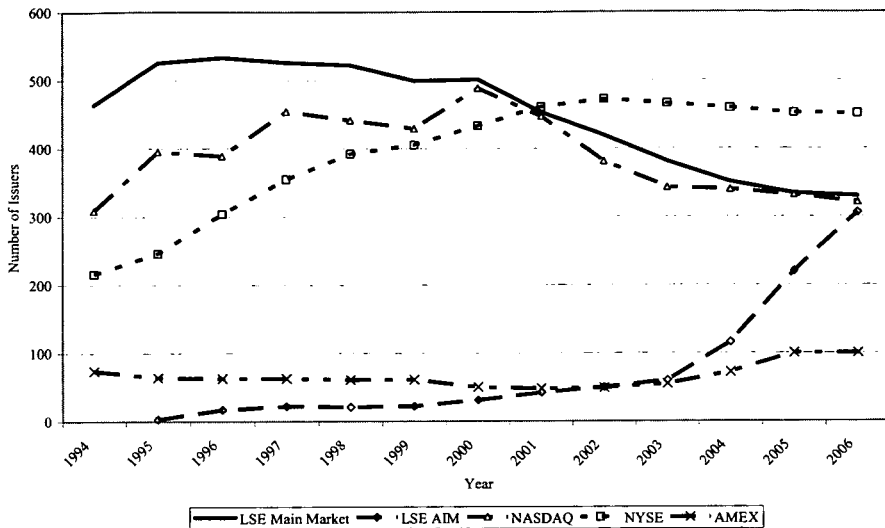


FIGURE 3: INTERNATIONAL ISSUERS ON U.K. AND U.S. MARKETS.

This figure shows the total number of international issuers on U.K. and U.S. markets between 1994 and 2006.



The literature remarks that during the last decade London has recorded a significant diminution of international listings.<sup>10</sup> Undeniably, the observation is correct, but only with a focus on the City's Main Market where the total number of international issuers declined from 533 in 1996 to 330 in 2006 (Table 1, Figure 3). Adding the numbers of AIM, London's decline lessens. Moreover, slightly shifting the period under consideration by incorporating the most recent developments, between 1995 and 2006 the City actually outperformed the AMEX as well as the NASDAQ in absolute numbers, though not the NYSE.<sup>11</sup> From the perspective of the legal bonding hypothesis, which attaches major importance to the pertinent market's regulatory environment, such lumping together may seem undue

10. G. Andrew Karolyi, *The World of Cross-Listings and Cross-Listings of the World: Challenging Conventional Wisdom*, 10 REV. FIN. 99, 110 (2006) (purporting that London had experienced the largest decline in absolute numbers of foreign listings out of 60 exchanges worldwide between 1995 and 2004).

11. Table 1 indicates that between 1995 and 2006 the LSE's Main Market and AIM combined increased the total number of international issuers by 108, whereas the AMEX only raised its count by 36 and the NASDAQ exhibited a decrease of 74. The NYSE went from 246 international issuers in 1995 to 451 in 2006, adding a total of 205.

in light of the diverging legal standards applicable to issuers on the respective market segments, although it can be shown that the differences between the City's market segments are in fact of minor magnitude.<sup>12</sup> But even if the focus is exclusively on the City's Main Market, a cautionary remark regarding the total numbers of foreign issuers seems in order. One must keep in mind that, until very recently, withdrawal from U.S. equity markets faced substantial obstacles, rendering the access route to U.S. capital markets practically a one-way street. Indeed, disclosure duties under U.S. securities laws were almost inescapable once American Depositary Receipt (ADR)<sup>13</sup> programs had been executed.<sup>14</sup> Consequentially, if it turns out that the ex ante hoped-for advantages of a U.S. listing cannot be realized, a foreign private issuer still has only limited incentives to pursue a delisting. Since this move would not unburden him of the cost incurred under the still-applicable SEC system of continuous disclosure, delisting would only lead to the loss of any advantage associated with U.S.-exchange trading. Hence, foreign private issuers will show a higher proclivity for maintaining their U.S.-listing even if they currently deem it unprofitable.<sup>15</sup> In contrast, no comparable legal restrictions hamper the complete retraction from U.K. capital markets.

*B. Proportion of International New Admissions to U.K. and U.S. Markets*

Another arguably more revealing way to appraise the attractiveness of equity markets from an issuer's vantage is to look at the number of new admissions that the respective markets capture. Doing so further elucidates evidence of the current appeal of certain markets. Of course, issuers presently questioning their earlier decision to cross-list, to wit, find their dual listing currently unattractive even in the absence of opportunistic considerations, and might be prevented in various ways from retreating

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12. See *infra* Part IV.C.2. (discussing admission standards).

13. ADRs are marketable instruments which represent an ownership interest in a specified number of securities. They are generated when the securities holder deposits the represented securities with a designated bank depository. ADRs facilitate U.S. trading in foreign securities by making it easier for a U.S. resident to collect dividends in U.S. dollars. Their most important function, however, lies in integrating foreign securities into the clearance and settlement process common for domestic securities. Hence, ADRs trade, clear and settle within automated U.S. systems and within U.S. time periods.

14. For a detailed description of the deregistration prerequisites, see *infra* Part IV.C.3.d.

15. It is exactly this effect of walling-in foreign private issuers which increasingly was regarded as inadequate and induced the SEC to promulgate relieving rule changes. See Termination of Foreign Private Issuer's Registration and Duty to File Reports, Securities Exchange Act Release No. 55,540, 72 Fed. Reg. 16,934 (April 5, 2007) (amending rules relating to foreign private issuers' abilities to terminate the registration of a class of equity securities and associated reporting obligations).

from the foreign trading venue.<sup>16</sup> Similarly, analyzing only the proportion of all domestic and international issuers listed may reveal a somewhat distorted picture if the market for corporate mergers was unequally vibrant between domestic and international issuers.<sup>17</sup> It is conceivable that substantial going-private transactions following acquisitions may unequally diminish the number of issuers of either fraction without any relation to a market place's attractiveness as a trading venue. The same holds true with regard to transactions in preparation of corporate work-outs.

The share of non-U.K. issuers introducing their equities to the City's Main Market meanders over the period analyzed. Despite a temporary slump in 2004, there was a relatively constant and significant rise in the proportion of international admissions since 2001, peaking at 26.79% in 2006 (Figure 4; Table 2). Even less ambiguously and more pronouncedly, on London's AIM a rapid and accelerating growth in the proportion of international new admissions can be observed since 2002, reaching a record high of 29.58% in 2006 (Figure 4; Table 2). A look at the total number of new admissions to U.K. markets (Figure 5) shows that the recent growth in non-U.K. listings even persisted when domestic additions to the markets declined in 2006.

The proportion of international additions to the NASDAQ does not exhibit a clear trend. While at the height of the "new economy" bubble in 2000, the share of non-U.S. new listings reached its peak (19.67%) and subsequently fell to record lows in 2003 (5.36%)<sup>18</sup>, the following two years saw a remarkable rebound to above-average values, followed, however, by another decline in 2006 (Figure 4). With regard to the NYSE, the picture is more distinct. After climbing to a staggering pinnacle of 49.18% in 2000, the proportion of new non-U.S. admissions fell sharply, reaching the lowest level in the sample in 2005 (13.01%). Yet, the following year saw a remarkable recovery to 21.88%, a proportion within the range observed prior to the year 2000 (18.54% - 23.08%) (Figure 4). In stark contrast to the NASDAQ and the NYSE, which exhibited their record highs in the year 2000, it is exactly this year that marked AMEX's low in regard to the proportion of international new admissions (3.57%) (Figure 4). Even more remarkably, contrary to the trend at the other U.S. exchanges, the AMEX was able to increase the proportion of new listings significantly after 2000:

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16. See *supra* note 14 and accompanying text.

17. The scenario of merger waves rolling unequally over the globe could be observed in recent years with the U.S. market for mergers and acquisitions outpacing those of other nations significantly. See *M&A Report*, CTR. FOR EUROPEAN ECON. RESEARCH (2007), available at [ftp://ftp.zew.de/pub/zew-docs/zn/en/schwerpunkte/mareport/mareport\\_052007.pdf](ftp://ftp.zew.de/pub/zew-docs/zn/en/schwerpunkte/mareport/mareport_052007.pdf) (devising an index for regional M&A activity (U.S.A., Europe, and Asia) for the period between January 2000 and January 2007).

18. Unfortunately, neither the NASDAQ itself nor any other available source reports information on new admissions distinguishing between U.S./non-U.S. issuers for 2002.

in 2005 it reached a level (35.05%) only exceeded by the NYSE's record of 2000 (Figure 4). This success, however, was followed by a sharp decline to 14.26% in 2006 (Figure 4).

A glance at the total number of new admissions (Figure 5) reveals that the NASDAQ's apparent comeback as an attractive market for international issuers may at least partly represent a corollary of a temporary backslide in new U.S. admissions. Consequently, when the NASDAQ captured an increasing number of new domestic issuers in 2006, international additions once again started to lag (Figure 5; Table 2). Similarly, albeit less pronouncedly, the NYSE 2006 comeback was at least partly facilitated by the coincidence of a rather distinct decline in domestic admissions and a less incisive increase in new international listings (Figure 5; Table 2). On the other hand, the AMEX's rise, only at its peak in 2004 and 2005, meets with a decline in domestic new admissions (Figure 5; Table 2).

TABLE 2: DOMESTIC AND INTERNATIONAL NEW ADMISSIONS TO U.K. AND U.S. MARKETS.

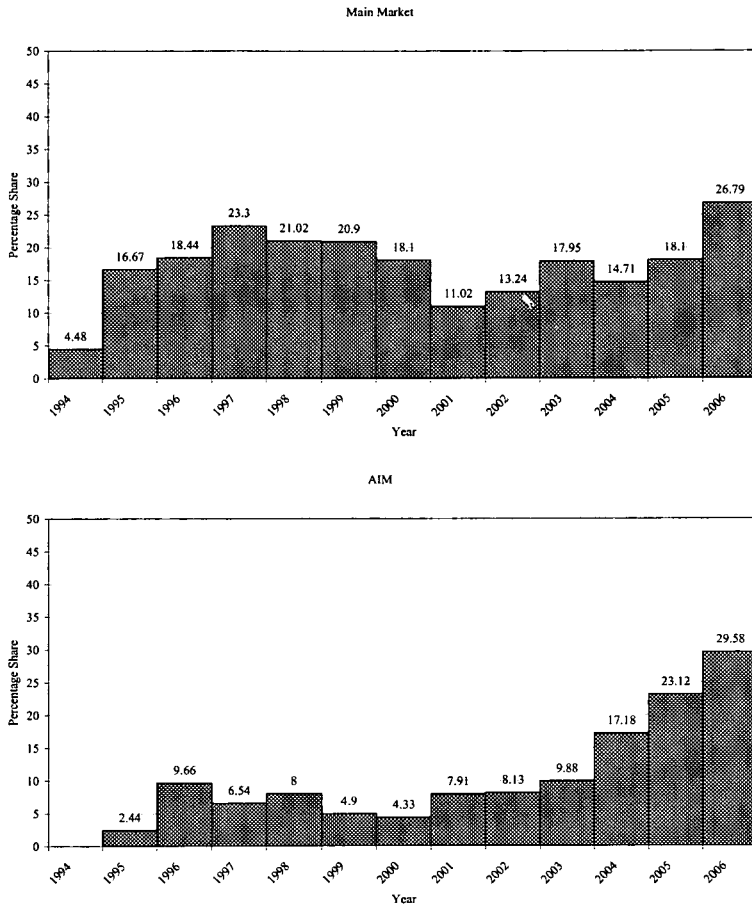
This table shows the total number of domestic and foreign issuers newly admitted to U.K. and U.S. markets during the period between 1994 and 2006 and the proportion of newly admitted cross-listing issuers relative to their domestic counterparts. The data source is the same as in Table 1.

Year	LSE Main Market				LSE AIM				AMEX			
	Dom.	Int'l	Total	Int'l %	Dom.	Int'l	Total	Int'l %	Dom.	Int'l	Total	Int'l %
1994	256	12	268	4.48					46	5	51	9.8
1995	190	38	228	16.67	120	3	123	2.44	70	5	75	6.67
1996	230	52	282	18.44	131	14	145	9.66	92	5	97	5.15
1997	135	41	176	23.3	100	7	107	6.54	91	13	104	12.5
1998	124	33	157	21.02	68	7	75	9.33	92	8	100	8
1999	106	28	134	20.9	96	6	102	5.88	83	7	90	7.78
2000	172	38	210	18.1	265	12	277	4.33	108	4	112	3.57
2001	113	14	127	11.02	162	15	177	8.47	39	5	44	11.36
2002	59	9	68	13.24	147	13	160	8.13	35	8	43	18.6
2003	32	7	39	17.95	146	16	162	9.88	60	16	76	21.05
2004	58	10	68	14.71	294	61	355	17.18	69	20	89	22.47
2005	86	19	105	18.1	399	120	519	23.12	63	34	97	35.05
2006	82	30	112	26.79	338	142	480	29.58	60	10	70	14.29
Year	NASDAQ				NYSE							
	Dom.	Int'l	Total	Int'l %	Dom.	Int'l	Total	Int'l %				
1994	419	26	445	5.84	201	52	253	20.55				
1995	413	63	476	13.24	138	35	173	20.23				
1996	598	57	655	8.7	219	59	278	21.22				
1997	453	54	507	10.65	210	63	273	23.08				
1998	437	50	487	10.27	162	43	205	20.98				
1999	553	61	614	9.93	123	28	151	18.54				
2000	486	119	605	19.67	62	60	122	49.18				
2001	123	21	144	14.58	93	51	144	35.42				
2002			121	0	118	33	151	21.85				
2003	53	3	56	5.36	91	16	107	14.95				
2004	147	23	170	13.53	132	20	152	13.16				
2005	117	23	140	16.43	127	19	146	13.01				
2006	135	21	156	13.46	100	28	128	21.88				



FIGURE 4: PROPORTION OF INTERNATIONAL NEW ADMISSIONS TO U.K. AND U.S. MARKETS.

This figure visualizes the development of the proportion of newly admitted international issuers on U.K. and U.S. relative to newly admitted domestic issuers over the period between 1994 and 2006.



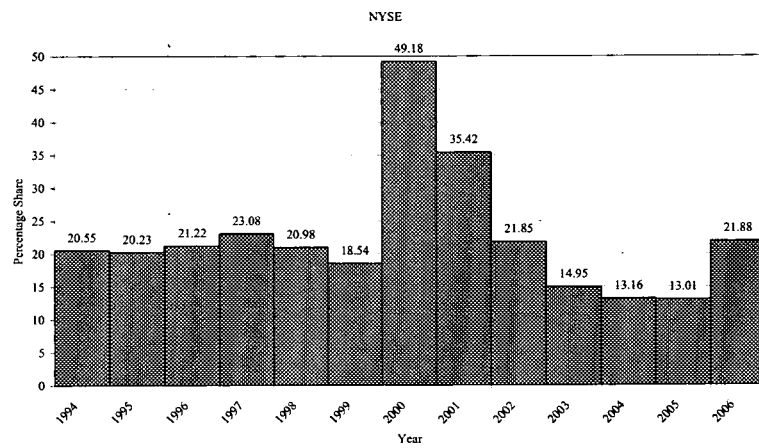
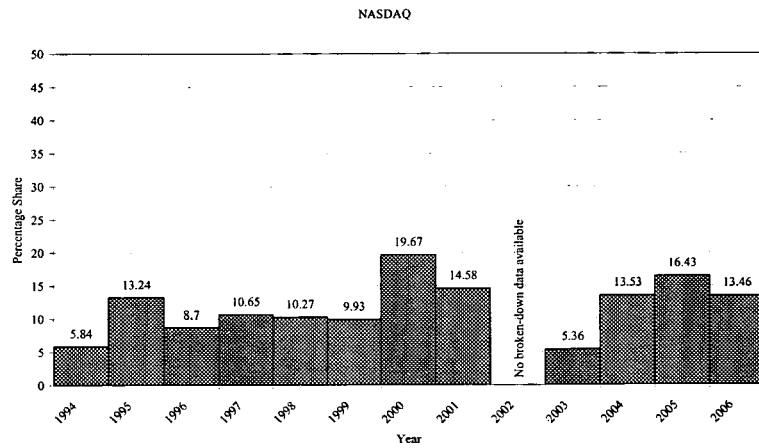
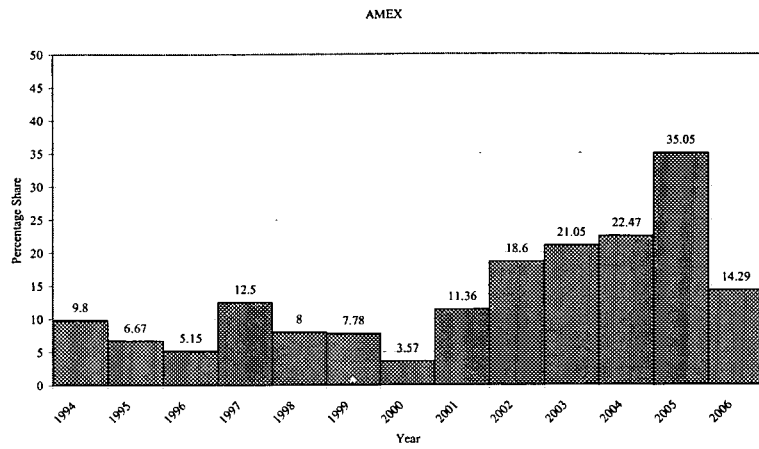
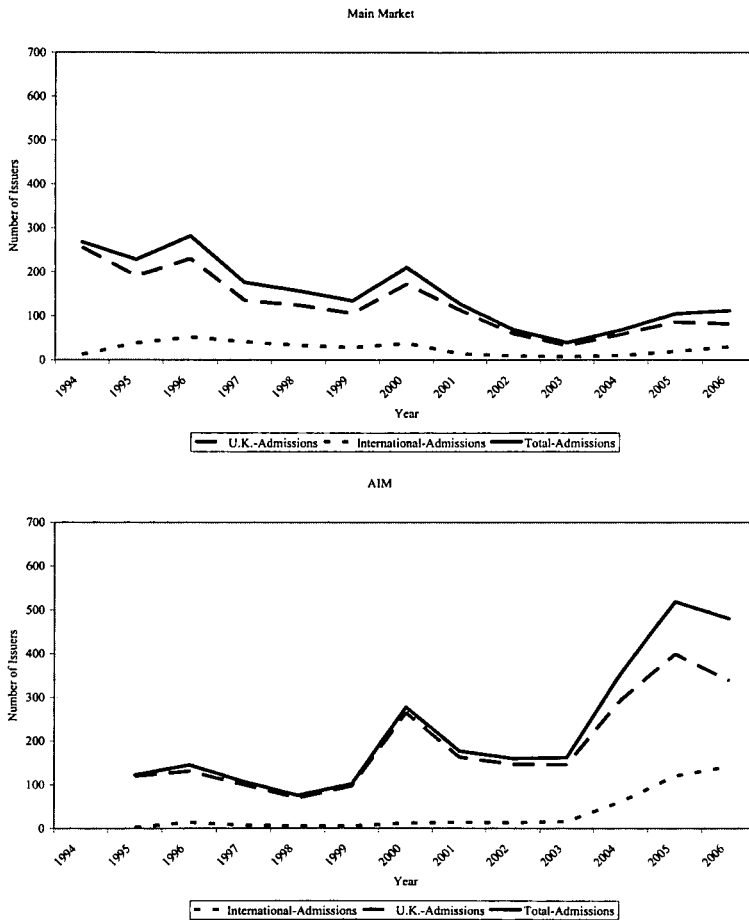


FIGURE 5: NUMBER OF INTERNATIONAL NEW ADMISSIONS TO U.K. AND U.S. MARKETS.

This figure visualizes the numbers of newly admitted international and domestic issuers as well as the aggregate number of new admissions on U.K. and U.S. markets for each year between 1994 and 2006.



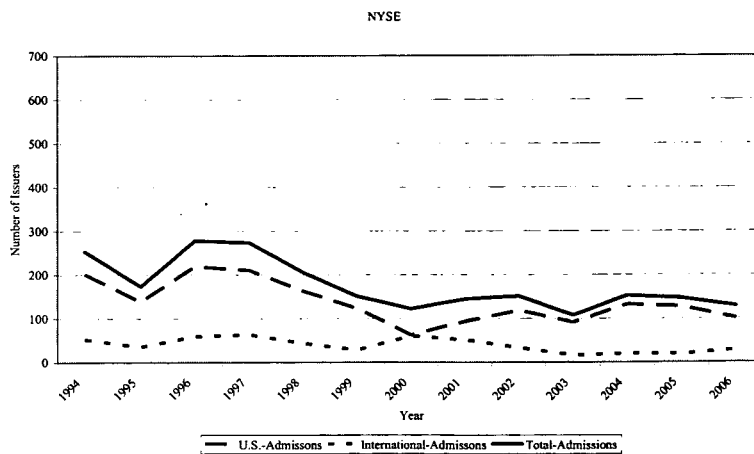
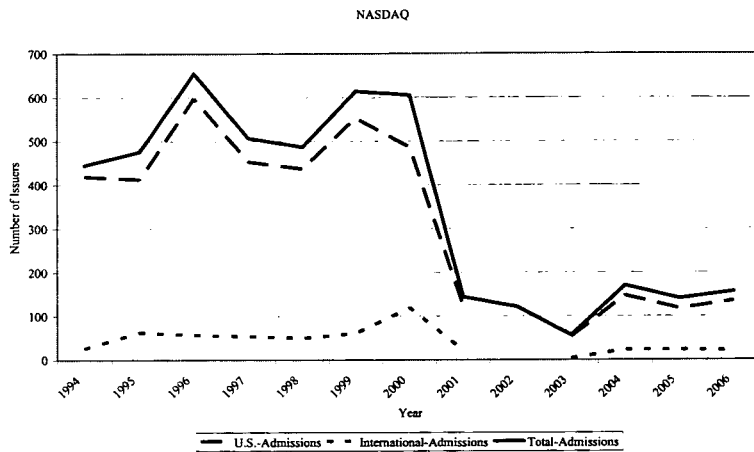
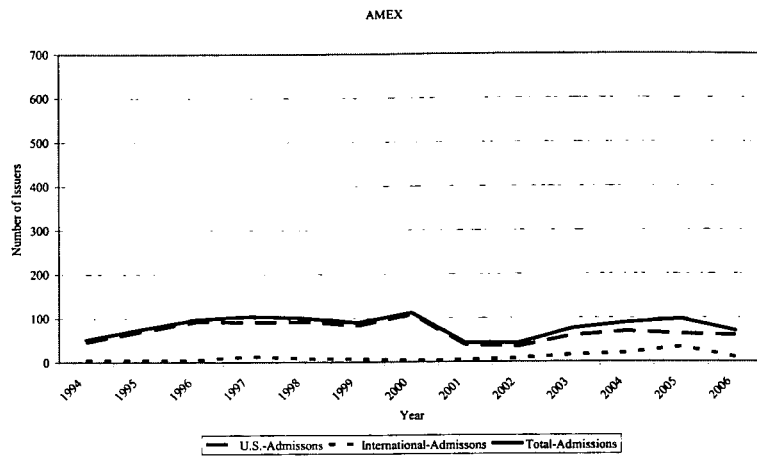
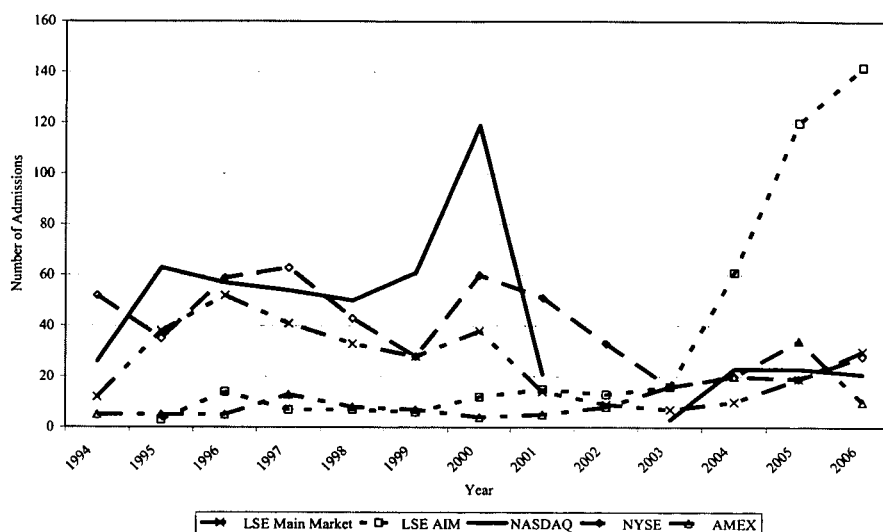


FIGURE 6: INTERNATIONAL ADMISSIONS TO U.K. AND U.S. MARKETS.

This figure compares the number of newly listed foreign issuers on U.K. and U.S. markets during 1994 and 2006.



The glance at the total numbers is particularly important with regard to new admissions. It has to be kept in mind that the U.K. economy is considerably smaller in size than that of the United States.<sup>19</sup> Consequentially, the U.K. should naturally produce a smaller number of potential domestic issuers. This fact will, in turn, give international issuers relatively more weight in calculating the proportion for U.K. markets. Despite the quite high proportions of international new admissions (constantly higher than at NASDAQ until 2000), the LSE's Main Market, during the period under scrutiny, lagged behind NASDAQ (except in 2003) and the NYSE (except in 1995 and 1999) (Table 2; Figure 6). Remarkably, however, during the last two years, the LSE's Main Market succeeded in catching up (Table 2; Figure 6). AIM's success is striking with the highest absolute number of new admissions in the sample for 2006; although of

19. In terms of GDP for the year 2005 the economic power of the U.S. (13.201 billions of U.S. dollars) was more than five and a half times as large as that of the U.K. (2.345 billions of U.S. dollars), World Bank Total GDP Statistics 2006, available at <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf> (last visited Dec. 5, 2007) (showing GDP statistics for U.S. and U.K. in 2005).

course, the complete lack of any quantitative qualification criteria<sup>20</sup> largely facilitates this success and deliberately renders AIM a trading venue catering especially to fledgling businesses.<sup>21</sup>

### C. *Trading Volume*

#### 1. Data

The data on annual trading volume in foreign equities reveals that London's Main Market clearly constitutes a more vibrant trading platform for cross-listed shares in comparison to NASDAQ and NYSE, which do not capture much of the trading in foreign shares (Table 3; Figure 7). In fact, until 2002, turnover in foreign equities exceeded that in domestic shares on the Main Market, whereas the proportion of trading in foreign stock on NASDAQ and the NYSE exceeded 10% only once during the period under survey (Figure 7). Over the whole sample period, despite the Main Market's considerably smaller total turnover (Figure 8), even the aggregate trading volume in foreign shares observed on NASDAQ and the NYSE never reached the magnitude found on the LSE's Main Market (Figure 9). Interestingly, the Main Market's edge persisted or was even expanded despite the decline in total numbers of foreign issuers on the City's market (compare Figure 3 with Figure 9).

Unfortunately, very little data is available regarding the trading volume of domestic and international AMEX and AIM companies respectively (Table 3). For 1996 - 1998, the only period AMEX reported broken-down data regarding turnover in U.S. and foreign stock, no trading in foreign stock occurred on its market (Table 3). AIM started to report broken down data (in GBP) only in 2000 and it was just very recently that trading in foreign shares listed on AIM took off. Yet, AIM immediately reached a proportion of around 20%, and thereby more than doubled the pertinent turnover ratio observed on U.S. exchanges (Table 3).

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20. For a comparison of quantitative listing standards, see *infra* Part IV.C.2.

21. In December 2006, of the 1632 domestic and international companies listed on AIM, 6 had a market value of more than 1 billion £, 15 ranged between 1 billion and 500 million £, 40 between 500 and 250 million £, and 167 between 250 and 100 million £. The great majority of AIM companies (1404) had a market value of less than 100 million £. See, London Stock Exchange, AIM Market Statistics December 2006, <http://www.londonstockexchange.com/en-gb/about/statistics/factsheets/aimmarketstats.htm> (last visited July 29, 2007) (illustrating December 2006 AIM Market Statistics).

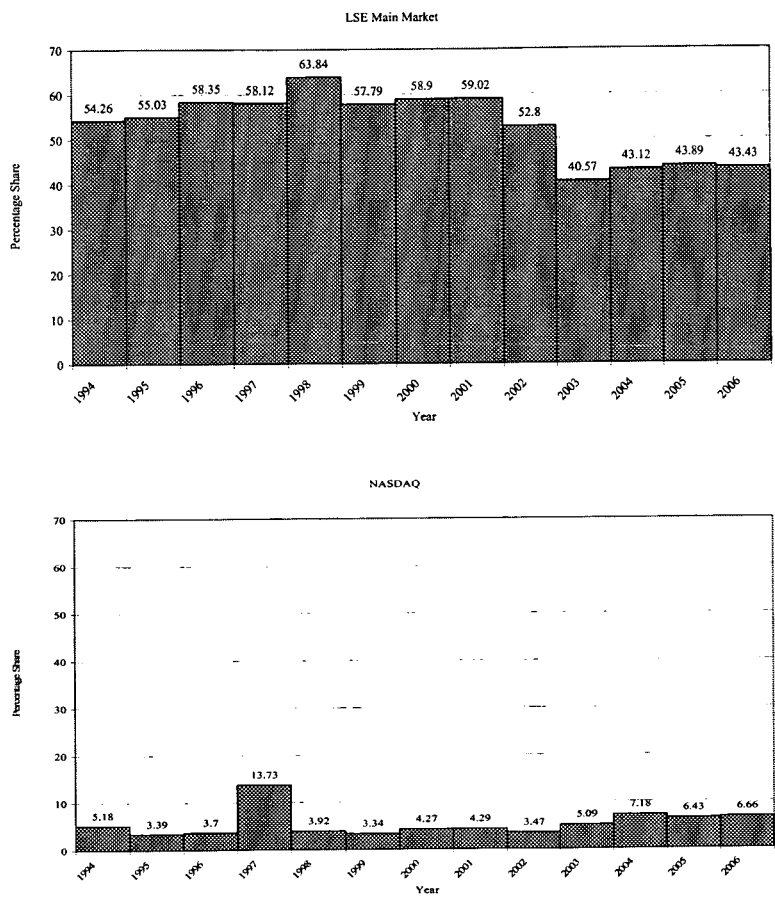
TABLE 3: ANNUAL TRADING VOLUME IN DOMESTIC AND INTERNATIONAL EQUITIES ON U.K. AND U.S. MARKETS.

This table shows the annual turnover in equity shares or depositary receipts of domestic and foreign issuers on U.K. and U.S. markets during the period between 1994 and 2006 and the proportion of turnover in cross-listing issuers' securities. The turnover value is in millions of U.S. dollars except for AIM which reported broken-down dollar values only for 2005 but itemized trading volume in GBP for 2000 - 2006. The data source is the same as in Table 1.

Year	LSE Main Market				LSE AIM (GBP)				AMEX			
	Dom.	Int'l	Total	Int'l%	Dom.	Int'l	Total	Int'l%	Dom.	Int'l	Total	Int'l%
1994	464862	551408	1016270	54.26								
1995	512323	626863	1139186	55.03			135	0				
1996	588675	824561	1413236	58.35			970	0	91330	0	91330	0
1997	833195	1156295	1989490	58.12			1208	0	143230	0	143230	0
1998	1043659	1842569	2886228	63.84			4438	0	287929	0	287929	0
1999	1425809	1952033	3377842	57.79			13469	0				
2000	1862589	2669122	4531711	58.9	6803	0	6803	0				
2001	1843956	2656076	4500032	59.02	2427	0	2427	0				
2002	1881103	2104628	3985731	52.8	1759	0	1759	0				
2003	2143317	1463012	3606329	40.57	3308	0	3308	0				
2004	2940092	2228932	5169024	43.12	9063	0	9063	0				
2005	3185654	2492067	5677721	43.89	17133	4082	21215	19.24				
2006	4283597	3288102	7571699	43.43	25617	7264	32881	22.09				
Year	NASDAQ				NYSE							
	Dom.	Int'l	Total	Int'l%	Dom.	Int'l	Total	Int'l%				
1994	1374191	75109	1449300	5.18	2216042	238200	2454242	9.71				
1995	2316860	81353	2398213	3.39	2789054	260643	3049697	8.55				
1996	3179552	122225	3301777	3.7	3694614	334356	4028970	8.3				
1997	3866420	615262	4481682	13.73	5255745	484908	5740653	8.45				
1998	5294889	215849	5510738	3.92	6722420	561362	7283782	7.71				
1999	10114054	349145	10463199	3.34	8223849	686637	8910486	7.71				
2000	18950660	844400	19795060	4.27	9885993	1141896	11027889	10.35				
2001	10464898	469185	10934083	4.29	9601548	787343	10388891	7.58				
2002	7000343	251537	7251880	3.47	9410337	701696	10112033	6.94				
2003	6703349	359851	7063200	5.09	8778300	728360	9506660	7.66				
2004	7984791	617774	8602565	7.18	10527681	976385	11504066	8.49				
2005	8605089	591029	9196118	6.43	16508678	1279353	17788031	7.19				
2006	9985361	712046	10697407	6.66	19916081	1795368	21711449	8.27				

FIGURE 7: PROPORTION OF TRADING VOLUME IN INTERNATIONAL EQUITIES ON U.K. AND U.S. MARKETS.

This figure visualizes for the period between 1994 and 2006 the proportion of annual turnover in equities or depository receipts captured by international issuers relative to the trading volume of their domestic counterparts. AMEX and AIM are not included due to the lack of sufficient data (Table 3).





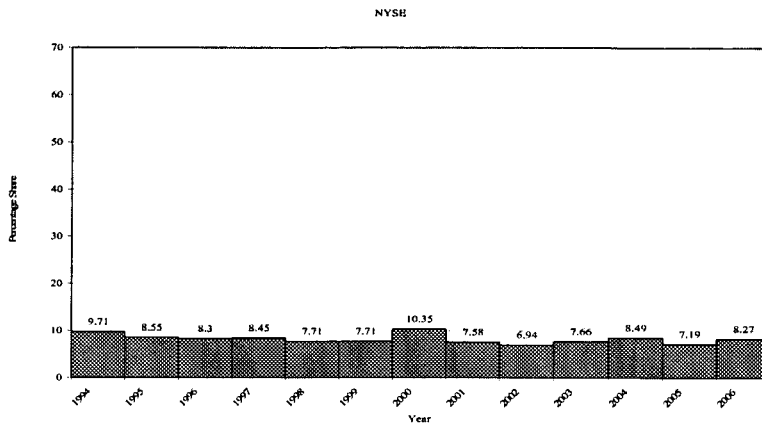
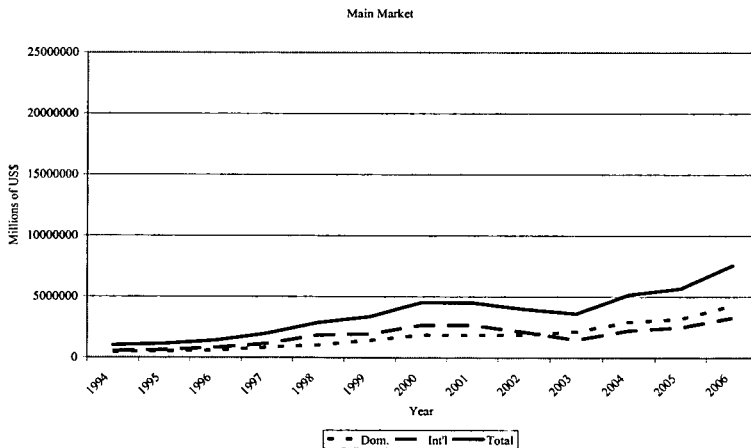


FIGURE 8: TRADING VOLUME IN INTERNATIONAL EQUITIES ON U.K. AND U.S. MARKETS.

This figure depicts the total annual turnover in equities or depositary receipts of international issuers relative to the total trading volume allocable to their domestic counterparts between 1994 and 2006. Values are in millions of U.S. dollars. AMEX and AIM are not included due to the lack of sufficient data (Table 3).



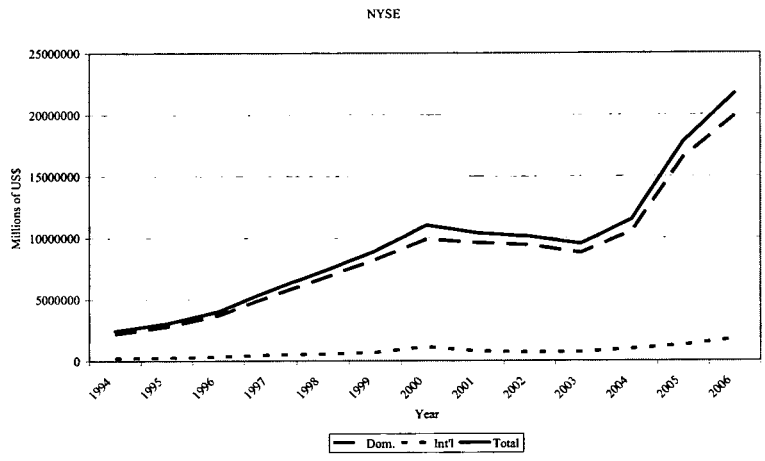
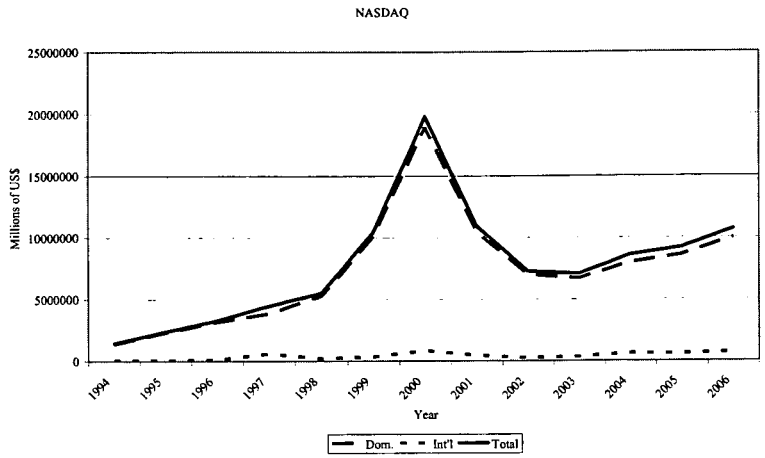


FIGURE 9: TRADING VOLUME IN INTERNATIONAL EQUITIES ON U.K. AND U.S. MARKETS.

This figure compares the annual trading volume in international equities observed on the LSE Main Market, the NASDAQ, and the NYSE between 1994 and 2006. AMEX and AIM are not included due to the lack of sufficient data (Table 3).



## 2. Excursus: Market Contribution to Price Discovery and Valuation Premiums

With regard to this Article's objective, a look at the trading volume of the cross-listing venues is not necessarily illuminative at first glance. Bonding premiums do not seem to depend directly on the trading volume that accrues on the exchanges where international issuers cross-list their equities. It has been established that after executing ADR programs investors may still prefer to buy equities on the issuer's home market.<sup>22</sup>

22. See Piotr Korczak & Martin T. Bohl, *Empirical Evidence on Cross-Listed Stocks of Central and Eastern European Companies*, 6 EMERGING MARKETS REV. 121 (2005) (noting a general increase in home-market liquidity as a result of Central and Eastern European

Moreover, there is evidence that cross-listings generally enhance home markets' liquidity. A large fraction of the global investor base might therefore buy shares on the issuer's home market, where consequentially, the bulk of possible bonding gains would be harvested. Still, some correlation between trading volume and bonding gains may exist. A recurring theme in the literature on cross-listings is the interdependence of liquidity and valuation effects.<sup>23</sup> The basic interest of market intermediaries in performing their various functions of monitoring management or controlling shareholders of cross-listing firms<sup>24</sup> may partly depend on the liquidity that arises in the market for the pertinent shares. The intensity with which these intermediaries (which include analysts, investment bankers, and institutional investors) fulfill their roles may also depend on that liquidity. Whether enhanced liquidity arises, may partly depend on the monitoring operations of such intermediaries. Changes in spreads, trading-volume, and volatility for cross-listed equities appear to be connected to shifts in the issuer's information environment, its ownership structure, and perhaps its corporate governance system.<sup>25</sup> The dispositive question seems to be: which factors in a firm's trading environment can account for such an upward trajectory and its sustained existence? If cross-listings lead to a more liquid trading environment for the pertinent stocks in which the new markets contribute significantly to price discovery, there is a good chance that a greater number of monitoring intermediaries from these markets might take an interest in the security. On the other hand, a scenario in which cross-listings lead to greater market fragmentation, added arbitrage opportunities, or systematic deviations from price parity might instead scare away these agents. Consequently, it is worthwhile to look at the contribution of cross-listing markets to price discovery for stocks as a proxy for overall market quality in the affected shares.

Generally, the contribution of new markets to price discovery is critically related to the fraction of global trading they capture.<sup>26</sup> Studies

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firms cross-listing); *see infra* notes 351 and 352 and accompanying text. Moreover, there is evidence that cross-listings generally enhance home markets' liquidity.

23. *See infra* Part V.A.1.

24. *Cf. infra* Parts III.B.2., III.B.3.a., and III.B.3.b. (describing the functions of monitoring management or controlling shareholders of cross-listing firms with regard to enhancing the informational environment, certification, and active shareholders).

25. Karolyi, *supra* note 10, at 126 ("We are learning that liquidity (spreads, volume, volatility) changes for newly cross-listed firms may very well be related closely to changes they incur in the information environment, the firm's ownership structure and perhaps even corporate governance systems.").

26. *See, e.g.,* Cheol S. Eun & Sanjiv Sabherwal, *Cross-Border Listings and Price Discovery: Evidence from U.S.-Listed Canadian Stock*, 58 J. FIN. 549 (2003) (Canadian stock cross-listed on NYSE); Joachim Grammig, Michael Melvin & Christian Schlag, *The Role of U.S. Trading in Pricing Internationally Cross-Listed Stocks* (February 2005) (Ariz. State Univ., Working Paper), available at

exploring the factors that determine the allocation of order flows found that the timely coincidence of foreign and U.S. trading was the dominant factor in determining where order flows gravitate.<sup>27</sup> Other country and firm specific factors that played a significant role were the home markets' development (domestic trading in less developed countries remained higher), the home markets' insider trading regime (domestic trading remained higher where home markets had worse protections), and firm characteristics (small, fast-growing, high-tech firms trade more on home markets).<sup>28</sup>

Price discovery on cross-listing markets may also be explored by looking at the activity of specialist trading in foreign stocks. Cross-listed, non-U.S. stocks generally have wider spreads and lower depth in relation to U.S. stocks. Studies attribute this result to more significant information asymmetries and higher adverse selection risks that induce market-makers to charge higher risk premiums.<sup>29</sup> The overall quality of markets is also influenced by competitive elements.<sup>30</sup> Similarly, models indicate that trading activity is likely to migrate to markets where specialists find "peer" companies, which can serve as an additional source of information,

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<http://www.public.asu.edu/~mmelvin/draftFeb05.1.pdf> (Canadian, French, German and British stock cross-listed on NYSE); Kate Phylaktis & Piotr Korczak, *Price Discovery Process in International Cross-Listings: Evidence from US-Listed British and French Companies* (March 2004) (Cass Bus. Sch., City Univ. of London, Working Paper), available at <http://kimmh.cbnu.edu/cited/cited45.pdf> (British and French stock).

27. See Michael Halling et al., *Where Is The Market? Evidence From Cross-Listings* (Ctr. for Econ. Policy Research, Discussion Paper No. 4987, 2005), available at <http://ssrn.com/abstract=771993> (finding that foreign trading declines sharply after cross-listing in the U.S., with the effect being weaker or absent for firms located in different time zones); Melek Pulatkonak & George Sofianos, *The Distribution of Global Trading in NYSE-Listed Non-U.S. Stocks* (New York Stock Exch., Working Paper No. 99-03, 1999) (discussing the way Latin American stock with home markets trading around the same time zone show higher U.S. trading).

28. Halling et al., *supra* note 27.

29. See, e.g., Jeffrey M. Bacidore & George Sofianos, *Liquidity Provision and Specialist Trading in NYSE-Listed Non-U.S. Stocks*, 63 J. FIN. ECON. 133 (2002) (identifying higher information asymmetry and increased adverse selection risk as primary drivers of liquidity differences between U.S. and non-U.S. stocks). But see Kate Phylaktis & Piotr Korczak, *Specialist Trading and the Price Discovery Process of NYSE-Listed Non-US Stocks* (March 10, 2006) (Cass Bus. Sch., City Univ. of London, Working Paper), available at <http://ssrn.com/abstract=567104> (showing that the concentration of trading of cross-listed stocks from one country in the hands of one individual specialist increases the share of U.S. markets in price discovery as a result of diminished information asymmetries).

30. Pamela C. Moulton & Li Wei, *A Tale of Two Time Zones: The Impact of Substitutes on Cross-listed Stock Liquidity* (May 25, 2007) (Soc. Sci. Research Network, Working Paper), available at <http://ssrn.com/abstract=807704> (finding lower spreads for cross-listed European stocks in the overlapping hours of trade).

facilitating inferences regarding prices and order flows pertaining to equities which market-makers handle.<sup>31</sup>

Static analyses of price discovery, as opposed to dynamic analyses, identify significant price deviations between foreign and U.S. markets following systematic patterns called “excess co-movements”.<sup>32</sup> However, studies indicate that both firm-specific and systematic deviations may play a role.<sup>33</sup>

### 3. Relevance of Trading Volumes

In light of the aforementioned, trading volumes cannot be ignored with relation to the bonding-aspect under scrutiny here. It is unlikely that the high turnover in foreign equities on the LSE’s Main Market (and recently on a smaller scale on AIM) is essentially generated by liquidity traders. Hence, it is no daring guess to assume that on one of the world’s most developed markets, where trading in foreign shares accounts for roughly half of the total turnover, a significant number of market-participants are well equipped for this kind of dealing, thus collecting and producing (e.g. through scrutinizing recent trades, their volume, their pricing, the identity of traders etc.; through analyzing the firm’s business) information on fundamental firm valuation. This in turn should provide for a proper informational environment and enhanced monitoring activity, particularly regarding international issuers. Consequently, important extra-

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31. Shmuel Baruch, Andrew Karolyi & Michael L. Lemmon, *Multi-Market Trading and Liquidity: Theory and Evidence* (December 2003) (Soc. Sci. Research Network, Working Paper), available at <http://ssrn.com/abstract=567064> (explaining how “The [theoretical model discussed and tested in the article] derives an equilibrium which predicts that, under fairly general conditions, the distribution of trading volume across exchanges competing for order flow is related to the correlation of the cross-listed asset returns to returns of other stocks in the respective markets. That is, volume migrates to the exchange in which the cross-listed asset returns have greater correlation with returns of other assets traded on that market.”).

32. See Louis Gagnon & G. Andrew Karolyi, *Multi-Market Trading and Arbitrage* (June 17, 2004) (Ohio State Univ., Working Paper), available at <http://www.cob.ohio-state.edu/fin/dice/papers/2004/2004-9.htm> (showing that potentially higher U.S. trading volumes lead to higher excess co-movements of ADR shares with U.S. market index returns); Susan Ji, *Does Investor Base Influence Stock Comovement?* (2004) (Zicklin Sch. of Bus., City Univ. of New York, Working Paper), available at <http://ccfr.org.cn/cicf2005/paper/20050201123856.pdf> (finding deviations from price parity associated with higher following of U.S. institutions).

33. See Ramon Rabinovitch, Ana Cristina Silva & Raul Susmel, *Returns on ADRs and Arbitrage in Emerging Markets*, 4 EMERGING MARKETS REV. 225 (2003) (showing that during a time of fixed exchange rate between peso and dollar, six Argentinean home-market/ADR stock pairs exhibited lower average daily spreads and more dramatic mean reversions from significant deviations from price parity in relation to fourteen pairs of stocks from Chile, which free-floated its exchange rate).

legal determinants of bonding gains<sup>34</sup> appear to be potentially significant with regard to the City's Main Market and its AIM.

*D. Preliminary Assessment: London as a Competitor with Custom-Tailored Offers*

The data largely buttresses the notion of a reversal of fortune in the competition for cross-listings. While U.S. market-places dominated the 1990s, at least during recent years, the City has become a serious challenger.<sup>35</sup> The LSE's Main Market, with a long standing tradition of trading in foreign equities,<sup>36</sup> incrementally lured international issuers reaching a level of attractiveness comparable to that of the NASDAQ and the NYSE. Yet, it is important to note, that U.S. markets still garner a significant fraction of new international cross-listings, with one of the U.S. exchanges—the AMEX—even exhibiting a formidable growth-rate over the last years. In light of the aforesaid, London's success does not necessarily compel the conclusion that it is a direct function of a decline of U.S. markets.

The LSE's AIM market segment which performed extraordinarily successfully during recent years draws attention to the demand-side of the market for international cross-listings. Earlier studies have already hinted that issuers listing equities on different foreign exchanges show diverging firm-specific characteristics and pursue varied strategies after execution of their cross-listing programs.<sup>37</sup> AIM's offer seems to ideally meet the demands of smaller, probably less mature issuers, from around the world seeking to strengthen their prospects by means of cross-listing their equities on one of the world's larger exchanges. It is important to note that studies scrutinizing firm characteristics found issuers cross-listing on AIM to differ significantly in size, sales growth, and leverage compared to issuers seeking a secondary listing on a U.S. exchange.<sup>38</sup>

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34. For a more detailed discussion, see *infra* Parts III.B.2. and III.B.3.

35. London's enhanced competitiveness has been noted by business magazines and newspapers as well. *Cf., e.g.,* Erika Brown, *London Calling*, FORBES, May 8, 2006 at 51-2; *What's Wrong with Wall Street*, ECONOMIST, Nov 25, 2006, at 11; *Is Wall Street Losing Its Competitive Edge?*, WALL ST. J., Dec. 2, 2006, at A6 (referring to COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (2006) available at [http://www.capmksreg.org/pdfs/11.30Committee\\_Interim\\_ReportREV2.pdf](http://www.capmksreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf)).

36. See *supra* at Part II.C.

37. See *infra* Part V.A.1.c.

38. Craig Doidge, G. Andrew Karolyi, & René M. Stulz, *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices Over Time* 18 (Charles A. Dice Center for Econ. Res., Working Paper No. 2007-9, 2007), available at <http://www.ssrn.com/abstract=982193> (finding for cross-listing issuers on AIM a median size of only \$11.5 million, sales growth of 10%, and a median leverage of 0% together with

As the discussion of the finance literature will indicate<sup>39</sup>, the legal bonding hypothesis is not necessarily exclusive and other explanations may supplement or even superimpose it. Hence, with regard to individual issuers' motives the explanation of cross-listing decisions may vary<sup>40</sup>—at least with regard to the weight particular aspects carry in the bundle. Analyzing the legal framework against the background of the data showing unequal success of the scrutinized marketplaces might enhance our knowledge of the legal prerequisites for achieving diverging cross-listing goals.

If the detailed analysis of the legal frameworks governing U.S. and U.K. exchanges warrants the conclusion that the LSE offers significantly lower standards of investor protection, then its recent success in the market for secondary listings warrants the conclusion that it at least offers enhanced financing conditions unavailable elsewhere<sup>41</sup>. These conditions render forgoing bonding-premiums acceptable for certain issuers, for example, because the loss of bonding gains is overcompensated by the retention of larger private benefits of control. In this scenario, cross-listing issuers are divided into groups characterized by diverging interests that are best served by either U.S. or U.K. markets.

If, on the other hand, similar levels of investor protection can be reached on the relevant markets, at least at the choice of issuers, it seems plausible that some actors on either side of the Atlantic pursue objectives that are similar in pertinent respect. In line with the central hypothesis advanced here, according to which investors tolerate a band of protective standards without deducting from the legal-bonding premium, the successful exchanges could be seen as featuring a regulatory environment which lies within this band.

With these hypotheses framing the analytical leitmotif, it is time to look at the relevant differences in the legal framework. Before plunging into the regulatory environment, however, the basic economic concepts of cross-listings are introduced in order to permit a more contextual and focused analysis.

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extremely high Tobin's  $q$  ratios compared to issuers pursuing other cross-listing activities).

39. See *infra* Part III.C.

40. See Stephen Choi & Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market*, 65 *FORDHAM L. REV.* 1855, 1876-79 (1997) (arguing that separating equilibria will occur in issuer choice environments with high quality issuers in a global search for stringent securities laws, other issuers limited to less incisively regulated markets, and rogue issuers looking for expropriation opportunities in weak legal environments); John C. Coffee, *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 *COLUM. L. REV.* 1757, 1814-17 (2002) (positing that both high and low disclosure exchanges could persist in light of diverging issuer characteristics).

41. *E.g.*, with regard to liquidity, visibility for investors.



### III. THEORY OF CROSS-LISTINGS

#### A. *Conventional Wisdom: Market Segmentation, Risk Exposure, and Liquidity*

The long unchallenged conventional wisdom—the market segmentation hypothesis—posited that cross-listings occur if the benefits from broadening a firm’s shareholder-base by accessing global investors, who were kept from holding shares by the segmenting effect of investment barriers, cancel out the costs associated with a secondary listing.<sup>42</sup> Besides straightforward regulatory barriers, information problems may account for market segmentation with investors lacking quality information or plainly not knowing about the security.<sup>43</sup> The dispositive impact of cross-listings was identified as the enhanced integration of the foreign shares in global capital markets allowed for more efficient investment diversification which in turn diminished the cross-listed securities risk. Hence, stock prices should rise and the issuer’s cost of capital should fall.<sup>44</sup> A different angle within this ambit is the decrease in a firm’s cost of capital associated with a decline in the costs of transacting its equities. Cross-listings that open access to a larger base of investors potentially lower transaction costs of a particular security by boosting trading volumes which enhances price discovery. Moreover, exchange-specific reasons can account for lower transaction costs on the market where the secondary listing occurs.<sup>45</sup>

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42. E.g., direct listing costs, costs of harmonizing financial statements with international accounting standards, cost of legal advice to secure compliance with reporting and registration requirements.

43. Cf. Robert C. Merton, *A Simple Model of Capital Market Equilibrium with Incomplete Information*, 42 J. FIN. 483, 494 (1987) (associating a firm’s investor base with the degree of “investor recognition”).

44. Consequentially, studies drawing on the market segmentation hypothesis scrutinized stock-price reactions associated with firm’s cross-listing decisions, e.g. Lorne N. Switzer, *The Benefits and Costs of Listing Canadian Stocks in U.S. Markets*, in CORPORATE STRUCTURE, FINANCE, AND OPERATIONS 241-54 (Lazar Sarna ed., 1986); Gordon Alexander, Cheol S. Eun & S. Janakiraman, *International Listings and Stock Returns: Some International Evidence*, 23 J. FIN. & QUANTITATIVE ANALYSES 135, 135-51 (1988); Stephen R. Foerster & G. Andrew Karolyi, *International Listing of Stocks: The Case of Canada and the U.S.*, 24 J. INT’L BUS. STUDIES 763, 763-84 (1993); Stephen R. Foerster & G. Andrew Karolyi, *The Effects of Market Segmentation and Investor Recognition on Asset Prices: Evidence from Foreign Stocks Listing in the United States*, 54 J. FIN. 981, 981-1013 (1999); Narayanan Jayaraman, Kuldeep Shastri & Kishore Tandon, *The Impact of International Cross-Listings on Risk and Return: Evidence from American Depositary Receipts*, 17 J. BANKING & FIN. 91, 91-103 (1993); Darius P. Miller, *The Market Reaction to International Cross-Listings: Evidence from Depositary Receipts*, 51 J. FIN. ECON. 103, 103-23 (1999) (all finding positive reactions, albeit of minor magnitude, associated with cross-listings in the U.S.).

45. Consistent with this explanation, studies found liquidity effects in the form of a decrease in spreads and an increase in trading volumes following cross-listings, e.g. Seha M.

### B. Broadening the Scope: Corporate Governance Aspects

The rise of agency theory informed approaches in finance theory and empirical analysis<sup>46</sup> spilled over to the theory of cross-listings and led to the occurrence of competing hypotheses, which scrutinize cross-listing decisions against the background of different markets' corporate governance institutions.<sup>47</sup> The fundamental reorientation of research triggered by these new attempts to explain the phenomenon of foreign listings is rooted in the assumption that a firm's cost of capital is pivotally determined by its corporate governance environment. In accordance with this premise, taking the effects of accessing more stringent corporate governance systems<sup>48</sup> into account should better explain the driving forces

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Tinic & Richard R. West, *Marketability of Common Stocks in Canada and the USA: A Comparison of Agent Versus Dealer Dominated Markets*, 29 J. FIN. 729, 729-46 (1974) (arguing that the price of marketability services is higher in the TSE than in the NYSE); Stephen R. Foerster & G. Andrew Karolyi, *Multimarket Trading and Liquidity: A Transactions Data Analysis of Canada-U.S. Interlistings*, 8 J. INT'L FIN. MKT., INSTITUTIONS & MONEY 393, 393-412 (1998) (arguing that the distribution of trading volume across foreign exchanges competing for order flow is related to the correlation of the cross-listed asset returns that arise in the respective markets); Ian Domowitz, Jack Glen & Ananth Madhavan, *International Cross-Listing and Order-Flow Migration: Evidence from an Emerging Market*, 53 J. FIN. 2001, 2001-27 (1998) (discussing Mexican stocks).

46. The law and finance pioneers (*cf. supra* note 1) opened the gateway to quantitative testing of hypotheses regarding diverging ownership structures and capital market developments under the assumption that Jensen & Meckling's insights (*cf. Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (analyzing agency costs and attempting to define the nature of a "firm")) not only improve our understanding of the conflicts between the firm's investors and its management/dominant shareholder after the acquisition of shares but also enhance our appreciation of the *ex ante* incentives determined by the institutions which are set-up to prevent expropriation.

47. The first to draw the link between the governance environment and the choice among cross-listing locations were René M. Stulz, *Globalization, Corporate Finance, and the Cost of Capital*, 12 J. APPLIED CORP. FIN. 8, 8-25 (1999) and John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U. L. REV. 641, 683-91 (1999) (both arguing that there is a link between issues affecting corporate governance and location choices for cross-listing). *But see* Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT'L L. 563, 582-83 (1998) (arguing that U.S. securities laws may enable foreign issuers to have lower costs of capital as a result of high quality, comprehensive disclosure prescriptions). In a purely domestic context, *see also* Jeffrey N. Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CAL. L. REV. 3, 9 (1988) (purporting that a NYSE listing functions as a device to effectively bond to a one-share-one-vote rule).

48. Internal and external corporate governance institutions bearing upon agency conflicts between shareholders and management/dominant shareholders are generally and in the pertinent context understood as encompassing rules and standards as well as non-legal mechanisms, *cf. Mark J. Roe, The Institutions of Corporate Governance*, in HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 371 (Claude Menard & Mary M. Shirley eds., 2005)

behind cross-listing decisions. The idea that corporate governance matters served as a starting point for a multiplicity of studies highlighting various, frequently complementary aspects of the common assumption.

### 1. Legal Bonding

It is well established that success in selling equities depends critically on a credible commitment of the issuer's management/dominant shareholder not to expropriate public investors ex post by consuming private benefits. Submitting to a stringent legal regime which continuously confines the controller's opportunities to extract resources collateralizes public investors' interests and hence should boost the results of subsequent share-offerings.<sup>49</sup> This kind of legal bonding seems particularly important for high-growth firms where the benefits from having better access to external financing are by assumption significant. On the other hand, it is conceivable that an "inferior law-discount" may be less noticeable with regard to high-growth firms, which might be capable of raising sufficient funds for firm specific reasons.<sup>50</sup>

### 2. Enhanced Informational Environment

According to one line of reasoning, changes in firm valuation around cross-listings and persistent premiums for cross-listed firms relate to improvements in the issuers' informational environment. Extensive and continuous disclosure renders monitoring the firm less costly for investors who in turn will be inclined to finance committed issuers at more favorable conditions. Controlling shareholders'/managements' motivations in choosing listing locations and incentives of multiple-market traders seeking liquidity across exchanges are sometimes regarded as resulting in a "race to the top." Exchanges competing for order flows will lower trading costs and

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(outlining and examining factors and features affecting corporate governance).

49. In fact, investor protection is necessary to allow cooperation of investors and equity issuers at all. It allows the deferred exchange of capital against a stake in the firm's future cash flow to be transformed from a non-cooperative game into a cooperative one. *See also supra* note 3.

50. It is important to keep in mind, that from the perspective of controlling insiders (management/dominant shareholder), the effect of legal bonding is ambiguous from the outset, *cf.* William A. Reese, Jr. & Michael S. Weisbach, *Protection of Minority Shareholders Interests, Cross-listings in the United States, and Subsequent Equity Offerings*, 66 J. FIN. ECON. 65, 78-79 (2002) (noting that enhanced investor protection means a loss in private benefits managers/controllers can extract); Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141, 148-49 (2003) (arguing that managerial opportunism may motivate cross-listings that avoid more stringent governance regimes).

will tighten disclosure requirements.<sup>51</sup> Others have argued that varying regulatory standards will prevail across exchanges as stringent mandatory disclosure rules only enhance firm value if investors are in a position to produce quality information on the issuer (in addition to the information compulsorily disclosed) at reasonable cost.<sup>52</sup> Hence, issuers from “remote” countries below international radars (*e.g.* those impaired by language-barriers) don’t benefit much from high disclosure standards.<sup>53</sup> More generally, mandated disclosure only constitutes a bait which potentially lures market intermediaries who on the other hand may still abstain from taking added interest in the cross-listed securities.

In conformity with aspects of the market segmentation hypothesis, foreign-listings are regarded as a device affording issuers an enhanced opportunity to credibly convey private information pertaining to their firm’s quality to outside investors.<sup>54</sup> In equilibrium information, asymmetries are diminished and market incompleteness is overridden.<sup>55</sup>

51. Steven J. Huddart, John S. Hughes & Markus K. Brunnermeier, *Disclosure Requirements and Stock Exchange Listing Choice in an International Context*, 26 J. ACCT. & ECON. 237, 237-69 (1999) (examining how public disclosure requirements affect listing decisions). *See also infra* note 378. For the converse view of a “race to the bottom” in issuer-choice scenarios, *see* Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom?*, 95 MICH. L. REV. 2498, 2626-27 (1997) (arguing that political pressure will induce regulators to reduce disclosure standards to garner trading volume); James D. Cox, *Regulatory Duopoly in US Securities Markets*, 99 COLUM. L. REV. 1200, 1233-36 (1999) (concurring with Fox’ argument); Merritt B. Fox, *Retaining Mandatory Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1410 (1999) (purporting issuers would “choose a regime requiring a level of disclosure well below what is socially optimal for it”); *see also* Robert Bloomfield & Maureen O’Hara, *Can Transparent Markets Survive?*, 55 J. FIN. ECON. 425, 448-452 (2000) (showing a preference of influential market participants for reduced transparency, because low transparency dealers are capable of outperforming more transparent competitors).

52. Thomas J. Chemmanur & Paolo Fulghieri, *Competition and Cooperation Among Exchanges: A Theory of Cross-Listing and Endogenous Listing Standards*, 82 J. FIN. ECON. 455, 472-73 (2006) (devising a model indicating that only the combination of high transparency standards and a large base of investors who can produce additional information on the firm at low costs increases the profitability of dual listings significantly). As a corollary, it can be extrapolated that cross-listings on highly reputed foreign exchanges with demanding disclosure regimes should lead to an increase in the production of supplemental information with regard to “visible” issuers.

53. This rationale complements the idea of a separating equilibrium in which domestic issuers rationally shun the costs of compliance with high-quality securities regulations, *cf. supra* note 40.

54. Studies have found the price amplitudes around the date of cross-listings, originally revealed in Foerster & Karolyi, *supra* note 44 considerably higher for NYSE-listed foreign equities than for those listed on the LSE and explained the difference by the more dense media coverage the former stock receives, *i.e.* its higher visibility for investors, H. Kent Baker, John R. Nofsinger & Daniel G. Weaver, *International Cross-listing and Visibility*, 37 J. FIN. & QUANTITATIVE ANALYSES 495-521 (2002) (finding that firms that list on both the NYSE and LSE experience a significant, yet distinguishable, increase in publicity).

55. The signaling equilibrium which constitutes an issuer’s optimal level of disclosure

### 3. Capital Markets

Furthermore, the operations of various capital market institutions surrounding cross-listing programs serve investor interests and hence lead to an enhanced attenuation of agency conflicts.

#### *a. Certification: lending reputation of investment banks*

By cross-listing their shares, issuers with bright prospects gain the opportunity to convey private information on firm quality even more credibly to global equity markets by using reputed investment banks as underwriters for their share issuances.<sup>56</sup> Access to the services of prestigious investment banks can be obtained by cross-listing on markets, where these esteemed international players offer their certification activity. In a sense, the certification role of investment banks serving as gatekeepers—an alleged historically familiar function of these institutions<sup>57</sup>—is a specific aspect of an enhanced informational environment.

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depends on market and firm specific determinants, *cf.* the earlier works of Shahrokh M. Saudagaran, *An Empirical Study of Selected Factors Influencing The Decision to List on Foreign Stock Exchanges*, 19 J. INT'L BUS. STUD. 101-127 (1988); Gary C. Biddle & Shahrokh M. Saudagaran, *The Effects of Financial Disclosure Levels on Firms' Choices Among Alternative Foreign Stock Exchange Listings*, 1 J. INT'L FIN. MGMT. & ACCT. 55-87 (1989); Shahrokh M. Saudagaran & Gary C. Biddle, *Financial Disclosure Levels and Foreign Stock Exchange Listing Decisions*, 4 J. INT'L FIN. MGMT. & ACCT. 106-148 (1992) (all analyzing the effects of disclosure requirements on cross-listing choices); Shahrokh M. Saudagaran & Biddle, *Foreign Listing Location: A Study of MNCs and Stock Exchanges in Eight Countries*, 26 J. INT'L BUS. STUD. 319-341 (1995) (finding that costs of enhanced disclosure were only vindicated with regard to firms with high market-capitalization on home equity markets and significant foreign relative to total sales)

56. Clinical studies found cross-listing firms to be rather mature, domestic champions and underwriters engaged significantly in credibly conveying the firms' commitment to transparency, accounting accuracy and respect of shareholder rights, *cf.* Robert Bruner, Susan Chaplinsky & Latha Ramchand, *US-bound IPOs: Issue Costs and Selective Entry*, 33 FIN. MGMT. 39-60 (2004) (complementing empirical findings with interviews of involved investment bankers).

57. *Cf.* J. Bradford De Long, *Did J.P.Morgan's Men Add Value? An Economist's Perspective on Financial Capitalism*, in INSIDE THE BUSINESS ENTERPRISE: HISTORICAL PERSPECTIVES ON THE USE OF INFORMATION 205 (Peter Temin ed., 1991) (finding a 30% increase in value for firms where J.P.Morgan bankers served on the board); Carlos D. Ramirez, *Did J.P.Morgan's Men Add Liquidity? Corporate Investment, Cash Flow, and Financial Structure at the Turn of the Twentieth Century*, 50 J. FIN. 661, 662 (1995) (noting lower sensitivity to cash flow in companies affiliated with J.P.Morgan); *but cf.*, Leslie Hannah, *What Did Morgan's Men Really Do?* (Working Paper, June 2, 2007) available at <http://h-net.org/~business/bhcweb/annmeet/hannah.pdf> (arguing that J.P.Morgan's main contribution to financial development in the U.S. did not flow from information signaling but stemmed from the successful copying of European precedents).

*b. Active shareholders*

Where cross-listings attract significant share-holdings by sophisticated, foreign institutions, more stalwart monitoring that benefits (minority) shareholders as a class is likely to occur. However, the actual occurrence of such advantageous monitoring activity and its effectiveness remains unclear both in principle<sup>58</sup> and with regard to cross-listing issuers in particular.

*c. Market for corporate control*

Cross-listings are frequently driven by the desire of foreign controllers to create an acquisition currency to finance external growth. Outside investors may benefit from the dilution of control positions and other prearrangements associated with these acquisition activities.

*C. Tentative Summary*

The surveyed functionalist explanations feature the cost of capital effect of cross-listings as the common denominator. Yet, the alleys through which these efficiency gains, arguably motivating cross-listing transactions, are effectuated differ. However, it is conceivable that issuers are capable of reaping all the benefits concurrently: obviously, overcoming investment barriers and enhancing investor recognition does not exclude the simultaneous submission to a significantly more stringent legal and non-legal set of corporate governance institutions. The flipside of the relative independence of each specific efficiency gain is that it can be associated with its own peculiar costs. Hence, from the perspective of those in control of the issuer's cross-listing decision, it may prove worthwhile to incur certain costs while avoiding others, as the respective benefits may offset some of the detriments but may be exceeded by others. For example, while the principal costs of maintaining an international cross-listing may be outvalued by the benefits of improved market integration, the additional costs of submitting to stricter disclosure standards may well surpass the pro-rata benefits controllers can reap from the further diminution of the issuer's cost of capital. Thus, from the perspective of cross-listing theories,

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58. Compare the optimistic position of Ronald Gilson & Rainier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991) (critically evaluating and suggesting improvements to monitoring strategies), with the skepticism of Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991) (criticizing irrational monitoring activity); see also, INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE (Theodor Baums, Richard M. Buxbaum & Klaus J. Hopt eds., 1994) (surveying the issue comprehensively).

it is plausible that equally successful marketplaces cater to different sets of issuers by offering distinct cost-benefit packages. Their successes could be seen as evidence of the separating equilibrium devised in theoretical studies of issuer choice.<sup>59</sup> Where a high degree of similarity regarding cultural background, informational environment, and market development measured by its depth and liquidity exists, these common factors deplete non-legal idiosyncrasies, and regulation and enforcement becomes the most prominent setscrew. The following comparison of the legal framework will indicate whether U.S. and U.K. markets indeed offer unequal regulatory packages for those who internationally cross-list.

#### IV. REGULATORY FRAMEWORK

##### A. *The 90's: The American Success Story*

Accessing U.S. equity markets by having shares or ADRs traded on stock exchanges or quotation systems results in the application of U.S. securities laws to foreign private issuers<sup>60</sup> due to the mandatory registration of these securities<sup>61</sup> with the SEC. With a momentous exemption afforded to Canadian issuers,<sup>62</sup> listing securities with a U.S. stock exchange requires SEC registration under § 12(b) of the Securities Exchange Act of 1934.<sup>63</sup> The listing of securities on the NASDAQ before it received exchange status in early 2006<sup>64</sup> triggered the SEC registration requirement under § 12(g) of the Securities Exchange Act<sup>65</sup> if the securities were held by more than 300 U.S. shareholders of record. The exemption granted for foreign private issuers under Rule 12(g)3-2(b)<sup>66</sup> became inapplicable<sup>67</sup>.

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59. *Supra* note 40.

60. Regardless of an issuer's jurisdiction of incorporation, it may be treated as a U.S. domestic issuer if its shareholdings, operations and management are too closely related to the U.S., *cf.* Rules and Regulations under the Securities Exchange Act of 1934, Rule 3b-4(c), Rules and Regulations under the Securities Exchange Act of 1934, 17 C.F.R. § 240.3b-4 (2006).

61. The relevant definitions of "security" in § 2(a)(1) Securities Act of 1933, 15 U.S.C. § 77b(a)(2) (2000), and § 3(a)(10) Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (2000), explicitly mention "stock" and "certificate of deposit".

62. *See infra* note 167 and accompanying text.

63. Securities Exchange Act of 1934, 15 U.S.C. § 78l(b) (2000 & Supp. IV 2004).

64. *Cf.* Application of the NASDAQ for Registration as a National Securities Exchange, Exchange Act Release No. 34-53128, 71 Fed. Reg. 3550 (Jan. 13, 2006) (discussing the NASDAQ request to be registered under the Exchange Act).

65. 15 U.S.C. § 78l(g) (2000 & Supp. IV 2004).

66. Rules and Regulations under the Securities Exchange Act of 1934, 17 C.F.R. 240.12(g)3-2(b) (2006).

67. *Cf.* Rule 12(g)3-2(d)(3), Rules and Regulations under the Securities Exchange Act of 1934, 17 C.F.R. 240.12(g)3-2(d)(3) (2006).

In a thought-provoking article, supporting the legal bonding hypothesis from a lawyer's perspective, John C. Coffee outlined several features of U.S. securities laws, unparalleled in the rest of the world, which arguably accounted for the success of U.S. markets in attracting foreign issuers.<sup>68</sup> Other members of the legal academy followed suit and introduced additional unique aspects of U.S. securities regulations that facilitate legal bonding.<sup>69</sup>

The fundamental problem with linking the surge in international listings on NASDAQ and NYSE during the 1990s<sup>70</sup> to a supposedly superior set of corporate governance institutions lies in the potential exaggeration of this rationale when exclusively relied upon. Clearly, the impact of enhanced investor protection on a firm's cost of capital potentially represents a meaningful determinant in the decision to cross-list.<sup>71</sup> Yet, as long as other aspects figure in the selection process,<sup>72</sup> it cannot be extrapolated from the choice of a certain market alone that the legal determinants of the corporate governance package associated with the listing are by all means superior. Even if decision makers strive for nothing but an enhancement of the issuer's utility, suboptimal outcomes with regard to the choice of law remain plausible. It is conceivable that other equity markets offer equally good or better corporate governance arrangements with functional equivalents accomplishing the agency conflict-reducing role just as efficiently as their U.S. counterparts do, but that these markets lag in other regards. If, for example, recognition among

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68. Cf. Coffee, *supra* note 47 (noting the following unique features of U.S. securities laws: strict reporting requirements under § 13(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(d) (2000), tender offer rules under § 14(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(d) (2000), SEC authority to regulate going private transactions under § 13(e) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78m(e) (2000 & Supp. IV 2004), broad liability for fraudulent statements under Rule 10b-5, 17 C.F.R. 240.10b-5 (2006), corporate governance prescriptions in the NYSE/NASDAQ listing rules, and preclusion of bribery and similar practices by prohibiting off book accounts under § 13(b)(2)(A)(B) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(b)(2)(A)(B) (2000 & Supp. IV 2004), and Rule 13b2-1, 17 C.F.R. § 240.13b2-1 (2006)).

69. E.g., Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675 (2002) (arguing that high hurdles to escape continuous disclosure requirements under § 12(g)(4) and § 15(d) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78l(g) and § 78o (2000 & Supp. IV 2004), make the commitment of foreign issuers especially credible).

70. It is interesting that new research even doubts the success of U.S. exchanges during the 1990's; see Eric J. Pan, *Why the World No Longer Puts its Stock in Us* 1-18 (Cardozo Legal Studies Research Paper No. 176, December 2006) available at <http://ssrn.com/abstract=951705> (purporting that the movement of foreign companies away from U.S. equity markets already began in the early 1990's).

71. An ambiguous one, though, as proponents of the legal bonding hypothesis do not fail to acknowledge, cf. *supra* note 50.

72. See *infra* Part V.A.2.



the global investor community remained significantly lower after a secondary listing on the LSE than cross-listing ADRs on the NYSE or the NASDAQ, then perfectly rational issuers might accept a slightly inferior corporate governance regime provided that the market integration effects outweighed the disadvantage and the bundle of cross-listing effects associated with a U.S. exchange listing represented the best overall offer. It is a plausible consequence that with enhanced integration of the world's major trading forums, U.S. exchanges may have incrementally lost the margin they derived from offering access to the world's deepest and most liquid equity markets. Hence, the relevance of the corporate governance regime issuers submit to when they cross-list may have increased.

*B. Backlash: Corporate Scandals, Sarbanes-Oxley, and a Strong European Competitor*

Since the millennium, the regulatory environment pertaining to issuers cross-listing shares on U.S. and U.K. markets changed substantially in two ways. U.S. legislators promulgated a sweeping reaction to the infamous accounting scandals associated with the names of Enron, Worldcom, Tyco, and the like. On the other side of the Atlantic, ambitious initiatives were taken by European institutions to modernize and enhance European securities laws. Given the fact that the City—with regard to international cross-listings—became a rival to U.S. markets only in recent years, it appears particularly important to give these regulatory developments and their consequences a closer look and link them to the data discussed earlier.

1. Tightening the Thumbscrew: Costly U.S. Regulatory Reactions to Corporate Scandals

It is well known that the Federal regulators in the wake of corporate scandals responded to perceived shortfalls in U.S. corporate governance by cutting deeply into the realm of state corporate law.<sup>73</sup> With regard to this Article's object of investigation, it is especially the tightening of reporting standards that affected foreign private issuers cross-listing their equities on U.S. exchanges.<sup>74</sup> The mandated CEO and CFO certification as to the

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73. See William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953 (2003) (gauging the magnitude of the shock this legislative initiative sent to the settled tectonic arrangement of U.S. corporate law).

74. For the rise in costs of maintaining a U.S. cross-listing after Sarbanes-Oxley, see, e.g., Xi Li, *The Sarbanes-Oxley Act and Cross-Listed Foreign Private Issuers* (June 2006) (SSRN Working Paper) available at <http://ssrn.com/abstract=952433> (finding a 10% negative abnormal return associated with Sarbanes-Oxley); Geoffrey Peter Smith, *A Look at the Impact of Sarbanes-Oxley on Cross-Listed Firms* (Jan. 2007) (SSRN working paper)

accuracy of the information published in the issuers Form 20-F annual report<sup>75</sup> did not substantially alter these persons' private liability risk.<sup>76</sup> However, a key intensification of an issuers obligations stemming from Sarbanes-Oxley lies in the extensive disclosure and auditing requirements with regard to an issuer's system of financial control and risk management. Under Section 404 of Sarbanes-Oxley,<sup>77</sup> a foreign private issuer's management is required to prepare a report on internal controls set up to secure reporting accuracy starting with the annual report for the fiscal year ending after July 7, 2006.<sup>78</sup> Importantly, they must also have the report assessed by auditors.<sup>79</sup> In fact, the auditors' assessment represents an audit of the internal controls, coercing the issuer to produce a vast amount of documentation on the firm's controls simply to prepare the ground for such auditing.

## 2. Catching Up: European Reforms and Innovative Variations

The U.S. developments concurred with major changes in European securities laws originating slightly earlier and independent from specific inducements.

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available at <http://ssrn.com/abstract=931051> (finding the highest negative and significant cumulative abnormal returns on Sarbanes-Oxley related announcement dates for exchange cross-listed firms from jurisdictions with high-standard regulatory and accounting systems in a sample including OTC-listed firms as control group). *But see infra* note 392 and accompanying text.

75. *Cf.* Sarbanes-Oxley Act of 2002, § 302, 15 U.S.C. § 7241 (Supp. IV 2004).

76. An important addendum has to be made, however, because the CEO/CFO certification enhances the risk of criminal punishment for a willful violation of the Securities Exchange Act, *cf.* § 32(a) Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a) (Supp. IV 2004).

77. 15 U.S.C. § 7262 (Supp. IV 2004).

78. Management's Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports of Non-Accelerated Filers and Foreign Private Issuers, Securities Act Release No. 8545, Exchange Act Release No. 51,293, 70 Fed. Reg. 11528 (Mar. 8, 2005). Small foreign private issuers, who are non-accelerated filers (*see* Exchange Act Rule 12b-2, 17 C.F.R. § 240.12b-2 (2006)) are exempt from Section 404 disclosure requirements until the fiscal year ending on or after July 15, 2007. Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies, Securities Act Release No. 8760, Exchange Act Release No. 54,942, 71 Fed. Reg. 76,580 (Dec. 21, 2006).

79. Compliance with the independent auditor attestation requirement is suspended until July 15, 2007 for foreign private issuers that are accelerated filers, but not large accelerated filers. Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Foreign Private Issuers That Are Accelerated Filers, Securities Act Release No. 8730, Exchange Act Release No. 51,293, 71 Fed. Reg. 47,056 (Aug. 15, 2006). With regard to non-accelerated filers, the suspension extends until Dec. 15, 2008. Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies, Securities Act Release No. 8760, Exchange Act Release No. 54,942, 71 Fed. Reg. 76,580 (Dec. 21, 2006).

Ever since Great Britain joined the European Community, the strategy behind European securities regulation aimed at closely integrating national securities markets without sacrificing their principal autonomy.<sup>80</sup> Hence, in contrast to the U.S. system where a sole legislator promulgates preemptive capital market regulations on the Federal level that are then further substantiated and administered by a single Federal agency, the E.U. largely relies on the transformation of rules and standards spelled out in various directives into the member states' securities laws. These national implementations are subsequently administered by domestic authorities in each member state. Clearly, in principle, the European system leaves greater latitude for member states and exchanges to tinker with different approaches to capital market regulation.<sup>81</sup> Yet, the process of integration through harmonized rules and standards was resumed vigorously during recent years, which saw an extensive consolidation, amendment, and extension of existing directives.<sup>82</sup> This completion of the new architecture of E.U. securities laws laid out in the 1999 Financial Services Action Plan (FSAP)<sup>83</sup> and later promulgated in accordance with recommendations in the

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80. Cf. RICHARD M. BUXBAUM & KLAUS J. HOPT, LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE: CORPORATE AND CAPITAL MARKET LAW HARMONIZATION POLICY IN EUROPE AND THE U.S.A. 1-23, 280-83 (1988) (examining the division of governmental powers between the Federal (Community) and state (member state) level in both the United States and Europe); Commission of the European Economic Community, *The Development of a European Capital Market: Report of a Group of Experts Appointed by the EEC Commission (Segré Report)* (Nov. 1966) (discussing the earlier goal of a single European market under the supervision of a sole authority).

81. See Jim Bartos, Esther Jeapes & Peter King, *Obligations of Issuers with Full Listings—US/EEA Comparative Review*, 1 CAP. MKTS. L.J. 32, 33-34 (2006) (providing a practitioner's view stretching the lack of "regulatory certainty" characterizing E.U. securities laws).

82. Council Directive 2001/34, On the Admission of Securities to Official Stock Exchange Listing and on Information to be Published on Those Securities, 2001 O.J. (L 184) 1 (EC) [hereinafter Consolidated Admission and Reporting Directive]; Council Directive 2003/6, Insider Dealing and Market Manipulation (Market Abuse), 2003 O.J. (L 96) 16 (EC) [hereinafter Market Abuse Directive]; Council Directive 2003/71, Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading and Amending Directive 2001/34/EC, 2003 O.J. (L 345) 64 (EC) (transposition deadline July 1, 2005) [hereinafter Prospectus Directive]; Council Directive 2004/25, Takeover Bids, 2004 O.J. (L 142) 12 (EC) (transposition deadline May 20, 2006) [hereinafter Takeover Directive]; Council Directive 2004/39, Markets in Financial Instruments Amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC and Repealing Council Directive 93/22/EEC, 2004 O.J. (L 145) 1 (EC) (transposition deadline Jan. 31, 2007) [hereinafter Markets in Financial Instruments Directive]; Council Directive 2004/109, The Harmonization of Transparency Requirements in Relation to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC, 2004 O.J. (L 390) 38 (EC) (transposition deadline Jan. 20 2007) [hereinafter Transparency Directive].

83. *Implementing the Framework for Financial Markets: Action Plan*, COM (1999) 232 final (Nov. 5, 1999) (outlining the purpose, measures, conditions, and strategies to

Lamfalussy Report,<sup>84</sup> in fact, rendered the law governing capital markets one of the most densely harmonized areas of the member states' legal systems. However, its multivoiced interpretation, application and enforcement remained an important hallmark.<sup>85</sup>

### C. *Substantive Rules Compared*

Analyzing the most important divergences in U.K. and U.S. securities laws including the relevant exchanges' listing-rules over the period of interest will reveal which legal framework accompanied the increased success of London's markets in relation to its U.S. competitors. The specific lesson with regard to law's relevance is one of two options. The lesson may be to enhance the understanding of the band of protective standards investors are willing to tolerate without charging a significantly higher risk premium. If, however, the cost of capital is measurably higher on either market, the lesson may be to learn about the standards corporate insiders are willing to accept in order to address a global investor base although they concomitantly may wish to retain as much of their private benefits as possible.

#### 1. General Scope of Application

While the rigid grasp of federal U.S. securities laws leaves only minor latitude for U.S. exchanges to design the legal framework governing the issuers' duties and the trading activity on their markets, European national regulators and exchanges find significantly more leeway to vary important parts of the legal package they wish to offer to cross-listing firms. In contrast to U.S. securities laws which generally do not distinguish between market segments and simply apply to all securities admitted to an official

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implement the new regulatory regime).

84. See Final Report of The Committee of Wise Men on the Regulation of European Securities Markets (Feb. 15, 2001), available at [http://ec.europa.eu/internal\\_market/securities/docs/lamfalussy/wisemen/final-report-wisemen\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wisemen_en.pdf) (reporting that the Committee of Wise Men, chaired by Alexandre Lamfalussy, proposed to purge the legislative process and leave most of the technical details covered by E.U. securities laws for the determination by certain non-parliamentary regulatory bodies).

85. Several Pan-European bodies are supposed to ensure the coherent interpretation and administration of E.U. law. One such body is the Committee of European Securities Regulators (CESR) established by Committee Decision of June 6 2001. See Council Directive 2001/527, 2001 O.J. (L 191) 43 (EC); see also EILÍS FERRAN, BUILDING AN EU SECURITIES MARKET 78-81 (2004) (discussing CESR's role as a coordinating network); Iris H-Y Chiu, *Three Challenges Ahead for the New EU Securities Regulation Directives*, 17 EUR. BUS. L. REV. 121, 128-32 (2006) (outlining the various obstacles CESR faces in its strive towards regulatory convergence which is dependent on national regulators' ungrudging cooperation).

stock exchange,<sup>86</sup> European laws regulate, with declining intensity, securities<sup>87</sup> which are admitted to official listing or are the subject of an application for admission to official listing on a stock exchange,<sup>88</sup> securities trading on regulated markets or multilateral trading facilities,<sup>89</sup> and securities admitted or seeking admission to other capital market segments. The distinction between official listing and regulated market trading historically set the course with regard to the magnitude of European regulatory predetermination. However, recent reforms largely leveled the differences. Today, only a few obligations imposed by European law still remain reserved for issuers with or in search of official listing.<sup>90</sup> Although this expansion of the regulatory grip only occurred over the last few years and very recently established the most extensive scope of legal bonding instruments at hand for issuers seeking listings on an E.U. regulated market,<sup>91</sup> this instance will not perceptibly affect the analysis conducted here. Shares admitted to the LSE's Main Market were admitted to official listing. In contrast, securities trading on AIM are neither admitted to official listing nor to a regulated market in terms of E.U. securities laws.<sup>92</sup> By establishing AIM outside the official list and the regulated market, the LSE afforded itself the highest degree of regulatory flexibility conceivable.

However, conflict of laws considerations are important with regard to European securities regulation. The traditional rules are based upon the principle of market affection. To wit, the legal regime of the market being affected most eminently will govern the pertinent conduct or transaction.

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86. *Supra* Part IV.A.

87. With relevance to the issues discussed here, the core definition of what constitutes a security governed by European capital market regulations is shares in companies and depositary receipts in respect to shares. *See* Markets in Financial Instruments Directive, *supra* note 82, art. 4(1)(18)(a). Prior to the promulgation of the Directive, an identical definition could be found in Council Directive 93/22/EEC of May 10, 1993 on investment services in the securities field. *See* Council Directive 93/22, art. 1(4), 1993 O.J. (L 141) 27 (EC) [hereinafter Investment Services Directive].

88. *Cf.* Consolidated Admission and Reporting Directive, *supra* note 82, art. 2(1).

89. *Cf.* Markets in Financial Instruments Directive, *supra* note 82, arts. 1(14), (15).

90. European law, while leaving conditions for admission into other market segments in the member states' discretion, mandates admission to official listing and sets out the conditions for it in the Consolidated Admission and Reporting Directive. *See* Consolidated Admission and Reporting Directive, *supra* note 82, arts. 5-19, 42-63.

91. Moreover, the deadlines for transposition of certain directives passed just very recently. *Cf.* Markets in Financial Instruments Directive, *supra* note 82, art. 70 as amended by Directive 2006/31/EC of the European Parliament and of the Council of 5 April 2006 amending in regards to certain deadlines Council Directive 2004/39/EC on markets in financial instruments, as regards certain deadlines (defining a transposition deadline of January 31 2007); Transparency Directive, *supra* note 82, art. 31 (bearing a transposition deadline of January 20 2007).

92. For a complete list of E.U. regulated markets, see Annotated Presentation of Regulated Markets and National Provisions Implementing Relevant Requirements of Investment Service Directive (93/22/EEC), 2007 O.J. (C 38) 5.

Hence, in the context of exchange traded securities, admission to a certain exchange in principle determines the applicability of the entire law of the market.<sup>93</sup> Yet, the post-FSAP conflict of laws rules differ in important respects, as they bundle pivotal parts of securities laws with the issuers' jurisdiction of incorporation if the latter lies in the European Economic Area (E.E.A.).<sup>94</sup> In particular, initial disclosure under the Prospectus Directive, continuing reporting duties under the Transparency Directive, and rules concerning mandatory bids and board obligations under the Takeover Directive are governed by the securities laws of an E.E.A. issuer's jurisdiction of incorporation, which will be administered by the pertinent member state's competent authorities.<sup>95</sup> As a consequence, opting into U.K. securities laws governing the LSE's Main Market<sup>96</sup> has become far more cumbersome for E.E.A. issuers, who would not only have to cross-list their equities but also transfer their registered offices.<sup>97</sup> On the other hand, life for third-country issuers remains as easy as before since after cross-listing they are governed by the securities laws of the E.E.A. host market.<sup>98</sup> Yet, even with regard to E.E.A. issuers, the relevance of the change in conflict of laws rules associated with the FSAP implementing measures is limited with regard to this paper's objective. The transposition deadlines of the pertinent Directives only passed very recently, some even after the period under scrutiny here.<sup>99</sup> Hence, during most of the time,

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93. See, e.g., Consolidated Admissions and Reporting Directive, *supra* note 82, arts. 2(1), 3(1), 11(1), 105 (prescribing primary and secondary market disclosure in accordance with the law and under the supervision of the competent authority of the member state where admission to listing is sought).

94. Agreement on the European Economic Area, Jan. 1, 1994, art. 7, 1994 O.J. (L 1) 3, 9 (iterating that the relevant E.U. Directives are binding for E.E.A. member states and have to be incorporated into domestic law).

95. As an underlying principle, the applicable law is determined by administrative competence which relieves the supervising bodies from applying foreign law. Cf. Prospectus Directive, *supra* note 82, arts. 2(1)(m)(i), 13; Transparency Directive, *supra* note 82, arts. 2(1)(i)(i), cl.1, 19(1), 21(1); Takeover Directive, *supra* note 82, art. 4(2)(e).

96. With AIM falling outside the scope of the FSAP-implementing Directives, it is also not subject to their conflict of laws rules. Cf. *supra* note 92 and text accompanying it (standing for the proposition that AIM falls outside the scope of FSAP-implementing Directives). As a consequence, the traditional rule of market affection applies.

97. For a detailed analysis, cf. Luca Enriques & Tobias H. Tröger, *Issuer Choice in Europe*, 17-22 (European Corporate Governance Institute (ECGI) Law Working Paper No. 90, 2007), available at <http://ssrn.com/abstract=1032281>.

98. See, e.g., Prospectus Directive, *supra* note 82, art. 2(1)(m)(iii) (defining the "home member state" for third-country issuers as where the securities are to be offered first or where the first application for admission to trading on a regulated market is made); Transparency Directive, *supra* note 82, art. 2(1)(i)(i) indent 2 (defining the "home member state" for a third-country issuer as the member state where it must file mandatory annual information, i.e. the "home member state" under the Prospectus Directive).

99. See *supra* note 82 (listing the transposition dates for the various Council Directives).

E.E.A. issuers were afforded the full scope of bonding opportunities available under U.K. securities laws when they had shares cross-listed on the Main Market.

## 2. Admission Standards

Substantive minimum standards for admission to a stock exchange do not add much to investor protection against ex-post expropriation. Neither does the financial standing of the company, nor its trading record say much about the threat of controller opportunism. Furthermore, requirements of a substantial free-float at best provide a viable, albeit tardy, exit opportunity if corporate insiders are observed exhibiting rent-seeking behavior. Yet, examining the relevant markets' admission standards is interesting as it hints at the regulatory strategy pursued by market operators.

The substantive admission standards for the LSE's Main Market are set by the U.K. Listing Authority (UKLA), a branch of the Financial Services Authority (FSA), which grants admission to the official list.<sup>100</sup> The LSE does not set higher standards. Under UKLA standards, eligible issuers are required to have a market capitalization of £700,000 (\$1,375,000).<sup>101</sup> Also, 25% of the securities<sup>102</sup> for which admission is sought have to be distributed in public hands.<sup>103</sup> The securities of a non-EEA issuer prior to admittance to secondary listing in the U.K. must also be listed in the issuer's country of incorporation or the country where the majority of shares are held.<sup>104</sup> Issuers can opt for stronger checks at the initial stage of their cross-listing program (as well as later down the road) by seeking a primary listing<sup>105</sup> where they must prove to the UKLA that

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100. The Financial Services and Markets Act [FSMA] 2000, c.8, §§ 73(1), 74(4), sched. 1 (Eng. 2005) (amending section 1 (1) to state the desirability of facilitating innovation and competition in listed securities and repealing section 74(4)).

101. FIN. SERVS. AUTH., LISTING RULES, Rule 2.2.7.(1)(a) (2007) (prescribing minimum market capitalization). FIN. SERVS. AUTH., LISTING RULES, Rule 14.2.1 (2007) (explaining that for overseas listing companies, i.e. non U.K. issuers, the requisites set up for U.K. issuers in Listing Rule 2 generally apply).

102. See FIN. SERVS. AUTH., GLOSSARY OF DEFINITIONS, "transferable securities" (2007) (note stating that the term as used in the Listing Rules refers to the European definition laid out in the Markets in Financial Instruments Directive, *supra* note 87, and its predecessors, so that it encompasses stock and depositary receipts).

103. FIN. SERVS. AUTH., LISTING RULES, Rule 14.2.2 (2007).

104. See FIN. SERVS. AUTH., LISTING RULES, Rule 14.2.4 (2007) (attempting to prevent those issuers from gaining access to U.K. equity markets who fail to comply with their home country standards of investor protection, although the requisite can be waived if the UKLA is convinced that it is not a lack of compliance with investor protection standards that accounts for the absence of a listing).

105. Cf. FIN. SERVS. AUTH., LISTING RULES, Rule 14.2.6 (2007) (giving overseas listing companies the choice to opt for a secondary listing in which case they only must meet the requisites set forward in FIN. SERVS. AUTH., LISTING RULES, Rule 2, or to seek a primary

they have sufficient working capital for at least 12 months<sup>106</sup> and have audited accounts for a three-year period which ends no earlier than 6 months before the prospective admission.<sup>107</sup> Moreover, they should have an independent trading and revenue-earning record for at least 75% of their business covering the same period that is required for audited accounts.<sup>108</sup>

As a trading platform catering to smaller, fast-growing companies, AIM deliberately has minimal substantive admission standards. It does not require a minimum company size, a minimum fraction of publicly held shares, or a trading record.

Accessing NASDAQ for the first time through its Capital Market segment<sup>109</sup> requires foreign private issuers to have stockholders' equity of at least \$5 million, a market value of the listed securities of at least \$50 million, or a net income from continuing operations in the latest fiscal year or in two of the last three fiscal years of \$750,000.<sup>110</sup> Moreover, NASDAQ requires 300 round-lot holders<sup>111</sup> (300 holders of at least 100 securities),<sup>112</sup> 1 million publicly held shares with a market value of \$5 million,<sup>113</sup> and a minimum bid-price for the stock or ADR of \$4.<sup>114</sup> In case of ADR-listings, 100,000 of the receipts shall actually be issued at initial inclusion.<sup>115</sup> An operating history<sup>116</sup> is not required for foreign issuers other than Canadian companies.

Equity securities or DRs of foreign issuers may be admitted to trading on the AMEX under Initial Listing Standard 1 if the issuer had a pre-tax income from continuing operations of at least \$750,000 during the last fiscal year or in two of the last three fiscal years, a market value of the public float of \$3 million, a minimum bid price for the stock or DR of \$3, and shareholders' equity of at least \$4 million.<sup>117</sup> Alternatively, issuers qualify for admission under Initial Listing Standard 2 if the market value of

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listing which requires full compliance with FIN. SERVS. AUTH., LISTING RULES, Rule 6-13).

106. FIN. SERVS. AUTH., LISTING RULES, Rule 6.1.16 (2007).

107. FIN. SERVS. AUTH., LISTING RULES, Rule 6.1.3 (2007).

108. FIN. SERVS. AUTH., LISTING RULES, Rule 6.1.4 (2007).

109. The NASDAQ operates two other market segments with higher admission requisites: the Global Select Market and the Global Market.

110. NASDAQ, INC., MARKET PLACE RULES, Rule 4320(e)(2)(A) (April 15, 2004).

111. NASDAQ, INC., MARKET PLACE RULES, Rule 4320(e)(4) (April 15, 2004).

112. NASDAQ, INC., MARKET PLACE RULES, Rule 4200(a)(33) (April 15, 2004) (stating that a round lot holder is a holder of a "normal unit of trading"); NASDAQ, INC., MARKET PLACE RULES, Rule 4200(a)(31) (April 15, 2004) (meaning that a round lot holder amounts to 100 securities).

113. NASDAQ, INC., MARKET PLACE RULES, Rule 4320(e)(5) (April 15, 2004).

114. NASDAQ, INC., MARKET PLACE RULES, Rule 4320(e)(2)(E) (April 15, 2004).

115. NASDAQ, INC., MARKET PLACE RULES, Rule 4320(e)(7) (April 15, 2004).

116. NASDAQ, INC., MARKET PLACE RULES, Rule 4310(c)(3) (April 15, 2004) (requiring U.S. issuers to have an operating history of at least one year or a market value of at least \$50 million US dollars).

117. AMEX, LLC, COMPANY GUIDE, § 101(a), § 102(b), § 110(a) (2007).



their public float is at least \$15 million, they have an operating history of at least 2 years, set the minimum bid price at \$3, and have shareholders' equity of no less than \$4 million.<sup>118</sup> Securities can also be admitted under Initial Listing Standard 3 if the issuer exhibits a market capitalization of \$50 million, the market value of the public float does not fall short of \$15 million, the minimum bid price is set at \$2, and shareholders' equity is at least \$4 million.<sup>119</sup> Finally, under Initial Listing Standard 4, issuers with a market capitalization of at least \$75 million or total assets and revenue of no less than \$75 million each in the last fiscal year or in two of their last three fiscal years can apply for admission of their equity securities to the AMEX if the market value of the public float is at least \$20 million and the securities are offered at a price of \$3 or more.<sup>120</sup> In addition to the requirements set forth in any of the Initial Listing Standards, the issuer must have at least 800 U.S. public shareholders together with a public float of 500,000 shares or 400 public shareholders together with either 1,000,000 publicly traded shares or 500,000 such shares if a daily trading volume of at least 2,000 shares was observed during the six months preceding the intended listing.<sup>121</sup> Alternatively, foreign issuers can satisfy the distribution requirements by showing that they had 800 round-lot public shareholders worldwide, 1 million shares were held publicly worldwide, and that the global public float had a market value of at least \$3 million.<sup>122</sup>

Foreign issuers can seek admission to the NYSE by fulfilling either the Domestic Listing requirements or the Alternate Listing standards for foreign private issuers. Compliance with the Domestic standards requires meeting the distribution criteria with regard to U.S. shareholders of record (or for Mexican and Canadian firms with regard to North American holders of record). In contrast, the Alternate Listing standards focus on worldwide distribution.<sup>123</sup>

To be admitted to the NYSE in accordance with the Domestic Listing requirements, a foreign private issuer must have 400 U.S. holders of a trading-unit.<sup>124</sup> Such unit is generally assumed to consist of 100 or more shares, 2,200 total U.S. stockholders and an average monthly trading-volume of 100,000 shares for the last six months, or 500 total U.S. stockholders and an average monthly trading volume of 1,000,000 shares

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118. AMEX, LLC, COMPANY GUIDE, § 101(b), § 102(b), § 110(a) (2007).

119. AMEX, LLC, COMPANY GUIDE, § 101(c), § 102(b), § 110(a) (2007).

120. AMEX, LLC, COMPANY GUIDE, § 101(d), § 102(b), § 110(a) (2007).

121. AMEX, LLC, COMPANY GUIDE, § 101(a)(3), (b)(3), (c)(4), (d)(3), § 102(b), § 110(a) (2007).

122. AMEX, LLC, COMPANY GUIDE, § 110(a) (2007).

123. NYSE, INC., LISTED COMPANY MANUAL, § 103.00 (2007).

124. The NYSE has recently lowered the requirement from 2000 round lot holders it demanded until August 2006.

for the most recent 12 months.<sup>125</sup> Issuers must publicly hold 1,100,000 shares<sup>126</sup> with an aggregate market value of \$100 million. This market value may also be \$60 million if the listing occurs at the time of an IPO, as a result of a spin-off, or under the Affiliated Company standard.<sup>127</sup> Finally, the issuer has to meet one of the following financial requirements.<sup>128</sup> The issuer must meet the earnings test, which requires either featuring an aggregate pre-tax income of at least \$10 million for the last three years with a minimum of at least \$2 million in the two preceding years and positive amounts in all three years or at least an aggregate of \$12 million for the last three years with a minimum of \$5 million in the recent year and \$2 million in the next most recent fiscal year.<sup>129</sup> Two other ways for the issuer to fulfill the financial standards for a NYSE listing is to either meet the valuation/revenue with cash flow test or the pure valuation revenue test. The valuation/revenue with cash flow test requires that the eligible issuer has a global market capitalization of at least \$500 million, at least \$100 million in revenues during the most recent 12 months, and at least \$25 million in aggregate cash flow for the last three fiscal years with positive amounts in all three. The pure valuation/revenue test requires issuers to have \$750 million in global market capitalization and at least \$75 million in revenues during the most recent fiscal year.<sup>130</sup>

To be admitted to NYSE in accordance with the non-U.S. listing requirements, foreign private issuers must have 5,000 holders of 100 or more shares worldwide<sup>131</sup> and no less than 2.5 million shares held publicly worldwide.<sup>132</sup> With regard to the aggregate market value of publicly-held shares, non-U.S. listing requirements conform to domestic standards.<sup>133</sup> Finally, demanding financial standards apply.<sup>134</sup> Issuers must meet an

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125. NYSE, INC., LISTED COMPANY MANUAL, § 102.01(A) (2007).

126. NYSE, INC., LISTED COMPANY MANUAL, § 102.01(A) (2007).

127. NYSE, INC., LISTED COMPANY MANUAL, § 102.01(B) (2007).

128. *See* NYSE, INC., LISTED COMPANY MANUAL, § 102.01(C)(III) (2007) (detailing the affiliated company test which is omitted here for the sake of brevity).

129. NYSE, INC., LISTED COMPANY MANUAL, § 102.01(C)(I) (2007). The second alternative of the earnings test was introduced only in August 2006. Until January 2004, the NYSE required \$2.5 million in the latest fiscal year together with \$2 million in each of the preceding two years or \$6.5 million in the aggregate for the last three fiscal years together with a minimum of \$4.5 million in the most recent fiscal year, and positive amounts for each of the preceding two years.

130. NYSE, INC., LISTED COMPANY MANUAL, § 102.01(C)(II) (2007). Until January 2004 the NYSE required at least \$200 million in revenues within the valuation/revenue with cash flow test and reserved the pure valuation/revenue test for issuers with a global market capitalization of \$1 billion and \$100 million in cash-flow.

131. NYSE, INC., LISTED COMPANY MANUAL, § 103.01(A) (2007).

132. NYSE, INC., LISTED COMPANY MANUAL, § 103.01(A) (2007).

133. NYSE, INC., LISTED COMPANY MANUAL, § 103.01(A) (2007) (requiring either \$100 million and \$60 million in case of IPO, spin-off, or affiliation).

134. *See also* NYSE, INC., LISTED COMPANY MANUAL, § 103.01(B)(III) (2007) (detailing

earnings test requiring an aggregate pre-tax income of at least \$100 million for the last three years with a minimum of at least \$25 million in the two preceding years.<sup>135</sup> They can also meet the financial listing requirements if they meet one of two tests. One is the valuation/revenue with cash flow test, which requires issuers to feature a global market capitalization of at least \$500 million, at least \$100 million in revenues during the most recent 12 months, and at least \$100 million aggregate cash flow for the last three fiscal years, where each of the two most recent years is reported at a minimum of \$25 million. The other is the pure valuation/revenue test, which requires issuers to have \$750 million in global market capitalization and at least \$75 million in revenues during the most recent fiscal year.<sup>136</sup>

In sum, the NYSE has by far the most demanding admission standards. U.S. exchanges generally erect higher hurdles for international issuers seeking access to their markets. As was hinted before, however, the effect of such relatively demanding listing requirements lies mainly in sorting out smaller, less mature issuers, rather than adding much to the mitigation of agency conflicts between shareholders and corporate insiders. From an investor's perspective, the higher risk typically associated with investments in fledgling businesses, which cannot be executed through U.S. exchanges by virtue of their more preclusive admission standards, does not represent a detriment to investment as long as investors are supplied with the information necessary to facilitate adequate adjustments in the financing contract.

### 3. Disclosure Duties

#### *a. Mandatory disclosure for new issuers (prospectus) and continuing disclosure requirements*

Since the passage of the cardinal legislation of the 1930s, a supporting pillar of U.S. securities laws is to mandate comprehensive disclosure to secure adequate investor information.<sup>137</sup> At the initial stage, issuers must prepare disclosure documents when offering securities to the public regardless of whether or not they conduct an exchange offering.<sup>138</sup>

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the affiliated company test, which is again omitted here).

135. NYSE, INC., LISTED COMPANY MANUAL, § 103.01(B)(I) (2007).

136. NYSE, INC., LISTED COMPANY MANUAL, § 103.01(B)(II) (2007).

137. Besides the historical fundamental controversy about the need to regulate securities markets to prevent information underproduction (*supra* note 5), there is also a modern debate relating to the merits of the compulsory U.S. system. See, e.g., Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998) (advocating institutional competition in securities law); Fox, *supra* note 51 (defending the U.S. system).

138. Essentially, § 5 of the Securities Act of 1933 (15 U.S.C. § 77e (2000)) prohibits

Similarly, irrespective of the manner of distribution, European law proscribes the offer of securities to be made to the public within a member state's territory without prior publication of a prospectus.<sup>139</sup> Basically, any new equity offerings on AMEX, NASDAQ, NYSE, LSE Main Market or AIM require a prospectus. The respective exemptions for private placements to sophisticated investors are of negligible relevance in this context.<sup>140</sup> The registration document and prospectus must contain detailed statements about the offered securities, the intended use of the proceeds, the nature and performance of the issuer's business as well as the identity of managers and large blockholders.<sup>141</sup> As aforementioned, under conflict of laws provisions contained in the Prospectus Directive, after July 2005, E.E.A. issuers could not escape their home country's prospectus regime by cross-listing shares on the LSE's Main Market.<sup>142</sup> However, the Prospectus Directive applies equally to all affected issuers and represents a maximum harmonization effort: it aims to implement identical substantive standards in all member states.<sup>143</sup> Hence, regulators are stripped of latitude for national variations restricting regulatory arbitrage considerations to differences in the common rules' administration and enforcement. Although differences between competent authorities and member states' liability systems exist, the potential for accomplishing significant improvements with a London cross-listing seems rather limited. This is particularly true as the UKLA is not the keenest watchdog and private enforcement in the U.K. is largely non-existent.<sup>144</sup>

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public offerings to U.S. investors by domestic and foreign private issuers when no registration statement complying with §§ 6 and 7 (15 U.S.C. §§ 77f, 77g (2000 & Supp. IV 2004)) has been filed with the SEC. Neither § 3 nor § 4 of the Securities Act (15 U.S.C. § 77c-d (2000 & Supp. IV 2004)) provides any categorical exemption for offerings of foreign private issuers.

139. Prospectus Directive, *supra* note 82, art. 3(1).

140. For details, *cf.* Regulation D, especially Rules 505 and 506, 17 C.F.R. § 230.505 (2006), 17 C.F.R. § 230.506 (2006), as well as Rule 144A, 17 C.F.R. § 230.144A (2006) for the U.S., and Prospectus Directive, art. 3(2), FSMA, § 85(1) for the U.K..

141. For details, *cf.* § 7 of the Securities Act, 15 U.S.C. § 77g (2000); Schedule A, 17 C.F.R. § 230.610a (2006); Regulation S-K Items 501-512, 17 C.F.R. § 229.501-229.512 (2006) (U.S.); Prospectus Directive, *supra* note 82, arts. 5, 7, and Annex I; Commission Regulation (EC) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, arts. 3-28, 2004 O.J. (L 149) 1. *Cf.* Simon Gleeson & Harold S. Bloomenthal, *The Public Offer of Securities in the United Kingdom*, 27 DENV. J. INT'L L. & POL'Y 359 (1999); Mark I. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Communitarity and Reciprocity*, 20 MICH. J. INT'L L. 207 (1999) (both providing partly outdated in-depth comparisons).

142. *Supra* Part IV.C.1.

143. For an assessment, *cf.* FERRAN, *supra* note 85, at 143.

144. *See infra* Parts IV.C.6. and IV.C.9.

With regard to continuous disclosure requirements, foreign private issuers enter the U.S. system under § 13(a) of the Securities Exchange Act by registering ADRs with the SEC pursuant to § 12 of the Act. Consequently, issuers cross-listing shares on the AMEX, the NASDAQ, or the NYSE are obliged to file annual reports according to Rule 13d-1<sup>145</sup> on Form 20-F<sup>146</sup> within six months after the end of the fiscal year covered in the report. They are, however, exempt from the requirement to file quarterly reports under Rule 13d-13,<sup>147</sup> but must file on Form 6-K<sup>148</sup> the information the issuer makes or is required to make public by law at home, the information the issuer files or is required to file with the stock exchange where his securities are listed if the pertinent information was made public by the exchange, and the information the issuer distributed or had to distribute to its security holders.<sup>149</sup> NASDAQ requires its listed companies to publish (and submit on Form 6-K) an interim balance sheet and income statement as of the end of its second quarter no later than six months after the end of the second quarter.<sup>150</sup> However, foreign private issuers can follow their home country's practices in lieu of Market Place Rule 4350 if they disclose their non-compliance.<sup>151</sup> Similarly, foreign private issuers on AMEX can waive the duty to publish quarterly earnings statements if they provide written certification from independent local counsel that the non-complying practice does not infringe upon domestic laws.<sup>152</sup> The NYSE, however, does not impose any duty to publish interim statements.

Akin to the relaxations of the duty to file quarterly reports, current reports of significant events on Form 8-K are not required from foreign private issuers who make reports on Form 6-K.<sup>153</sup>

The European Transparency Directive, which applies to issuers of securities trading on a regulated market, compels companies to publish annual reports within four months after the end of the fiscal year. These annual reports must be comprised of the audited financial statements and the management report, among other things.<sup>154</sup> Semi-annual reports, including condensed financial statements and interim management reports, must be published within two months after the end of the second fiscal quarter.<sup>155</sup> Granted, this rather stringent regime only very recently replaced

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145. 17 C.F.R. § 240.13d-1 (2006).

146. 17 C.F.R. § 249.220f (2006).

147. 17 C.F.R. § 240.13d (2006).

148. 17 C.F.R. § 249.306 (2006).

149. 17 C.F.R. § 240.13a-16(b) (2006); 17 C.F.R. § 249.306 (2006).

150. The NASDAQ Stock Market, Inc., *Market Place Rules*, Rule 4350(b)(4) (2004).

151. The NASDAQ Stock Market, Inc., *Market Place Rules*, Rule 4350(a) (2004).

152. AMEX, LLC, *Company Guide*, § 110 (2007).

153. 17 C.F.R. § 240.13a-11(b) (2006).

154. Transparency Directive, *supra*, note 82, art. 4(1).

155. Transparency Directive, *supra* note 82, art. 5(1).

the Interim Report Directive<sup>156</sup> and its successor, the Consolidated Admission and Reporting Directive. However, even before the scope of application was extended to regulated markets, issuers cross-listing their shares on the LSE's Main Market were subject to respective interim reporting duties as admission to the main market represented an official listing in terms of the directives.<sup>157</sup> AIM companies were not included in the disclosure obligations mapped out by European law, as AIM neither belongs to the official list nor constitutes a regulated market. However, the AIM rules require companies to publish not only annual accounts but also half-yearly reports within three months after the end of the respective six-month period.<sup>158</sup>

In terms of significant events that arise during the issuer's normal course of business, the Market Abuse Directive establishes a comprehensive regime of ad hoc disclosure of non-public information with relevance to stock prices applicable to securities admitted to a regulated market.<sup>159</sup> The European disclosure obligation has been incorporated into U.K. securities laws in the Disclosure Rules applying to foreign issuers that have their shares cross-listed on the LSE's Main Market.<sup>160</sup> The stringent U.K. regime also extends to AIM companies whose securities do not trade on a regulated market.<sup>161</sup> Consequently, with regard to significant events, the U.K. disclosure regime seems far stricter. The law on the books offers more bonding opportunities than the one applicable under U.S. securities laws, which exempts foreign private issuers from original ad hoc disclosure duties on Form 8-K.

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156. Council Directive 82/121/EEC of 15 February 1982 on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing [hereinafter Interim Reporting Directive], art. 2, 1982 O.J. (L 48) 26.

157. *Id.*, art. 2; Consolidated Admission and Reporting Directive, *supra* note 82, art. 70. For the implementation of the obligations, see FIN. SERVS. AUTH., LISTING RULES, Rules 9.8.1., 9.8.2. (2007) (covering overseas issuers with primary listings); FIN. SERVS. AUTH., LISTING RULES, Rules 14.4.8-14.4.13 (2007) (covering overseas issuers with secondary listings, in force until Jan. 19, 2007).

158. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 18 (2007).

159. Market Abuse Directive, *supra* note 82, art. 6. Materially identical regulations could be found in both the Consolidated Admission and Reporting Directive, *supra* note 82, art. 68 (covering official listings), and Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing, art. 7, 1989 O.J. (L 334) 30 (governing regulated markets).

160. FIN. SERVS. AUTH., DISCLOSURE AND TRANSPARENCY RULES, Rule 2 (2007).

161. Originally, AIM ad hoc disclosure standards were laid out in statutory law, *cf.* The Traded Securities (Disclosure Regulations) Statutory Instrument 1994 No. 188, Reg. 3, (1994) (Eng.). These provisions were repealed in 2005; see The Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005, Reg. 9 (2005) SI 2005/381 (Eng.). The pertinent disclosure duties are now contained in the LSE's self-regulation; see LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 11 (2007).

Commentators have pointed to the fact that while the contents of annual and interim reports (where required) generally are roughly equivalent across the jurisdictions compared here, significant differences persist in forward-looking information.<sup>162</sup> Although particularly short-term prognoses of earnings per share are incrementally regarded as supporting undesirable myopic speculation, surveys among issuers indicate the growing importance of more complex long-term forecasting.<sup>163</sup> While U.S. law requires issuers rather extensively to discuss “known trends or uncertainties” in the management discussion and analysis report (‘MD&A-report’),<sup>164</sup> European law is less stringent in this respect.<sup>165</sup>

Another regulatory aspect worth noting pertains to the disclosure duties of a specific group of foreign private issuers under U.S. securities laws. Studies reveal that Canadian issuers comprise by far the largest share of international new admissions to U.S. exchanges.<sup>166</sup> This insight is particularly important from the bonding angle: the Multijurisdictional Disclosure System (MJDS),<sup>167</sup> first adopted by the SEC in 1991, establishes a regime of far reaching mutual recognition, which allows eligible Canadian issuers to fulfill both disclosure obligations to primary markets and continuous disclosure requirements pertaining to secondary markets by providing Canadian prospectuses and ongoing disclosure instruments that are subject only to Canadian authorities’ oversight.<sup>168</sup> Although the MJDS has had the side-effect of bringing Canadian securities laws closer to U.S.

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162. Gérard Hertig, Rainier Kraakman & Edward Rock, *Issuers and Investor Protection*, in *THE ANATOMY OF CORPORATE LAW* 193, 199-200 (2004).

163. Cf. NATIONAL INVESTOR RELATION INSTITUTE (NIRI), *2007 Earnings Guidance Practices Survey Results*, 5-6 (2007), available at [http://www.niri.org/news\\_media\\_center/ea070604data.pdf](http://www.niri.org/news_media_center/ea070604data.pdf) (finding 58% of respondents providing only annual earnings estimates compared to 27% also publishing quarterly forecasts and 50% of respondents supplying other quantitative financial data than earnings per share, revenue and cash flow).

164. 17 C.F.R. § 229.303 (2006).

165. In fact, the interim management statements mandated by the Transparency Directive, art. 6, do not compel an extensive discussion of the issuers prospects. The state familiar from the Consolidated Admission and Reporting Directive has not changed.

166. Doidge, Karolyi & Stulz, *supra* note 38, at 49-50, Tables 2 & 3 (showing 399 exchange cross-listings from Canada and a total of 1244 between 1990 and 2005).

167. Multijurisdictional Disclosure and Modifications of the Current Registration and Reporting System for Canadian Issuers, Exchange Act Release No. 29,354, 56 Fed. Reg. 30,036 (proposed July 1, 1991).

168. For details, cf. 17 C.F.R. § 239.40 (2006) (regarding registration statements on Form F-10); 17 C.F.R. § 249.240f (2006) (covering annual reports on Form 40-F); 17 C.F.R. § 249.306 (pertaining to interim disclosure on Form 6-K). For a detailed description of the MJDS eligibility criteria, see Harold S. Bloomenthal & Samuel Wolff, *The Multijurisdictional Disclosure System and other Cross-Border Offerings*, 20 *DENV. J. INT’L L. & POL’Y* 551, 557-64 (1992); Samuel Wolff, *Recent Developments in International Securities Regulation*, 23 *DENV. J. INT’L L. & POL’Y* 347, 385-87 (1995).

standards,<sup>169</sup> thereby producing changes in Canadian firms' governance environment via harmonization, the pivotal aspect regarding the bonding hypothesis persists: nearly one-third of the foreign issuers cross-listing on U.S. exchanges are not compelled to submit to critical parts of U.S. securities regulation. Hence, a huge fragment of issuers cross-listing in the U.S. in fact are not afforded a strong bonding opportunity from the pertinent transactions in terms of black-letter law and public enforcement. However, the aspect of enhanced deterrence of false or incomplete disclosure as a result of significantly stricter penalties for violations in private litigation remains.<sup>170</sup>

*b. Related-party transactions*

Ex post expropriation of investors looms large when controllers (management and dominant shareholders) engage in transactions with the company. Hence, important legal bonding devices can accrue from safeguards applicable with regard to related-party transactions.

U.S. securities laws require a domestic issuer to disclose its top five managers' compensation in its annual report.<sup>171</sup> U.S. issuers must also disclose all transactions between the issuer and its managers if the latter had a material interest in the transaction and it exceeded \$120,000 in value.<sup>172</sup> The latter disclosure duty also applies if the transaction involves a 5% shareholder as referred to in Item 403(a) of Regulation S-K.<sup>173</sup> However, foreign private issuers are largely exempt from this regime. First, U.S. law does not compel the disclosure of the individual remuneration of executives if the issuer does not provide this information for other reasons anyway.<sup>174</sup> Second, instead of hinging on a rather low, bright-line threshold, the duty to disclose information on transactions of the

169. Douglas W. Arner, *Globalisation of Financial Markets: An International Passport for Securities Offerings?*, 35 INT'L LAW. 1543, 1551 (2001) (finding increased harmonization in U.S. and Canadian regulation with "Canadian authorities making most of the compromises").

170. See *infra* Parts IV.C.6. and IV.C.9.

171. Executive Compensation, 17 C.F.R. § 229.402 (2006).

172. Certain Relationships and Related Transactions: Transaction With Management and Others, 17 C.F.R. § 229.404(a) (2006) (requiring disclosure where "the registrant was or is to be a participant and the amount involved exceeds \$120,000, and in which any related person had or will have a direct or indirect material interest."). Until November 2006, the threshold was set at \$60,000, *cf.* SEC Release Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 174,53158 (Sept. 8, 2006) (proposing amendment increasing threshold to adjust for inflation).

173. 17 C.F.R. § 229.404(a) (2006).

174. See Form 20-F, Item 6B, 17 C.F.R. § 240.220f (2006) (requiring individual disclosure of executive compensation only if it is required in the issuer's home country or is otherwise publicly disclosed).



issuer with its officers, directors and control persons depends on a fluctuating materiality test or the conditions of the transaction.<sup>175</sup> Similarly, Generally Accepted Accounting Principles (GAAP) in the U.S. require annual disclosure of all “material” transactions between the company and its directors, officers, and controlling shareholders.<sup>176</sup> Finally, while U.S. issuer’s directors, officers, and principal shareholders who hold a stake of at least 10% must report any of their transactions in the issuer’s shares within two business days,<sup>177</sup> no such duty applies to these persons in relation to a foreign private issuer.<sup>178</sup> Substantive safeguards beyond disclosure (like approval made by a disinterested board or shareholder ratification) fall within the ambit of corporate law<sup>179</sup> and are hence unavailable as bonding devices for cross-listing issuers incorporated outside the U.S.

In Europe, disclosure duties with regard to related-party transactions have traditionally been chary. Issuers with shares trading on regulated markets only have to disclose transactions with managers that are unusual in their nature or conditions, along with aggregate remuneration paid to members of management and the executive board, and the total of outstanding loans to these persons.<sup>180</sup> A tighter regime is likely to find its way into pertinent European securities laws only through the prescription

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175. Form 20-F, Item 7B, 17 C.F.R. § 240.220f (2006) (requiring disclosure of related-party transactions involving foreign private issuers only if they “are material to the company or the related party, or . . . are unusual in their nature or conditions”).

176. FINANCIAL ACCOUNTING STANDARDS BOARD, STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 57, RELATED PARTY DISCLOSURE (Mar. 1982) (“Financial statements shall include disclosures of material related-party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business.”).

177. Securities Exchange Act of 1934, § 16(a), 15 U.S.C. § 78p(a) (2000 & Supp IV 2004). The two business-day filing requirement was introduced by the Sarbanes-Oxley Act of 2002. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 403(a), 116 Stat. 745, 746 (2002).

178. Rule 3a12-3, 17 C.F.R. § 229.3a12-3 (granting foreign private issuers exemption from Securities Exchange Act of 1934, § 16).

179. State laws do not submit related-party transactions to mandatory board or shareholder approval but provide protection against shareholder suits challenging the fairness of conflicted transactions by applying the business judgment rule in case of prior consent of independent board members or shareholders. *See, e.g.,* *Cooke v. Oolie*, 2000 WL 710199 (Del. Ch. 2000) (discussing board approval); *Lewis v. Vogelstein*, 699 A.2d 327 (Del. Ch. 1997) (discussing shareholder approval of board compensation); *In Re Wheelabrator Technologies Inc.*, 663 A.2d 1194 (Del. Ch. 1995) (discussing shareholder approval). For a general discussion, see Melvin A. Eisenberg, *Self-Interested Transactions In Corporate Law*, 13 J. CORP. L. 997 (1988).

180. Consolidated Admission and Reporting Directive, art. 67, Annex I, Schedule A, 6.2.0, 6.2.2., 6.2.3. (EC) (requiring annual accounts and reports to provide a “true and fair view of the company’s assets and liabilities, financial position and profit or loss,” which includes the mentioned information).

of International Accounting Standards/International Financial Reporting Standards (IAS/IFRS)<sup>181</sup> for international issuers. These standards, however, will not be effective for years.<sup>182</sup>

Yet, for international issuers on the LSE's markets, somewhat stricter disclosure rules are spelled out in domestic securities regulations. Issuers listing on the Main Market and seeking only a secondary listing<sup>183</sup> are not subject to the pertinent parts of the U.K. listing rules.<sup>184</sup> But overseas issuers that obtained a primary listing are subject to a sophisticated regime,<sup>185</sup> governing related-party transactions,<sup>186</sup> except where the transaction is of insignificant proportion in relation to the issuer's key data<sup>187</sup> or is of a specified kind and does not contain any unusual features.<sup>188</sup>

181. *Cf.* International Accounting Standards Board, International Accounting Standard No. 24, Related Party Disclosure. (U.K.) (enumerating stringent disclosure requirements for related-party transactions).

182. *See infra* note 299 and accompanying text.

183. *Cf. supra* note 105.

184. FIN. SERVS. AUTH., LISTING RULES, Rule 11 (2007).

185. FIN. SERVS. AUTH., LISTING RULES, Rule 11 (2007) (becoming applicable in case of a primary listing of an overseas issuer); *cf.* FIN. SERVS. AUTH., LISTING RULES, Rule 14.2.6. (2007) (indicating rules that must be complied with by “[a]n overseas issuer with a secondary listing of equity securities applying for a primary listing of its securities”).

186. For the broad definition, see FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.5 (2007).

187. FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.6(1) (2007) and FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (1) (2007). The rule exempts any related-party transaction where each of the applicable percentage ratios is below 0.25%. The implicitly referred-to class tests are determined in FIN. SERVS. AUTH., LISTING RULES, Rule 10 Annex 1 (2007). The gross-asset test (FIN. SERVS. AUTH., LISTING RULES, Rule 10 Annex 1 (2R) (2007)) looks at the ratio of the gross assets involved in the transaction to the issuer's gross assets. The profit test (FIN. SERVS. AUTH., LISTING RULES, Rule 10 Annex 1 (4R) (2007)) conducts the same calculation with regard to the profits attributable to the assets subject of the transaction and the issuer's total profits. The consideration test (FIN. SERVS. AUTH., LISTING RULES, Rule 10 Annex 1 (5R) (2007)) relates the consideration received in the transaction to the aggregate market value of the issuer's ordinary shares (excluding treasury shares). Finally, the gross-capital test (FIN. SERVS. AUTH., LISTING RULES, Rule 10 Annex 1 (7R) (2007)) divides the gross capital of the acquired entity by the gross capital of the issuer.

188. FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.6(2) and Rule 11 Annex 1R (2)-(10) (2007). Under usual conditions, the rule exempts the participation of a related party in the issuance of new securities and the sale of treasury shares (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (2) (2007)), in employee share schemes and long-term incentive schemes (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (3) (2007)), in the extension of credit (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (4) (2007)), in granting directors' indemnity (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (5) (2007)), in underwritings (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (6) (2007)), and in smaller joint investment activities (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (8) (2007)). With regard to 50:50 joint ventures, any transaction not relating to the joint venture is also exempted (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (7) (2007)). Finally, transactions with parties whose relation is only to an insignificant subsidiary (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (9) (2007)) or results

Issuers engaging in related-party transactions included in the regime have to publicly disclose<sup>189</sup> and circulate to their shareholders<sup>190</sup> a detailed description of the pertinent dealings. Most importantly, the issuer must seek shareholder consent in a general meeting in which neither the related party nor any associate is allowed to cast its vote.<sup>191</sup> Where the related-party transaction is of minor magnitude, the issuer does not have to seek *ex ante* shareholder approval but is only obliged to provide the FSA with a detailed description and an independent fairness assessment of the transaction.<sup>192</sup> In the latter case the issuer must disclose the relevant details of the transaction in his next annual accounts.<sup>193</sup>

Issuers cross-listing on AIM are required to disclose details of related-party transactions that surpass a 5% threshold in any of the class tests<sup>194</sup> without delay once the terms are fixed, along with the related party's identity and her interest in the transaction.<sup>195</sup> Furthermore, disinterested directors have to consult and decide on the fairness of the transaction in so far as it affects the interests of the issuer's shareholders.<sup>196</sup> Moreover, AIM companies are, without relevant exception, subject to stringent accounting standards.<sup>197</sup> Hence, they fall within the ambit of their demanding disclosure requirements with regard to related-party transactions. Finally, AIM-listed issuers have to disclose without delay any information they have on their directors' dealings in the companies' shares.<sup>198</sup>

Compared to the U.K. related-party transaction regime, the U.S. system applicable to foreign private issuers does not rely on significantly more stringent disclosure duties. Moreover, it stops there, whereas the

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from an insignificant joint venture (FIN. SERVS. AUTH., LISTING RULES, Rule 11 Annex 1R (10) (2007)) are also not subject to the rule.

189. For the precise content, *cf.* FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.7(1) (2007) and FIN. SERVS. AUTH., LISTING RULES, Rule 10.1.4 R (2007).

190. FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.7(2); FIN. SERVS. AUTH., LISTING RULES, Rules 13.3 and 13.6 (2007).

191. FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.7(3)(4) (2007).

192. FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.10(2)(a)(b) (2007) (covering transactions that do not reach a 5% ratio in any class test, but exceed the 0.25% ratio); FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.10(1) (2007).

193. FIN. SERVS. AUTH., LISTING RULES, Rule 11.1.10(2)(c) (2007).

194. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Schedule Three (2007) (showing that besides the class tests familiar from the Listing Rules (*supra* note 187) the AIM rules provide a turnover test in which the ratio of the turnover attributable to the assets subject of the transaction to the total turnover of the issuer is determined).

195. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 13, indents 1 and 2 (2007).

196. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 13, indent 3 (2007).

197. *See infra* Part IV.C.7.

198. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 17, indent 1 (2007).

rules governing cross-listing issuers on the LSE's Main Market that have sought a primary listing provide considerably stronger bonding possibilities by requiring disinterested shareholder approval in some instances.

*c. Significant holdings*

Dispersed shareholders and potential investors have a substantial interest in learning early about the assembling of substantial block holdings, which may indicate takeover ambitions or at least the emergence of a stronger concentration of power within the firm. U.S. securities laws accommodate this interest in information by imposing a duty under §13(d) of the Securities Exchange Act to disclose any acquisition of a 5% stake in registered equities within ten days to the issuer, the exchange where the security is traded, and the SEC.<sup>199</sup> A similar obligation to report such shareholding within 7 days to the issuer and the competent authority exists pursuant to art. 9(1) of the Transparency Directive with regard to shares trading on regulated markets. Yet it is important to remember that, according to the Major Holding Directive and the Consolidated Admission and Reporting Directive, effectively superseded by the Transparency Directive only in 2007, until very recently the reporting threshold was set at 10%.<sup>200</sup> Furthermore, the pertinent rules applied only to officially listed companies incorporated under the laws of the member states, to wit, were ultimately part of corporate law.<sup>201</sup> Consequently, shareholders of European issuers were exposed to a much higher risk of sneak-ups, and shareholders of non-E.E.A. issuers were left practically unprotected. Although the United Kingdom has a long-standing tradition of compelling public disclosure of substantial beneficial share-ownerships,<sup>202</sup> this does not alter the picture with regard to the aim of this paper. The important aspect here is that the autonomous U.K. disclosure rules, which bit at a proportion of 3% of the nominal value of shares, were part of English company law: applied only to issuers incorporated in the United Kingdom.<sup>203</sup> Consequentially, they did not protect the shareholders or potential investors of cross-listing international issuers, regardless of whether they were listed

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199. Securities Exchange Act, 15 U.S.C. § 78m(d) (2000).

200. Council Directive 88/627 of 12 December 1988 on the Information to be Published when a Major Holding in a Listed Company is Acquired or Disposed of [hereinafter the Major Holding Directive], art. 4(1), 1988 O.J. (L 348) 62 (EC). The Consolidated Admissions and Reporting Directive in art 89 maintained the reporting threshold.

201. *Cf.* Original Transparency Directive, art. 1(1); Consolidated Admissions and Reporting Directive, art. 85(1).

202. The U.K. rule originated from the recommendations of the so called Cohen Committee in 1945; *cf.* REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT, 1945 Cmd. 6659 at 39-45.

203. Companies Act, 1985, c.6, §§ 198-220 (Eng.).

on the LSE's Main Market or on AIM. The new European regime applying to issuers admitted to regulated markets, regardless of their jurisdiction of incorporation,<sup>204</sup> compelled the U.K. to adopt a new system of notification as of January 20, 2007, which, naturally, is of no relevance in explaining past events.<sup>205</sup> However, an attenuated version of the strict U.K. regime of disclosure of 3%-holdings was always imposed on issuers cross-listing on AIM.<sup>206</sup> It has significantly less bite insofar as it attaches the disclosure obligation only to the issuer and compels it only to disclose the information on significant shareholdings it actually has.

In light of the inapplicability of the European and most of the English provisions in force during the period of interest with regard to foreign issuers, it is of marginal importance that the scope of disclosure under the U.S. system was and will be much broader than the pertinent European and English provisions. In Schedule 13D, the acquirer of a substantial shareholding must not only disclose his identity but also the source and amount of funds deployed to buy the securities, the purpose of the acquisition, and the nature of any arrangements relating to the target's future to which he is a party.<sup>207</sup> Neither European nor U.K. law knows any equivalent. It is here in particular that the limitations of the disclosure regime imposed on AIM issuers becomes most palpable. Even if the issuer knows of any significant block-building it will not typically be familiar with the shareholder's interests in the transaction which would have to be disclosed were they known to the issuer.<sup>208</sup>

*d. Exit from the disclosure regime*

It has been purported that one of the most important bonding opportunities that U.S. securities laws provided—until June 2007<sup>209</sup>—

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204. See Transparency Directive, *supra* note 82, art. 2(1)(d).

205. The U.K. regulator chose to implement the rules in chapter 5 of the new *Disclosure and Transparency Rules* sourcebook. FSA, Transparency Obligations Directive (Disclosure and Transparency Rules) Instrument 2006, available at [http://fsahandbook.info/FSA/handbook/LI/2006/2006\\_70.pdf](http://fsahandbook.info/FSA/handbook/LI/2006/2006_70.pdf) (showing that, with regard to non-U.K. issuers, the FSA simply copied the E.U. directive).

206. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 17 indent 2 (2007). On the other hand, FIN. SERVS. AUTH., LISTING RULES, Rule 9.6.10, which applies to overseas issuers with a primary listing on the LSE's Main Market (*supra* note 105), does not impose any disclosure requirements beyond the issuer's domestic law. Hence, it does not provide a legal bonding device.

207. Securities Exchange Act of 1934 § 13(d)(1), 15 U.S.C. § 78m(d)(1) (2000); 17 C.F.R. § 240.13d-101, Schedule 13D, Items 2-6 (2006).

208. Cf. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 17 indent 2 and Schedule Five (f) (2007).

209. Termination of Foreign Private Issuer's Registration and Duty to File Reports, Securities Exchange Act Release No. 55,540, 72 Fed. Reg. 16,934 (April 5, 2007).

resulted from the inescapability of their disclosure regime.<sup>210</sup> This feature arguably rendered international issuers' commitment to continuous high quality investor information particularly credible and, consequently, should have resulted in high bonding premiums for U.S. listings.

Under the regime in force during the whole period under scrutiny here, the first step for cross-listing issuers wishing to terminate their reporting duties under U.S. securities laws was to cancel their listing with the U.S. exchange in order to end registration under § 12(b) of the Securities Exchange Act.<sup>211</sup> Rule 12d2-2(c)<sup>212</sup> provided that at least ten days prior to filing for delisting with the SEC, the issuer had to notify the exchange and the public via a press release and a posting on its website of its intentions to withdraw a class of securities, and reveal the reasons for such a withdrawal.<sup>213</sup> However, withdrawal from listing did not entail the ultimate discontinuance of disclosure duties under § 13(a)<sup>214</sup> or § 15(d)<sup>215</sup> of the Securities Exchange Act. According to Rule 12g-2<sup>216</sup>, upon termination of registration under § 12(b) of the Securities Exchange Act, the affected securities were deemed to be registered under § 12(g) of the Securities Exchange Act if they were originally exempt from such registration solely because of the now terminated registration under § 12(b) of the Securities Exchange Act, no other exemption from the registration requirement applied,<sup>217</sup> and the shares were held by at least 300 persons of record. As a consequence, continued reporting duties under § 13(a) of the Act applied. Similarly, reporting duties under § 15(d) of the Securities Exchange Act were suspended with regard to a registration pursuant to § 12 of the Securities Exchange Act and became active again in case such registration was terminated.

Hence, the ultimate termination of reporting duties was only possible if the affected securities were held by less than 300 persons of record or

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210. Rock, *supra* note 69.

211. 15 U.S.C. § 78l(b) (2000 & Supp. IV 2004).

212. 17 C.F.R. § 240.12d2-2(c) (2006).

213. *Cf.* NYSE, INC., LISTED COMPANY MANUAL, § 808.00, 809.00 (2007); NASDAQ, INC., MARKET PLACE RULES, Rule 4380 (NASDAQ) (showing also that neither the NYSE nor the NASDAQ impose any further substantive delisting prerequisites).

214. 15 U.S.C. § 78m(a) (2000).

215. 15 U.S.C. § 78o(d) (2000).

216. 17 C.F.R. 240.12g-2 (2006).

217. Foreign private issuers are in principle exempt from the registration duty under Rule 12g3-2(b), 17 C.F.R. §240.12g3-2(b) (2006), as long as they provide the SEC with the mandated documents from their home jurisdictions. Yet, as a consequence of the qualifications under 17 C.F.R. 12g3-2(d)(1)(2006), the exemption is of no practical relevance. To wit, an obligation to register securities under § 12(g) of the Securities Exchange Act accrues if during the most recent 18 months securities were registered under § 12 of the Securities Exchange Act, or during this period an active or suspended reporting duty under § 15(d) of the Securities Exchange Act existed.

less than 500 such persons if the issuer had assets of less than \$10 million on the last day of each of the three most recent fiscal years.<sup>218</sup> Contrary to the practice for U.S. issuers where shares held by brokers, dealers, banks or nominees for their clients in street name are counted as belonging to one holder,<sup>219</sup> foreign private issuers had to satisfy the holder-requirements with regard to individual U.S. beneficial owners.<sup>220</sup> In preparatory squeeze-out transactions, comprehensive disclosure duties under Rule 13e-3<sup>221</sup> applied; their violation gave shareholders a private right of action.<sup>222</sup> Finally, reporting duties under § 15(d) of the Securities Exchange Act could only be suspended after the filing of at least one annual report and could never be irrevocably terminated. The latter compelled issuers to check the number of U.S. beneficial owners at the end of each fiscal year as such investors might have acquired outstanding shares on the issuer's home market.

On the other side of the Atlantic, disclosure duties under European and U.K. securities laws depend on a sustained listing, *i.e.* cross-listing issuers "go dark" automatically after delisting from the LSE's markets. Hence, the pivotal aspect with regard to investor protection and legal bonding is how easily cross-listing issuers can terminate their U.K. listings.

Cross-listing issuers on the LSE's Main Market who wish to cancel their listing have to send to their shareholders a circular disclosing this intention and all relevant information pertaining to it.<sup>223</sup> The circular has to be approved by the FSA prior to its publication.<sup>224</sup> Concomitant with the information sent to shareholders, the intention to de-list has to be made public.<sup>225</sup> Furthermore, the issuer has to seek prior approval of the cancellation by no less than 75% of the shareholder votes cast in a general meeting.<sup>226</sup> The cancellation cannot take effect until 20 business days after the shareholder resolution is passed.<sup>227</sup> Shareholder approval is not required if the securities are admitted to trading on a regulated market in an E.E.A. member state when cancellation takes effect.<sup>228</sup> Finally, shareholder

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218. 17 C.F.R. 240.12g-4 (2006); 17 C.F.R. 240.12h-3 (2006).

219. 17 C.F.R. 240.12g5-1 (2002).

220. *Cf.* Rule 12g4(a)(2), 17 C.F.R. 240.12g4(a)(2) (2006); 17 C.F.R. 240.12h-3(b)(2) (2006).

221. 17 C.F.R. § 240.13e-3 (2006); 17 C.F.R. § 240.13e-100 Schedule 13E-3 (2006).

222. *Howing Co. v. Nationwide Corp.*, 826 F.2d 1470, 1474 (6th Cir. 1987), *aff'd* 927 F.2d 263 (6th Cir. 1991). In essence, the threat here is that shareholders claim a violation of the disclosure duty because the issuer omitted facts with relevance to the transaction's material fairness, *i.e.* they do not have to claim or even prove the transaction's unfairness.

223. FIN. SERVS. AUTH., LISTING RULES, Rule 5.2.5(1)(a); FIN. SERVS. AUTH., LISTING RULES, Rule 13.3.1, 13.3.2.

224. FIN. SERVS. AUTH., LISTING RULES, Rule 5.2.5(1)(b).

225. FIN. SERVS. AUTH., LISTING RULES, Rule 5.2.5(3).

226. FIN. SERVS. AUTH., LISTING RULES, Rule 5.2.5(2).

227. FIN. SERVS. AUTH., LISTING RULES, Rule 5.2.5(1)(c).

228. FIN. SERVS. AUTH., LISTING RULES, Rule 5.2.6. The underlying principle of mutual

consent is dispensable if delisting is vital in a corporate work-out of the issuer or its group. In this case, the issuer has to give notice of his cancellation intentions at least 20 business days prior to the completion of such cancellation and is subject to comprehensive disclosure duties relating to the reasons and merits of delisting and why shareholder approval is not sought.<sup>229</sup>

Cross-listing issuers on AIM have to notify the exchange of their intentions 20 business days in advance and have to seek consent of no less than 75% of the shareholder votes cast in a general meeting.<sup>230</sup> The LSE may grant exemptions from the latter requirement. The practice in this respect is based on the principles spelled out in the Listing Rules.

With regard to the escape from disclosure duties, from a bonding vantage the picture is mixed. U.S. securities laws largely upheld disclosure duties even after cross-listing issuers had retreated from the AMEX, the NYSE or the NASDAQ. Yet, the effectiveness this protection afforded to investors seems at least partly dubious since shareholders can use the information only to trade on the issuer's home (or new host) market. Consequentially, the main function of the adherence to the ongoing disclosure duties should be viewed in light of its deterring effect: by burdening issuers with the costs of continuous reporting under the Securities Exchange Act, it arguably chilled de-listings in the first place. U.K. regulators, on the other hand, pursue a similar objective by creating comparably high hurdles for the retraction of the exchange listing. They also try to secure for investors the deep and liquid trading environment of the host market. Obviously, however, the procedural preconditions do not constitute a significant impediment for dominant shareholders, large enough not to fear the supermajority vote.

#### 4. Takeovers and Public Tender Offers

Public tender offers pose various threats to dispersed shareholders who are confronted with informational asymmetries, face collective action problems, and hence tend to be prone to coercive offer designs.<sup>231</sup> Provisions promulgated to prevent expropriation of public shareholders in tender offers are an important feature of U.S. securities law. In particular,

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recognition of securities regulations within the E.E.A. goes as far as practically admitting issuers to terminate their U.K. listing within 24 hours; *cf.* FIN. SERVS. AUTH., LISTING RULES, Rule 5.3.5.

229. FIN. SERVS. AUTH., LISTING RULES, Rule 5.2.7.

230. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 41 (2007).

231. *Cf.* Roberta Romano, *A Guide to Takeovers: Theory, Evidence and Regulation*, 9 YALE J. REG. 119-179 (1992); STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 612-22 (2002) (both providing an overview of the policy concerns public tender offers raise).



the Williams Act of 1968 introduced § 14(d) to the Securities Exchange Act,<sup>232</sup> which compels the bidder to comprehensively disclose his plans with regard to the target corporation, his own financial standing, etc.,<sup>233</sup> if after consummation of the offer he would be the beneficial owner of more than 5% of the target's securities.<sup>234</sup> Moreover, the traffic rules reacted to the infamous street-sweeps of the early days and largely cut-off coercive practices.<sup>235</sup> The decisive aspect relating to this paper's objective is that the provisions of the Williams Act apply to foreign private issuers with securities registered under § 12 of the Exchange Act of 1934<sup>236</sup> (i.e. investors holding ADRs of issuers cross-listed on either the AMEX, the NASDAQ, or the NYSE enjoy full protection under U.S. securities laws in tender offers).<sup>237</sup>

In contrast, the European Takeover Directive treats public tender offers ultimately as a matter of corporate law. Hence, it only applies to takeover bids for the securities of companies governed by the laws of a member state, where all or some of those securities are admitted to trading on a regulated market in one or more member states.<sup>238</sup> With regard to investor protection in tender offer scenarios, issuers cannot normally gain from cross-listing their shares on the LSE's Main Market, because if issuers are governed by the (corporate) law of a member state, as the Takeover Directive requires, they will typically have shares listed on their domestic regulated market. Consequently, issuers will already be governed by the directive and its national implementation. Cross-listing shares on AIM cannot afford the protection of the Takeover Directive anyway, as AIM is not a regulated market. Yet, London has a highly-regarded takeover regime at its disposal in the City Code on Takeovers and Mergers [City Code] administered by the Takeover Panel.<sup>239</sup> However, the City

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232. 15 U.S.C. § 78m(d) (2000).

233. Securities Act of 1934 § 14(d)(1), 15 U.S.C. § 78m(d) (2000); Schedule TO, 17 C.F.R. § 240.14d-100 (2006).

234. In case of "mini tender-offers" where the bidder would hold less than 5% after consummation of the offer, Commission Guidance on Mini-Tender Offers and Limited Partnership Tender Offers, 65 Fed. Reg. 46,581 (July 24, 2000) (to be codified at 17 C.F.R. pts. 241 and 271), applies, which requires certain disclosures with regard to the terms of the offer.

235. The offeree has, for example, a right to withdraw under Rule 14d-7, 17 C.F.R. § 240.14d-7, benefits from the best-price rule, Securities Act of 1934 § 14(d)(7), 15 U.S.C. § 78n(d)(7) (2000) and can rely on the pro-rata rule, Securities Act of 1934 § 14(d)(6), 15 U.S.C. § 78n(d)(6) (2000).

236. See, e.g., Securities Act of 1934 § 14(d)(1), 15 U.S.C. § 78n(d)(6) (2000).

237. See also Licht, *supra* note 50, at 150 (arguing that the legal safeguards governing takeover-offers may be less relevant for shareholders of foreign private issuers as a consequence of more concentrated ownership structures which preclude public tender offers anyway).

238. Takeover Directive, *supra* note 82, art. 1(1).

239. THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER CODE (8th ed. 2006).

Code only applies to issuers with a registered office in the U.K. (and the Channel Islands or the Isle of Man) or in a member state of the E.E.A., if the latter have shares admitted to a regulated market in the U.K.<sup>240</sup> Again, although well equipped with seasoned devices for sophisticated investor protection, English securities laws do not contribute significantly to a heightened protection of shareholders of cross-listing international issuers.

### 5. Insider Trading

Critical voices in the academic debate have deemed restrictions on insider trading superfluous or even pernicious.<sup>241</sup> However, a consensus that rests upon the converse position has emerged in regulatory practice and adjudication, arguing that both individual fairness and market efficiency require intervention.<sup>242</sup>

The U.S. legal response to insider trading relies partly on discouraging certain transactions typically involving insider information, regardless of whether they actually do.<sup>243</sup> Section 16(b) of the Securities Exchange Act<sup>244</sup> captures 'round-trip' purchase-and-sale or sale-and-purchase transactions within a six-month period and ejects short-swing profits garnered by corporate insiders, including 10% beneficial owners (principal shareholders). The interpretation of the terms 'equity security' and 'purchase and sale' are both rather extensive, and include trading in derivatives that track the characteristics of an issuer's security and certain transactions of securities in conjunction with a merger.<sup>245</sup> Yet, as noted

240. *Id.*, at A3.

241. *E.g.*, HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET* 78-104 (1966) (arguing that insider trading ameliorates price discovery and enhances allocation efficiency); Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 *STAN. L. REV.* 857, 870-873 (1983) (assenting positive effects of insider trading opportunities on managements' risk preference); Daniel R. Fischel, *Insider Trading and Investment Analysis: An Economic Analysis of Dirks v. Securities and Exchange Commission*, 13 *HOFSTRA L. REV.* 127 (1984) (arguing that insider trading occasions induce managers to produce valuable information by offering immediate compensation for their efforts which benefit shareholders); Kenneth J. Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 *J. LEGAL STUD.* 801 (1980) (positing that diversified investors on active markets would not be hurt by insider trading because share-prices would be discounted accordingly).

242. *Cf.* Reinier Kraakman, *The Legal Theory of Insider Trading Regulation in the United States*, in *EUROPEAN INSIDER DEALING* 39-55 (Klaus J. Hopt & Eddy Wymeersch eds., 1991) (giving an overview of regulatory practices and adjudications regarding restrictions).

243. *Kern County Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (finding that the rule does not apply only where the nature of the transaction eliminates the involvement of insider knowledge).

244. 15 U.S.C. § 78p(b) (2000).

245. *See Colan v. Mesa Petroleum Co.*, 951 F.2d 1512 (9th Cir. 1991) (describing the voluntary conversion into debt securities in a similar situation); *Allis-Chalmers Mfg. Co. v.*

earlier, registered securities of foreign private issuers are generally exempt from the provisions of § 16 of the Securities Exchange Act.<sup>246</sup> This lenience may not be critically important, however, because the most important and far more extensive sanctions for insider trading apply under § 10(b) of the Securities Exchange Act<sup>247</sup> and SEC Rule 10b-5<sup>248</sup> promulgated thereunder anyway. In a series of *grands arêtes*, U.S. Federal Courts broadly banned trading on undisclosed material information. These courts mainly based their holdings on a presumed duty of insiders either to make undisclosed information public or to refrain from trading on it altogether.<sup>249</sup> Consequently, insiders who do not stick to the rule, but rather trade on non-public information, are deemed to commit a fraud on the market. Even market participants who do not rely directly on false representations are presumed to be deceived because they believe that the price of the pertinent stock reflects all available material information regarding the issuer and its business.<sup>250</sup> As a matter of practice, Rule 10b-5 reaches shares of a foreign private issuer cross-listed on a U.S. exchange.<sup>251</sup>

The European insider trading regime is mapped out in the Market Abuse Directive. The complete ban on insider trading spelled out in the directive via legislative fiat,<sup>252</sup> similar to the preceding Insider Dealing Directive,<sup>253</sup> only applies to securities admitted or about to be admitted to a regulated market.<sup>254</sup> Furthermore, European law only mandates effective, proportionate, and dissuasive administrative measures or sanctions where the prohibition of insider trading was infringed upon,<sup>255</sup> but leaves the

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Gulf & Western Indus., Inc., 527 F.2d 335 (7th Cir. 1975) (describing the voluntary sale of securities by the bidder in the face of a failing takeover attempt).

246. See *supra* note 178.

247. 15 U.S.C. § 78j(b) (2000).

248. 17 C.F.R. § 240.10b-5 (2006).

249. See, e.g., SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (in which the Second Circuit assumed a duty of all traders owed to the market under an equal access theory). But see *Chiarella v. United States*, 445 U.S. 222 (1980) (in which the Supreme Court later clarified that the duty to disclose or abstain is based on a relationship of trust and confidence between corporate insiders and shareholders).

250. See *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) (holding that omitted facts are material if a reasonable investor would have viewed the fact as significantly altering the “total mix” of the available information), which is not a binding precedent on the Supreme Court as the majority of justices did not join on the decision’s reliance deliberations. But *cf.* *Freeman v. Laventhol & Horwath*, 915 F.2d 193 (6th Cir. 1990) (showing that the latter commands the adjudication of lower courts in a case discussing the reliance element in a misrepresentation fraud claim under *Basic Inc. v. Levinson*).

251. See *infra* Part IV.C.6., Liability for False Statements.

252. Market Abuse Directive, *supra* note 82, art. 2.

253. Council Directive 89/592/EEC, Coordinating Regulations on Insider Dealing, 1989 O.J. (L 334) 30-32 (EC).

254. Market Abuse Directive, *supra* note 82, art. 9; Council Directive 89/592/EEC, arts. 5 and 2(2), 1989 O.J. (L 334) 30, 31 (EC).

255. Market Abuse Directive, *supra* note 82, art. 14.

determination of adequate sanctions generally to the member states discretion. The older conception on the appropriate legal reaction to insider trading in the U.K. regarded trading on non-public information as an improper conduct of directors. Hence, insider trading was treated as a matter of corporate law, with pertinent rules applying only to U.K. companies and consequentially lacking relevance in the cross-listing context.<sup>256</sup> The FSA today requires overseas issuers with a primary listing to adopt a Model Code for Securities Transactions for Directors [Model Code], which bans any dealing of directors in the issuer's securities within the 60 days preceding the preliminary announcement of the annual and bi-annual results.<sup>257</sup> However, the respective director duty is owed to the company and not the FSA as enforcer.<sup>258</sup> AIM companies are under a similar regime established by the AIM Rules.<sup>259</sup> Clearly, the core of the U.K. insider dealing regulation can be found in Part V of the Criminal Justice Act of 1993, which penalizes "[a]n individual who has information as an insider . . . if . . . he deals in securities that are price-affected securities in relation to the information."<sup>260</sup> Any market that was established under the rules of the LSE is governed by the provision,<sup>261</sup> rendering both the Main Market and AIM subject to the rule. With the enactment of the FSMA in 2000, insider trading also became a form of market abuse governed by Part VIII of the Act.<sup>262</sup> The important consequence of the latter is the full availability of administrative sanctions conferred on the FSA.<sup>263</sup>

While the general intolerance of insider dealing constitutes a commonality reflected in the applicable rules, the mode of enforcement is notably different. A hallmark of the U.S. insider trading regime is that it relies on both the SEC<sup>264</sup> and private enforcement.<sup>265</sup> U.K. legislators, on

256. *See, e.g.*, Companies Act, 1985, c. 6, § 323 (U.K.) (creating a criminal offense for the taking of certain options relating to shares of the company for directors of listed companies); Companies Act, 1985, c. 6, § 324 (U.K.) (mandating disclosure of directors' dealings in the company's securities).

257. For details and exceptions, *cf.* FIN. SERVS. AUTH., LISTING RULES, Rule 9.2.7-9.2.10, and Rule 9, Annex I, The Model Code. Overseas issuers maintaining only a secondary listing are exempt from compliance with FIN. SERVS. AUTH., LISTING RULES, Rule 9 (*supra* note 105) and hence are not obliged to conform to the Model Code.

258. *Chase Manhattan Equities Ltd. v. Goodman*, [1991] B.C.C. 308, [1991] B.C.L.C. 897 (holding that under the Model Code, there is a duty to disclose to the board of directors of the company in securities dealings, but not to the market-maker).

259. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 21 (2007).

260. CRIMINAL JUSTICE ACT, 1993, c. 36, § 52(1) (Eng.).

261. *Cf.* Insider Dealing (Securities and Regulated Markets), 1994, SI 1994/87, art. 10.

262. FSMA, §§ 118, 118b, 118c.

263. *Cf. infra* Part IV.C.6., text accompanying notes 290-296.

264. The Insider Trading Sanctions Act of 1984, Pub. L. 98-376, 98 Stat 1264 (1984) (giving the SEC standing to sue for treble damages). The Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. 100-704, §4 102 Stat 4677 (1988) (empowering the

the other hand, focus on imposing criminal and administrative sanctions. It is not necessary to decide the fundamental controversy over the relative efficacy of different enforcement mechanisms here.<sup>266</sup> Yet, although the evidence regarding the impact of U.S. insider trading restrictions in particular is mixed,<sup>267</sup> they are widely believed to be more of a deterrent than their European equivalents, including the criminal law-centered approach in the U.K.<sup>268</sup>

## 6. Liability for False Statements (Antifraud Provisions)

Disclosure duties arguably do not receive much energy as viable instruments of investor protection until they are collateralized by strong liability provisions. The U.S. system of overlapping private and public

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SEC to seek fines of up to \$1 million and jail sentences up to a maximum of 10 years).

265. *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) (establishing the right of private action under Rule 10b-5).

266. *E.g.*, La Porta, Lopez-de-Silanes & Shleifer, *supra* note 1 at 14-23 (presenting data suggesting that private enforcement via class-actions is strongly related to the development of deep and liquid securities markets); Howell E. Jackson & Mark J. Roe, *Public Enforcement of Securities Laws: Preliminary Evidence* 15-29 (Working Paper 2007) available at <http://www.ssrn.com/abstract=1000086> (devising public enforcement variables based on securities regulators' staffing levels and budgets that exceed and often dominate private enforcement measures in explaining capital market development); John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement* 28-35 (Columbia Law and Economics Working Paper No. 304, 2007) available at <http://ssrn.com/abstract=967482> (showing that public enforcement in the U.S. is significant with regard to resources devised and penalizing output created).

267. *Cf.* H. Nejat Seyhun, *The Effectiveness of Insider-Trading Sanctions*, 35 J. L. & ECON. 149 (1992) (presenting data suggesting that, despite regulation in the 1980s, insider trading has actually increased); and Thomas H. Eyssell & James P. Reburn, *The Effects of the Insider Trading Sanctions Act of 1984: The Case of Seasoned Equity Offerings*, 16 J. FIN. RES. 161 (1993) (giving evidence that, following the passage of the Insider Trading Sanctions Act of 1984, insider trading has declined).

268. For this assessment, *see, e.g.*, Gérard Hertig, *Convergence of Substantive Law and Convergence of Enforcement: A Comparison*, in CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 328, 340-42 (Jeffrey N. Gordon & Mark J. Roe eds., 2004); Gérard Hertig & Hideki Kanda, *Related Party Transactions*, in RAINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 101, 112-14 (2004); PAUL L. DAVIES, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 774-75 (7th ed. 2003); Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, in AFTER ENRON, 641, 653 note 56 (John Armour & Joseph McCahery eds., 2006) (the previous four sources all pointing to the high burden of proof under criminal law which arguably complicates enforcement); FERRAN, *supra* note 85 at 33 (contrasting 19 convictions in Britain, Germany, France, Switzerland and Italy in 1997-2001 with 46 successful prosecutions under the jurisdiction of a Manhattan District Court). These assessments, however, might be outdated in light of the newly available administrative enforcement mechanisms, which, if nothing else, at least lower the burden of proof for imposing sanctions; *see infra* at note 291 and accompanying text.

enforcement of antifraud provisions under Rule 10b-5<sup>269</sup> is supposed to secure the accuracy and integrity of information disclosed to the investing public. This system of safeguarding informational integrity, among others, with shareholder class-suits received a sweeping extraterritorial reach in U.S. Federal courts.<sup>270</sup> U.S. courts assumed jurisdiction in a case involving a foreign plaintiff and a non-U.S. defendant. The dispute arose from a purchase of shares issued by a U.K. company. The Second Circuit upheld subject matter jurisdiction mainly on the ground that a substantial amount of the shares (10%) traded on U.S. public markets.<sup>271</sup> Hence, from a bonding angle, foreign private issuers can successfully submit themselves to the stringent regime of liability for misleading information under Rule 10b-5 and add extra credibility to their communications. It must be kept in mind that Rule 10b-5 liability attaches to the person responsible for the deceptive communication,<sup>272</sup> although corporate insiders rarely bear the costs of their wrongful actions due to indemnification arrangements and liability insurance coverage.<sup>273</sup> Moreover, it is worth noticing in this context that the now mandated CEO and CFO certification as to the accuracy of the information published in the issuer's Form 20-F annual report,<sup>274</sup> at least in principle, reinforces these persons' personal liability and facilitates criminal punishment—a declared goal of SOX.

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269. 17 C.F.R. 240.10b-5 (2006). See *supra* note 265 and accompanying text.

270. For a detailed analysis, see Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Laws*, 17 NW. J. INT'L L. & BUS. 207, 215-19 (1996) (explaining that American courts apply a two-prong test on a case-by-case basis to determine the extraterritoriality of section 10b-5). See also Coffee, *supra* note 47 at 690-91 (the first to relate this finding to cross-listings).

271. *Itoba Ltd. v. Lep Group Plc*, 54 F.3d 118, 125 (2d Cir. 1995) (holding that material issues of fact existed regarding whether or not the British issuer had committed securities fraud, and therefore precluded summary judgment).

272. Currently, it is unclear how broadly the circle of responsible persons can be construed. In *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 443 F.3d 987 (8th Cir. 2006), the Supreme Court granted certiorari to a class-action suit in which plaintiffs sought to hold liable the suppliers of an issuer under Rule 10b-5 who helped inflate revenues, although the defendants did not make any fraudulent statements themselves. If the Supreme Court goes along with the plaintiffs' argument of "scheme liability" and holds the defendants responsible, even though it held in an earlier case that aiding and abetting does not trigger liability under Rule 10b-5 (*cf. Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 192 (1994) (holding that a private plaintiff may not maintain an aiding and abetting suit under 10b, because the act does not specifically prohibit aiding and abetting)), then the risk of suppliers as well as of advisers would rise tremendously, adding another layer of (costly) liability exposure designed to eradicate false or misleading statements.

273. John C. Coffee, *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation* 45-48 (Columbia Law and Economics Working Paper No. 293, 2006) available at <http://ssrn.com/abstract=893833>.

274. *Cf. Sarbanes-Oxley Act of 2002*, § 302, 15 U.S.C. § 7241 (Supp. IV 2004) (listing requirements of corporate responsibility for financial reports).

Both the Prospectus Directive and the Transparency Directive leave the tailoring of adequate sanctions for infringements on disclosure duties largely to the discretion of member states, mandating only that effective, proportionate and dissuasive administrative measures be taken or administrative or civil sanctions of such quality be imposed.<sup>275</sup> The Market Abuse Directive,<sup>276</sup> which so far is, in pertinent part, not further substantiated by implementing measures on the E.U. level, potentially covers false statements as a form of prohibited market manipulation with regard to securities trading on a regulated market.<sup>277</sup> Yet again, the tailoring of effective, proportionate and dissuasive sanctions is left to the member states' discretion.<sup>278</sup>

With regard to prospectus duties, besides the administrative and criminal sanctions at hand for the FSA, the FSMA<sup>279</sup> and—until its repeal in the course of the implementation of the Prospectus Directive in 2005—the Public Offers of Securities (POS) Regulations<sup>280</sup> erect a liability of those responsible for the prospectus to any person who has acquired securities to which the prospectus relates and suffered loss as a result of a misleading statement.<sup>281</sup> However, the enforcement level in general is believed to be lower in the U.K. than in the U.S.,<sup>282</sup> let alone with regard to cross-listing foreign issuers. The same holds with regard to the ongoing

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275. Prospectus Directive, *supra* note 82, art. 25; Transparency Directive, *supra* note 82, art. 28.

276. Market Abuse Directive, *supra* note 82, arts. 1(2)(c), 5 (proscribing the dissemination of false or misleading information where the person making such dissemination knew or ought to have known that the information was false or misleading).

277. Market Abuse Directive, *supra* note 82, arts. 1(2)(c), 5, 9(1). Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation, arts. 4, 5, 2003 O.J. (L 339) 70, 72 only substantiate Market Abuse Directive, arts. 1(2)(a) and (b).

278. Market Abuse Directive, *supra* note 82, art. 14.

279. FSMA, § 90(1) (the section refers in terms to listing particulars but is extended to prospectuses, (*see* FSMA § 90(11)) thereby covering all instances in which a prospectus is required (*see* FSMA § 85(1) and *supra* note 140). On the limited practical relevance of the provision, *see* Eilis Ferran, *Cross Border Offers of Securities in the EU: The Standard Life Flotation* 17-18 (University of Cambridge, Centre for Corporate and Commercial Law Working Paper), available at <http://ssrn.com/abstract=955252> (reporting that no single claim was brought successfully under FSMA § 90 or its predecessor and that investors tend not to even commence such claims).

280. Public Offers of Securities (POS) Regulations, Reg. 13-15, (1995) SI 1995/1537 (Eng.) repealed by The Prospectus Regulations 2005, Sched. 3, Reg. 2, (2005) SI 2005/1433 (Eng.).

281. For details, *see* DAVIES, *supra* note 268 at 671-73.

282. Hertig, Kraakman & Rock, *supra* note 162 at 212. *See also* Ferran, *supra* note 279 at 17-22 (arguing that although private enforcement of prospectus duties has left only marginal traces in UK case law so far, it may still play a more significant role in forcing compliance).

disclosure duties. Most notably, it was only in January 2007, at the occasion of the implementation of the Transparency Directive,<sup>283</sup> that a liability of issuers to investors for misleading statements in the periodic disclosure documents was established with regard to foreign issuers admitted to U.K. regulated markets as well.<sup>284</sup> Similarly, under the Transparency Directive, executive officers' certifications as to the accuracy of the issuer's financial statements became mandated for issuers with shares admitted to regulated markets.<sup>285</sup> Yet, the U.K. legislator does not attach any personal liability of directors in case these certifications are misleading, but contents himself with a personal liability of directors for knowing or reckless misrepresentations grounded in company law.<sup>286</sup> Hence, this liability is only of relevance to U.K. incorporated issuers.<sup>287</sup>

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283. Transparency Directive, *supra* note 82, art. 7, mandates

that responsibility for the information to be drawn up and made public in accordance with Articles 4, 5, 6 and 16 lies at least with the issuer or its administrative, management or supervisory bodies and shall ensure that [the member states'] laws, regulations and administrative provisions on liability apply to the issuers, the bodies referred to in this Article or the persons responsible within the issuers.

In the eyes of the Commission, this leaves member states considerable leeway in tailoring the liability sanction they deem appropriate. *Cf.* letter from Alexander Schaub (European Commission) to Lord Woolf (UK Financial Markets Law Committee), *available at* <http://www.fmlc.org/papers/Ltr2WoolfFromSchaub.pdf> (reinforcing the idea that member states are free to determine the extent of liability and noting that no standard "duty of care" is imposed on issuers with regard to investors when making mandatory public information available).

284. FSMA, § 90A. It is remarkable that the passage of this liability rule triggered a debate over whether it was reasonable to extend the provision's implicit safe-harbor for corporate directors to other types of disclosure. The controversy ultimately led to the appointment of an expert who was mandated with a comprehensive examination of the policies underlying the established liability regime for corporate disclosures: *see* Paul Davies, *Davies Review of Issuer Liability: Final Report* (June 2007), *available at* [http://www.hm-treasury.gov.uk/media/4/7/davies\\_review\\_finalreport\\_040607.pdf](http://www.hm-treasury.gov.uk/media/4/7/davies_review_finalreport_040607.pdf) (recommending to extend the liability regime under FSMA § 90A to all forms of periodic disclosure relating to any securities traded on exchange-regulated markets (*e.g.* AIM), to retain the high liability standard of fraud, and to confine liability to issuers only).

285. Transparency Directive, *supra* note 82, art. 4(2)(c).

286. Companies Act 2006, § 463, 2006 c. 46 (Eng.) (in effect as of January 20, 2007).

287. Even without civil liability under U.K. law, the possibility of private enforcement to secure accurate and comprehensive disclosure as prescribed by U.K. law may exist, at least on a theoretical level. Qualifying actions of public investors relating to false or misleading statements and omissions in issuers' disclosures as tort claims may lead to jurisdiction of the courts at the location of the harmful event which encompasses the place where the harm is suffered (*e.g.* EC Regulation No. 44/2001 of 20 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, art. 5(3), 2001 O.J. (L 12) 1; *Case C-21/76, Bier v. Mines de Potasse*, 1976 E.C.R. 1735). Conflict of laws rules may rely on similar criteria for the choice of applicable law (*e.g.*, Commission Proposal for a regulation of the European Parliament and the Council on the law applicable to non-contractual obligations ("Rome II"), art. 3(1), COM (2003) 427 final (Jul 22, 2003)).



Still, international issuers stand to gain some bonding opportunities from the U.K. regime on market manipulation. With regard to the E.U.-mandated prohibition of the dissemination of false or misleading information as a form of market manipulation, the U.K. implemented the Market Abuse Directive by incorporating a precise copy of the European rule into Part VIII of the FSMA.<sup>288</sup> The pertinent part of the FSMA, which includes several other prohibitions of manipulative behavior, applies to securities trading on both the Main Market and on AIM.<sup>289</sup> The bulk of enforcement is burdened on administrative sanctions, the imposition of which has been placed in the hands of the FSA.<sup>290</sup> The FSA has to be satisfied to the civil standard of proof that a person has engaged in an abusive conduct.<sup>291</sup> The geographical jurisdiction of the FSA covers, among other things, market abuse wherever it occurs, if it relates to qualifying securities traded on a prescribed market situated in, or operating in the U.K.<sup>292</sup> Hence, the U.K. regime should have an international scope comparable to the U.S. model under Rule 10b-5, *i.e.* it applies to false information related to securities cross-listed on either the LSE's Main Market or on AIM. The FSA can also seek injunctions and restitution orders issued by the High Court.<sup>293</sup> Importantly, however, the FSMA does not confer a right of private action on aggrieved market participants.<sup>294</sup> Finally, sanctions for more severe instances of abusive practices potentially including the dissemination of false information, like under the earlier

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Consequently, investors who bought the cross-listing issuer's shares on its home market may address domestic courts to pursue claims arising from false or misleading statements in disclosure documents filed under U.K. law under the relevant provisions of the law of the market.

288. FSMA, § 118(7) (introduced with effect of July 1, 2005 by the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005, SI 2005/381 (Eng.)).

289. Both market segments constitute 'prescribed markets' as they are established under the rules of the LSE, a recognized investment exchange. *See generally* FSMA, § 130A(1)(a); Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001, (2001) SI 2001/996, Reg. 4(1)(a).

290. FSMA, § 123. For details, *see* Enforcement Manual (ENF) of the Financial Services Authority, *available at* <http://fsahandbook.info/FSA/html/handbook/ENF>, in particular ENF 14 (sanctions for market abuse).

291. *Mohammed v. FSA*, Fin. Serv. & Mkts. Tribunal, March 29, 2005, unreported, *available at* <http://www.financeandtaxtribunals.gov.uk/decisions/documents/Fin%20serv/012.pdf>. *See also* Stephen W. Mayson, Derek French & Christopher L. Ryan, *COMPANY LAW* 416 (23rd ed. 2006).

292. FSMA, § 118A(1)(b).

293. FSMA, §§ 381, 383.

294. In particular, no such right accrues under FSMA § 150 because abusive practices do not contravene FSA rules in the first place, constituting a violation of statutory proscriptions instead. For the latter, the legislator arguably did not intend to create a right of private persons to sue for damages, *cf.* DAVIES, *supra* note 268 at 788, note 25 (holding that private cause of action was not valid).

regulations, follow from criminal law with its high burden of proof.<sup>295</sup> The territorial reach of the more important offence of creating a false market is defined by the requirement that the penalized act or course of conduct occurs in the U.K. or the misleading impression is created in the U.K.<sup>296</sup>

In sum, the most important difference between the two systems seems to lie in the far broader reliance on private enforcement exhibited by U.S. securities regulations. Yet it must be kept in mind that the efficacy of the latter has been contested for a long time.<sup>297</sup> In any case, the issue of enforcement will be revisited in more detail and in a broader context in Part IV.C.9.

### 7. Accounting Principles

It has been illustrated above, in Part IV.C.3, that significant variations in the intensity of an issuer's transparency duties do not occur at either the initial introduction of cross-listed securities to foreign equity markets or later under the obligations of continuous disclosure. Yet, with regard to the bonding-consequences of cross-listings, an important determinant lies in the accounting methodology that applies when international issuers prepare their financial statements. It would be an impudent undertaking to dare to determine the superiority of either U.K. or U.S. GAAP or IAS/IFRS. However, it can be said regarding the aim of this analysis that the bonding-effect of cross-listing equities is higher where the foreign issuer is obliged to at least comply with any of the mentioned accounting methodologies.

United States securities laws essentially require financial statements for admission or continuous disclosure purposes to be prepared in accordance with U.S. GAAP, but leave issuers the latitude to stick to the familiar accounting standards from their home waters. Yet, if foreign private issuers choose to prepare their financial statements in accordance with their domestic accounting rules that provide substantially similar informational content, they still have to reconcile them with U.S. GAAP.<sup>298</sup>

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295. Cf. FSMA, § 397(2)(3). For the equally structured offence under the FSMA's predecessor, cf. FINANCIAL SERVICES ACT 1986, § 47(2), 1986, c. 60 (Eng.).

296. FSMA, § 397(7).

297. For recent critical assessments, see, e.g., Coffee, *supra* note 273 at 67 (concluding that the contemporary system of U.S. securities litigation "benefits three sets of actors: corporate insiders, plaintiff's attorneys, and insurance companies—but not shareholders"); Jackson & Roe, *supra* note 266 at 5-9 (surveying the legal literature that finds the efficacy of many American private securities lawsuits compromised because the system frequently yields meager compensation to wronged plaintiffs, the cost of wrong-doings are not imposed on the acting insiders but result in a transfer of losses among groups of innocent investors).

298. See Form 20-F, Items 17 and 18, 17 C.F.R. § 240.220f (2006).

European law (at least until January 1, 2009) exempts foreign issuers from the obligations to prepare financial statements in accordance with articles 4 and 5 of the Transparency Directive and the E.U. regulations referred to therein, if the issuer satisfactorily proves that its domestic regulator is undertaking efforts to converge the domestic standards with IFRS.<sup>299</sup> Consequentially, European law has not granted and does not grant much of a bonding opportunity. However, the relevant listing particulars of the pertinent market segments do a slightly better job. With regard to issuers listing shares on the Main Market, the Listing Rules allow financial statements to be prepared in accordance with the issuer's national law and accounting standards or IAS. Regardless, they must at least provide enough information to give a true and fair view of the issuer's state of affairs.<sup>300</sup> Far more stringent bonding is possible for AIM companies. Until August 2006, AIM companies' accounts had to be prepared in accordance with U.K. or U.S. GAAP or IAS, but equivalence of Canadian GAAP and Australian IFRS was recently acknowledged. Issuers incorporated in a member state of the European Economic Area (EEA), however, as a result of European legislation,<sup>301</sup> must prepare and present their annual accounts in accordance with International Accounting Standards.<sup>302</sup>

## 8. Corporate Governance Provisions

One of the most direct forms of legal bonding occurs where issuers submit to certain corporate governance standards prescribed in the respective exchanges' listing rules. In addition to the indispensable duties spelled out by U.S. securities laws, the NASDAQ requires its listed companies to make public the receipt of an audit containing a going concern qualification.<sup>303</sup> Furthermore, NASDAQ issuers must have an audit committee comprised of independent directors,<sup>304</sup> a requirement

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299. Commission Decision 2006/891 on the use by third country issuers of securities of information prepared under internationally accepted accounting standards, art. 1(c), 2006 O.J. (L 343) 96, 98 (EC) (outlining the conditions under which foreign accounting standards are deemed to be in compliance with EC transparency requirements).

300. FIN. SERVS. AUTH., LISTING RULES, Rules 9.8.2.; 14.2.2 (2007) (prescribing United Kingdom listing rules).

301. Cf. Regulation (EC) No. 1606/2002 on the application of international accounting standards, art. 4, 2002 O.J. (L 243) 1, 3 (describing the new standard for consolidated accounts).

302. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rule 19, at 8 (2007) (requiring AIM companies to publish audited accounts).

303. NASDAQ, INC., MARKET PLACE RULES, Rule 4350(b)(1)(B) (Apr. 15, 2004) (outlining certain procedures for an issuer who receives an audit with a going concern qualification).

304. NASDAQ, INC., MARKET PLACE RULES, Rule 4350(d)(2)-(3) (Apr. 15, 2004)

called for by SOX.<sup>305</sup> Foreign private issuers may waive the rest of the governance prescriptions in favor of their domestic rules if they give proper notice of such deviation.<sup>306</sup> Similarly, NYSE-listed foreign private issuers may waive most of the corporate governance standards stipulated in the Listed Company Manual except the provisions on the independent audit committee.<sup>307</sup> Finally, foreign issuers admitted to AMEX may also remain in non-compliance with the exchange's corporate governance prescriptions.<sup>308</sup>

The main governance tool imposed on issuers listed on the LSE's markets is mandatory shareholder approval prior to certain significant transactions.<sup>309</sup> Yet, some remarkable differences can be observed. Issuers listing shares on the LSE's Main Market who have opted for a secondary listing<sup>310</sup> do not incur any such obligation. On the other hand, overseas issuers who opted for a primary listing are required to seek advance shareholder approval if they wish to execute acquisitions or disposals of interest in an undertaking where the transaction surpasses a 25% magnitude in relation to the issuer's business as determined by several class tests laid out in Annex 1 of the Listing Rules, Rule 10. Furthermore, Main Market companies have to address shareholders prior to executing a reverse takeover.<sup>311</sup> Analogously, while *ex ante* shareholder approval is dispensable for the majority of transactions involving AIM companies, consent given in a general meeting is mandatory. No opt-out is possible in case of reverse takeovers and disposals resulting in a fundamental change of business.<sup>312</sup> In determining whether a transaction passes the 100% (reverse take-overs) or 75% (fundamental change of business disposals)

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(describing audit committee composition and responsibility).

305. Sarbanes-Oxley Act of 2002, § 301 and SEC Rule 10A-3, (codified as amended at 17 C.F.R § 240.10A-3 (2006)).

306. NASDAQ, INC., MARKET PLACE RULES, Rule 4350(a)(1) (Apr. 15, 2004) (allowing foreign issuers to use accepted business practice from their own countries).

307. NYSE, INC., LISTED COMPANY MANUAL, § 303A (2006) (describing corporate governance standards for foreign private issuers).

308. AMEX, LLC, COMPANY GUIDE, §§ 110 (2007) (outlining rules for private issuers listed on AMEX).

309. From June 29, 2008, onwards, European law will mandate audit committees for "public interest entities", i.e. in pertinent context, issuers having shares admitted to a regulated market. Yet, only one committee member will have to be independent. Council Directive 2006/43, on statutory audits of annual accounts and consolidated accounts, art. 41(1), 53(1), 2006 O.J. (L 157) 87, 103, 107. (amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC).

310. *Cf. supra* note 105.

311. *See* FIN. SERVS. AUTH., LISTING RULES, Rule 10 (2007) (covering significant transactions); FIN. SERVS. AUTH., LISTING RULES, Rule 14.2.6 (2007) (stating that Rule 10 applies to overseas issuers with a primary listing).

312. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Rules 13 & 14, at 5 (2007) (discussing reverse takeovers or fundamental changes of business).

thresholds that trigger the approval requirements, several class tests laid out in Schedule 3 of the AIM-Rules apply.<sup>313</sup>

#### 9. General Assessment in the Light of Diverging Enforcement Intensity

The survey of U.K. and U.S. securities laws with relevance for legal-bonding results in an illuminative picture. In some respects, U.S. law allows foreign private issuers to bond themselves more strongly by subjecting their businesses to more stringent provisions. The major differences with relevance to the legal bonding hypothesis can be observed by looking to the publication of significant shareholdings, the escape from disclosure requirements, takeover-rules, and the liability for false statements. Yet, U.K. markets, far from being laxly regulated, allow issuers to opt for similarly high standards with regard to black letter law. To clarify, overseas issuers exempt themselves from many pivotal parts of U.K. securities laws by seeking only a secondary listing under the Listing Rules. Those overseas issuers that pursue a primary listing, however, become subject to rather stringent provisions.<sup>314</sup> This is particularly true with regard to initial and ongoing disclosure where the City exhibits a more stringent regime of mandatory interim reports and ad hoc disclosure of significant events. Similarly, issuers with primary listings have to ensure shareholder approval prior to significant transactions and are bound by more constricting rules in case of related-party transactions. In sum, it seems hard to gauge a doubtless superiority of any one legal system. This is all the more true since some of the U.S. margins are ambivalent. The far reaching private liability for fraudulent statements must not necessarily bring net gains as a result of facilitated bonding but may also result in heightened litigation expenses borne by the issuer that are apt to consume

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313. The Gross Asset, Profit, and Turnover tests respectively relate the gross assets, the profits attributable to the assets, the turnover attributable to the assets, and the subject of the transaction to the particular figures of the AIM company. The Consideration test relates the consideration of the transaction to the aggregate market value of all ordinary shares (excluding treasury shares) of the AIM company. Finally, the Gross Capital Test relates the Gross capital of the company or business being acquired to the gross capital of the AIM-company. Cf. LONDON STOCK EXCHANGE, PLC., AIM RULES FOR COMPANIES, Schedule 3, at 19 (2007).

314. It is a shortfall of otherwise impressive studies that they do not fully embrace the entire scope of options offered under the U.K. regulatory regime but focus instead exclusively on the lowest available standards for admission to the LSE's Main Market, although foreign issuers can opt for significantly more stringent rules. See Coffee, *supra* note 266, at 11 n.17; Doidge et al., *supra* note 38 at 9-10 (both relying on Iain MacNeil & Alex Lau, *International Corporate Regulation: Listing Rules and Overseas Companies*, 50 INT'L & COMP. L.Q. 787, 795-806 (2001) who only discuss the status quo prior to incisive European and U.K. reform efforts).

contingent bonding gains.<sup>315</sup> Taking an even tougher stance in this respect in reaction to corporate scandals certainly shifted the balance even more. These burdens represent an addition to the heightened compliance costs under Sarbanes-Oxley that potentially reduce the benefits of a U.S. listing.

However, even if securities law regimes governing U.S. and U.K. exchanges provide, at least at the issuers' choice, standards of investor protection that are largely equivalent, a striking difference still emerges if the topic of enforcement is further explored. Regardless of the controversy surrounding the superiority of a specific mode of enforcement,<sup>316</sup> the undisputed underlying assumption of all pertinent studies is: enforcement matters a great deal.<sup>317</sup> Recent research reveals that the U.S. clearly trumps the U.K. when it comes to enforcement activity, particularly regarding enforcement "output" measured in numbers of public enforcement actions brought, aggregate financial sanctions levied, and financial penalties (settlements, trial and arbitration awards) imposed in private enforcement actions.<sup>318</sup> A similarly staggering margin of enforcement output can be observed with regard to criminal sanctions.<sup>319</sup> Obviously, the significantly higher threat of strict enforcement under U.S. securities laws and the punitive character of the sanctioning system account for a palpable difference in the regulatory environment governing New York's and London's exchanges. While substantive rules may stipulate largely equivalent standards, at least for benign issuers willing to submit to investor-protective securities laws, it is the considerably larger deterring effect of enforcement under U.S. regulation that marks a clear difference between U.S. and U.K. markets. Moreover, it is likely that enforcement of many regulations principally apt to protect investors but stipulated only in AIM listing rules (e.g. interim reporting obligations (Part IV.C.3.a), rules on related-party transactions (Part IV.C.3.b), reporting duties for significant

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315. See *supra* note 297, and accompanying text.

316. See *supra* note 266.

317. E.g., Jackson & Roe, *supra* note 266, at 3 (arguing that private and public enforcement play a complementary role in building strong securities markets). For further evidence, see also Licht, *supra* note 50, at 154 (arguing that adherence to and enforcement of the law are of critical importance in corporate governance); Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, 57 J. FIN. 75, 78 (2002) (finding - in a global sample of 87 countries - that while the mere existence of insider prohibitions did not affect the cost of equity, the first prosecution did).

318. Howell E. Jackson, *Variations in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 27-29 (John M. Olin Center for Law Economics, and Business Discussion Paper No. 521, 2005) available at <http://ssrn.com/abstract=839250> (period between 2000 and 2002); Coffee, *supra* note 266 at 36-44 (period between 2002-2006).

319. Compare the numbers reported in Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Legal Penalties for Financial Misrepresentation*, 42 Panel B (Working Paper, 2007) available at <http://ssrn.com/abstract=933333>, with FERRAN, *supra* note 85, at 33.

holdings (Part IV.C.3.c), and the prescription of accounting standards (Part IV.C.7)) will suffer from severe enforcement deficiencies. This is because the LSE (a self-regulatory body without significant public support from the FSA) is badly equipped to crack down on foreign issuers and administer truly deterring sanctions on its own.

## V. LONDON'S SUCCESS IN THE MIRROR OF EMPIRICAL EVIDENCE ON CROSS-LISTING IMPACTS AND MOTIVES

Recent data indicates that the LSE's Main Market and AIM emerged as competitors to U.S. equity markets in the pursuit of international cross-listings. By and large, very similar non-legal institutions and determinants such as capital market development, informational environment, and cultural group affiliation, characterize the pertinent equity markets and provide a promising background for specifically assessing the relevance of securities laws and their bearing upon sophisticated capital markets. I present the hypothesis that despite transparent differences in the regulatory framework—particularly at the enforcement level—London's success can be explained by issuers' diverging motives, and results from a regulatory offer to a demand side significantly distinct from that of U.S. markets. To test this hypothesis, I will link the results of the analysis conducted thus far to the abundant empirical data presented in finance literature on cross-listings.

### A. *Empirical Evidence*

The empirical evidence indicates that capital markets indeed honor legal and non-legal improvements in a firm's corporate governance environment. Nevertheless, neither all nor even the bulk of positive abnormal returns associated with cross-listings may be attributable to this kind of bonding effect.

#### 1. Evidence: Cross-Listing Issuers Can Reap Legal-Bonding Premiums

Empirical observations about the bearing of cross-listing programs on a firm's financial standing have generated major indicators of the law's relevance to a firm's cost of capital. A growing body of complex finance literature presents a multitude of pertinent data that is somewhat ambiguous, especially within the context of specific legal environments, and bolsters the notion that the competing theories are not mutually

exclusive.<sup>320</sup> But the empirical evidence generally supports the hypothesis that an observable legal-bonding effect exists as a result of U.S. cross-listings.

*a. Inferences from older studies*

The results from older analyses, which were conducted with the goal of appraising the market segmentation hypothesis, can be studied under the new bonding theory. Event studies scrutinizing share price reactions around the announcement of ADR programs exposed positive abnormal returns at significantly higher rates for exchange and NASDAQ listings<sup>321</sup> compared to private placements under SEC Rule 144A<sup>322</sup> and minimally regulated Over the Counter (OTC) offerings.<sup>323</sup> The longer-run price reactions and more permanent, positive long-run returns for Asian firms<sup>324</sup> reflect particularly large benefits in investor protection, which issuers from jurisdictions with reputedly poor corporate governance institutions<sup>325</sup> stand to reap from ADR programs.<sup>326</sup>

*b. Testing the legal-bonding hypotheses directly*

Research conducted under René M. Stulz's fundamental critique directly scrutinizes the legal bonding hypothesis, and finds that companies from jurisdictions with what the La Porta et al. index considers to be weak

320. For a comprehensive survey of this literature, see G. Andrew Karolyi, *Why Do Companies List Shares Abroad?: A Survey of the Evidence and its Managerial Implications*, 7 FIN. MKTS., INSTS. & INSTRUMENTS 1 (1998) (tracking a chronology of research studies on cross-border listings of stocks); Karolyi, *supra* note 10 (synthesizing research initiatives relating to the bonding hypothesis).

321. U.S. securities laws are applicable with regard to foreign private issuers (*cf.* Rules and Regulations under the Securities Exchange Act of 1934, Rule 3b-4(c), 17 C.F.R. § 240.3b-4 (2005)) whose shares are to be admitted for exchange trading. For details *cf. supra* at Part IV.A.

322. Private Resales of Securities to Institutions Rule, 17 C.F.R. § 230.144A (2006).

323. Miller, *supra* note 44.

324. See Foerster & Karolyi, *supra* note 44 (drawing inferences from eleven Asian firms included in a study on stock price performance and risk exposure of non-U.S. stocks cross-listed in U.S. markets).

325. The ranking of jurisdictions by investor protection, as mentioned in the studies here, generally follows the "Antidirector Rights Index" presented in La Porta et al., *supra* note 1, at 1134. For an astute critique of this index, *cf.* Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s 'Antidirector Rights Index' Under Consistent Coding* 1-84 (European Corporate Governance Inst., Law Working Paper No. 67/2006, 2006), available at <http://ssrn.com/abstract=894301> (concluding the index was systematically measured incorrectly and thus an invalid indicator of shareholder protection).

326. See also Coffee, *supra* note 40 (discussing the corporate governance implications of cross-listing on a U.S. exchange).



investor protection are generally more likely to cross-list in the United States. Moreover, equity offerings that followed such cross-listings occurred much more frequently, this observation being sensitive to the quality of minority shareholder protection in the issuers' home jurisdictions.<sup>327</sup>

On average, a U.S. cross-listing valuation-premium of around 16% was documented in terms of Tobin's  $q$ ,<sup>328</sup> which met concerns regarding the explanatory power of event studies; the premium was significantly greater (37%) for issuers from countries with weaker investor protection and for firms opting for exchange listings instead of Rule 144A private placements or OTC listings.<sup>329</sup> Subsequent studies confirmed the valuation premium for U.S. exchange listings for each year between 1991 and 2005.<sup>330</sup> Recent studies, however, have called into question the persistence of this valuation-premium by revealing that Tobin's  $q$  rose significantly both before cross-listing ("internationalization") and during the year in which the program was executed, but subsequently fell to previous levels. Ultimately, cross-listing firms are left without a sustained valuation premium compared to their domestic peers.<sup>331</sup> Yet, the paper was

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327. Reese & Weisbach, *supra* note 50, at 80-104 (finding issuers from weak investor protection jurisdictions are also more likely to conduct their post-cross-listing offerings in their home markets outside the United States). *But see* Licht, *supra* note 50, at 161 (interpreting the fact that cross-listing issuers prefer to conduct equity offerings on their home markets as evidence of a lack of strong bonding).

328. Firm valuation in terms of Tobin's  $q$  is calculated as the ratio of the company's market value to its asset value. More precisely, the numerator reflects the book value of equity subtracted from the book value of total assets, to which the market value of equity is added. The denominator consists of the book value of total assets. James Tobin, *A General Equilibrium Approach to Monetary Theory*, 1 J. MONEY, CREDIT & BANKING 15 (1969) (illustrating a general framework for monetary analysis). Thus, high ratios above one suggest that management maximizes shareholder value by making the firm's market value substantially exceed the replacement value of its assets.

329. Craig Doidge, G. Andrew Karolyi & René M. Stulz, *Why Are Foreign Firms that Are Listed in the U.S. Worth More?*, 71 J. FIN. ECON. 205 (2004) (conducting Tobin's  $q$ -analysis for the year 1997 of a worldwide sample of 712 issuers relative to a global benchmark sample of 4078 publicly-traded firms).

330. *See* Doidge, Karolyi & Stulz, *supra* note 38, at 33 (estimating that cross-listed U.S. exchange firms were on average worth 17.5% more than non-listed firms between 1990 and 2001, and worth about 14.3% more between 2002 and 2005, a difference that is statistically insignificant and disappears completely if the values from the exceptional year 1999 are eliminated from the sample).

331. Juan Carlos Gozzi, Ross Levine & Sergio L. Schmukler, *Internationalization and the Evolution of Corporate Valuation* 1-47 (World Bank, World Bank Policy Research Working Paper No. 3933, 2006), available at [http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2006/05/30/000016406\\_20060530160901/Rendered/PDF/wps3933.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2006/05/30/000016406_20060530160901/Rendered/PDF/wps3933.pdf) (scrutinizing 9096 firms from seventy-four countries from 1989-2000 and finding that cross-listing facilitates corporate expansion by persistently raising market capitalization and increasing corporate assets, but does not consistently enhance firm valuation).

legitimately criticized for lumping together diverging exchange listings from different jurisdictions. Valuation premiums associated with U.S. exchange listings were shown to be persistent.<sup>332</sup>

In apparent discord with the bonding hypothesis, issuers from reputedly weak legal systems with high ownership concentration who pursue Rule 144A private placements experience positive valuation effects without becoming subject to the more stringent U.S. securities laws enforced with exchange listings.<sup>333</sup> On one hand, the latter may be ascribed to reputational bonding that signals truthfulness at a very early stage in a firm's history.<sup>334</sup> On the other hand, a decomposition of valuation effects reveals the following: regardless of whether equities are offered through exchange-listings or OTC offerings and Rule 144A private placements, U.S. securities markets generally afford firms more financial room to exploit growth opportunities, while only exchange listings substantially reduce firms' cost of capital.<sup>335</sup> Hence, although positive valuation effects stem from unregulated share offerings, the legal bonding hypothesis remains intact: positive abnormal returns result from cash-flow effects and bonding-premiums, as well as potential gains from enhanced market integration.

Voting premiums in dual-class shares were significantly lower for foreign firms with shares cross-listed in the United States than for firms with no such secondary listing, the difference being even larger for firms from jurisdictions assigned to low minority protection.<sup>336</sup> A tiny sample of Mexican firms, however, experienced a total absence of voting premiums in dual-class stocks where both classes of shares were cross-listed.<sup>337</sup> The

332. Doidge, Karolyi & Stulz, *supra* note 38, at 33-40.

333. See J. Michael Pinengar & Ravi Ravichandran, *When Does Bonding Bond? The Case of ADRs and GDRs*, 1-40 (May 2004) (unpublished manuscript, on file with the Indian School of Business), available at <http://www.isb.edu/cafi/docs/MichaelPinengar.pdf> (arguing that firms substitute voluntary disclosure for legal bonding).

334. Cf. *supra* Part III.B.3.a. (describing methods that facilitate reputational bonding).

335. See Luzi Hail & Christian Leuz, *Cost of Capital Effects and Changes in Growth Expectations Around U.S. Cross-Listings*, 1-47 (European Corporate Governance Inst., Working Paper No. 46/2004, 2006), available at <http://ssrn.com/abstract=938230> (documenting substantial cash-flow effects for all kinds of cross-listings, but significantly reduced cost of capital for exchange listings). See also *supra* note 331 and accompanying text.

336. Craig Doidge, *U.S. Cross-Listings and the Private Benefits of Control: Evidence from Dual-Class Firms*, 72 J. FIN. ECON. 519, 520-21 (2004) (finding premiums 43% lower for 137 cross-listing issuers compared to 745 domestic firms whose voting premiums decreased around the announcement date).

337. J. Michael Pinengar & R. Ravichandran, *U.S. Investors' Perceptions of Corporate Control in Mexico: Evidence from Sibling ADRs*, 38 J. FIN. & QUANTITATIVE ANALYSIS 213 (2003) (finding within a sample of five Mexican sibling-ADRs that those backed by superior voting shares traded at a discount inexplicable by differences in cash-flow rights, market risks, liquidity, voting control of major shareholders, or ownership limitations).

latter finding may be rationalized to reflect the (rather unlikely) total disappearance of consumable private benefits following cross-listing, or to question the viability of voting premiums as an indicator of available private benefits.<sup>338</sup> Yet, such a proposition contradicts several theoretical models that establish control premiums as a measure for the availability of private benefits.<sup>339</sup>

Dominant shareholders shun the stern institutions of investor protection in the United States.<sup>340</sup> Their decision to not cross-list is sometimes interpreted as a signal that the dominant blockholder wishes to reveal the high private benefits of control available in his or her firm.<sup>341</sup> Control changes associated with cross-listing decisions reputedly indicate that new dominant shareholders who operate under the more confining U.S. corporate governance regime place a lower value on the private benefits of control.<sup>342</sup>

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338. For a survey of literature on how U.S. cross-listings affect the availability of private benefits, see Evangelos Benos & Michael S. Weisbach, *Private Benefits and Cross-Listings in the United States*, 5 EMERGING MKTS. REVIEW 217 (2004) (concluding empirical evidence makes a “compelling case” for the bonding hypothesis).

339. E.g., Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537 (2004) (providing alternate estimates of private control benefits across thirty-nine countries); Sanford J. Grossman & Oliver D. Hart, *One Share-One Vote and the Market for Corporate Control*, 20 J. FIN. ECON. 175 (1988) (using the one share-one vote rule to study private benefits under corporate control); Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 J. FIN. ECON. 325 (2003) (using a vote-value approach to study private benefits).

340. See Craig Doidge et al., *Private Benefits of Control, Ownership, and the Cross-Listing Decision* 1-38 (Nat’l Bureau of Econ. Research, Working Paper No. 11162, 2005), available at <http://www.nber.org/papers/w11162> (using a sample of 4000 firms from thirty-two countries to show the likelihood of cross-listing decreases where controlling shareholders exist).

341. Michal Barzuza, David C. Smith & Elio Valladares, *Signaling a Lemon: The Decision Not to Cross-List and High Private Benefits of Control* 16-21 (Soc. Sci. Research Network, Working Paper, 2006), available at <http://ssrn.com/abstract=914000> (finding a positive and significant change in the frequency of control transactions among firms that chose not to cross-list).

342. Craig Doidge, *What is the Effect of Cross-Listing on Corporate Ownership and Control?* 1-43 (August 2005) (unpublished manuscript, on file with the University of Toronto Rotman School of Management), available at [http://www.rotman.utoronto.ca/~CDoidge/Files&Documents/draft\\_v020805.pdf](http://www.rotman.utoronto.ca/~CDoidge/Files&Documents/draft_v020805.pdf) (finding that, upon cross-listing, controllers of emerging market firms significantly reduce their stake, while family owners and partnerships transfer their blocks to foreign public corporations, resulting in an average abnormal return of 6.31% around the announcement of the control change). See also Meghana Ayyagari, *Does Cross-Listing Lead to Functional Convergence? Empirical Evidence*, 1-64 (World Bank, World Bank Policy Research Working Paper No. 3264, 2004), available at [http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2004/05/20/000009486\\_20040520151243/Rendered/PDF/wps3264convergence.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2004/05/20/000009486_20040520151243/Rendered/PDF/wps3264convergence.pdf) (listing firm-specific factors such as smaller size, low debt-levels, and high growth of foreign income, as meaningful predictors of a control change for foreign investors).

c. *Challenges*

A core criticism of the legal bonding hypothesis argues that enforcement of U.S. securities law regarding foreign issuers is poor at best.<sup>343</sup> Not surprisingly, however, warranted counter-criticism, supported by empirical evidence,<sup>344</sup> points to the deterrent effect of high profile cases and the statistically distorting effect of silent settlements.<sup>345</sup> Moreover, even though the pressure to comply with U.S. securities regulations may be less coercive for foreign than for domestic issuers,<sup>346</sup> cross-listings might still lead to an improved protection of minority shareholders' interests, as compared to the standards prevailing in the cross-listing issuers' home jurisdictions. Putting emphasis on the relative enhancements, it is of minor relevance that cross-listing may not yield legal safeguards to protect shareholders of foreign private issuers as equally efficient as those of U.S. issuers. In light of this "incomplete bonding hypothesis," it is not surprising that the value of cross-listed shares as acquisition currency is enhanced relative to domestic shares, but still depends on the quality of investor protection in the issuer's home jurisdiction.<sup>347</sup>

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343. See Amir N. Licht, *David's Dilemma: A Case Study of Securities Regulation in a Small Open Market*, 2 THEORETICAL INQUIRIES OF LAW 673, 708 (2001) (examining the Israeli dual listing project to explore challenges faced by regulators in small, open markets); Amir N. Licht, *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, 22 U. PA. J. INT'L ECON. L. 325, 347 (2001) (finding that the dual listing project suggests "managerial opportunism is a significant factor in the decision-making processes in public organizations"); Licht, *supra* note 50, at 143 (identifying a "hands-off" policy at the SEC with regard to foreign issuers); Jordan Siegel, *Can foreign firms bond themselves effectively by renting U.S. securities laws?*, 75 J. FIN. ECON. 319-59 (2005) (finding neither the SEC nor private actors effectively enforcing U.S. securities law against cross-listing firms, nor preventing insiders of Mexican firms from tunneling assets).

344. Hermann P. Tribukait-Vasconcelos, *The Invisible Enforcer: Price Behavior of Mexican Firms Cross-listed on the NYSE around Corporate Announcements* (Harvard Economics Dep't, Working Paper, 2002), available at [http://www.law.harvard.edu/programs/olin\\_center/corporate\\_governance/papers/Tribukait\\_Paper.pdf](http://www.law.harvard.edu/programs/olin_center/corporate_governance/papers/Tribukait_Paper.pdf) (attributing the movement of significant price reactions closer to the actual date of cross-listed Mexican firms' earnings announcements to U.S. securities laws that inhibit insider trading).

345. Coffee, *supra* note 40, at 1794-96 (elaborating on several legal enforcement techniques used with regard to foreign companies that are often unknown to the public); see also Coffee, *supra* note 266, at 56 (naming prominent instances of settlements and public enforcement actions against foreign private issuers, and noting that securities fraud may well receive more attention in the U.S. than abroad).

346. See Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience*, in INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MiFID AND BEYOND 485, 496-501 (Guido Ferrarini & Eddy Wymeersch eds., 2006) (showing reasons for a "home bias" in SEC enforcement actions, owing in part to the costs and benefits of such actions in a context where enforcement resources are scarce).

347. Natasha Burns, *The Role of Cross-Listed Stocks as an Acquisition Currency*:

Valuation premiums for Canadian firms cross-listing in the U.S. accrue only to issuers who obtain sufficiently large order flows in the U.S.<sup>348</sup> While this lack of a legal-bonding premium is readily explained with the impact of the MJDS that allows Canadian issuers to avoid U.S. disclosure rules altogether,<sup>349</sup> this rationale is not available where similar studies of emerging markets (*i.e.* Korea) found value-enhancing effects of cross-listing events (among other circumstances reflecting openness to foreign equity investors) related to the size of U.S. portfolio flow.<sup>350</sup> Still, the findings can be rationalized as yet another manifestation of the bundling phenomenon: some valuation effects, which issuers from remote home jurisdictions incur, certainly stem from improved market integration, for which turnover generated by U.S. investors represents a proxy. Moreover, it seems plausible to argue that only significant U.S. trading—which does not need to occur in U.S. markets<sup>351</sup>—enables foreign issuers to piggyback on the highly efficient informational environment and the improvements in outside monitoring associated mainly with U.S. institutions (such as analysts, institutional investors, etc.), whose appetite

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*Evidence from Takeovers of U.S. Firms* (Terry College of Business, Working Paper, 2004), available at <http://ssrn.com/abstract=587921> (finding that in a sample of 438 bids between 1984 and 2000, foreign acquirers of U.S. firms with listed ADRs used equity far more frequently than non cross-listed buyers (48% compared to 3%) and paid lower premiums (23.7% versus 29.5%)).

348. Michael R. King & Dan Segal, *International Cross-Listing and the Bonding Hypothesis* (Bank of Canada, Working Paper No. 2004-17, 2004), available at <http://www.bankofcanada.ca/en/res/wp/2004/wp04-17.pdf>.

349. See *supra* note 167 and accompanying text.

350. Kee-Hong Bae, Warren Bailey & Connie X. Mao, *Stock Market Liberalization and the Information Environment*, 25 J. INT'L MONEY & FIN. 404, 425-27 (2006) (reporting on the associations between the information environment and “the degree of openness to foreign equity investment across a sample of emerging markets”).

351. U.S. investors' choice to buy ADRs in U.S. markets or the underlying shares on the issuers' home markets depends on both the level of legal protection—which may still be lower in foreign markets even though the pertinent governance and minority protection provisions affect ADRs and the underlying shares equally—and the ease of trading (*i.e.* transaction cost, liquidity). See V.T. Alaganar & Ramaprasad Bhar, *Diversification Gains from American Depositary Receipts and Foreign Equities: Evidence from Australian Stocks*, 11 J. INT'L FIN. MARKETS, INST. & MONEY 97-113 (2001) (stating that the economically significant higher reward/risk ratio of ADRs compared to the underlying stock is partly due to lower transaction cost). Cf. Reena Aggarwal, Sandeep Dahiya & Leora Klapper, *American Depositary Receipts (ADR) Holdings of U.S. Based Emerging Market Funds*, (The World Bank, Working Paper No. WPS3538, 2005), available at [http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2005/12/28/000112742\\_20051228122622/Rendered/PDF/wps3538.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2005/12/28/000112742_20051228122622/Rendered/PDF/wps3538.pdf) (examining American investors' motivations for holding ADRs rather than the underlying stock of foreign issuers). For evidence of integrated global trading environments in contrast to segmented markets, see David Ely & Mehdi Salehizadeh, *American Depositary Receipts: An Analysis of International Stock Price Movements*, 10 INT'L REV. OF FIN. ANAL. 343 (2001) (finding ADRs co-integrated with ordinary shares trading in the U.K., Japan, and Germany).

for foreign equities increases after a U.S. cross-listing.<sup>352</sup> If, however, the benefits from cross-listing do at least partly depend on turnover, this can be regarded as clear evidence that other factors apart from legal bonding, which homogeneously affects all cross-listing issuers, figure in the determination of the precise valuation premiums accruing to these firms. The query becomes: what firm specific reasons determine the success of an issuer in attracting order flow? Clearly, a thriving business does not hurt in this respect. It opens up the possibility of extensive disclosure beyond the mandated levels, which notably constitutes the indispensable starting point for establishing a reputation as an issuer who is open-minded about investor interests.

## 2. The Impact of Non-Legal Institutions

Even though the survey of the empirical evidence suggests that legal-bonding premiums accrue to cross-listing issuers, the discussion has already hinted that non-legal institutions responsible for improvements in investor protection also play a role. This finding can also be documented with regard to the relevant non-legal institutions outlined earlier.<sup>353</sup>

### a. *Informational environment*

It is intuitive that prospering firms which can credibly communicate their high profitability can reap the largest benefits from disseminating private knowledge into an enhanced informational environment capable of accurately validating the issuer's statements.<sup>354</sup> In accord with this argument, during the 1986-97 period, when European disclosure duties were undoubtedly less developed than their U.S. counterparts, finance scholars observed European companies listing abroad—mainly in the U.S.—while U.S. companies' share-registrations in Europe slumped. European companies, typically being export-oriented firms from the high-

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352. Cf. Reena Aggarwal, Leora Klapper & Peter D. Wysocki, *Portfolio Preferences of Foreign Institutional Investors*, 29 J. OF BANKING & FIN. 2919-46 (2005) (finding that U.S. investment funds prefer to invest in emerging market firms that issue ADRs); John Ammer et al., *Look at Me Now: The Role of Cross-Listing in Attracting U.S. Investors*, (Board of Governors of the Federal Reserve System, International Finance Discussion Paper No. 815, 2004), available at <http://www.federalreserve.gov/pubs/ifdp/2004/815/default.htm> (using a 1997 survey to demonstrate U.S. investors' preference for cross-listed foreign equities and finding differences based on the country of origin).

353. *Supra* Parts III.B.2 and III.B.3.

354. Oren Fuerst, *A Theoretical Analysis of The Investor Protection Regulations Argument for Global Listing of Stock* (Social Science Research Network, Working Paper, 1998), available at <http://ssrn.com/abstract=139599> (predicting high operational profits for (growth-oriented) firms cross-listing in the U.S. because of America's stricter legal regime and lack of extraordinary results of operation for (mature) U.S. firms listing overseas).

tech industries, frequently pursued a strategy of rapid expansion and initiated large equity issues after listing abroad,<sup>355</sup> while U.S. companies did not aim at extraordinary growth, but instead increased their leverage significantly after cross-listing.<sup>356</sup> The latter findings obviously hint at a looming self-selection bias relating to U.S. cross-listing firms' valuation.

Empirical studies substantiating the improvements in a firm's informational environment associated with U.S. listings found not only an increase in the number of analysts following cross-listed foreign stock, but also an enhanced forecast accuracy translating into higher firm valuations.<sup>357</sup> The same studies found accounting data of U.S. cross-listing issuers more closely related to share prices and less prone to earnings management.<sup>358</sup> Closer conformity with U.S. GAAP whets U.S. institutional investors' appetite for cross-listed securities.<sup>359</sup> This potentially reinforces the governance aspects of enhanced accounting standards. Yet, an important caveat with regard to the explanations of valuation premiums for cross-listers relates to the previously mentioned self-selection bias. It is conceivable that increases in valuation represent the result of management efforts to dress-up the bride prior to the wedding.

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355. The latter characteristics, not surprisingly in light of the strategic orientation of the pertinent market, also applied to NASDAQ-listed Israeli companies. *Cf.* Blass & Yafeh, *supra* note 8, at 555 (stating that companies choosing to list in the U.S. are often young and high-tech oriented, willing to incur additional expenses to distinguish themselves).

356. Pagano, Roell & Zechner, *supra* note 8. *See also* Stijn Claessens & Sergio L. Schmukler, *International Financial Integration through Equity Markets: Which Firms from Which Countries Go Global?* (IMF, Working Paper 07/138, June 2007), available at <http://sccie.ucsc.edu/webpages/Schmuklerpaper.pdf> (finding for the 1991-2000 period, in a set of 2,546 firms pursuing capital raising activities on international markets (though not only via cross-listings), a generally larger market capitalization and greater liquidity, as well as higher leverage, valuation, performance and foreign sales compared to a benchmark of 36,971 purely domestic firms).

357. *See* Mark H. Lang, Karl V. Lins & Darius P. Miller, *ADRs, Analysts and Accuracy: Does Cross-Listing in the United States Improve A Firm's Information Environment and Increase Market Value?*, 41 J. ACCT. RES. 317-345 (2003) (using a sample of 235 U.S. listed foreign stocks relative to a benchmark of 4,859 equities from 28 countries to conclude that cross-listed firms have better information environments, which is associated with higher market valuations); Mark H. Lang, Karl V. Lins & Darius P. Miller, *Concentrated Control, Analyst Following and Valuation: Do Analysts Matter Most When Investors Are Protected Least?*, 42 J. ACCT. RES. 581-623 (2004) (showing that increases in analyst following often lead to an increase in firm valuation, and that such increases are greater if issuers have dominant blockholders or come from countries with poor minority protection).

358. Mark H. Lang, Karl V. Lins & Darius P. Miller, *ADRs, Analysts and Accuracy: Does Cross-Listing in the United States Improve A Firm's Information Environment and Increase Market Value?*, 41 J. ACCT. RES. 317-345 (2003) (using a time series study to show changes that occur after cross-listing, such as analyst following and forecast frequency).

359. Mark T. Bradshaw, Brian J. Bushee & Gregory S. Miller, *Accounting Choice, Home Bias and U.S. Investment in Non-U.S. Firms*, 42 J. ACCT. RES. 795-841 (2004) (finding greater conformity to U.S. GAAP standards usually means higher levels of U.S. institutional ownership, owing to familiarity, lower processing costs, and to a perceived higher quality).

From this angle, changes in analyst accuracy may be generated endogenously.<sup>360</sup>

*b. Investment banks*

Empirical studies found (SEC Rule 144A) privately-placed firms from developed countries that were cross-listing shares in the U.S. underperformed more significantly than public-offerings of exchange-listed ADRs (Level 3 ADR programs<sup>361</sup>).<sup>362</sup> This finding is consistent with the certification hypothesis, if it is assumed that public offerings represent a tougher task to investment banks, because they require comprehensive disclosure and due to their size, have to attract a larger number of investors, both institutional and retail.

*c. Active Shareholders*

Studies have found a strong preference of U.S. institutional investors for ADRs over purely domestic stock.<sup>363</sup> More precisely, U.S. investors prefer ADRs especially where foreign ordinaries are issued by firms with limited analyst following on domestic markets and where issuers come from countries with poor investor protection, low liquidity, and high transaction costs.<sup>364</sup> Although some evidence of a beneficial effect from the presence of foreign investors exists,<sup>365</sup> it is largely unclear how much

360. Cf. Karolyi, *supra* note 10, at 123-24 (exploring sources of endogeneity on the firm and country level).

361. The most important distinction of so called "Level 3 ADR-programs" is that the foreign private issuer publicly offers new shares in the U.S., instead of simply depositing shares already issued on the company's home market with a U.S. depository (the Level 2 ADR program). The foreign company is required to draw up a registration statement and an offering prospectus compelling comprehensive disclosure in accordance with Form F-1, similar to Form S-1 which applies to domestic issuers.

362. Stephen R. Foerster & Andrew G. Karolyi, *The Long-Run Performance of Global Equity Offerings*, 35 J. FIN. & QUANTITATIVE ANALYSIS 499-528 (2000) (using a sample of 333 global equity offerings with ADR tranches from Asia, Latin America, and Europe between 1982 and 1996 to show that companies from segmented markets issuing equity in the U.S. under-perform local market benchmarks over the following three years).

363. See Hali J. Edison & Francis E. Warnock, *U.S. Investors' Emerging Market Equity Portfolios: A Security-Level Analysis*, 86 REV. ECON. & STAT. 691-704 (2004) (showing that U.S. cross-listed emerging market firms are held in accordance with the international capital asset pricing model, while purely domestic firms are underrepresented); Ammer et al., *supra* note 352, at 2 (stating that 17% of the shares outstanding of foreign firms cross-listing in the U.S. are held by U.S. investors, while the fraction of purely domestic firms amounts to no more than 3%).

364. Aggarwal, Dahiya & Klapper, *supra* note 351.

365. Bernard S. Black, Hasung Jang & Woonchan Kim, *Does Corporate Governance Predict Firms' Market Values? Evidence from Korea*, 22 J. L. ECON. & ORG. 366, 403 (2006) (finding foreign share ownership positively correlated to firm valuation of Korean



mitigation of agency conflicts increased stockholdings of U.S. institutional investors can accomplish. At the very least, the danger of expropriation still looms large with cross-listing firms, where the ownership structure (large shareholdings of managers or families) suggests an increased risk of private benefit consumption.<sup>366</sup>

*d. Mergers and acquisitions*

In fact, cross-listed foreign firms are more likely to engage in acquisition activity and to finance their transactions with equity at lower premiums than non-cross-listed foreign bidders.<sup>367</sup> Importantly, foreign firms that exhibit a higher likelihood to acquire a U.S. target within three years after cross-listing typically initiate secondary offerings which dilute cash-flow and control rights of dominant shareholders, institute other government improving actions, and have higher valuations (Tobin's q) before and after the cross-listing and the offering.<sup>368</sup>

*B. Assessment*

In sum, the empirical evidence supports the availability of bonding premiums for cross-listing issuers. However, it remains unsettled whether the complex governance repercussions of cross-listings translate into valuation premiums which accord to an exact taxonomy of the precise merits of and differences in the institutional packages involved. In particular, the alterations in the issuer's legal environment seem to elude perfectly accurate assessment. At first glance, this touches to the core of

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firms and rationalizing these findings as being attributable to enhanced market integration (access to diversified investors) and/or corporate governance induced by the foreigners, amongst other factors).

366. Christian Leuz, Karl V. Lins & Francis E. Warnock, *Do Foreigners Invest Less in Poorly Governed Firms?* (European Corporate Governance Institute, Working Paper No. 43/2004, April 2006), available at <http://ssrn.com/abstract=677642> (using a sample of 4,411 firms from 29 emerging market countries to show that foreigners invest significantly less in firms that are poorly governed, the governance being directly effected by a country's information rules and legal institutions).

367. See Pasi Tolmunen & Sami Torstila, *Cross-Listings and M&A Activity: Transatlantic Evidence*, 31 FIN. MGMT. 123-142 (2005) (finding no increased likelihood for European cross-listing firms to engage in acquisition activity but validating the observation that equity-financing of the pertinent transactions is facilitated); cf. Burns, *supra* note 347 (finding that cross-listed firms using equity pay an average of 10% less than non-cross-listed firms paying in cash, but noting that the cross-listed firms use equity less often than U.S. firms).

368. Praveen Kumar & Latha Ramchand, *Takeovers, Market Monitoring, and International Corporate Governance* (University of Houston, Working Paper, May 2006), available at [http://papers.ssrn.com/so13/papers.cfm?abstract\\_id=901525](http://papers.ssrn.com/so13/papers.cfm?abstract_id=901525).

the efficient market hypothesis.<sup>369</sup> Yet, the supposition becomes less radical if it is taken into account that the appraisal of specific legal arrangements, more often than not, is controversial among lawyers, economists, etc.<sup>370</sup> This can be illustrated with the contentious assessment of the mandatory bid rule,<sup>371</sup> the debate regarding board passivity in takeover situations,<sup>372</sup> the controversy regarding the most efficient way to enforce securities laws,<sup>373</sup> or the overall assessment of SOX<sup>374</sup>. As a consequence, there is frequently no clear information pertaining to the details of the legal framework which could be impounded into share-prices. Hence, it is no surprise that there is ample evidence that even highly efficient capital markets do not respond to rather minor changes in the law governing a firm's internal operations.<sup>375</sup> Studies arguably indicating the

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369. Simply put, markets are assumed to reflect available information in share prices instantaneously. Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970). For a lawyer's perspective, see Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984) (discussing the institutional preconditions and limits of efficient capital markets). For a discussion of the efficient capital market hypothesis in light of the behavioral finance literature, see Ronald J. Gilson & Rainier H. Kraakman, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias*, 28 J. Corp. L. 715, 722-37 (2003) (arguing that cognitive biases as well as agency and incentive problems put limits on security pricing by professionally-informed trading but do not generally impede efficient markets within these binding institutional constraints).

370. See Licht, *supra* note 47 at 612-13 (pointing to the complexity of assessing law's merits).

371. For an illustration, see the extensive discussion of the two schools of thought marked by William D. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505, 515-45 (1965) (arguing for an equal opportunity rule) and Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982) (arguing against any obligation of controllers to share control premiums). See also Lucian A. Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q.J. ECON. 957 (1994) (concluding that the efficiency of the equal opportunity rule, which can be implemented by a mandatory bid rule, depends on the efficacy of the other institutions devised to contain controller opportunism).

372. See, e.g., Lucian A. Bebchuk, *The Case against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002) (advocating to limit the board's role to facilitating an informed shareholder decision); Marcel Kahan & Edward B. Rock, *Corporate Constitutionalism: Antitakeover Charter Provisions as Pre-Commitment*, 152 U. PA. L. REV. 473 (2003) (explaining board entrenchment as satisfying shareholders' desire to install a strong bargaining agent in takeover situations).

373. See *supra* note 266.

374. For a survey of the evidence regarding SOX's effects on U.S. firms, see Christian Leuz, *Was the Sarbanes-Oxley Act of 2002 Really this Costly? A Discussion of Evidence from Event Returns and Going-Private Decisions*, 44 J. ACCT. & ECON. 146 (2007) (cautioning that, in light of the existing evidence, the overall cost-effect of SOX with regard to U.S. firms remains unclear).

375. See, e.g., Elliott J. Weiss & Lawrence J. White, *Of Econometrics and Corporate Law: A Study of Investors' Reactions to "Changes" in Corporate Law*, 75 CAL. L. REV. 551 (1987) (finding no market reaction to unforeseen decisions of the Delaware Supreme Court);

opposite with regard to U.S. firms' incorporation choices,<sup>376</sup> at best measure the overall effect of the bundle of changes in the corporations' institutional environment associated with the change in jurisdiction.<sup>377</sup> Yet, they leave law's contribution to the whole unspecified. In fact, investors might rather look at the overall reputations of the pertinent legal systems which emerge over time.<sup>378</sup> But they are in a bad position to gauge the exact consequences of particular variations in the weaving structure of the seamless web constituted by specific norms and standards. To be clear, sweeping changes in investor protection standards have observable effects on firm valuation. But this need not be the case for less grave discrepancies. This hypothesis once again receives some support from research scrutinizing the U.S. incorporation scenery, where despite remaining variations in state corporate statutes, Delaware's valuation premium disappeared.<sup>379</sup> In light of these findings, it is plausible that success on international capital markets with regard to legal-bonding premiums requires only submission to certain minimum standards which lie within a band of regulatory models that equally enjoy investors'

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Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 181-85 (1987) (uncovering market indifference towards the enactment of antitakeover statutes); see also Licht, *supra* note 47 at 617-21 (showing that interaction between different legal regimes in the cross-listing context renders accurate pricing of individual rules difficult).

376. Robert M. Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001) (finding a 5% positive effect of reincorporation in Delaware using Tobin's q analysis).

377. Oren Bar-Gill, Michal Barzuzza & Lucian A. Bebchuk, *The Market for Corporate Law*, 162 J. INST. & THEO. ECON. 134 (2006) (arguing that Delaware firms' higher Tobin's q may be attributed not only to its corporate law, but also to network externalities and the legal infrastructure offered and that Delaware has incentives to underprice this package in the incorporation market to chill competitors).

378. With the important qualification that investors' ability to assess the general quality of a pertinent set of securities rules and standards allows for an upward mobility, the hypothesis advanced here is not in disaccord with fundamental views submitted by advocates of issuer-choice in international securities regulation. See Romano, *supra* note 137, at 2366-67 (arguing that informed investor assessments of the governing legal framework will make issuers internalize the expropriation potentials under "bad" securities laws and will induce them to seek "good" regulatory domiciles); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQ. L. 387, 390, 493 (2001) (arguing the same proposition); Choi & Guzman, *supra* note 270 at 227 (arguing that diverging issuers' properties and investors' risk preferences will lead to the persistence of various securities law regimes alongside each other with investors making informed decisions taking the differences in the legal framework into account); see also Choi & Guzman, *supra* note 40, at 1878 (arguing the same proposition); Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 942-44 (1998) (refining their key argument that investors are in a position to make informed investments).

379. See Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32 (2004) (presenting evidence that Delaware firms' higher Tobin's q disappeared over the course of the 1990s).

appreciation. As an important consequence of this view, the prospect of a race to the absolute top in regulatory standards<sup>380</sup> looks somewhat clouded.

It is important to note that the latter conclusion even holds, if contrary to the argument presented here, bonding premiums precisely metered to regulatory variations indeed existed. Just like it has been argued with regard to corporate decision makers in the context of incorporation choices,<sup>381</sup> corporate insiders may refrain from subjecting the company to the most stringent, investor-friendly legal regime thereby deliberately sacrificing extra bonding gains—which they would have to share with minority shareholders—in order to retain more of their private benefits of control. Accounting for the looming self-selection bias denoted earlier<sup>382</sup>, the scenario is especially plausible as long as the costs of inferior bonding are counterbalanced by firm-specific factors (*e.g.* high-growth opportunities) that allow for sufficient financing at overall acceptable conditions. Buying the entrance ticket to highly developed, globalized capital markets, hence, could still be seen as linked with a suboptimal mitigation of agency conflicts from an investor's perspective.

Highly topical studies indicate that the LSE's success corresponds to the latter explanation. While significant and permanent valuation premiums for U.S. exchange listings could be demonstrated over a longer period, no such premiums were found for a London listing.<sup>383</sup> To be sure, the evidence with regard to AIM is scarce and some reservations with regard to the grouping of Main Market listings seem warranted.<sup>384</sup> Yet,

380. See *supra* note 51 and accompanying text.

381. It is a particularly dominant shareholders'/managers' aptitude to seek insulation from the market for corporate control in conjunction with reincorporation transactions that warrants the proposition of suboptimal outcomes on the U.S. market for corporate law. For recent expansions and refinements of this argument, see Lucian A. Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168 (1999) (arguing that regulatory competition works to produce takeover law that excessively protects managers); Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775 (2002) (producing evidence for the pro-managerial tilt); Bar-Gill, Barzuza & Bebchuk, *supra* note 377 (developing a formal model explaining why State competition favors managers). For an alternative interpretation, see Kahan & Rock, *supra* note 372 (arguing that shareholders may wish to endow their board with sweeping takeover-defenses and have it serve as a bargaining agent pursuing value-increasing selling strategies).

382. See *supra* Part V.A.2.

383. Doidge, Karolyi & Stulz, *supra* note 38, at 31.

384. A lack of sufficient data compels the study to report regression results for AIM only for 2005. *Id.* at 30. Moreover, the authors distinguish ordinary shares and depository receipt listings (*id.* at 9), which seems to miss the regulatory characterization of different forms of Main Market admissions. Regardless of the type of security listed, shares or depository receipts, the regulatory divide runs between primary and secondary listings. *Cf. supra* notes 102 and 105. As a consequence, in both groups, high-standard issuers with primary listings are pooled with low-standard issuers entertaining only secondary listings. Clearly, such inadequate composition of the dataset is apt to distort outcomes.

older studies can be interpreted in a similar manner: the significantly higher price amplitude surrounding a NYSE-listing compared to a LSE-listing<sup>385</sup> indicates the absence of a bonding component contributing to the valuation effects associated with a London cross-listing. Moreover, in light of the significant differences in enforcement levels outlined earlier,<sup>386</sup> the result of diverging bonding premiums seems plausible even under the hypothesis that exactly metered bonding premiums do not exist: we are confronted with a palpable and easily assessable divergence in the regulatory framework, the lack of enforcement constituting an uncontroversial shortfall of the one securities law regime.<sup>387</sup> Hence, by cross-listing in London, controlling insiders sacrifice an available reduction in the firm's cost of capital in order to safeguard more of their private benefits. This assumption is reinforced if it is taken into account that for other related reasons, the U.S. is arguably a significantly less comfortable place for CEOs than the U.K.<sup>388</sup>

Still, the purely functionalist approach looking primarily at costs of capital, firm valuations, and bonding costs in explaining cross-listings might not capture the whole picture anyway. Studies found that geography matters in listing choices. Cultural proximity seems to constitute a driving force in listing decisions.<sup>389</sup> However, cultural proximity may only serve as a proxy for general economic integration which seems to be an important determinant of the success of cross-listings.<sup>390</sup> Yet, these additional aspects

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385. See *supra* note 54.

386. See *supra* Part IV.C.9.

387. As outlined earlier (*supra* note 266), a controversy centers on the proper mode of enforcement. However, no dispute exists regarding whether the lack of enforcement is suboptimal from an investor's perspective.

388. Ugur Lel & Darius P. Miller, *International Cross-Listing, Firm Performance and Top Management Turnover: A Test of the Bonding Hypothesis* (U.S. Fed. Reserve Bd. Int'l Fin. Discussion Paper No. 877, 2006), available at <http://ssrn.com/abstract=926606> (finding that foreign issuers with U.S. exchange cross-listings shed underperforming CEOs with higher likelihood than those with listings in London).

389. Pagano et al., *supra* note 8 (finding a 33% higher likelihood for firms to list within a group of culturally homogenous countries); see also Sergei Sarkissian & Michael Schill, *The Overseas Listing Decision: New Evidence of Proximity Preference*, 17 REV. FIN. STUD. 769-809 (2004) (finding proximity, i.e. the distance between capitals, an important factor in listing choices especially for non G-5 (U.S.A., U.K., France, Germany, Japan) countries); Jordan I. Siegel, Amir N. Licht & Shalom H. Schwartz, *Egalitarianism and International Investment* (Working Paper, 2007) available at <http://ssrn.com/abstract=899082> (arguing that issuers' home and host countries' orientation towards egalitarianism, i.e. their intolerance for abuses of economic or political power, explains choices of cross-listing locations).

390. Sergei Sarkissian & Michael Schill, *Are There Permanent Valuation Gains to Overseas Listing? Evidence from Market Sequencing and Selection* (Darden Sch. of Bus., Working Paper No. 03-03, 2003), available at <http://ssrn.com/abstract=395140> (finding the decline in cost of capital more significant for listings across strongly connected product markets, which they attribute to the importance of investor familiarity).

that seem to be critical in determining the overall success of a secondary listing—just like the propositions of the still relevant market segmentation hypothesis—are less significant with regard to the more focused goal of this paper. The hypothesis here is that, all else equal, legal-bonding premiums of similar magnitude accrue with regard to different markets' regulatory offerings although these offerings vary within a band of acceptable standards. With regard to the significant differences in enforcement level, this hypothesis could not be tested against the background of the varying success of U.S. and U.K. markets. However, we gain evidence that trading venues with inferior legal standards can successfully coexist with high-quality suppliers in the market for secondary listings, as long as inferior law-discounts imposed are of minor magnitude and do not meaningfully hamper the issuers' financing needs. The impressive success of AIM is consistent with the latter proposition, as particularly high-growth firms that dominate AIM are capable of digesting higher risk-premiums.<sup>391</sup> Interpreted from this perspective, AIM's success does not accrue due to a competitive advantage because it offers a different product than the one U.S. exchanges supply.

Despite the deficits in enforcement levels which affect both London markets, the Main Market's less significant, but still cognizable upswing could at least partly be attributed to competitive forces. Obviously, the magnitude of the cross-listing premiums determines the point at which, at the margin, the sacrifice of private benefits is warranted. Hence, if the valuation premiums associated with a U.S. exchange listing had fallen as a result of SOX, some issuers would arguably face different trade-offs now. The evidence on such SOX-related discounts is mixed, however,<sup>392</sup> proscribing sustainable general conclusions in this regard. Yet, it is likely that SOX brings about unequal compliance costs depending on the corporate law of the cross-listing issuer's home jurisdiction.<sup>393</sup>

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391. See Doidge, Karolyi & Stulz, *supra* note 38, at 18 (finding AIM issuers to have extremely large Tobin's q ratios compared to issuers that pursue cross-listings at the Main Market, AMEX, NASDAQ, or NYSE).

392. See Kate Litvak, *Sarbanes Oxley and the Cross-Listing Premium*, 105 MICH. L. REV. 1857, 1860-61 (2006) (finding Tobin's q and market-to-book values decline significantly for cross-listing issuers subject to SOX during 2002, particularly at more profitable issuers with high levels of pre-SOX disclosure from countries with high transparency standards); Luigi Zingales, *Is the U.S. Capital Market Losing its Competitive Edge?* 13 (Univ. of Chi., Working Paper, 2006) available at <http://faculty.chicagosb.edu/luigi.zingales/research/PSpapers/competitiveness.pdf>. (reporting a relatively larger decline in the cross-listing premium post-SOX for firms with better corporate governance); Doidge, Karolyi & Stulz, *supra* note 38, at 37 (finding no impact of SOX on the cross-listing premium).

393. See Larry E. Ribstein, *Cross-Listing and Regulatory Competition*, 1 REV. L. & ECON. 97, 124-27 (2005) (showing examples of potential conflicts between SOX prescriptions and specific foreign corporate laws).

Consequentially, a larger chilling effect with regard to issuers from certain incorporation domiciles is conceivable and awaits future testing.

## VI. CONCLUSION

To foster its conclusions, this Article has looked at the comparative success of U.S. and U.K. equity markets. These markets feature the closest real-world examples of exchanges situated identically with regard to cultural background, market development, depth and liquidity, informational environment, etc. This resemblance in the basic parameters, although imperfect in detail, is suitable to scrutinize law's impact in particular. In this scenario, the regulatory framework governing exchange-listed<sup>394</sup> equities becomes a central distinguishing feature, far less superimposed by other factors. Hence, differences in applicable securities laws should be reflected more directly in the pertinent exchanges' success in the competition for international cross-listings. Consequentially, law's influence could be scrutinized especially meaningfully by relating the relative success of U.S. and U.K. markets to the divergences and changes in the pertinent legal frameworks.

A survey of the legal environment framing the respective equity markets showed that U.K. exchanges did not offer palpably inferior standards of investor protection when judged by the law on the books. The latter is all the more true if it is recalled that it were the ongoing reforms of European and U.K. securities laws that incrementally brought about more demanding regulations. Yet, persistent and substantial divergence was identified with regard to the levels of enforcement of securities laws.

The latter finding cautions an interpretation that understands London's emerging success as a result of both a skillful enhancement of U.K. regulatory standards and a less felicitous overregulation of U.S. markets. Another interpretation is favored here. There is good reason to believe that capital markets do not exactly measure the bonding gains associated with a specific legal framework if it does not deviate from a band of accepted rules and standards. The underlying rationale stems from the hypothesis that even informed investors do not assess individual rules and standards but reflect only the general reputation of regulatory packages in their pricing. In this scenario, issuers can capture bonding premiums of comparable magnitude by cross-listing on equally prestigious markets in spite of regulatory differences in detail. Yet, the differences in

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394. Studies comparing U.S. exchange cross-listings with Rule 144A/OTC-offerings (*supra* Part V.A.1.b.) have to deal with the fact that the respective markets differ significantly not only with regard to the regulatory framework. Contrasting NYSE/NASDAQ and LSE cross-listed securities on the other hand produces insights for public trading venues with largely similar market structure.

enforcement levels are of a magnitude and visibility that can be expected to leave traces in firm valuation. In the taxonomy of international capital markets advanced in the literature<sup>395</sup>, both the New York and London markets constitute high-quality trading venues in a position to attract foreign national champions. Still, U.S. exchange cross-listings expose the issuer and controlling insiders to the world's most austere enforcement regime and hence require significantly less aversion to stringent investor protection than London listings. Consequentially, the emergence of a new competitive player only indicates that an arrangement of legal institutions incrementally gained recognition that satisfies alternative demands investors pose to capital market regulation and that it has earned prestige in its ambit. The fact that U.S. markets are anything but dead and still attract international issuers alongside the success of U.K. markets lends plausibility to this interpretation. Moreover, it militates against the assumption of an institutional competition between equity markets with high cross price elasticity where changes in the legal environment, which increase the cost of cross-listings, are immediately translated into a higher demand for the substitute. In effect, the surge in London listings cannot be explained mainly as a function of U.S. overregulation. On the other hand, if the LSE was inclined to compete with U.S. exchanges for issuers featuring identical preferences it could mount its enforcement efforts accordingly.

The absence of a legal-bonding premium that accrues in the event of a London cross-listing suggests that corporate decision makers have motives to sacrifice bonding gains, like retaining private benefits under a legal regime less hospitable to investor interests, as long as the other reasons for pursuing a foreign listing (*e.g.* to enhance the shares' liquidity, to improve their global market integration etc.) can be met at a less incisively regulated market. Similarly, another possible explanation of London's success largely disappears, even though it takes the relative inferiority of the U.K. securities law regime into account. To be sure, it is not counterintuitive from the outset that issuers and their management found a way to compensate for losses which would otherwise result as a consequence of weaker legal bonding opportunities, *e.g.* the efficient deployment of reputational bonding devices such as voluntary disclosure beyond mandated standards and the like. Yet, the lack of valuation premiums for a London listing suggests the failure of such reputational mechanisms.

Finally, London's recent success indicates that a race to the absolute top with regard to disclosure and corporate governance standards in securities laws will not occur. The City's recent upswing hints that at least

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395. *Cf. supra* note 40.



some corporate decision makers in fact prefer somewhat inferior financing conditions. Consequently, a separating equilibrium is likely to evolve.