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ARTICLE: RACING TOWARDS THE TOP?: THE IMPACT OF CROSS-LISTINGS AND STOCK MARKET COMPETITION ON INTERNATIONAL CORPORATE GOVERNANCE

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LEXISNEXIS SUMMARY:
... Today, there are an estimated 150 securities exchanges trading stocks around the world. ... - That a foreign firm lists on the NYSE or Nasdaq does not imply that its common stock will principally trade there (as opposed to on its home country exchange). ... If a foreign issuer can list on the NYSE, and yet the majority of the trading in its stock eventually flows back to the issuer's home country exchange, the NYSE gains less from such a listing than from a comparable domestic listing. ... Because both it and its dealers gain less from such a listing and because the NYSE must compete with a foreign exchange for trading volume, the NYSE logically has less incentive to pursue a bonding policy that benefits it only marginally. ... This mismatch means the NYSE may be under-motivated to offer bonding services because such listings may not attract revenues if the trading stays in, or flows back to, the foreign issuer's home jurisdiction. ... If the foreign issuer has a higher level of trading in the United States than on any non-U.S. exchange, then such an issuer should not be able to escape U.S. listing standards that are intended to protect the investors who trade on U.S. exchanges. ...

TEXT:
[*1759]

Introduction

Today, there are an estimated 150 securities exchanges trading stocks around the world. n1 Tomorrow (or at least within the reasonably foreseeable future), this number is likely to shrink radically. Indeed, this was the U.S. experience at the beginning of the twentieth century when over 100 securities exchanges in the United States either consolidated or simply shut down, as improved communications and transportation systems lowered the informational cost barriers that had sustained them. n2 At the beginning of the twenty-first century, the two great forces reshaping the contemporary world - globalization and technology - appear to be forcing a similar consolidation. n3 Because globalization has lowered the barriers to cross-border capital flows and because technology has facilitated instantaneous information flows, securities markets can now compete on a global basis that previously was infeasible. As a result, issuers, **[*1760]** particularly those in emerging economies, have a choice of markets on which to list their securities and raise equity capital.

As with consolidation in other markets, competition among securities markets leads to a wave of mergers and affiliations, as the principal players seek to increase their market share. This process is already well underway. n4 But where does this process end? Some who have studied this new competition have assumed that the winners (or at least the survivors) in this consolidation process will be those who can offer the greatest liquidity, the lowest trading costs, or the most advanced technology. n5 They believe that this competition inherently will result in a "winner-takes-all" contest that will leave only a few large pools of liquidity in major international financial centers. n6 The premise here is that "liquidity attracts liquidity," n7 and thus larger markets should drain order flow and liquidity from smaller markets, ultimately leaving them hollowed out shells.

[*1761] This Article resists the claim that competition will produce uniformity or any single winner. Although trading costs, liquidity, and technology will certainly influence the competition for order flow, their relative impact cannot sensibly be assessed until one addresses a prior question: Why do issuers cross-list in the first place? The more closely one examines the actual motives and behavior of both those firms that do cross-list and those that do not, the more one finds that issuers are motivated or deterred by considerations of corporate governance and access to equity finance. As a result, because cross-listing on a U.S. exchange commits an issuer to at least some marginal change in its governance and disclosure practices, a deeper regulatory competition over governance and disclosure philosophies thus underlies the surface cross-border competition among market centers for listings and trading volume. Competition need not, however, drive corporate governance in a single direction. If firms have different preferences, competition can result in greater specialization, rather than uniformity. At present, however, the available evidence suggests that regulatory competition, as it actually has developed, will (1) restrain the centralizing forces that others see as leading to a natural monopoly of a few dominant "super-exchanges," (2) encourage private action by firms seeking to distinguish themselves from the herd, and (3) result in the enhanced protection of minority shareholders.

At this point, definitions become critical. Although the term "regulatory competition" has been much used in recent debates over securities regulation, n8 competition among regulatory systems can take very different forms. Academic proponents of regulatory competition have conceived of it as a struggle to eliminate or prune excess regulation. These proponents, both convinced that securities markets are often overregulated and skeptical of the motives of public regulators, have advocated a system of "issuer choice" under which each issuer could choose the regulatory regime under which its securities would trade. n9 Thus, issuers incorporated **[*1762]** in a U.S. jurisdiction and trading on the New York Stock Exchange (NYSE) could elect to have their disclosure standards determined by the laws of India, Taiwan, or Switzerland. By forcing different regulatory regimes into competition, "issuer choice," in the view of its proponents, would enable firms to engage in a regulatory arbitrage that would thereby purge out-of-date or inefficient regulation from the legal system, leaving only that degree of regulation that sophisticated market participants would design for themselves.

Yet the regulatory competition that in fact has developed involves not issuers choosing a regulatory regime from a menu of available options, but issuers cross-listing on an international securities market - and thereby opting into additional and usually higher disclosure and corporate governance standards. Two critical differences distinguish this system from the "issuer choice" model. First, issuers choose a market and a regulatory regime together, and cannot sever their choice of market from their choice of regulatory principles. Thus, issuers cannot enter a deep and developed market while observing only the laws governing a thin or primitive market. n10 Second, issuers cannot "exit" their home jurisdictions in a manner that truly escapes those jurisdictions' potentially more stringent regulations. n11

Under these conditions, this Article finds that strong legal standards today attract, rather than repel, issuers who are cross-listing. Indeed, when one examines the actual movement of issuers and listings across jurisdictions, the dominant pattern has been a pronounced migration of listings and trading to exchanges in jurisdictions that are noted for their **[*1763]** strong protection of minority shareholders. n12 Even in Europe, where firms today do possess a substantial degree of "issuer choice" - namely, the ability to choose the disclosure standards that apply to them - few firms seem to be opting for the less demanding options, but instead are voluntarily complying with the highest level of disclosure. n13 By listing under the standards of a higher disclosure regime, the migrating firms enhance their share price and become able to raise additional equity at lower cost. n14

This finding that migrating firms are opting into stronger, more mandatory legal standards is, of course, consistent with a new, important, and controversial academic literature that argues that liquid and deep securities markets develop only in jurisdictions that protect the rights and expectations of minority shareholders. n15 Still, the temptation to **[*1764]** overgeneralize must be resisted here. Even if the need to assure minority investors that they will be adequately protected underlies the contemporary race among foreign firms to cross-list on U.S. exchanges, one cannot fairly leap from this conclusion to a broader scenario under which intermarket competition produces an all-encompassing, regulatory "race to the top." n16 Not only is the world more complicated and path dependent than such a simple Darwinian competitive model suggests, n17 but, more importantly, such a scenario misunderstands the normal impact of competition. Put simply, competitive pressures tend to produce not uniformity, but specialization and fragmentation. n18

Particularly in the case of securities markets, any assumption that competition will produce uniformity disregards the critical fact that the universe of firms that use securities markets divides radically into two groups: those with concentrated ownership and those with dispersed ownership. n19 Concentrated ownership firms tend to behave differently than dispersed ownership firms, with the former often acting to maximize the private benefits of control for their controlling shareholders, while the latter seek to maximize their share price in the market. As a result, to **[*1765]** the extent that firms are the ultimate consumers of exchange listings, n20 different types of firms are likely to have correspondingly different attitudes toward migration to exchanges that impose stronger legal protections for minority shareholders. Specifically, this Article predicts that those firms that decline to migrate to "high disclosure" exchanges will be disproportionately those with controlling shareholders who prefer to maximize their receipt of the private benefits of control rather than to maximize the share price of their firms' publicly-held minority shares.

Phrased more generally, in a path dependent world, the regulatory posture of an exchange is likely to be heavily influenced by the structure of shareholder ownership of the firms traded on it. This conclusion implies, in turn, that different markets will serve different clienteles. Some may become more transparent and impose higher listing standards in order to foster dispersed ownership, attract portfolio investors, and maximize the share value of listed companies, while others may persist as lower cost, relatively opaque exchanges that accommodate firms with concentrated ownership in which the private benefits of control will remain high. As a result, a dual equilibrium becomes possible under which "high" and "low" disclosure exchanges persist side by side, reflecting the fact that firms with both concentrated and dispersed ownership will also persist side by side.

This prediction - that competition should produce not conformity, but market fragmentation - rests on the assumption that consumers in the market for exchange services have very different preferences, thereby inducing this market to increase, rather than decrease, consumer choice, as competitive pressures also increase. At first glance, this prediction may seem at variance with the contemporary evidence, which shows that issuers have been delisting from "low disclosure" exchanges and moving to "high disclosure" exchanges. In particular, European companies have migrated heavily to U.S. exchanges over recent years, while U.S. companies have reduced their cross-listings in Europe and Japan. n21 Overall, the **[*1766]** competitive ability of European exchanges to attract foreign listings has declined, while that of U.S. exchanges has soared. n22 Yet, as will be seen, the firms that have migrated to the U.S. market show special characteristics that are not shared by those that have stayed behind. n23

This picture becomes even more complex once we recognize that the process of competition among markets does not end with the decision of some firms to cross-list abroad. Rather, as national and regional markets lose liquidity and trading volume to international exchanges, a political reaction has sometimes followed. In those countries where the local market has been most adversely affected, legislative and regulatory reforms have been adopted to enhance governance and disclosure standards in the hope of stemming the flight of firms and trading to foreign markets. n24 Where once the legislative extension of voting rights or rights to share in control premiums would have been opposed by the local securities industry as egalitarian interference with the market, such reforms now have been championed by this same industry in these countries in an effort to stem the exodus of trading to overseas markets. n25 This political response is also a form of regulatory competition, although not the sort **[*1767]** envisioned by proponents of "issuer choice." As a result, the ability of controlling shareholders in at least some emerging markets to retain the traditional private benefits of control may increasingly be challenged. In short, there is a trade-off: Firms with concentrated ownership may wish to persist in their traditional system of corporate governance, but the viability of their market is threatened unless the exodus of trading to international exchanges can be reversed.

Organizationally, this Article is divided into five sections. Part I begins with an overview of developments in the international securities markets, with a particular focus on the rise and growth of the cross-listing phenomenon. Part II then turns to the obvious questions that the rapid growth in international cross-listing poses: Why do firms cross-list? What is the source of the gains that cross-listing produces for these firms? Two competing explanations for the cross-listing phenomenon will be assessed: (1) a market segmentation explanation, and (2) a corporate governance, or "bonding," hypothesis. n26 It was once assumed that cross-listing was basically a means of integrating segmented markets and thus enabling the issuer to access trapped pools of liquidity. n27 A newer interpretation is today emerging that cross-listing may also be a bonding mechanism by which firms incorporated in jurisdictions with weak protection of minority rights or poor enforcement mechanisms can voluntarily subject themselves to higher disclosure standards and stricter enforcement in order to attract investors who would otherwise be reluctant to invest (or who would discount such stocks to reflect the risk of minority expropriation). n28 Although both explanations have some validity, the second, or "bonding," explanation has the greater predictive power for the future, because the barriers that once segmented markets have largely eroded (and will continue to do so), thus reducing the need for issuers to enter distant markets to access trapped pools of liquidity. Nonetheless, Part II will find that bonding is a complex phenomenon **[*1768]** that needs to be unpacked to be properly understood. Significant differences distinguish those firms that do wish to bond from those that do not.

Parts III and IV assess the changes impacting securities markets globally and analyze the strategies individual exchanges can pursue to become more successful competitors. Part III focuses on transitional economies and in particular on the recent introduction of "high disclosure" exchanges in Europe and Brazil. Surveying the clientele of exchanges and market centers, Part IV predicts increased specialization among exchanges and market centers, as they attempt to serve very different clienteles. But it also notes that "higher disclosure" exchanges have encountered at best mixed success, in part because of the ceiling imposed on their ability to compete by the relaxed listing standards imposed on foreign issuers by U.S. exchanges. That is, although some of these markets have actually leapfrogged the United States in terms of the governance and disclosure standards that the United States now mandates for foreign issuers, they have encountered a ceiling on their ability to upgrade standards because of the laissez-faire attitude of U.S. exchanges toward foreign issuers. n29

The status quo is, however, about to change. Probably unintentionally, the United States has just taken a major and potentially destabilizing step towards heightened regulatory competition by enacting the Public Company Accounting Reform and Investor Protection Act of 2002 (popularly known as the "Sarbanes-Oxley Act"). n30 This legislation, passed in response to the Enron, WorldCom, and other recent corporate scandals, imposes important substantive governance standards on issuers listed on U.S. exchanges, without distinguishing between foreign and domestic issuers. n31 As a result, foreign issuers will seemingly be required to adopt U.S. governance standards to a new and unanticipated degree. At the same time, the scandals prompting this legislation may have taken some of the luster off a listing on a U.S. exchange. These developments seemingly set the stage for a natural experiment that tests the accuracy of the bonding hypothesis: Will foreign issuers delist in response to these developments (and, if so, which ones)? Part V examines the new form of regulatory **[*1769]** competition that appears to be developing and ultimately recommends what it terms an "exitless" model for regulatory competition.

I. An Overview of Market Competition

The history of head-to-head intermarket competition among stock exchanges is conspicuous by its absence. That is, such competition was and remains rare. n32 In the past, most firms simply listed on their home country exchange, which was generally a public or a quasi-public entity that possessed a de facto monopoly. Historians can point to a few counterexamples, but these prove little. For example, in the late nineteenth century, the Consolidated Stock and Petroleum Exchange challenged the NYSE by beginning to trade NYSE-listed stocks, charging lower commissions in part because it simply used the NYSE's quotes and did not have to invest in establishing the NYSE's price discovery mechanism. n33 For a while, this tactic worked, but the challenger was eventually driven out of business by the NYSE's exclusionary practices. n34 More recently, in the late 1980s, the London Stock Exchange (LSE) unilaterally began to quote the major European-listed stocks and quickly gained a dominant share over the European national exchanges. n35 Essentially, much like the Consolidated Stock and Petroleum Exchange a century earlier, the LSE was free-riding on a price discovery process that actually occurred on the home-country exchanges. By offering a faster execution at lower cost, the LSE was able to divert a significant percentage of trades to its exchange. n36 The advantage, however, again proved short-lived. The European exchanges updated their trading technology, n37 and, by 2000, the LSE had **[*1770]** sufficiently fallen behind that it was forced to agree in principle to a merger with the Frankfurt exchange. n38

Although the LSE's competitive challenge was successfully resisted, it set off a wave of defensive mergers and alliance building that continues today. The goal in this process of alliance building has been to erect a network that both (1) has superior liquidity to its rivals, and (2) is deliberately incompatible with its rivals' networks, thereby excluding members of rival exchanges or markets. Even once networks are established, however, the phenomenon of cross-listing may still drain trading from one network to another, as discussed in the following subsections.

A. Cross-Listing: The Dominant Competitive Technique

By far, the principal mechanism that produces competition among market centers has been the issuer's decision to cross-list its stock on a foreign exchange, typically in the United States. Cross-listing on a U.S. exchange is usually effected by the issuer first establishing a depository receipts facility (typically, with a major U.S. bank). The bank will hold shares of the foreign issuer and issue depository receipts to U.S. investors, who will thereby achieve the convenience of dollar-denominated trading. These depository receipts then may (or may not) be listed on a U.S. exchange or Nasdaq.

During the 1990s, the popularity of American Depository Receipts (ADRs) soared. In 1990, 352 depository receipt programs from twenty-four countries were in effect in the United States, n39 but, by 1999, this number had grown to 1,800 programs from 78 countries n40 - an increase of over 500%. At the end of 1999, the combined market capitalization of these companies exceeded $ 6 trillion. n41 Correspondingly, the number of foreign companies listed on the two principal U.S. stock markets (the NYSE and Nasdaq) grew from 170 in 1990 to over 750 in 2000 (or roughly a 450% increase). n42 As of April 2001, over 970 non-U.S. firms were listed **[*1771]** on the NYSE, Nasdaq, or the Amex. n43 During the 1990s, trading of ADRs grew rapidly, reaching $ 1,185 billion in 2000. n44 While depository receipts are most commonly used simply to list outstanding securities in a foreign market, they also provide a vehicle by which to effect primary offerings pursuant to which the listing firm issues new equity securities in the foreign market. During the late 1990s, foreign issuers exploited this possibility. Not only did foreign listings in U.S. markets soar, but the trading of foreign shares and equity issuances by foreign issuers in the U.S. markets increased even more dramatically. n45

The impact of cross-listings has been particularly pronounced on the NYSE. As Table 1 shows, foreign listings on the NYSE have grown from approximately 2% of all NYSE listings in 1975 and just over 5% in the early 1990s to nearly 17% today. n46 Table 1 also indicates that foreign listings have more than quadrupled since 1990, while domestic listings on the NYSE have steadily declined since 1998.

[br n:tab1,l(.10,.10)]

Table 1
Foreign Listed Companies on the New York Stock Exchange

[cp9,10] [tdm'July 0; 0000',ql [tcgp1,m'Total Listings',qc,vu1 [tcgp1,m'Foreign',qc,vu1 [tcgp1,m'Domestic',qc,vu1 [tcgp1,m'Percentage of Total Listings',qc,vu1] [tu3;5] Year Total Listings Foreign Domestic Foreign Listings as Percentage of Total Listings [tu3;5] 1975 1,557 33 1,524 02.12% 1980 1,570 37 1,533 02.35% 1985 1,541 54 1,487 03.5% 1990 1,774 96 1,678 05.4% 1991 1,885 105 1,780 05.6% 1992 2,089 120 1,969 05.7% 1993 2,361 153 2,208 06.5% 1994 2,570 216 2,354 08.4% 1995 2,675 247 2,428 09.0% 1996 2,907 304 2,603 10.5% 1997 3,047 356 2,691 11.7% 1998 3,114 379 2,735 12.2% 1999 3,025 406 2,619 13.4% 2000 2,862 434 2,428 15.2% 2001 2,798 462 2,336 16.5% July 1, 2002 2,796 468 2,328 16.7% [tu3;5]

The NYSE's recent inability to attract a net increase in domestic listings, while its foreign listings have soared over the same period, suggests that a NYSE listing does something for a foreign issuer that it does not do for a domestic issuer. Within the United States, the NYSE's trading technology - which still relies on an open outcry system on an actual trading floor and is significantly less computerized than its chief rival, Nasdaq - **[*1772]** strikes many as relatively antiquated, n47 and firms listed on Nasdaq have shown less interest in recent years in moving up to the NYSE once eligible for listing there. But for the foreign issuer, the NYSE still offers a critical advantage: its reputation as the leading repository of high disclosure standards and market transparency. Here, it clearly outranks its leading international competitor for listings, the LSE. n48 The NYSE's relative success against the LSE suggests that reputation may be more important than technology - at least for firms that cross-list.

Why did the rate of foreign listings in the United States suddenly accelerate in the 1990s? To some extent, the sudden growth in popularity of ADRs in the early 1990s was a consequence of state privatizations of formerly state-owned enterprises, which swept across Europe and South America beginning in the late 1980s. Prior to this time, depository receipt **[*1773]** programs were typically used to facilitate over-the-counter trading and, in most cases, were not associated with a listing on the NYSE, Nasdaq, or a contemporaneous equity offering in the United States. Yet these privatization offerings were often so large as to necessitate access to the world's largest capital market in the United States. Once these offering techniques were developed, they were increasingly copied later in the 1990s by already private companies.

More generally, however, there was a worldwide explosive growth in stock market capitalization during the 1990s. This growth is best measured in terms of the ratio of market capitalization to gross domestic product (GDP). A recent World Bank study finds that this ratio increased from a mean of 31% in 1990 to 62% in 2000, and from a median of 18% in 1990 to 34% in 2000. n49 While rich countries outperformed poor countries, n50 the direction was positive everywhere.

1. The Impact on Local Markets. - As stock markets grew exponentially during the 1990s, firms listed in the local market also listed abroad. Indeed, the ratio of market capitalization listed abroad to total market capitalization rose even more dramatically than did the ratio of market capitalization to GDP, particularly in emerging markets. n51 Although a foreign listing does not necessarily imply that trading will also shift to the foreign market, trading during the 1990s did in fact follow the migration of listings, at least in the case of "middle-income" countries (which category includes most emerging market economies in Asia and Latin America). For these nations, the ratio of trading abroad to total trading rose over the 1990s "from a few percentage points to some 40 percent in 2000." n52 Obviously, this growth in foreign trading represents a significant loss to the local securities industry, which at some point could imperil the liquidity of the local market.

On the positive side of the ledger, foreign listings enabled firms in emerging markets to raise vast amounts of equity capital. In 2000 alone, $ 29 billion in new equity was raised through some 115 depository receipt offerings in the U.S. and European markets. n53 For "middle-income" countries, the majority of equity had been raised domestically up until the mid-1990s, but after that point equity raised abroad began to vastly **[*1774]** exceed the equity raised domestically, with the foreign to domestic ratio peaking at 3.7:1 in 2000. n54

On the other side of the ledger, the adverse impact on local markets from cross-listings comes into clearest focus when we examine the special case of Latin American markets. In 1989, only two Latin American companies were cross-listed in U.S. markets, but by January 1999, this number had grown to 106. n55 This growth seems best explained by the fact that companies found, over this period, that cross-listing increased the value of their firms and enhanced the liquidity of their stock. n56 Indeed, the market capitalization of the four principal Latin American stock exchanges soared from $ 66 billion in 1990 to $ 434 billion in 1996 (or over 650%). n57

Along the way, however, something else happened: Stock turnover increased, and trading migrated from Latin American countries to the United States. By mid-1995, stocks representing over 87%, 54%, 62%, and 71% of the Mexican, Argentine, Chilean, and Brazilian stock market indices, respectively, were listed through ADRs in the United States. n58 Even more dramatically, trading moved to the United States, as Table 2 shows.

Table 2
Growth in U.S. Trading in Proportion to Domestic Trading (in $ Millions) n59

[cp8,9] [tdm'Domestic trading value:',ql [tcgp1,m'00;000',qc,vu1 [tcgp1,m'00;000',qc,vu1 [tcgp1,m'000;000',qc,vu1 [tcgp1,m'00;000;',qc,vu1 [tcgp1,m'000;000',qc,vu1] [tu3;6] 1990 1993 1994 1995 1996 [tu3;6] Argentina Domestic trading value: 852 10,339 11,372 4,594 4,382 U.S. trading value: 0 6,125 12,612 15,679 12,445 Turnover ratio (%) 26.1 37.4 65.0 53.6 37.7 Brazil Domestic trading value: 5,598 57,409 109,498 79,186 112,108 U.S. trading value: 0 96 284 3,284 25,801 Turnover ratio (%) 34.2 57.8 58.0 55.9 63.2 Chile Domestic trading value: 783 2,796 5,263 11,072 8,460 U.S. trading value: 92 2,369 7,210 11,600 9,584 Turnover ratio (%) 6.4 11.6 18.3 30.7 27.3 Mexico Domestic trading value: 12,212 62,454 82,964 34,377 43,040 U.S. trading value: 2,577 37,307 83,496 54,400 29,391 Turnover ratio (%) 45.2 49.7 127.8 97.9 67.9 [tu3;6] **[*1775]**

If one looks at the pivotal year 1995, one sees that the value of Mexican, Argentine, and Chilean ADRs traded in the United States was greater than the total value of all stocks traded in their respective domestic markets during that year. n60 Although Brazil may have seemed relatively exempt from this trend in the above table, the picture changed dramatically in the latter half of the decade. As of 1997, the S<tild a>o Paulo Stock Exchange (Bovespa), the largest Brazilian stock exchange, had a volume roughly equal to that of the Toronto Stock Exchange, but, by 2001, its trading volume had fallen to one-sixth of that of the Canadian exchange. n61 Indeed, daily trading volume on Bovespa fell by over 80% from $ 1 billion to $ 150 million. n62 In part, this decline reflected the enactment in Brazil of an unpopular stock transfer tax that made trading on the NYSE cheaper. n63 But, as most Brazilian commentators recognized, the stagnation of Brazil's capital markets and its inability to finance initial public offerings was primarily explained by the inadequacy of investor protections for minority shareholders. n64

2. Who Cross-Lists? - The evidence shows that firms establishing depository facilities in the United States come heavily from emerging market economies. One recent study found that 73% of non-U.S. companies establishing such facilities were from emerging markets. n65 In 2001, when ADR issuances fell sharply in the wake of terrorism and uncertainty, emerging market issuers again accounted for 73% of new ADR issuances, with Asian companies representing more than half this total. n66 A basic difference also seems to distinguish the motivation for cross-listings: European

[*1776] countries often cross-list in the United States to gain a currency with which they can make stock-for-stock acquisitions of U.S. companies, whereas emerging market companies tend to be interested primarily in raising equity capital. n67 At least for emerging market issuers, the depository receipt market, which is heavily concentrated in the United States, is the principal source of equity capital. n68

In this light, the Latin American experience, which saw much of the trading in its markets also move to the United States in the wake of the earlier migration of listings, could prove prophetic for other emerging market issuers, but not for European issuers. On the other hand, Latin America may be unique in that trading on its exchanges overlaps in time closely with the trading hours of U.S. markets, n69 which may make Latin American markets uniquely vulnerable to the loss of trading to a dominant market in its same time zone. n70

Although relative transfer taxes and the overlap in trading hours probably explain some of the trading loss that Latin American markets have recently experienced, they cannot be assigned the primary causal role for the stagnation in these markets. The chairman of Brazil's capital markets regulatory agency notes that, during the 1990s, Brazil averaged primary equity issuances of only $ 1 billion per year, but received foreign direct investment of $ 30 billion per year. n71 This 30:1 ratio reflects, he concludes, basic weaknesses in Brazilian corporate governance that leave foreign investors willing to invest as partners or joint venturers in Brazilian economic opportunities, but not as minority shareholders. n72

Yet if Latin American firms cannot raise equity capital in their own markets, they may be able to raise it in the U.S. market, as next discussed.

B. IPOs in International Markets

Issuers can go one step beyond cross-listing on a foreign exchange; they can do their initial public offering and listing on such an exchange and simply ignore their host country exchanges. This would not seem a **[*1777]** logical step for most young companies because they have greater visibility in their home countries, where price discovery can naturally occur more quickly and with lower transaction costs. Still, it may be a necessary step if their home countries cannot sustain liquid and active equity markets.

The clearest illustration of issuers in one country adopting a foreign market for their initial public offerings is supplied by Israel. Over the last decade, young Israeli companies have in large numbers forsaken their home exchange, the Tel Aviv Stock Exchange, and done their initial public offerings on Nasdaq in the United States. Nasdaq currently lists ninety-six Israeli companies, "more companies than from any other country outside of North America," and the dollar value of equity trading in Israeli stocks was estimated to be $ 44 billion in 1999. n73 Since 1995, at least 88% of all equity capital raised by Israeli firms was done through offerings on Nasdaq. n74 Consequently, Israel has the highest ratio of foreign to domestic market capitalization: 95.7% in 2000. n75 In effect, it has largely piggybacked on U.S. markets rather than developing its own.

Why do these Israeli companies ignore their home country exchange (or at least accord it little active role)? Professor Edward Rock has examined these offerings and found a common denominator: "Without exception, the audience is a relatively small group of U.S. institutional investors." n76 In effect, these offerings are marketed to a small group of U.S. institutional investors, ten of whom might easily control a majority of the firm's shares. In addition, the venture capitalists who originally financed the infant firm (typically, a collection of U.S. and Israeli firms) had themselves obtained much of their capital from U.S.-based venture capital investors, with the result that beneficial ownership was in effect being transferred upon the IPO from one cohesive group of largely U.S. owners to another such group by means of Nasdaq. Moreover, some of these Israeli issuers have actually incorporated in the United States, where they typically have significant operations and market their products.

In this light, the Israeli example does not demonstrate that other young companies can adopt the U.S. market and abandon their own. Rather, these Israeli companies were already highly integrated into the U.S. corporate governance system. The Israeli experience instead underscores that access to equity capital on the attractive, one-stop basis developed by Israeli firms may require significant prior accommodation to U.S. governance norms and expectations.

[*1778]

C. Satellite Markets and Market Networks

A final mechanism for increased competition among market centers involves the unusual act of bringing the mountain to Mohammed: namely, exporting the international market to other areas of the world through satellite operations or a network of affiliations. This approach requires significant start-up and operating costs and thus might be beyond the financial capacity of many exchanges, which generally have limited capital resources.

Nonetheless, one U.S. market - Nasdaq - has aggressively sought to expand on a global basis, establishing major subsidiary markets in Europe and Japan. n77 Its announced goal has been to create an integrated global marketplace that would offer round-the-clock trading, and its timetable has been to link its Asian and European outposts with its U.S. trading operations by 2003. n78 However, its success to date has been limited at best. For example, Nasdaq recently decided to close its Japanese market by the end of 2002. n79 What explains Nasdaq's inability to achieve a broader acceptance despite its strong brand name? The prevailing interpretation appears to be that, as an outsider, it has inevitably encountered resistance from entrenched interests within the local region. n80

In this light, the alternative and more logical means of extending the competitive range of an exchange may be to buy, merge, or affiliate with the leading local exchange. This appears to be the NYSE's strategy: to negotiate affiliations with other exchanges and seek cross-listings. n81 Probably the leading example of growth through merger is Euronext, a combination of the Paris, Amsterdam, and Brussels exchanges, which the Lisbon exchange is also scheduled to join in 2002. n82 Almost concomitantly with the creation of Euronext, the Deutsche Borse and the LSE negotiated a similar merger, only to see it ultimately collapse over control issues. OM Gruppen Inc., the owner of the Swedish exchange, later made an unsuccessful hostile bid for the LSE, n83 thereby foreshadowing the likelihood that as exchanges are privatized their control may become increasingly contestable in the market.

Market consolidation - either through mergers or, more likely, through network alliances - seems the most probable scenario for the future, with relatively few exchanges seeking to cross national borders and establish outposts in foreign jurisdictions. Over the near future, affiliations among market centers may increase and begin to be negotiated **[*1779]** with the same competitive intensity as were diplomatic alliances in the nineteenth century - in both cases based primarily on the fear that those who are left out will become the most vulnerable.

II. Why Do Firms Cross-List?: The Competing Explanations

To this point, it has been argued that cross-listing is a dynamic and destabilizing force that has moved liquidity from local exchanges to international "super-markets," thereby impelling a consolidation among market centers. But this explanation leads to an obvious further question: What motivates firms to cross-list?

The answer may seem apparent: Firms can increase their value through cross-listing. The evidence here is relatively clear. n84 But this answer only leads to a further question: Why do stock prices increase when firms cross-list? Here, there are two competing explanations, one old and one new. The traditional explanation was that cross-listing broke down market segmentations and allowed the firm to reach trapped pools of liquidity. n85 Segmentation of markets because of investment barriers (e.g., taxes, regulatory restrictions, or informational constraints) creates an incentive for firms to cross-list in order to achieve market integration. Economic theory has long suggested that stock prices should rise for firms in segmented markets that cross-list. n86 A variation on this basic theory has suggested that, as cross-listing increases the shareholder base, the firm's risk is shared among more shareholders, and this increased diversification reduces the firm's cost of capital. n87 For a time, the empirical evidence seemed to confirm this explanation because the stock prices of **[*1780]** cross-listing firms seemed to rise and then decline post-listing. n88 Until recently, little evidence suggested that a dual listing actually increased firm value for the long term. n89

But at least one recent study by Professor Darius Miller ("Miller Study") has found a different pattern: Cross-listing results in positive abnormal returns that are statistically significant and that do not dissipate post-listing. n90 Unlike earlier studies, this study focused on the announcement date of the decision to cross-list, not the actual listing date. n91 The announcement date is clearly the theoretically more appropriate date because the market should react to news of the expected improvement, and frequently there is an appreciable delay between the announcement and the actual listing. In addition, this study found that the abnormal returns were considerably greater in magnitude when the firm cross-listed on the NYSE or Nasdaq than when the firm just established a depository receipt facility in the United States and listed only on an over-the-counter market. n92 Although these findings are not necessarily inconsistent with the market segmentation hypothesis, they better fit an alternative hypothesis that this Article will call the "bonding hypothesis."

A. The Bonding Hypothesis

Essentially, the bonding hypothesis posits that cross-listing on a U.S. stock exchange (including Nasdaq) commits the listing firm to respect minority investor rights and to provide fuller disclosure. Listing on a U.S. exchange does so because (1) the listing firm becomes subject to the enforcement powers of the Securities and Exchange Commission

(SEC); (2) investors acquire the ability to exercise effective and low-cost legal remedies, such as class actions and derivative actions, that are simply not available in the firm's home jurisdiction; n93 and (3) entry into the U.S. markets commits the firm (at least when it lists on an exchange or Nasdaq) **[*1781]** to provide fuller financial information in response to SEC requirements and to reconcile its financial statements with U.S. generally accepted accounting principles (GAAP). n94

Beyond these strictly legal requirements, entry into the U.S. equity markets exposes the foreign issuer to the scrutiny of "reputational intermediaries," including U.S. underwriters (if the issuer undertakes an initial public offering in the United States, as is frequently the case), auditors, debt rating agencies, and securities analysts. n95 Analysts can reasonably be viewed as financial watchdogs who should be at least as skillful as public regulators in uncovering financial chicanery, and hence a firm that subjects itself to their scrutiny is arguably "bonding" its promise to make full and fair disclosure. The foreign issuer also becomes subject to any listing requirements imposed by the U.S. exchange on which it lists. Although U.S. exchanges do impose significant corporate governance requirements **[*1782]** on domestic firms that regulate board structure and protect shareholder voting rights, n96 they have largely waived these substantive corporate governance requirements in the case of foreign issuers. n97 Morever, the SEC has acquiesced in this pattern. n98 Accordingly, whatever increase in minority protection that results from listing in the United States comes almost exclusively from SEC disclosure requirements and from public and private enforcement, but not from the U.S. exchanges themselves. Indeed, the broad exemption afforded by U.S. exchanges to foreign issuers from the listing requirements that they apply to domestic companies represents a new and important barrier to efforts by emerging markets to upgrade their corporate governance standards. n99

Because the only mandatory changes incident to entering the U.S. markets relate to disclosure, the bonding hypothesis must postulate that improved disclosure can be a functional substitute (even if an imperfect one) for higher substantive standards of corporate governance. To the extent that this premise is valid, listing in the United States resembles a bonding mechanism, similar, for example, to the use of sureties or special monitors, that reduces the potential for the expropriation of minority investors. This Article will both defend the proposition that enhanced disclosure can be a second-best substitute for governance reform and argue that entry into the U.S. markets should require foreign issuers to meet substantially similar governance standards to those applicable to domestic companies.

[*1783] As a matter of theory, the idea that a credible promise of improved disclosure should produce a positive stock price reaction is neither surprising nor unorthodox. Economic theory has long predicted that the more credibly a firm commits itself to increased levels of disclosure, the more that this action should reduce the informational asymmetry component of the firm's cost of capital. n100 Empirically, this view has been supported by a recent notable study's conclusion that, as German firms switched from German accounting principles to U.S. GAAP or International Accounting Standards (IAS), their bid-asked spread declined and their trading volume increased. n101 Although these converting firms did not technically "bond" themselves to observe higher standards, they did make a credible promise to provide superior disclosure, and the market reacted positively. Similarly, another recent study finds that as foreign firms cross-list in the United States, they obtain significantly increased coverage by securities analysts and, as an apparent result, forecasts of their future earnings become more accurate relative to forecasts of firms that do not cross-list. n102 Moreover, firm value increases in direct response to increased analyst coverage. n103 Finally, a study completed in 2002 finds that when a foreign firm cross-lists in the United States, the market's reaction to the firm's subsequent earnings announcements increases significantly, suggesting that information is both followed more closely and deemed more credible. n104

B. The Case for Bonding

Evidence supporting the bonding hypothesis tends to fall under four distinct headings, each of which will briefly be examined.

1. The Market Reaction to Cross-Listings. - An initial source of evidence consists of studies of the stock market's reaction to a U.S. cross-listing by a foreign firm. Although there are numerous such studies, most do not consider the possibility that a U.S. cross-listing serves to protect **[*1784]** and assure minority investors, and only one study has carefully focused on the market reaction around the announcement date, rather than the often much later date of the actual listing. The Miller Study found positive abnormal returns on the announcement of a prospective U.S. listing, without any subsequent post-listing dissipation of those returns. n105 Alone, this is significant because proponents of the segmentation hypothesis have long interpreted their theory to predict that post-listing expected returns would decline because investors would accept a reduced rate of return with greater liquidity. n106 More importantly, the Miller Study also found that the stock price performance of foreign firms that established a depository receipt facility depended heav-

ily on whether they also listed on an exchange or Nasdaq. Those that did not experienced only modest positive abnormal returns, n107 while, in sharp contrast, those that also listed on the NYSE or Nasdaq experienced much larger positive abnormal returns, which were in fact more than double those of the firms **[*1785]** that did not list. n108 Additionally, foreign firms that only did private placements under Rule 144A in the U.S. market and then listed on PORTAL, a special electronic market restricted to large institutional investors, had statistically insignificant abnormal returns. n109

Why are these differences significant? Here, it is necessary to understand that a foreign firm wishing to access the U.S. capital markets by establishing a depository receipt facility has essentially four options. First, it can establish only a "Level I facility," which means that while a U.S. bank, or other agent, will hold its shares and issue receipts reflecting interests in them to investors, trading in these receipts will be conducted only on the over-the-counter market (typically, in the so-called "pink sheet" market). Second, the foreign firm can again establish a depository receipt facility, but now the firm lists its ADR securities on an exchange or Nasdaq. (This is called a "Level II" facility.) Third, the foreign firm can establish the same depository facility, list its securities, and in addition conduct an underwritten public offering of ADRs in the U.S. markets - in effect, entering the primary market as well as the secondary market. (This is known as a "Level III" facility.) Finally, one last alternative is to conduct a Rule 144A private offering (which does not entail SEC registration or sales to public retail investors) and then list these securities on PORTAL, which is a private electronic market on which only very large institutional investors can trade (who are known as "qualified institutional buyers" or "QIBs"). n110 This last technique is sometimes referred to as a "RADRs" (that is, a Rule 144A offering of ADRs), and it does not involve any entry into the public markets (either the primary or secondary markets) in the United States.

Legally, there are important differences between these various levels. Basically, firms that establish only a depository facility without listing on an exchange or Nasdaq (a Level I facility in the standard parlance of securities lawyers) are not required to become "reporting companies" under U.S. federal securities laws, need not reconcile their financial statements in accordance with U.S. GAAP, n111 and need not file Form 20-F with **[*1786]** the SEC. n112 Rather, an exemptive SEC rule (Rule 12g3-2(b)) permits unlisted foreign private issuers to continue simply to file with the SEC only the same documents that they file with their home country regulator and/or stock exchange. n113 In short, from a corporate governance perspective, little of significance happens when only a Level I facility is created; there is no upgrading in the quality of financial disclosure and no bonding of any consequence. In contrast, when a foreign firm lists on a U.S. stock exchange or with Nasdaq (i.e., a Level II facility), it must become a reporting company, must annually file Form 20-F with the SEC, and must reconcile its financial statements to U.S. GAAP. n114 In addition, it becomes subject to SEC oversight and to private enforcement in the U.S. courts through class and derivative actions. Thus, there are meaningful corporate governance changes, and the Miller Study's findings therefore suggest that the market has responded to these changes by increasing the firm's share price. n115

Finally, when a foreign firm establishes a depository facility in the United States, lists on a stock exchange, and makes a public offering of securities in the United States (i.e., a Level III facility), the Miller Study found a much stronger positive market reaction than when the firm simply **[*1787]** listed on an exchange or Nasdaq (i.e., a Level II facility). n116 Intriguingly, this is in sharp contrast to the normal U.S. experience in which public firms announcing a public offering of equity typically experience an abnormal negative stock price movement. n117 Further complicating the picture is another finding in the Miller Study: When foreign firms sell equity in the U.S. markets under a Rule 144A private transaction, there is a negative price reaction, while in contrast U.S. firms increase shareholder wealth on average by making private placements. n118 The apparent paradox is that while a public sale by a foreign issuer in the U.S. market increases firm value, a private sale does not, whereas the reverse is true in both cases for domestic issuers.

Curious as this pattern may seem, it makes sense from a corporate governance perspective. By making a public registered sale in the United States, a foreign issuer voluntarily subjects itself to the strict liability provisions of section 11 of the Securities Act of 1933. n119 In principle, this gives added credibility to what it says because it faces high liability for any material misrepresentation or omission. In contrast, a foreign issuer that merely lists on the NYSE or Nasdaq faces antifraud liability only under Rule 10b-5, which requires the plaintiff to prove the defendant's fraudulent intent, or scienter. n120 The difference between strict liability and liability only for statements made with fraudulent intent is ultimately a difference in the degree to which the firm has "bonded" itself to tell the truth. Also, a public offering in the United States involves both the preparation of a detailed registration statement that provides more current information than the typical Form 20-F n121 and the use of U.S. reputational **[*1788]** intermediaries (i.e., underwriters and securities attorneys) who will test the adequacy of its disclosures. Arguably, the positive market reaction to a public offering by a foreign firm reflects the value of both more information and enhanced credibility.

Ultimately, the markedly greater positive stock price reaction to foreign firms that conduct public offerings in the United States versus those that simply list on the NYSE or Nasdaq corroborates the bonding hypothesis, but not the market segmentation explanation. Once a foreign firm has listed on the NYSE or Nasdaq, market segmentation has been largely broken down, and the international capital markets have been largely integrated as to that security. Thus, if the market responds even more positively to the additional circumstance that the firm announces a public offering, this additional share price increase cannot logically be attributed to the market segmentation explanation. Conceivably, the public offering might be seen as a signaling device (much as stock splits are viewed as positive signals). n122 Yet no inherent reason suggests why the announcement of a public offering in the United States would be seen as a positive signal of still undisclosed information, particularly when the firm has every incentive to disclose such information or to delay the offering until it can be disclosed, in order in either case to assure that the positive information has been fully incorporated into its share price. On balance, the simpler explanation is that the market realizes that it can rely with greater confidence on the issuer's statements in a U.S. prospectus, because (1) the issuer faces strict liability for material misstatements or omissions; n123 (2) a powerful engine of private enforcement (e.g., the contingent fee-motivated plaintiff's bar) stands ready to enforce U.S. legal rules; and (3) more reliable gatekeepers (e.g., U.S. underwriters and auditors) have conducted a "due diligence" investigation into the offering, motivated in part by their own high liability for negligent errors or omissions.

Further evidence of bonding may lie in the differing market reaction to the announcement of a foreign firm's decision to list on a U.S. exchange depending on the particular firm's geographic location. The Miller Study finds that, over a three-day announcement window, foreign firms in emerging markets experienced nearly double the cumulative abnormal **[*1789]** returns of firms from developed markets. n124 However, the study also found that this difference was not statistically significant. n125 Still, after further refinement of its data, the Miller Study ultimately concluded that, on announcement of a U.S. exchange listing, firms within a subcategory that it defined as the "Free Emerging" market experienced a statistically significant share price gain that was nearly double that experienced over this same period by developed market firms. n126 Although Miller attributed this difference to the breakdown of market segmentation, it is likely that the firms within this sub-category would have been rated as having weak corporate governance by more recent researchers. Hence, the additional protections afforded by a U.S. listing might mean more to their investors than to investors in more established European firms.

Another study has also found a positive and permanent market reaction for Asian firms that list in the United States. n127 While the magnitude of this positive movement was modest, it did not fade away post-listing. This was in contrast to the finding in these same studies that most non-Asian foreign firms earn high positive abnormal returns in the year prior to listing, but then experience high negative abnormal returns in the year after listing.

What could explain the persistence of these gains in the case of Asian firms? Recent empirical research on corporate governance has identified several Asian countries as having corporate governance systems that particularly expose minority shareholders to expropriation by controlling shareholders. n128 Although these findings do not apply to all Asian countries, they could explain, at least in part, why a sample of Asian firms cross-listing on U.S. exchanges would show a more permanent stock market reaction, namely because, consistent with the bonding hypothesis, **[*1790]** their shareholders gain more from a U.S. listing, precisely to the extent that they were more exposed to expropriation.

All these studies are, however, dated in at least one critical respect: They examine periods prior to the Asian financial crisis of 1997-1998. Corporate governance theorists have plausibly proposed that the expropriation of minority shareholders is not a constant, steady phenomenon, but is an episodic one that occurs primarily in periods of declining expectations, particularly following major stock market retreats. n129 The Asian financial crisis thus may have produced an increased rate of expropriation, and, in response, portfolio investors may have become more skeptical of such firms. Accordingly, Asian firms wishing to access international equity markets thereafter would have increased incentives to bond in order to overcome this skepticism.

2. The Cross-Listing Premium. - A second source of data involves a comparison of the foreign firms that cross-list in the United States with those that do not. A 2001 study by Doidge, Karolyi, and Stulz focused not on stock price reaction, but on the valuations of foreign firms that cross-list in the United States in comparison to a control group that did not so cross-list. n130 Using the Worldscope database of firms, they find that "the firms listed in the U.S. have a Tobin's q ratio that exceeds the q ratio of firms from the same country that do not list in the U.S. by 16.5% on average." n131 This valuation difference, which they call the "cross-listing premium," depends significantly on the particular form of listing chosen and is largest for exchange-listed firms, where it reaches 37%. n132 In the abstract, such a valuation disparity could reflect either segmentation or bonding. Because an exchange listing increases the firm's liquidity, it is fully

consistent with the market segmentation hypothesis, but at the same time it also supports the bonding hypothesis because it requires the issuer to reconcile its financial statements to U.S. GAAP.

Yet, if this data does not seemingly favor one explanation over the other, two additional factors suggest at least the special relevance of the bonding hypothesis: First, firms "from countries with poorer accounting standards" were found "more likely to list in the U.S." n133 This makes sense from a bonding perspective, because a U.S. listing would uniquely signal for such companies that their accounting had been upgraded. Second, those firms that not only cross-listed on an exchange but also raised equity capital in connection therewith (that is, a Level III facility) had a **[*1791]** "significantly higher premium." n134 Again, because an exchange-listed firm already has high liquidity, this added premium for capital raising efforts suggests that SEC registration and the use of a U.S. underwriter are interpreted by the market as further and persuasive evidence that the issuer has credibly committed itself to a full disclosure policy.

3. Post-Listing Behavior: Common Law Firms Versus Civil Law Firms. - Although the foregoing stock price studies did not consciously seek to test the bonding hypothesis (and indeed may have been unaware of it), one study has made a deliberate effort to test this explanation by comparing firms incorporated in common law jurisdictions to those in civil law jurisdictions. The premise of this comparison is the well-known assertion made by LLS&V (and, more recently, by others) that the civil law provides inferior protection for minority shareholders. n135 If this is true, then it would also logically follow that firms incorporated in civil law jurisdictions would gain more from cross-listing in the United States.

To test this hypothesis, William Reese, Jr. and Michael Weisbach examined the composition and post-listing behavior of foreign firms that cross-listed in the United States and concluded that the evidence tends to corroborate the bonding hypothesis. Among their principal findings were the following:

1. Firms incorporated in countries with legal systems deriving from French civil law, which according to LLS&V provides the weakest shareholder protections, n136 were the most likely to cross-list in the United States; n137

2. Such French civil law firms are also the most likely to cross-list on securities exchanges, such as the NYSE and Nasdaq, while firms incorporated in English common law jurisdictions are more likely to establish only Level I facilities and remain on the over-the-counter market;

3. Firms that cross-list in the United States significantly increase their equity offerings following a U.S. listing. n138 This would appear **[*1792]** consistent with the hypothesis that a United States listing in some way protects minority shareholders;

4. Although the post-listing increase in equity offerings occurs both inside and outside the United States, the substantial increase in post-listing equity offerings outside the United States that Reese and Weisbach find cannot be explained in terms of a market segmentation hypothesis, but is consistent with a bonding explanation; n139 and

5. The weaker the shareholder protections in the foreign firm's home jurisdiction, the greater the quantity of equity offered by the firm after the time of its U.S. listing. n140 Finally, equity issuances following cross-listings tend to be inside the United States for "common law" firms with strong legal protections, but outside the United States for French civil law firms. This suggests that "common law" firms come to the United States to tap its capital markets, while "civil law" firms come more for bonding purposes.

The reverse side of this argument has been investigated by Pagano, Roell, and Zechner. n141 They find that the number of U.S. companies cross-listing in Europe shrank over the 1986 to 1997 interval (despite continued expansion by U.S. firms in Europe). Moreover, European firms cross-listing in the United States behaved very differently from European firms cross-listing on other European exchanges. European firms cross-listing in the United States pursued a strategy of rapid expansion fueled by high leverage before the listing and made large equity offerings after the listing. n142 They also tended to be in high-tech industries. In contrast, European firms cross-listing in Europe did not grow at a more rapid rate than a control group and did not tend to make equity offerings after the offering; rather they increased their leverage after the cross-listing. n143 Pagano et al. conclude that "the motivation for a U.S. listing appears to be the need for an equity infusion by rapidly expanding, highly leveraged companies that plan to expand their sales internationally and/or belong to high-tech industries." n144 Although this finding is consistent with the bonding hypothesis, it suggests that those firms that enter the U.S. market from a particular country differ distinctively from those firms in that same country that do not enter the United States, quite apart from the fact that those that do enter the United States may provide greater legal protection or more credible disclosure to their shareholders. As next discussed, **[*1793]** this ex ante difference between listing and non-listing firms requires some reinterpretation of the bonding thesis.

4. Flow Back and Market Share. - That a foreign firm lists on the NYSE or Nasdaq does not imply that its common stock will principally trade there (as opposed to on its home country exchange). In general, the NYSE fraction of total global trading volume for foreign firms listed on the NYSE ranges widely, from under 1% to more than 90%. n145 In most cases, the allocation of trading between the NYSE and the home country exchange is constrained by an inherent limitation in the nature of the securities traded: The NYSE will trade the issuer's ADRs, while the home country exchange will trade the issuer's ordinary shares. This was not the case, however, when Daimler-Benz AG merged in a share-for-share exchange with Chrysler Corporation in 1998 to form Daimler-Chysler AG (DCX). Rather, Daimler-Benz carefully designed a new security - a Global Registered Share - that could trade and settle on both the NYSE and the Frankfurt Stock Exchange (and other exchanges). n146

What happened? Within six months of the commencement of trading in DCX, American equity ownership had shrunk by over 50% (from 44% to 21%), and the percentage of DCX trading conducted on the NYSE fell from 28% to 5%. n147 What does this imply? A few years earlier, Daimler-Benz had elaborately negotiated its listing on the NYSE and had undergone the painful and costly experience of converting its earnings from German to U.S. GAAP, which transition had turned a reported profit (under German principles) into a loss (under U.S. GAAP). n148 In short, Daimler management saw a U.S. listing as important to its growth **[*1794]** strategy, but on the merger, the shareholder class became overwhelmingly German and trading moved back to Frankfurt. Such evidence suggests that, although the U.S. listing was useful to Daimler, its value lay not in breaking down market segmentation or in improving liquidity, but in serving as a credibility-enhancing mechanism. Without a NYSE listing, Daimler could not have made a major U.S. acquisition for stock, because U.S. shareholders would not have been willing to accept a foreign, risky, and illiquid security in exchange for their Chrysler shares. Even after trading moved to Germany, DCX has maintained its NYSE listing, because it apparently creates value for the company.

This phenomenon of "flow back" supports the bonding hypothesis, because it shows that the value of a U.S. listing may have relatively little to do with improving liquidity or expanding the shareholder base. At the same time, however, it also suggests that a U.S. exchange may have little incentive to cause foreign issuers to bond in this fashion, because the U.S. exchange does not necessarily capture the value of the trading in that stock. That is, although the NYSE does receive a listing fee from DCX, its dealers and specialists make little revenue from trading the stock, if 95% of the trading occurs instead on German exchanges. As a result, the NYSE should rationally be under-motivated to offer bonding services.

C. The Case Against Bonding

The simple bonding story also has its critics, who raise variations on the following themes:

1. Litigation Risk. - One skeptical response has been that increased enforcement risk associated with a U.S. listing has been exaggerated. A detailed study by one critic argues that SEC actions against foreign firms listed in the United States have been rare. n149 For example, between January 1995 and June 2001, the SEC apparently took legal action against just five foreign firms with listed ADRs. n150 Private enforcement of the securities laws against foreign firms also appears to have been limited. The same study finds a total of only twenty-five private actions against foreign firms between the enactment of the earliest federal securities laws in 1933 and July 31, 2001. n151

This evidence is, however, far from dispositive, either on the empirical or theoretical level. First, the SEC has recently brought high-profile **[*1795]** enforcement actions against foreign firms listed on U.S. exchanges, n152 and private class actions involving foreign companies listed in the United States similarly have been filed and settled at significant cost to the foreign defendants. n153 Second, as with other administrative agencies, the SEC's litigated actions resemble the tip of the proverbial iceberg. More enforcement occurs through informal contacts, warnings, and administrative enforcement than through litigated actions. If the SEC is suspicious of a company or its disclosures, it can exercise very practical but low-visibility sanctions, such as simply failing to clear or declare effective a registration statement. Such warnings are likely to be particularly respected by a foreign issuer, who is typically used to deferring to governmental instructions.

On the level of theory, it is a fundamental mistake to believe that the deterrent threat of a legal standard can be reliably inferred from evidence about the actual rate of apprehension or the actual severity of sanctions. Deterrence theorists have long recognized that the population to be deterred has only limited and generally inaccurate knowledge of the "true probabilities" of a detection. n154 More important is the manner in which the legal threat is communicated. Here, the corporate bar in the United States is the government's natural ally, because it maximizes its own importance by focusing its client on the possibility of SEC enforcement (and thus on the need to consult closely with U.S. counsel). Moreover, the basic message communicated by U.S. counsel - that there are legal risks associated with entering the United States - is one that much of the world already believes, as the United States is widely perceived by foreign firms and their officers as a litigation-crazed environment in which **[*1796]** almost any dispute ends up in court. Overstated as this perception may be, it is the subjective perception that counts for deterrence purposes.

Although perceptions can be debated, hard, quantitative evidence also exists that entry into the U.S. capital markets exposes the foreign firm to a significantly heightened risk of litigation. A 2002 study finds that when U.K. firms access the U.S. capital markets, their auditors raise their fees and that this fee increase reflects the difference in risk across the two legal regimes. n155 Further, no such increase occurs when U.K. firms access other capital markets. n156 Because auditors in the United States are not liable for aiding and abetting a securities law violation n157 (with the issuer being the primary violator in such cases), it therefore follows that the foreign firm has a greater exposure to liability than does its auditor. Hence, if auditors charge more when their client enters the U.S. market because of U.S. liability exposure, it logically follows that the issuer also faces an even greater increase in its exposure to liability. Finally, because the U.K. legal system shares obvious similarities with the U.S. system, it also seems logical that companies incorporated in civil law countries, which lack any such similarities, would experience an even greater relative increase in their litigation exposure on entry into the U.S. capital market.

Accordingly, even if some foreign firms do engage in fraud after cross-listing in the United States, n158 most firms (and their auditors) perceive themselves as exposed to significantly greater litigation risk on entry to the U.S. capital markets. All that is necessary for the bonding hypothesis to have validity is that the defendant's perceived risk of liability rises at least marginally with its entry into the U.S. markets, not that the SEC or private enforcers will always be omniscient or vigilant policemen. If, as a result, the controlling persons of the foreign issuer provide superior disclosure or consume less private benefits of control, even if they do so only marginally upon their firm's entry into the United States, then the value of the public shares in such companies should logically rise (and it does). To be sure, if the deterrent threat were greater, the price rise in the stock of foreign firms listing in the United States might also be greater, but both logic and the evidence support the existence of a correlation.

[*1797]

2. The Self-Selection Problem. - A second difficulty with the simple bonding story may require greater reformulation of this thesis. Here, the problem is that when we compare firms that cross-list into the United States from any given country with those firms in that same country that do not, we are essentially comparing apples and oranges. Even prior to their entry into the U.S. markets, these two classes of firms were different. The Doidge, Karolyi, and Stulz study n159 finds that cross-listing firms have a higher Tobin's q, n160 and this finding reinforces the Pagano, Roell, and Zechner study's finding of higher leverage and recent rapid expansion by firms cross-listing into the United States. n161 Together, they suggest that firms cross-listing into the United States have higher growth prospects (and hence a higher Tobin's q).

This apparent finding that firms cross-listing into the United States have superior growth prospects makes obvious sense because it explains a motivation for cross-listing: to obtain the higher valuations that those growth prospects would command if the issuer's public statements were deemed credible by the market. The firm with such prospects needs the certification that entry into the U.S. market provides far more than does the firm without such prospects. Also, such an issuer may need an equity infusion in order to finance those growth prospects, and this will be obtained with less dilution if the issuer provides its new minority shareholders with superior legal protections. Both these reasons, in turn, explain why controlling shareholders might be willing to forego some private benefits of control: They expect to gain more from enhanced valuations than they lose in foregone private benefits.

Yet this interpretation implies that firms cross-listing into the United States receive higher valuations at least partly because they have superior growth prospects. The implicit claim by cross-listing firms of high growth prospects is credible precisely because the controlling shareholders will be sacrificing some measure of private benefits. Hence, the positive stock price reaction to cross-listing in the United States is not exclusively a reaction to bonding. Rather, it is a mixed response to bonding (i.e., superior legal protections) and the implicit signal of superior earnings growth. No simple formula seems possible by which to allocate the stock price reaction between these two categories.

This interpretation suggests that the bonding hypothesis explains some of the motivation to list on a U.S. exchange or Nasdaq, but that we cannot measure with precision the actual price reaction attributable to bonding.

3. The Market Bubble Explanation. - Finally, one last reason for skepticism about bonding must be at least acknowledged. Some of the motivation **[*1798]** to cross-list in the United States could be explained by the claim that the equity market in the United States experienced a bubble during the latter half of the last decade. On this premise, foreign issuers rushed to cross-list in the United States in order to share in stock market valuations not attainable elsewhere (possibly because these inflated valuations were irrational). Although this premise could have some partial explanatory power, it cannot easily explain the decade-long migration of foreign issuers to the United States. Nor has it been only high-tech firms that have cross-listed. Finally, high stock market valuations also characterized other markets outside the United States during this period (emerging markets may have had even more unrealistic valuations prior to the 1997-1998 Asian financial crisis). The bubble hypothesis works only to the extent that there is a relative disparity in valuations between the United States and other markets that cross-listing exploits. At most then, the bubble hypothesis should lead us to be cautious about how much of the valuation premium inherent in cross-listing should be attributed to the bonding effect.

A variant on this bubble hypothesis is that Enron and the related market scandals in the United States following the collapse of the high-tech bubble have so taken the luster off a U.S. listing and so undercut the presumed superiority of the U.S. disclosure and governance system that the bonding thesis will not apply prospectively (even if it was valid in the past). Yet, significant as the U.S. scandals have been, they have been paralleled by similar episodes in Europe, where they have resulted in the closing of the principal European high-tech exchange. n162 Moreover, both in the United States and Europe, the response to these scandals has been calls for heightened standards and more rigorous controls on management. n163 Although it may prove true that the rate of cross-listings will slow in the immediate future, the underlying cause will be economic uncertainty that leads firms to delay public offerings and attempts to access foreign capital markets. Over the long run, however, for firms seeking external capital and subject to weak law in their jurisdictions of incorporation, the need to bond in some fashion is inescapable.

D. A Revised Interpretation

Under close examination, most phenomena can be unpacked, and different subsidiary trends or forces detected. In the case of the bonding hypothesis, it is clear that only some firms wish to bond: namely, those with high earnings prospects and frequently high leverage. For these firms, it is a rational tradeoff to surrender some private benefits of control for equity financing that may simply be unavailable in their own country. Recognizing this limited and selective incentive to bond in no **[*1799]** way rejects the bonding hypothesis, but it does underscore the point made at the outset of this Article: Competition naturally produces specialization, not uniformity.

The other criticism made of the bonding hypothesis - that it exaggerates the litigation risk incident to entering the U.S. market - is less telling (because subjective perceptions are what counts when measuring deterrence). Still, it does suggest that a closer look may be needed at the actual mechanics of bonding. When one examines the process by which firms from emerging markets cross-list in the United States, one finds that this transition is sometimes accompanied by significant changes in governance, effected either by charter amendment or by contract. To cite one recent example, Ultrapar, a large Brazilian gas and petrochemicals firm, decided in 1999 to make a Level III entry into the U.S. market by offering its non-voting shares through an ADR program that would list on the NYSE. n164 Despite Ultrapar's strong financial record in Brazil, the proposed offering ran into difficulty in the United States when U.S. institutional investors demanded "tag along" rights that would entitle them to a proportionate share of any control premium received by Ultrapar's controlling shareholders. n165 As they saw it, Ultrapar was an inviting "takeover play," but, absent changes in the firm's charter, they would be excluded from any share of the control premium. Eventually, the transaction was restructured so that Ultrapar amended its charter to grant such tag along rights. n166 Of course, there is no legal requirement that a cross-listing firm change its governance structure, but access to equity capital may necessitate changes.

In overview, such an example illustrates bonding achieved not based on liability rules, but through actual contractual provisions. The relative frequency of "contractual bonding," as opposed to simply "liability bonding" (which occurs when the cross-listing firm simply subjects itself to U.S. legal and disclosure requirements), remains unknown, but this example shows the actual implementation of bonding through self-help measures. The ability of U.S. institutional shareholders to demand such governance changes therefore supplies an alternative, if partial, explanation for the **[*1800]** positive share price reaction on the announcement of a foreign firm's decision to cross-list in the United States. n167

III. The Current Competitive Landscape: Can Foreign Markets Compete?

Is the tide toward international (and mainly U.S.) markets irreversible? Or can foreign markets compete at protecting minority shareholder rights? This Part will survey the institutional and legal developments that will shape and constrain the emerging competition among securities markets.

A. The Trend Towards Demutualization

Historically, securities exchanges in the U.S. and generally elsewhere have operated as non-profit mutual or membership organizations. As such, they behaved more like sluggish monopolies than dynamic entrepreneurs. That pattern is, however, rapidly changing. The first exchange to demutualize was the Stockholm Stock Exchange in 1993; it was quickly followed by the Helsinki Stock Exchange in 1995, the Copenhagen Stock Exchange in 1996, the Amsterdam Stock Exchange and the Borsa Italiana in 1997, and the Australian Stock Exchange in 1998. n168 In 2001, each of the London Stock Exchange, the Deutsche Boerse, and Euronext N.V. (itself the union of the Paris, Brussels, and Amsterdam stock exchanges) completed its initial public offering, and the Italian Bourse has announced similar plans. n169

Within the United States, Nasdaq has been partially privatized, with its former parent, the NASD, now owning only a minority equity interest in it, but still holding majority voting control until the SEC acts on its pending application to convert to the formal status of a stock exchange under the Securities Exchange Act of 1934. n170 A Nasdaq initial public offering appears likely in the near future. The NYSE alone has not changed. Although it has publicly discussed the possibility of demutualization, it has backed off from this proposal at least for the present, apparently because of internal tensions.

What will demutualization imply for competition and consolidation? When organized as a membership or mutual organization, the governance of American stock exchanges generally gave the specialists and certain market-making members control of the price, quality, and range of **[*1801]** services offered by the exchange. n171 With demutualization comes a more simplified governance structure in which the interests of the new shareholders are likely to dominate over those of the constituent groups within the exchange who formerly exercised veto power. Shareholders in turn will predictably wish to maximize the share value of their investment, and so will look favorably both upon acquisition and merger proposals and innovation generally. This does not mean that takeover proposals will necessarily be accepted (managements of private corporations in the United States and elsewhere have a long history of blocking them), but the rate of merger and acquisition activity seems likely to grow and, independently, the profitability of the exchange will become the dominant consideration.

B. The Shaky Status of Exchanges in Transitional Economies

Of the twenty-six transition economies, stock markets have emerged or been created in twenty of them, beginning with the Prague Stock Exchange in 1992. n172 Typically, the new exchange in these transitional economies simply listed the shares of all mass-privatized companies. This was the Czech model, but it produced disastrous results for the credibility of these new exchanges. Mass listing of all privatized companies produced a very large number of listings, but relatively thin trading in most of these stocks. Illiquidity in turn invited market manipulation, and a series of scandals accompanied the early history of exchanges that followed this approach. Ownership of these firms quickly concentrated, leaving only a small minority float in the public market.

In contrast, in a few transitional markets (most notably, Hungary and Poland), a different approach to privatization was followed, and fewer companies were listed. n173 In these markets, the principal route to listing was through an initial public offering conducted through the exchange. While fewer stocks were listed, they enjoyed more liquid trading.

Not surprisingly, the number of listed companies on those exchanges that listed virtually all mass-privatized companies has subsequently shrunk. Nor have most of these exchanges been able to provide equity financing. The Prague Stock Exchange still has not seen a single initial public offering. n174 This inability to provide equity financing can partly be ascribed to regulatory failures and a resulting lack of investor confidence in many transitional economies. But this is not the total explanation. **[*1802]** In many Central and Eastern European countries, large firms could obtain bank credit through political lobbying. n175 The cost of equity was high in comparison to lower-cost debt from often state-controlled banks, and hence newly privatized firms relied on debt financing and disdained equity financing (in part also because equity issuances would dilute the controlling stakes of those running the privatized firm).

As a result, of the twenty stock markets in transition countries, only four - Estonia, Hungary, the Czech Republic, and Poland - have market capitalization-to-GDP ratios in excess of 20% (which is a standard benchmark that many emerging market countries have surpassed). n176 The average capitalization-to-GDP ratio in transition economies is only 11%. n177 Market turnover (defined as the value of trading over market capitalization) is similarly low, with Hungary (93%), the Czech Republic (81%), and Poland (69%) standing apart and comparing favorably with Latin American countries. n178 The average turnover ratio in the transitional economies is only 30%. n179

Transitional stock markets are also typically dominated by a few, disproportionately large firms. The top 5% of listed companies account on average for 75% of all turnover. (Poland is a dramatic exception to this pattern, with the top 5% accounting for only 40% of all turnover.) Indeed, in a number of transitional markets, five or fewer firms account for 95% or more of the total market turnover. n180 Hence, if these major firms cross-list on an international exchange and trading in their stocks predictably follows, the home country exchange will predictably suffer a major loss of liquidity and will experience higher trading costs with regard to its remaining stocks (because the exchange's largely fixed overhead will now have to be charged against this reduced level of trading).

Consistent with the pattern of dual listings discussed earlier, larger public companies in transitional economies have listed in the United States or on the LSE. At the end of 1999, some seventy-two companies from transitional economies had listed on the NYSE or Nasdaq, and sixty-one such companies had listed in London. n181 Trading has similarly migrated abroad, with "the number of shares traded abroad [being] twice as high as the number of shares traded locally." n182 As local trading dries up, smaller public firms in transitional economies, which would not qualify **[*1803]** for a NYSE listing, have also begun listing on German exchanges, most commonly the Frankfurt. n183

The prospects for many transitional stock markets are not encouraging. A World Bank study, released in September 2000, predicts that even by the year 2005 and "under the best possible policy outcomes," only six of the twenty-six transitional economies will have securities markets with market capitalizations equal to 25% or more of GDP - a level that is more or less the median for other emerging markets today. n184 Market turnover is also predicted to remain low in most transitional economies, with only a minority approaching the 50% level needed to assure liquidity. n185 Low liquidity then seems an endemic problem for these exchanges.

To achieve economies of scale sufficient to produce decreasing costs in the processing of trades, some estimate that a securities market needs to have a market capitalization in excess of $ 15 billion. n186 On this basis, only four transitional economies are likely to reach this point by 2005: the Czech Republic, Hungary, Poland, and Russia. n187 This analysis suggests that trading costs will remain comparatively high on most smaller markets, further inhibiting their ability to compete on an international level. In turn, this may motivate issuers on these markets to seek other trading venues, even if they are not interested in improving their corporate governance.

This bleak picture does not establish that smaller markets will necessarily fail. For political reasons, including nationalistic pride, some may be subsidized, much as national flag airlines have been. Still, as these markets stagnate, the firms listed on them will need to cross-list elsewhere if they are to raise equity or maintain liquidity. Hence, the combined impact of demutualization and poor economic prospects suggest that many smaller markets will seek alliances, including mergers. Although mergers have been admittedly rare to this point, a precedent has been set by the three Baltic exchanges (Estonia, Latvia, and Lithuania), which have merged and also established a linkage with the Helsinki Stock Exchange. n188 All in all, it is difficult to describe a future for securities exchanges in transitional economies that does not involve radical consolidation. Even regional exchanges may find it hard to survive unless they either (1) obtain subsidies from the state, or (2) establish a "brand name" that attracts listings.

[*1804]

C. A Success Story?: The Experience of New "High Standards" Markets

The foregoing bleak description of the stock markets in transitional economies suggests that the odds are stacked formidably high against any new entrant. But two counterexamples need to be considered before a serious evaluation is possible. In both Germany and Brazil, new "high standards" markets have been recently established by existing exchanges in an effort to halt the migration of listings and trading to the United States.

1. The Neuer Markt. - Established in 1997 by its parent, the Deutsche Borse, the Neuer Markt swiftly became Europe's dominant market for high growth firms, both in terms of number of listings and market capitalization. n189 Indeed, in so doing, it outdistanced earlier established rivals (such as Easdaq, which eventually was acquired by Nasdaq), and successfully resisted Nasdaq's own efforts to achieve dominance in the European market.

Intended as a market for high growth firms, the Neuer Markt adopted a unique style by advertising itself as the "most regulated market" in Europe. n190 Whenever possible, it regularly stressed its high disclosure and transparency standards, which it continued to upgrade. Listing eligibility on the Neuer Markt required that an issuer: (1) adopt either

IAS or U.S. GAAP; (2) publish quarterly financial reports within two months after each quarter; (3) hold at least one analyst conference per year; (4) prepare and publish audited annual financial statements no later than three months after the end of its fiscal year; (5) have a minimum free float of 20%; (6) adhere to a six month lock-up period following its initial public offering before insiders can sell their shares; and (7) disclose all share transactions by managers, the company, and supervisory board members. n191 In addition, the contents of the required IPO prospectus were also elaborately specified. n192

In substance, these requirements were more rigorous than those specified either by its parent, the Deutsche Boerse, or, more surprisingly, by the SEC, which permits foreign issuers to file only its Form 20-F. In comparison to the Neuer Markt's quarterly reporting and tight deadlines, Form 20-F does not require quarterly reporting and permits the issuer to delay until six months after its fiscal year before filing its annual audited financial report. Initially, the Neuer Markt's strategy worked: It quickly grew from only two listed companies in 1997 to 302 in 2000 and acquired a market capitalization of $ 172 billion in only three years. n193 Only a handful of exchanges had larger capitalizations.

[*1805] More recently, however, the Neuer Markt became plagued by scandals and saw its market capitalization slide by 73% since the end of 1999. n194 All this is not surprising for an exchange populated with low priced, high risk stocks. In response, the Neuer Markt tightened its rules, required more disclosure, and adopted standards that delisted a number of firms. n195 Even more interestingly, it did so at the request of its larger, more established issuers, which pressured the Neuer Markt to purge its more questionable listed firms. n196

Nonetheless, despite strong efforts at reform, the Neuer Markt's reputation had become sufficiently tarnished that the Deutsche Borse, its parent, announced in late 2002 its intent to shut down the Neuer Markt by the end of 2003. n197 Yet, even if the Neuer Markt thus failed, its idea of heightened listing standards survives. In its place, the Deutsche Borse will create a new market category - known as the "Prime Standard" - which will impose "much more stringent standards of corporate disclosure than were required by the Neuer Markt." n198

Ultimately, the fate of Neuer Markt shows less the failure of heightened disclosure standards than the strength of the network externalities that link firms traded on the same high profile market. Once some firms on the Neuer Markt became mired in scandals, the Neuer Markt's reputation became tarnished. Stronger firms first tried to upgrade standards, but ultimately began to flee, causing the Deutsche Borse to close down its experiment because its name had become synonymous with scandal.

The Neuer Markt's problems also underscore the inevitable limits of self-regulation. Observers report that many of the scandals plaguing the Neuer Markt were the product of a shortfall in deterrence attributable to the lack of enforcement of insider trading restrictions in Germany. n199 In this light, there may be outer limits on the ability of bonding to work, **[*1806]** which are set by the strength of the legal protections in the jurisdiction of listing.

2. The Novo Mercado. - If the Neuer Markt was the product of Europe's desire to emulate Nasdaq and create an indigenous nursery in which to grow young high-tech companies, Brazil's Novo Mercado was the product of the massive migration of local firms to the United States and the consequent decline in liquidity in Latin American markets. n200 The S<tild a>o Paulo Stock Exchange (Bovespa), Brazil's largest exchange, was adversely affected by these developments and perceived the weakness in Brazil's protection of minority shareholders to be a principal factor inhibiting the development of its securities market. n201

Frustrated in attempts to secure legislative reform, n202 Bovespa instead decided to follow the example of the Neuer Markt. Indeed, it invited U.S. institutional investors to participate in the design of the listing rules for this new exchange in order to assure that they would be "investor friendly." n203 Basically, its goal was less to create a specialized incubator for high-tech companies (of which Brazil had relatively few) than a "high corporate governance" listing section that would be open only to issuers that voluntarily elected to subscribe to its stricter rules. To maximize its attractiveness to new issuers, Bovespa created three special listing segments of its exchange, in addition to its traditional exchange (whose listing requirements were not changed): Special Corporate Governance Level 1, Special Corporate Governance Level 2, and the Novo Mercado. n204

This creation of three enhanced listing options in addition to a standard listing on the Bovespa was essentially a concession to the desire of listed firms to adopt some reforms, but not all. Level 1 issuers simply agreed to higher disclosure and transparency standards, but did not revise their corporate governance standards. Level 2 issuers and those who list on the Novo Mercado obligated themselves to settle shareholder disputes using a "Market Arbitration Panel," which represents a new legal remedy in Brazil. n205 Functionally, this arbitration remedy appears to have been intended as a substitute for class actions and derivative actions, which could not have been easily established without legislation (and, even then, might have been difficult to graft onto Brazil's highly traditional **[*1807]** and civil law-oriented judicial system). To list on the Novo Mercado, however, the issuer had to accept major corporate governance reforms and obligate itself to (1) not issue non-voting shares and comply with a "one-share, one-vote" rule; (2) maintain a free float equivalent to 25% of the outstanding stock; (3) grant "tag along" rights under which all non-controlling shareholders would be accorded the same right to sell their shares and on the same terms (including price) as were to be given the controlling shareholder; and (4) elect all directors at each annual meeting. Additionally, the issuer agreed to observe heightened disclosure standards, including quarterly reporting and the use of U.S. GAAP or IAS accounting standards. On the practical level, the leading differences between Level 2 and the Novo Mercado were that an issuer who listed only on the former could still utilize non-voting shares and its controlling shareholders would not be required to share control premiums. Similarly, a Novo Mercado listing differed from a NYSE listing in that it required substantive governance reform in addition to enhanced disclosure. n206

So what happened? The Novo Mercado's listing rules were officially announced in December 2000, but it was not until February 2002 that the first (and still the only) company listed on it. n207 As of April 2002, some nineteen companies had listed on Level 1 (which does not require any revisions in substantive corporate governance), but none had listed on Level 2 (although a few companies have announced their intention to do so after obtaining shareholder approval of the requisite corporate governance changes). n208

What does this weak (or at least equivocal) response suggest about the desire to bond? At a minimum, it implies that a new exchange or listing segment will face difficulty in competing with the stronger "reputational brand" of the NYSE. Firms that list on the NYSE also obtain the practical ability to effect an initial public offering, while the feasibility of such an offering remains doubtful in Brazil. Such "high standards" exchanges may therefore appeal only to firms that do not qualify for a NYSE listing or that find the expenses associated with cross-listing to be prohibitive. Yet, it is noteworthy (and perhaps ironic) that the Novo Mercado essentially leapfrogged the NYSE by precluding the use of non-voting **[*1808]** shares (while the NYSE continues to list foreign firms with non-voting classes of stock). Taken together, the relative success of the Neuer Markt and the relative failure (at least to date) of the Novo Mercado may show that there is a market for "high disclosure," but that emerging market firms are less willing to opt into substantive governance reform. In turn, this may reflect that the logical alternative to a local listing is a NYSE listing, which does not require foreign issuers to subscribe to the NYSE's own governance rules.

D. The "New" Regulatory Competition: The Latin American Evidence

The Novo Mercado was essentially a response by Bovespa to Brazil's inability to enact meaningful corporate governance reform legislation. n209 Yet, since 2000, the major Latin American markets - Argentina, Brazil, Chile, and Mexico - have enacted significant corporate governance reform legislation, after decades of inaction. n210 At least one precipitating cause of this new legislation appears to have been the loss of liquidity in Latin American markets as a result of listing migration to the NYSE. This section will briefly review the Brazilian and Mexican experiences.

1. Brazil. - Brazilian companies typically issue much more preferred stock than common stock, frequently approaching the 2:1 ceiling that Brazilian corporate law places on the ratio of preferred stock to common stock. n211 Because the preferred stock carries no voting rights, this tactic permits a controlling shareholder to hold control with as little as 17% ownership of the company's stock. n212 Typically, a minority of the voting shares (which are known in Brazil as "ON" shares, while the non-voting preferred shares are known as "PN" shares) will be held by public investors and will trade at an even greater discount than the non-voting preferred because the ON shares' voting rights are meaningless and, unlike the preferred, they carry no special dividend rights. The discount on both ON and PN shares is steep because the controlling shareholders (1) can and do monopolize the control premium if an acquirer wishes to buy their company, and (2) often deliberately understate earnings, or suspend the company's communications with the market, in order to drive down the market price before they tender for the stock, themselves. n213 A 1998 tender offer by an American acquirer for a Brazilian retailer created a political furor when it offered no premium to any shareholders other than those in the controlling group. n214

[*1809] As a result of both a series of scandals and the recognition that Brazil's capital market was shrinking, n215 a four-year political struggle climaxed in 2001 with the passage of compromise corporate governance legislation that contained the following principal elements:

a. Restrictions on Non-Voting Stock. - Future Brazilian companies will be permitted to issue non-voting preferred stock only up to 50% of their capitalization. n216 The long-term effect thus will be to raise the minimum ownership level necessary to hold absolute voting control to 25%.

b. Tag Along Rights. - In its most fundamental compromise, the new law confers a right on common shareholders to receive 80% of the premium paid to controlling shareholders in a takeover; however, this right was not extended to preferred shareholders. n217

c. Board Representation. - Preferred shareholders holding more than 10% of the non-voting shares receive the right to appoint a director, and shareholders holding more than 15% of the voting shares receive a similar right. However, this right was counterbalanced by granting the controlling shareholders the right to appoint the same number of board members as minority shareholders, plus one, thereby ensuring that the new voting rules would not cause control to shift. n218

d. Right to Call a Shareholder Meeting.

- Shareholders with 10% or more of a company's equity, or 5% of its voting power, received the right to call a general meeting of the shareholders if they believe that there is a conflict between their interests and those of the controlling shareholders. At this meeting, absent shares may, under some conditions, be voted against the management, n219 and, under at least some circumstances, the meeting may appoint an arbitrator to resolve differences. n220

e. Minimum Liquidity and Buybacks.

- When regulators determine that controlling shareholders have reduced the company's liquidity, they can require a tender by them for the remaining shares at a minimum price specified by the regulators. n221 In addition, company buybacks must be approved by at least half of all shareholders in the affected class or classes. n222

The impact of these changes remains uncertain, particularly in light of high interest rates, political uncertainty, and deteriorating **[*1810]** macroeconomic conditions. n223 Controlling shareholders were able to thwart the original reform campaign to extend "tag along" rights to non-voting shareholders, but were defeated in turn in their opposition to board representation for non-voting shareholders. To the extent that there has been even piecemeal reform, it appears to have been significantly motivated by the fear of the Brazilian securities industry that, without change, the industry would decline. n224

2. Mexico. - The recent Mexican experience differs from that of Brazil primarily in that the campaign to extend "tag along" rights to non-voting shares was more successful. As noted earlier, Mexico experienced a migration of listings and trading volume to the NYSE that was at least as significant as that experienced by Brazil. n225 In response, in April 2002, pursuant to earlier enacted legislation delegating the requisite power to them, Mexico's National Commission on Banking and Securities, in combination with the Mexican Stock Exchange and the Mexican Association of Market Intermediaries, substantially revised its rules on tender offers in order to strengthen the rights of minority shareholders and accord them a proportionate share of control premia. n226 Under this reform, non-voting shares now enjoy full "tag along" rights in the event of takeover offers. Specifically, the new rules preclude partial bids for just the controlling shares by requiring that if the bidder seeks to purchase between 30% and 50% of the voting stock, it must tender for all share classes on a similar basis and at the same price; further, any offer for more than 50% of the voting stock obligates the bidder to tender for 100% of all shares in all classes. n227 While the rules do not prohibit non-voting shares, they were intended to create an incentive to cause issuers to abandon their existing structure of multiple share classes, and some issuers have already responded by doing so. n228 In turn, the goal of this effort was to make "local and foreign investors feel more secure about investing in Mexican equities." n229

The irony in the Mexican experience is that, while the benefits of improved corporate governance will be principally felt by Mexican firms **[*1811]** (which in theory should be able to raise more equity at lower cost with improved governance), the impetus for these reforms has come not from Mexican corporations (which could have adopted them voluntarily), but from the Mexican securities industry (which was the principal loser from cross-listings). The indifference or even hostility of Mexican firms to corporate governance reform is understandable, because improved governance implies reduced private benefits of control, and controlling shareholders may anticipate that these lost benefits will exceed the value to them of any improvement in their firm's stock price. Nonetheless, political reforms, even if piecemeal, may have come for the unexpected reason that the controlling shareholders' desire to retain the private benefits of control conflicts with the ability of the local securities market to survive in a globalizing world.

IV. How Markets Will Compete: Rival Scenarios

To this point, it has been argued that the world of securities markets is in flux: Exchanges are privatizing; issuers are cross-listing; some markets may fail; and others may consolidate by any of several techniques. Finally, the latest development is that some legislatures are responding to the loss of trading to international exchanges by enacting reform legislation. But will this new competition produce a race to the top or to the bottom? As next examined, a plausible case can be made for either scenario.

A. The "Race to the Top" Scenario

The case for governance reform as a strategy to increase the competitiveness of a market center is becoming increasingly easy to make. Although comparative studies of corporate governance in the United States have not been able to correlate "higher" standards of governance with improved market value, the reverse has been true in the case of emerging markets. Several studies have shown that firms with higher quality governance have higher market values. n230 Similarly, the cost of capital appears to be lower for firms that make fuller disclosure. In the most complete **[*1812]** of these studies, Durnev and Kim survey 859 firms in 27 countries and find not only a positive relationship between firm valuation and corporate governance, but that the relationship is strongest in countries having the weakest protection of minority shareholders. n231 The apparent implication for emerging market companies based on such studies is that they can reduce their costs of capital by taking private action that improves their corporate governance. Specifically, they found that "a 10-point increase (out of 100) in CLSA corporate governance scores increases a firm's market value by 13.3%, while a 10-point increase (out of 98) in S&P transparency scores increases a firm's market value by 16.3%." n232 In short, even under weak legal regimes, private action can apparently work to assure investors and thereby maximize share value. Such data is entirely consistent with this Article's thesis because bonding is essentially a form of private action. Whether through cross-listing or charter amendments, firms desiring external finance have an incentive voluntarily to undertake actions that assure minority investors that they will be fairly treated. This incentive actually grows stronger the weaker the legal regime under which the firm is incorporated.

Durnev and Kim's finding that increased transparency also translates into increased market value reinforces the work of other finance theorists, who have argued that traders, in addition to issuers, will also prefer "high disclosure" exchanges. Huddart, Hughes, and Brunnermeier claim that liquidity traders will opt to trade on "high disclosure" exchanges and that informed traders (i.e., those possessing material non-public information) will follow them in order to "exploit the disguise afforded by the greater depth on that exchange." n233

The "race to the top" scenario must face, however, two important objections. First, exchanges may not benefit by establishing themselves as high quality, "high disclosure" exchanges if the trading in the foreign issuers that list on these exchanges still flows back to the issuer's home country exchange. Such flow back is common, as shown by the DaimlerChrysler experience, n234 and it may accelerate as firms come to replace ADRs with global shares that can settle in either country. n235 If a foreign issuer can list on the NYSE, and yet the majority of the trading in its stock eventually flows back to the issuer's home country exchange, the NYSE gains less from such a listing than from a comparable domestic listing. n236 **[*1813]** This may explain why the NYSE has long been more willing to waive listing requirements that it applies to domestic issuers for foreign issuers. n237 Because both it and its dealers gain less from such a listing and because the NYSE must compete with a foreign exchange for trading volume, the NYSE logically has less incentive to pursue a bonding policy that benefits it only marginally.

Second, the increase in stock value associated with listing on a "high disclosure" exchange may mean little to controlling shareholders, who are more focused on retaining the private benefits of control, as next discussed.

B. The "Race to the Bottom" Scenario

The alternative perspective begins with the recognition that firms with controlling shareholders may not wish to upgrade their disclosure or governance practices because controlling shareholders enjoy (and do not wish to reduce) high private benefits of control. For controlling shareholders, what is particularly important is the ability to receive a control premium that is based on their participation in the firm's voting rights, rather than on their typically lower participation in the firm's cash flow. n238 On any given exchange outside the United States and the United Kingdom, firms with controlling shareholders are likely to be in the majority and hence able to outvote those firms that wish to upgrade the local exchange's governance or disclosure requirements - if these reforms seem likely to challenge their ability to receive the traditional private benefits of control. Even a privatized exchange would be unlikely to seek to raise its governance standards for listed companies if this effort were likely to cause the delisting of a significant number of listed companies. Hence, a powerful coalition of entrenched forces appears ready to resist governance reform in most markets.

Dealers also may have little innate desire to upgrade transparency or disclosure standards. One recent study notes several examples in which non-transparent exchanges seem to have dominated transparent ones. n239 In particular, the

LSE was able to outcompete the Paris Bourse for large block traders by permitting dealers to delay the reporting of such block transactions for several days. n240 So much of the block trade volume migrated **[*1814]** from Paris to London that the Paris Bourse was eventually compelled to change its trade reporting rules to match those of London. n241

These objections do not imply, however, that the world will remain static; rather, they suggest that there are institutional rigidities that reforms will have to accommodate.

C. Combining the Scenarios: A Mixed World of "High and Low Disclosure"

Assume for a moment that the controlling shareholders of many listed issuers outside the United States and the United Kingdom would prefer to enjoy the private benefits of control, rather than maximize their market valuations through bonding. On this assumption, can additional "high disclosure" markets emerge? Of course, we have already witnessed the appearance of "high disclosure" exchanges in Europe and Latin America in the forms of the Neuer Markt and the Novo Mercado. n242 But their creation proves the point that old markets will resist change. Precisely because the Deutsche Boerse, the parent of the Neuer Markt, and BOVESPA, the parent of the Novo Mercado, were unwilling or unable to upgrade significantly their own listing standards, they instead founded new markets, in one case as a wholly-owned subsidiary and in the other as a special listing section. In so doing, they offered an additional alternative to their clients without forcing any listed firm to change its governance or face delisting. This approach is likely to be repeated.

For those firms that do list on a Neuer Markt, Novo Mercado, or some similar infant exchange, the rationale for listing will be essentially that the expected gains to their controlling shareholders - i.e., their pro rata share of the gains that result from being able to finance "high growth" investment opportunities with equity capital - exceeds the expected losses - i.e., their forgone private benefits of control. Typically, cross-listing firms will be companies with high growth prospects that require equity capital because they are already highly leveraged. n243 Pagano, Roell, and Zechner report that this was basically the profile of European firms that cross-listed in the United States during the 1986 to 1997 period that they studied. n244

High growth prospects are not the only reason that a firm might migrate to a "high disclosure" exchange, even at the cost to its controlling shareholders of forgoing some of the private benefits of control that they previously enjoyed. An alternative scenario starts from the fact that, as the worldwide barriers to product market competition have fallen, firms are increasingly forced either to grow to global scale or to accept the fate **[*1815]** of being acquired by a competitor. n245 For example, an auto maker based in Sweden or Germany faced the choice, after the integration of the European market, of either expanding its activities to a European-wide scale or expecting that its rivals that did so would soon dwarf it and realize probable economies of scale and scope. The most ambitious firms in the industry might even expand to become worldwide manufacturers, as clearly some U.S., German, and Japanese producers have done. The quickest, most logical mechanism for expansion to global scale is the cross-border merger or acquisition. This scenario principally fits many European firms that have recently cross-listed in the United States, while in contrast, emerging markets firms that have cross-listed generally have been smaller and motivated more by the desire to finance high growth opportunities.

On this playing field of cross-border mergers, firms with dispersed ownership that are listed on "high disclosure" exchanges have a distinct advantage. Their stock will predictably trade at less of a discount to reflect the lesser prospect of expropriation by controlling shareholders. Other things being equal, they will find it easier to make acquisitions with equity securities. To be sure, firms with concentrated ownership can make acquisitions for cash, but there may be a ceiling on the magnitude of cash acquisitions that are feasible. For example, one has difficulty imagining Daimler acquiring Chrysler for $ 50 billion in cash; hence, the prior decision of Daimler to list on the NYSE may have been a necessary prerequisite to effectuating this transaction. Other recent large acquisitions (including British Petroleum's 1999 acquisition of Amoco for $ 48 billion, Ford's purchase of Volvo, and the Exxon/Mobil merger) also seem to strain the limits of practical finance if these were attempted as cash transactions. The point is not simply that stock-for-stock acquisitions are easier, but that firms that maximize the value of their publicly held shares can make acquisitions at less dilutive costs to themselves. As a result, firms listed on "high disclosure" exchanges are more likely to be the survivors and acquirers, rather than the targets, in the wave of acquisitions that the drive for global scale entails. In fact, the parade of large German firms recently listing on the NYSE evidences the fact that corporations seeking global scale perceive the need for a listing on a "high disclosure" exchange. n246

Even if "high disclosure" exchanges can thus attract listings from high growth or acquisition oriented companies, and even if some controlling shareholders would willingly abandon some private benefits of control to achieve these ends, one practical issue remains: Has the United States already monopolized the market for "high disclosure" exchanges? The weak response to the creation of the Novo Mercado may suggest that other new entrants will similarly find it hard to compete against the **[*1816]** strong "reputational brands" of the NYSE and Nasdaq. Still, a residual market may remain to the extent that many issuers cannot satisfy the listing standards of the NYSE or Nasdaq or find a U.S. listing too costly. n247

In this light, regional "super-markets" might develop from exchanges that already have relatively high disclosure standards and could offer greater credibility to companies incorporated in jurisdictions perceived by investors as having weak governance standards. Conversely, firms less interested in attracting minority investors, but still desiring some degree of liquidity, might trade only on lower disclosure exchanges, such as the Korean or Shanghai Stock Exchanges.

This prediction has two implications: First, "high" and "low disclosure" exchanges could both persist, each attracting a different core constituency of issuers. Second, the fiercest competition will likely be between those regional exchanges that aspire to attract dual listings from issuers originally listed on smaller exchanges. For example, the Australian and Singapore exchanges in Asia and the LSE and Euronext in Europe are natural competitors. Although single country exchanges will probably endure in large market countries (such as the Korean or Milan exchanges), they seem likely to lose trading volume progressively to the regional "super-market." Exchanges in small market countries (i.e., many of the transitional stock exchanges) will either close, consolidate, or be subsidized by their respective states. Whatever the outcome, they will lose liquidity.

If some exchanges wish to upgrade their disclosure standards to attract listings, or to organize a subsidiary market that does so, what specific reforms should they adopt? The Neuer Markt has already shown that quarterly reporting and the use of U.S. GAAP or IAS can be required. Beyond these obvious requirements, institutional investors will probably most want "tag along" rights: namely, the right to share on proportionate terms in any control premium. Both the recent Mexican reforms and a similar, although largely unsuccessful, legislative struggle in Brazil indicate that this is the corporate governance reform that most divides controlling shareholders and institutional shareholders. n248 Effectively, conferring this right reduces the significance of the disparity between cash flow and voting rights that characterize many firms in emerging markets. n249

[*1817] Is it realistic to expect exchanges outside the Untied States to attempt to adopt anything resembling the NYSE's old "one share, one vote" rule? Although both the Novo Mercado and the Mexican Stock Exchange have done so, it is uncertain whether other exchanges will follow. Put differently, so long as the NYSE allows foreign firms to list their non-voting shares on it, there may be little willingness on the part of cross-listing foreign firms to upgrade their substantive corporate governance.

D. Other Competitors: Who Else Can Offer Bonding Services?

Few of the functions performed by securities exchanges are inherently beyond the capacity of other institutions. In fact, competitive substitutes have developed in some markets for certain of the traditional services performed by exchanges. n250 In this light, if exchanges do provide bonding services, it does not follow that they have a natural monopoly which others cannot effectively challenge. Conceivably, competitors could emerge who could provide the same or a similar signaling function at lower cost. But who else could enter this field? Phrased differently, who besides an exchange can credibly assure investors that a foreign corporation possesses adequate governance protections to safeguard minority investors from expropriation? The answer is almost certainly that others could perform this function, but whether such new entrants will in fact emerge remains very speculative.

One conceivable candidate to challenge the traditional exchange might be the "Electronic Communications Network" (ECN), n251 but it is unlikely to perform this role. Although these electronic markets have captured an impressive share of overall trading volume, they have essentially followed an old competitive strategy: Free ride on the price discovery process conducted by traditional exchanges, but offer lower cost and faster executions. n252 This strategy may capture trading volume, but free-riding does not position ECNs to offer bonding services or other reputational **[*1818]** benefits. First, ECNs do not have listing standards of their own, but simply trade stocks that are listed elsewhere. Second, because ECNs are not good liquidity providers, they cannot cope with large blocks because they have little capacity to adjust their prices for such blocks or, more generally, to handle price discovery when a large block hits the market. As a result, ECNs are likely to be only a secondary market, and not the primary market, for most companies. In particular, ECNs are unsuited to handle companies that trade inactively or sporadically because ECNs only provide matching of buy and sell orders and not the residual liquidity offered by dealers or specialists.

The real significance of ECNs is that they represent one more competitor that can trade securities that are listed on a high quality exchange. Thus, as in the earlier discussed case of trading that flows back to the home country, ECNs erode the incentive for an exchange to invest in reputational capital or to maintain high listing standards if the exchange cannot fully capture the trading in that security. n253 For example, if a foreign corporation were to list on the NYSE but still trade 50% on its home country exchange and 25% on ECNs, then the NYSE might well have conferred a reputational benefit on the foreign company, but it would capture only 25% of the trading. This mismatch means the NYSE may be under-motivated to offer bonding services because such listings may not attract revenues if the trading stays in, or flows back to, the foreign issuer's home jurisdiction. n254

In this light, the greater potential challenge to exchanges will more likely come not from ECNs, but from investment banking firms. The most realistic alternative to the contemporary pattern of corporate issuers cross-listing on international exchanges is for large, world-class brokerage firms to cross borders to search out attractive investments for their clients. n255 Potentially, either the issuer on the sell side or the broker on the buy side can today cross borders to link investors with issuers. If brokers will do so, issuers can stay at home and avoid the costs of cross-listing. Thus, the issue from a transaction cost perspective becomes: Who can cross borders more cheaply?

[*1819] Because cross-listing can be expensive (both in terms of listing expenses and the reconciliation of financial statements), the intuitive answer to this question would seem to be that the broker can cross borders more cheaply than can issuers. n256 Moreover, the broker has a natural ally: the traditional exchange that today faces the risk that it will lose substantial order flow to a more liquid market when its listed companies cross-list elsewhere. The logical strategy for these traditional exchanges that cannot or will not upgrade their corporate governance standards is to solicit international brokerage firms to trade on them by making themselves cheaper, and hence more attractive, to these brokerage firms. Rather than raise listing standards, such exchanges could seek to reduce costs to attract international brokers and thereby similarly break down market segmentations.

But even if such an alliance is possible, what relevance does it have for any future competition to provide bonding services? The answer is that brokerage firms could potentially provide the assurances that foreign portfolio investors demand through the stable of securities analysts that they employ. This strategy would require: first, that the foreign firm adopt charter and/or bylaw provisions that protect minority shareholders, including a commitment to "high disclosure;" and second, that securities analysts be capable of verifying the adequacy of such private, self-help efforts. If this were possible, foreign firms would not need to cross-list; instead, global brokerage firms would focus the attention of their securities analysts on selected foreign stocks that they expect to trade globally. This scenario is plausible precisely because analyst attention has long been a key attraction luring foreign issuers to list on U.S. exchanges. On cross-listing, a foreign firm receives greater analyst coverage and forecasts of its future earnings become correspondingly more accurate relative to those made with respect to firms that do not cross-list. n257 These are important advantages to the firm, but to the extent that such analyst attention can be achieved without cross-listing, the foreign issuer has an obvious incentive to use the less costly alternative in order to bond its implicit promise not to expropriate minority investors. In short, analyst attention and cross-listing are not inextricably linked, and the former can potentially be achieved without the latter. If so, an alliance between brokers and foreign firms to trade on less costly exchanges offers gains to both and thus constitutes the gravest threat to more costly, "high disclosure" exchanges.

[*1820] This potential approach does, however, shift costs in a manner that may not necessarily be attractive to the brokerage firm. Although the issuer avoids the costs of both establishing a depository receipts facility in the United States and listing on a U.S. exchange, the broker incurs (and must pass on, to some degree, to its customers) the costs of foreign execution, clearance, and settlement. On the other side of the ledger, however, the broker captures trading that might have otherwise gone to an ECN if the firm had instead cross-listed in the United States. Hence, although the broker may incur some increased costs, the net balance is uncertain. Over the long run, cost differences should be determinative, and any cost differential favoring brokers should reduce the issuer's incentive to cross-list. This point has a further implication: If the driving force behind cross-listing were only the desire to break down market segmentation, one would logically expect that the cheaper means to this end would be through international executions by global brokerage firms, which can specialize in this activity, rather than through each issuer listing globally. In this light, the trend toward cross-listing again suggests that the market segmentation hypothesis cannot fully explain this phenomenon.

A further difference between bonding through cross-listing and the use of international brokerage firms to design and verify corporate governance reforms on an individualized basis is that, in the latter case, the issuer does not expose itself to litigation in the United States (either by private plaintiffs or by the SEC). This difference raises the question of whether bonding can occur in the absence of a strong enforcement mechanism. Clearly, issuers would prefer to offer the promise of better disclosure without also incurring the heightened risk of litigation. But can issuers have one without the other? Those who doubt that securities class actions achieve much will argue that improved governance can come without increased litigation, and those who disagree will note that alternative means to bonding have never developed (even though they may be cheaper). n258 At present, whether bonding requires exposure to litigation is a debatable but unanswerable question.

Subject to this caveat, the bottom line is that rival strategies are possible and thus may lead exchanges increasingly to polarize and signal very different strategies. Some exchanges will "race for the top" in the manner of the Neuer Market and the Novo Mercado, while others should increasingly pursue a cost-minimization strategy. Those opting for the latter approach may focus also on speed of settlement and seek a reputation for relative regulatory flexibility. Conceivably, issuers that did cross-list on a high quality exchange might also deliberately maintain their listing on a lower quality market in order to escape regulatory oversight for **[*1821]** some transactions in which their controlling shareholders wished to engage.

V. Policy Issues: How Should Regulatory Competition Be Structured?

The efforts by emerging markets to develop new "high disclosure" markets and to upgrade their corporate governance standards is motivated both by the obvious desire to spur economic development and by the equally obvious fear that, in the absence of reform, their securities markets will wither away as trading migrates to international exchanges. These efforts are complicated, however, by a long-standing position of the U.S. exchanges and the SEC: They do not require foreign firms that list in the United States to satisfy the same listing requirements as domestic firms. n259 As a result, when a foreign market, such as the Novo Mercado, seeks to upgrade its governance standards, it encounters resistance (or at least apathy) from its audience of potential listed companies that know they can list in the United States and obtain both greater liquidity and lower governance requirements. The unwillingness of U.S. exchanges to impose governance or voting listing requirements on foreign listed firms thus surfaces as a barrier to improved governance in emerging markets; indeed, it may create a perverse form of regulatory competition in which U.S. exchanges in effect underbid their competitors in terms of substantive governance requirements. This section will first examine the special status of foreign listed companies on U.S. exchanges and then turn to the broader question of regulatory competition.

A. The Domestic/Foreign Listing Disparity

Listing standards were pioneered by the NYSE as a means of creating "a brand name associated with high quality." n260 While its early listing standards primarily related to financial disclosures, the NYSE began to adopt substantive corporate governance standards in the early twentieth century and effectively imposed its famous "one share, one vote" listing standard in 1926. n261 Over time, the NYSE has similarly adopted listing rules requiring (1) an independent audit committee, n262 (2) shareholder **[*1822]** approval of certain stock option plans, n263 and (3) shareholder approval of issuances of 20% or more of a listed company's common stock in order to protect shareholders against dilutive issuances. n264 Today, both the NYSE and Nasdaq restrict listed companies from disparately reducing or restricting, through any corporate action or stock issuance, the voting rights of existing shareholders of common stock. n265 All of these provisions were intended to protect minority shareholders and most go beyond the requirements of state corporate law.

Yet under each of the NYSE, the Amex, and Nasdaq rules, foreign issuers are effectively exempt from these provisions. n266 Moreover, the SEC has approved this disparity. n267 Why has this disparity in the treatment of foreign and domestic issuers developed? The principal reason was probably that, at the time the SEC approved this distinction in 1987, foreign issuers represented only a small fraction of both the securities listed or traded on U.S. exchanges. n268 Thus, if only 5% of a foreign company's stock traded on all U.S. exchanges, it seemed disproportionate to require such a firm to observe the NYSE's "one share, one vote" rule; indeed, application of such a rule might discourage foreign listings. Additionally, an inevitable issue of cultural relativism surfaces here: If foreign corporations frequently use non-voting stock or if they consider audit committees to be incompatible with the two-tier board structure common to most civil law countries, the SEC and the NYSE arguably were less justified in overruling these firms in their use of local corporate governance practices than they were in imposing local best practices on U.S. firms. n269 Given these arguments, foreign issuers were broadly permitted to obtain a waiver from most NYSE corporate governance listing requirements, so long as an independent attorney licensed in the issuer's home **[*1823]** country opined that the firm's governance practices were not prohibited in its home jurisdiction. n270

Even at this time, the result was a sharp disparity between the NYSE's mandatory approach to domestic firms and its laissez-faire approach to foreign firms. Since that point, however, much has changed. Foreign issuers now account for nearly 17% of the NYSE listings, not the 2% to 3% level of the 1980s. n271 More importantly, many foreign issuers now trade principally in the United States. n272 For these issuers, the burden no longer seems disproportionate. In addition, if the purpose of the listing rules is investor protection, it is hard to understand why investors trading on U.S. exchanges need or deserve more protection in the case of U.S.-incorporated companies and less in the case of foreign-incorporated issuers. If anything, the latter class of companies presents higher risks.

Finally, exempting all foreign issuers on an across-the-board basis undercuts the efforts of those foreign exchanges, including both the Novo Mercado and the Mexican Stock Exchange, that are seeking to upgrade corporate governance through higher listing standards, as this exemption enables the foreign issuer to evade domestic governance-related standards by listing on a U.S. exchange. n273 In effect, given its size and position, the U.S. market becomes the regulatory price setter, with its relaxed standards for foreign issuers placing a ceiling on the standards that local exchanges can impose on their constituent firms. n274

These arguments have had some modest impact on the NYSE, but not enough. In the wake of Enron and growing investor skepticism, the NYSE has proposed to upgrade its listing standards in a number of respects, n275 but with regard to foreign issuers, its only reform proposal has been to "require listed foreign private issuers to disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards." n276 While such disclosure may be useful, it would still permit a foreign listed company - but **[*1824]** not a domestic one - to reduce retroactively the voting rights of non-controlling shareholders.

The appropriate compromise here does not require treating all foreign issuers identically to U.S. companies. Rather, the practical test might look to the volume of trading in the United States. If the foreign issuer has a higher level of trading in the United States than on any non-U.S. exchange, n277 then such an issuer should not be able to escape U.S. listing standards that are intended to protect the investors who trade on U.S. exchanges. n278 Conversely, if the issuer listed ADRs on the NYSE that account for, say, only 10% of its total trading, the United States has less justification for seeking to impose its standards on that security, as it has only a limited presence in U.S. markets. This proposed standard also recognizes that there could someday develop substantive differences between what two exchanges in different jurisdictions require, thereby making it impossible to comply with both.

Above all, this approach would end the prospect that U.S. markets will entice cross-listing firms to make better and more detailed disclosure, but still permit them to utilize non-voting stock in order to preserve the private benefits of control for its controlling shareholders. Such an outcome might attract cross-listings, but it would not benefit U.S. investors.

B. The Impact of the Sarbanes-Oxley Act

If the NYSE and the SEC have assiduously avoided imposing governance requirements on foreign issuers, Congress has just done precisely the opposite and imposed sweeping governance reforms on both foreign and domestic issuers that are listed on U.S. markets. The Public Company Accounting Reform and Investor Protection Act of 2002 (popularly known as the Sarbanes-Oxley Act, after its co-sponsors), requires listed companies to upgrade their disclosures and governance in a number of respects, n279 but its most important and sweeping revision is its requirement **[*1825]** of independent audit committees. n280 Although this was not a major change for most U.S. companies, it represents a revolutionary reform for corporations incorporated under civil law regimes, because civil law codes often require a two-tier board, with the lower or "managing board" having no independent directors and the upper or "supervisory board" being half composed of representatives of employees. As a result, because codetermination laws staff the supervisory board with employee and union representatives, civil law corporations have generally resisted giving the supervisory board significant substantive responsibilities. n281 Thus, the Sarbanes-Oxley Act is particularly threatening to many European firms precisely because it assigns to the audit committee all responsibility "for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including **[*1826]** resolution of disagreements between management and the auditor regarding financial reporting)." n282 Furthermore, although some modest exemptive authority is provided, n283 the Act precludes members of the audit committee from receiving any compensation from the company (other than their directors' fees). n284 The net result is a mismatch for civil law corporations: Members of the managing board are barred from service on the audit committees, and members of the supervisory board, who may also be conflicted, are given powers that few civil law corporations would willingly entrust to them.

What will be the response of foreign issuers to the Sarbanes-Oxley Act? Some could delist, n285 but it is a far more difficult decision to delist (and thereby abandon existing shareholders) than to decline to list in the first place. Yet, for those firms hoping to raise equity financing, make U.S. acquisitions, or bond their promise to make credible disclosures, this may not be an attractive option, as the need to satisfy these priorities may require them to adapt the audit committee, incongruent as it is, to their own very different governance system. n286 Some form of accommodation, therefore, seems desirable that would permit foreign corporations, or at least those in civil law jurisdictions that mandate two-tier boards, to utilize an alternative procedure for enhancing the credibility of their accounting **[*1827]** policies and results. n287 The bottom line is that U.S. policy towards foreign issuers seeking to cross-list into the United States is now entirely unrationalized, with the most incompatible provisions of U.S. corporate governance for the foreign issuer (e.g., the independent audit committee) having been made mandatory, while less difficult, but more important, provisions (e.g., the prohibition on derogation of voting rights) remain inapplicable.

C. Regulatory Competition Reconsidered

This Article has recognized that some forms of regulatory competition may be desirable. For example, the higher disclosure and governance standards adopted by both the Neuer Markt and the Novo Mercado are clearly the product of a competitive desire to attract listings. In addition, recent legislation adopted in Latin America clearly seems intended to upgrade local corporate governance in order to stem the migration of trading and listings abroad. n288 But if these forms of regulatory competition are desirable, why should we not go further and adopt the "issuer choice" approach that several commentators have endorsed under which an issuer could trade on any exchange using the disclosure and governance standards of any recognized jurisdiction? n289 This Article presents three brief reasons for rejecting "issuer choice" and then describes an alternative model to issuer choice that it calls "exitless" regulatory competition:

1. Complementarity. - Because investors do not evaluate individual stocks in isolation, but rather compare them, it is desirable that any market have a set of common standards and rules that facilitates investor comparison. Under "issuer choice," one U.S.-incorporated company could adopt Italian accounting and disclosure standards; another Greek; and a third, Korean. While each set of standards may be internally consistent, they are not externally comparable. Hence, these three companies could have performed very similarly, but appear very different. The claim here is not that one set of accounting standards is necessarily superior to another, but that a common standard is better than diverse and non-comparable standards. n290 Similarly, the spread of English as the language of business does not reflect the natural superiority of English, but rather the natural desirability of a common standard language. To be sure, markets **[*1828]** can function without such a common standard, but they are less transparent and more costly for investors to use.

2. Strong Laws Encourage Economic Development. - The available empirical evidence suggests that adopting and enforcing a prohibition against insider trading significantly reduces the cost of capital. n291 Such a finding is consistent with the broader proposition advanced by LLS&V and others that strong laws protecting minority investors are a precondition to financial development. n292 Given this evidence, consider now the impact of the "issuer choice" approach to securities regulation. If issuers could opt to be governed by a non-U.S. legal regime, even though they were listed on the NYSE, some might well opt for the law of a jurisdiction that does not prohibit insider trading. Proponents of "issuer choice" will, of course, respond that an issuer that did so would be penalized by the market and would experience an appropriate discount in its share value. Perhaps it would, n293 but this does not respond to the more basic point that an externality has arisen: The immunity conferred on some firms to engage in insider trading may affect the cost of equity capital for all firms trading in that market. Rather than research the laws of numerous jurisdictions, investors may simply assume that they were vulnerable to insiders misappropriating material, nonpublic information and adjust prices downward in response. Moreover, there is also the prospect that the ability of some persons to engage in lawful insider trading may induce others to similarly engage in this behavior, even if it were illegal in their case. In effect, the moral foundations of the norm against insider trading are undercut. n294

3. Reputational Brands. - The foregoing example involving insider trading can be generalized to apply to most other forms of disclosure deficiencies. If some firms are permitted to trade in the market while making less than the prescribed level of disclosure, there is a potential effect on other issuers, who may incur a higher cost of equity capital as a result. Scandals affect not only the subject company, but others listed in the same market, as the Neuer Markt sadly learned. Essentially, this is why the NYSE developed listing standards, beginning in the late nineteenth century. Put simply, it recognized that to develop a "reputational brand," it had to exclude those unwilling or unable to comply with its high quality standards. n295 In short, "issuer choice" is incompatible with **[*1829]** the idea of a market developing a "high standards" reputation. Yet, only those markets that have developed such a brand name have developed into major international market centers with deep liquidity.

Where then is the dividing line between desirable and undesirable forms of regulatory competition? Proponents of "issuer choice" favor a form of regulatory arbitrage that is designed to allow firms to escape undesired regulation. Such an approach makes sense from a policy perspective only if one believes firms are systematically subject to overregulation. n296 In contrast, cross-listing represents an alternative form of regulatory competition that can be called "exitless" because the issuer does not escape its home jurisdiction's law and rules and must comply with any additional standards prescribed by the market on which it cross lists. Hence, the race can only be in the direction of increased regulation. As a result, this form of regulatory competition can involve bonding, but not a regulatory arbitrage designed to weaken legal rules. At best, it is desirable; at worst, it is benign.

Conclusion

This Article adds to an existing literature that has generally concluded that "law matters" and the strength of legal protections predicts a company's access to external finance. n297 What that literature misses and what this Article stresses is the relevance of private action. Law matters most to those firms needing access to external finance. To the extent that these firms are incorporated under legal regimes that do not protect minority rights, private action becomes the necessary (if partial) substitute for stronger law. Cross-listing is ultimately a form of private action and is most likely to be undertaken by firms seeking access to equity capital and needing to compensate for weak law in their jurisdictions of incorporation. Firms that do not fit this profile are less likely to cross-list (or to do so for other reasons). Non-cross-listing firms remain indifferent to this prospect of a higher market valuation for an understandable reason: **[*1830]** because any higher market valuation would be offset by reduced private benefits of control to their controlling shareholders. The firms that do and do not cross-list thus appear to be as different as proverbial apples and oranges. As a result, different forms of securities markets, each catering to a different clientele, appear likely to persist.

Admittedly, ambiguity still surrounds the precise cause of the increase in market valuation associated with cross-listing: Is it the higher likelihood of legal enforcement, the signal of profitable investment opportunities, the more credible promise of improved disclosure, contractual protections negotiated on entry into the U.S. market, the enhanced analyst coverage - or all in combination? Cross-listing may in part be a signaling device that the firm has high growth prospects, in part a bonding mechanism to assure public investors that they will not be exploited, and in part a means of attaining greater analyst attention and reducing informational asymmetries. Our understanding of the motives that drive it is far from complete. Yet, cross-listing cannot continue to be explained satisfactorily as simply a search for additional sources of capital in a segmented world; nor can the "law matters" thesis continue to ignore the critical role of private action in choosing among legal regimes.

In an increasingly competitive and consolidating environment, stock exchanges and other market centers will come under heightened pressure to specialize. Some will move toward the "high disclosure," high transparency approach that both the NYSE historically and the Neuer Markt more recently have pursued, while others may persist in following the "low transparency," cost minimization approach that many European and Asian stock exchanges have traditionally followed. This Article has suggested that different exchanges will move in different directions because of a basic path-dependent fact: They have different clienteles of listed companies. But even where the principal exchange resists enhanced disclosure or governance standards, it may follow the German and Brazilian examples by forming a "high disclosure" subsidiary or special listing segment. In addition, the one destabilizing prospect on the horizon is that legislation in many jurisdictions may begin to upgrade governance standards in order to slow the loss of liquidity from the local market. Here, powerful interest groups may clash.

The legislative reforms that have been provoked by cross-listings are an example of a new form of regulatory competition in which issuers opt into higher standards without seeking to escape their local jurisdiction's law. Such "exitless" competition seems desirable, but it is impeded by the increasingly inconsistent distinction that U.S. law makes between foreign and domestic issuers, sometimes applying governance standards to the latter, but not to the former, and sometimes applying them to both. Although this Article has not advocated specific governance requirements for any class of issuers, it would argue that functionally similar rules should apply to both foreign and domestic issuers that principally trade in the United States. In contrast, "issuer choice" represents a form of **[*1831]** competition that would largely undercut the ability of markets to develop their own reputational brands.

Finally, precisely because exchanges today do not capture the full value of the bonding services that they provide to issuers - both because of trading flow back and other reasons that divert trading away from exchanges - the market for bonding services can fail. That there is a demand for bonding services on the part of issuers does not imply that there is necessarily an incentive to supply them on the part of those currently most able to do so (i.e., stock exchanges). Thus, a case exists for regulatory oversight to protect and preserve the reputational benefits of exchange listing. The "race to the top" via cross-listing should be encouraged - but it will slow if "issuer choice" is permitted.

Legal Topics:

For related research and practice materials, see the following legal topics:
International LawAuthority to RegulateSecuritiesInternational Trade LawGeneral OverviewSecurities LawSelf-Regulating EntitiesNational Securities ExchangesNew York Stock Exchange

FOOTNOTES:

n1. For this estimate, see Craig Karmin et al., Vision Test: Nasdaq's Drive to Build Global Exchange Hits Some Major Potholes, Wall St. J., June 25, 2001, at A1 [hereinafter Karmin et al., Vision Test]. The term "exchange" is defined in section 3(a)(1) of the Securities Exchange Act of 1934, Pub. L. No. 291, *48 Stat. 881 (1934).* The actual functions performed by an exchange have been the subject of much academic writing. See generally Ruben Lee, What Is an Exchange? The Automation, Management, and Regulation of Financial Markets (1998) (describing the range of functions performed by exchanges and the potential for competitive substitutes). For purposes of this Article, neither the statutory definition of an exchange nor the legal differences among exchanges and other market centers, such as electronic communications systems (ECNs), is important, and the term "exchange" will be used in its ordinary sense of a market center.

n2. During the nineteenth century, approximately 250 different stock exchanges operated in the United States, with most sheltered from competition by geographic and communication barriers. R.C. Michie, The London and New York Stock Exchanges: 1850-1914, at 167 (1987). As late as 1900, over 100 stock exchanges were still functioning in the United States. Marshall Blume et al., Revolution on Wall Street 30 (1993). Their survival into the twentieth century was a direct function of both the high cost of long distance communications and the costly and cumbersome settlement process, which required physical delivery of the stock certificates. Id. Technological innovations in the late nineteenth century (most notably, the telephone, the stock ticker, and, earlier, the telegraph) reduced these cost barriers and resulted in more efficient national exchanges absorbing or eliminating smaller local exchanges.

n3. The impact of stock migration and cross-listings has been clearest on exchanges in emerging markets. Within these markets, a few large companies often account for a majority of the trading volume, and their migration to international exchanges drains liquidity from the local market, leaving its viability uncertain. See Stijn Claessens et al., Explaining the Migration of Stocks from Emerging Economies to International Centers 18-19 (World Bank, Working Paper No. 2816, 2002), available at http://papers.ssrn.com/sol3/delivery.cfm/SSRN ID296960 code020116500.pdf?abstractid=296960 (on file with the Columbia Law Review) [hereinafter Claessens et al., Migration]; see also infra notes 51-64 and accompanying text.

n4. Euronext, the second largest European securities market with a market capitalization of $ 2.4 trillion, was the product of a September 2000 merger of the Paris, Amsterdam, and Brussels exchanges. A newly privatized exchange, Euronext made a public offering of its shares in July 2001. Norman S. Poser, The Stock Exchanges of the United States and Europe: Automation, Globalization, and Consolidation, *22 U. Pa. J. Int'l Econ. L. 497, 504-05 (2001).* Europe's first and third largest exchanges are the London Stock Exchange (LSE), with a market capitalization of roughly $ 2.9 trillion, and the Frankfurt Stock Exchange, with a market capitalization of $ 1.4 trillion, which is in turn owned by the Deutsche Borse, an affiliate of Deutsche Bank. A London/Frankfurt merger was negotiated in 2000, but was abandoned in September 2000, following the announcement of a hostile bid for the LSE by OM Gruppen, Inc., the owner of the Stockholm Stock Exchange. See *id. at 502-05.* In addition to mergers and proposed mergers, there have also been strategic alliances between exchanges. A leading example is Norex, an affiliation of the Stockholm and Copenhagen exchanges in which several other Baltic markets now participate. See *id. at 506.* See generally Alberto Cybo-Ottone et al., Recent Development in the Structure of Securities Markets, in Brookings-Wharton Papers on Financial Services 2000, at 223 (Robert E. Litan & Anthony M. Santomero eds. 2000) (analyzing the recent alliances and consolidation of some international exchanges within the European Union and the United States and assessing the outlook for further consolidation); Claessens et al., Migration, supra note 3 (discussing the growing migration of listings and trading to international exchanges).

n5. This short list does not exhaust the ways in which market centers can compete. For example, exchanges also have very different clearance and settlement systems. Some markets are "quote driven" (that is, dealers compete by offering rival quotes for the same security), while others are increasingly "order driven" (that is, orders flow to a central location and interact, possibly through the mechanism of a specialist acting as auctioneer). Some are non-profit membership organizations, while increasingly more have been demutualized and are privately owned. See Poser, supra note 4, at 514-16, 518-28.

n6. Viewing exchanges as a kind of natural monopoly, these theorists argue that large pools of liquidity in major markets will exercise a vacuum cleaner-like effect that drains smaller markets in order to concentrate liquidity in a few major markets. See, e.g., Carmine Di Noia, Competition and Integration Among Stock Exchanges in Europe: Network Effects, Implicit Mergers and Remote Access, 7 Eur. Fin. Mgmt. 39, 42 (2001) (arguing that, as a matter of theory, competition will result in "only one exchange surviving," except when exchanges form alliances to avoid competition).

n7. See id. at 55.

n8. Theories about "regulatory competition" trace back to a classic 1956 article by Charles Tiebout. Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. Pol. Econ. 416 (1956). While Tiebout's model essentially applied to the provision of public goods, it was quickly and logically applied by others to the private market and the regulation of business firms.

n9. Typically, proponents of "issuer choice" view this approach as initiating a process of regulatory arbitrage that would pare back excessive over-regulation. See, e.g., Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, *107 Yale L.J. 2359, 2427 (1998)* (advocating "competitive federalism" as system under which firms select their securities regulator from among U.S. jurisdictions and foreign nations); Stephen J. Choi & Andrew T. Guzman, Portable Reciprocity: Rethinking the International Reach of Securities Regulation, *71 S. Cal. L. Rev. 903, 922-24 (1998)* (advocating "portable reciprocity" regime under which securities issuer selects from among several countries' regulatory regimes). For the latest statement of Professor Romano's views, see generally Roberta Romano, The Need for Competition in International Securities Regulation, 2 Theoretical Inquiries L. 387 (2001). Others have emphatically disagreed. See, e.g., Merritt B. Fox, Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment, *85 Va. L. Rev. 1335, 1338-41 (1999)* (arguing that issuer choice would decrease U.S. economic welfare by leading issuers to disclose at sub-optimal levels). For Professor Fox's latest statement of his views, see generally Merritt B. Fox, The Issuer Choice Debate, 2 Theoretical Inquiries L. 563 (2001). A few economists have suggested that competition among regulatory regimes will produce a "race to the top" toward higher, more restrictive standards. See, e.g., Steven Huddart et al., Disclosure Requirements and Stock Exchange Listing Choice in an International Context, 26 J. Acct. & Econ. 237, 260 (1999) (arguing that trading concentrates on high disclosure exchanges prompting exchanges to engage in "race for the top" in setting disclosure requirements to maximize trading volume). But still others have disagreed, finding that competition among markets has already produced a "race to the bottom" and lesser transparency. See, e.g., Robert Bloomfield & Maureen O'Hara, Can Transparent Markets Survive?, 55 J. Fin. Econ. 425, 452 (2000) (discussing effects of transparency on market behavior and claiming that low-transparency dealers are able to outcompete more transparent counterparts in many dimensions including profitability).

n10. There is growing evidence that "strong" markets may have developed at least in part because of strong legal institutions. See infra note 15 and accompanying text.

n11. Increasingly in the global economy, it may be possible to make such an exit from the home country's laws. See, e.g., Dan L. Burk, Virtual Exit in the Global Information Economy, *73 Chi.-Kent L. Rev. 943, 977-80 (1998)* (arguing that increasing ease of exit from jurisdictions will produce regulatory arbitrage and reduced regulation). But that is not what is happening in the system of cross-listings that is currently emerging. Rather, the issuer would continue to disclose to its home country regulator according to its home country's rules and, in addition, disclose to the exchange on which it cross-lists according to that jurisdiction's rules.

n12. See infra notes 21-29, 39-48 and accompanying text.

n13. See Howell E. Jackson & Eric J. Pan, Regulatory Competition in International Securities Markets: Evidence from Europe in 1999 - Part I, 56 Bus. Law., Feb. 2001, at 655 (reporting results of survey showing that, despite availability of issuer choice, few firms employ it to reduce disclosure obligations).

n14. This is consistent with standard economic theory, which has long maintained that a commitment to higher disclosure reduces the cost of capital. See Douglas W. Diamond & Robert E. Verracchia, Disclosure, Liquidity, and the Cost of Capital, 46 J. Fin. 1325, 1325 (explaining how revealing information to reduce information asymmetry can reduce a firm's cost of capital by attracting increased demand from large investors due to increased liquidity of its securities); see also infra notes 100-104 and accompanying text.

n15. The seminal work of Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny (LLS&V) has established the existence of two rival structures of share ownership - dispersed ownership and concentrated ownership - and that the structure of share ownership in a given jurisdiction correlates with significant differences in the legal protection provided to minority shareholders. See generally Rafael La Porta et al., Corporate Ownership Around the World, 54 J. Fin. 471 (1999) [hereinafter La Porta et al., Corporate Ownership] (finding that, except in economies with strong shareholder protection, relatively few large firms are widely held); Rafael La Porta et al., Law and Finance, 106 J. Pol. Econ. 1113 (1998) (finding that the concentration of share ownership in the largest public companies is negatively related to investor protections, supporting a hypothesis that minority shareholders are unlikely to be influential in countries that fail to protect their rights). This author remains skeptical as to whether this "legal explanation" can truly account for the appearance of the separation of ownership and control in Anglo-American countries. See John C. Coffee, Jr., The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control, *111 Yale L.J. 1, 9-11 (2001)* [hereinafter Coffee, Rise of Dispersed Ownership] (arguing that the early development of a relatively autonomous and self-regulating private sector in certain countries - some common law and some civil law - better accounts for stock market development than do legal differences). However, this author agrees with the thesis that "law matters" and that minority legal protections can affect share value. See John C. Coffee, Jr., The Future As History: The Prospects for Global Corporate Convergence in Corporate Governance and Its Implications, *93 Nw. U. L. Rev. 641, 673-74 (1999)* [hereinafter Coffee, The Future As History] (advancing thesis that many firms migrate to U.S. securities markets as a form of bonding). Nonetheless, the "law matters" literature has undervalued and tended to ignore the role of private action by individual firms. At bottom, cross-listing is a form of private action that may be undertaken by many firms to compensate for weak law in their jurisdictions of incorporation.

n16. The terms "race to the top" and "race to the bottom" have become familiar shorthand expressions in a longstanding academic debate in the United States over whether interjurisdictional competition among states for corporate charters produces more or less efficient legal rules. Compare William Cary, Federalism and Corporate Law: Reflections Upon Delaware, *83 Yale L.J. 663, 705 (1974)* (expounding theory that Delaware has promoted a race to the bottom among states in corporate regulation by adopting laws that favor managers over shareholders), with Roberta Romano, The Genius of American Corporate Law 14-24 (1993) (analyzing empirical evidence as showing that the race is more to the top because the many markets in which firms operate - the capital, product, and corporate control markets - constrain managers from choosing a legal regime detrimental to shareholders' interest). In a number of respects, the competition among market centers for listings is different from the competition among states to grant corporate franchises, not least of all because the state does not typically increase its own tax revenues by luring firms to cross-list on its markets.

n17. Path dependency postulates that institutions evolve in a manner that is heavily determined by initial starting points and pre-existing conditions. See Lucian Bebchuk & Mark Roe, A Theory of Path Dependency in

Corporate Ownership and Governance, *52 Stan. L. Rev. 127, 168-69 (1999)* (explaining institutional persistence, or path dependency, in terms of sunk adaptive costs, complementarities, network externalities, and, most of all, self-interests of those who benefit from the existing system and hence resist change). While this perspective has been applied by several authors to corporate structure and evolution, it has not been previously used as a means by which to model the competition among market centers.

n18. For this generalization applied to securities markets, see Marshall E. Blume, The Structure of the U.S. Equity Markets 3 (Rodney L. White Ctr. for Fin. Res., Working Paper No. 17-00, 2000), available at http://papers.ssrn.com/sol3/delivery.cfm/SSRN ID263033 code010312130.pdf?abstractid=263033 (on file with the Columbia Law Review) ("Fragmentation is at the heart of competition.").

n19. See La Porta et al., Corporate Ownership, supra note 15, at 491-98, 511 (analyzing ownership of firms in twenty-seven countries, and concluding that while large corporations in the richest countries tend to be widely held, concentrated ownership of companies is more common in other countries).

n20. It is, of course, debatable in many cases whether the listing choice is made to further the interests of public shareholders or controlling persons (either managers or a dominant shareholder). If public shareholders determined where firms listed, a regulatory race to the top would be predictable, because it would maximize share value. Controlling shareholders are, however, less interested in maximizing the value of the firm's shares in the public market because they can sell their control block privately for a control premium and because they stand to receive private benefits from control. Hence, they may resist greater disclosure or transparency if it interferes with their receipt of private benefits.

n21. See Marco Pagano et al., The Geography of Equity Listing: Why Do Companies List Abroad?, 57 J. Fin. (forthcoming Dec. 2002) (Ctr. for Studies in Econ. & Fin., Working Paper No. 28, 2001, at 11-12 & 40 tbl.2), available at http://www.dise.unisa.it/WP/wp28.pdf (presenting statistics on foreign listings of U.S. and European companies; noting that the number of European companies on foreign listings increased during the years 1986 through 1997, while the number of American companies on foreign listings decreased during that same period); see also Jackson & Pan, supra note 13, at 684-87 (concluding that few issuers in Europe are opting to utilize lower disclosure standards even though legally permitted to do so).

n22. Pagano et al., supra note 21, at 1. The authors add, "Interestingly, the European markets with the highest trading costs, lowest accounting standards and worst shareholder protection have also fared worst in attracting or retaining foreign listings, and companies from those countries have been comparatively eager in seeking foreign listings." Id. In essence, this is a finding that many foreign firms desire to bond. See infra note 26 (defining "bonding").

n23. In particular, firms that cross-list in U.S. markets tend to have higher market valuations, greater leverage, and better earnings prospects than firms that do not cross-list. See infra notes 130-148 and accompanying text.

n24. Since late 2000, significant securities markets reforms have been adopted in Argentina, Brazil, Chile, and Mexico; in addition, Colombia has revised its regulations regarding pension funds to encourage more active participation in corporate governance by institutional shareholders. Chile approved a new tender offer law in late 2001, and Argentina and Mexico adopted new capital markets laws in 2001. Global Investing: Be Nice to Minorities in Latin America, Fin. Times, July 23, 2001, at 20. After a four-year struggle, Brazil also approved a compromise statute in 2001 that significantly revised its corporate governance standards, at least prospectively, in order to enhance the rights of minority shareholders. John Barham, A Compromise Solution, LatinFinance, Oct. 2001, at 40, 41-42. This Article will also focus on developments in Brazil and Mexico, two countries that had been especially adversely affected by the exodus of their leading issuers to the NYSE. See infra notes 200-201, 225 and accompanying text.

n25. A good example is supplied by the recent comments of Raymundo Magliano, the chairman of the Bovespa in Brazil, which is Latin America's largest stock market. A champion of recent corporate governance reform in Brazil, he was recently quoted by the New York Times, proclaiming: "What we want to do is transform the Bovespa into a market for all... . We are revolutionaries, and we are going to spark a cultural revolution." Tony Smith, Stoking a Stock Market "Revolution," N.Y. Times, July 30, 2002, at W1. Yet the Bovespa has seen its daily average trading volume fall from around $ 1 billion in 1997 to $ 200 million today, and "about 40 percent of investors have migrated to American depository receipts." Id. In consequence, some thirteen S<tild a>o Paulo brokerage firms have closed over the last year. As he concedes, legal reform is an attempt to save a market that is otherwise losing its liquidity. Id.; see also infra notes 200-224 and accompanying text.

n26. "Bonding" is a term of art in modern institutional law and economics. It refers to the costs or liabilities that an agent or entrepreneur will incur to assure investors that it will perform as promised, thereby enabling it to market its securities at a higher price. The paradigmatic example would be the surety bond purchased by the agent to protect the firm's shareholder principals. The term was coined in Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 325 (1976).

n27. This explanation dates back to a well-known article by Robert Merton that modeled a world segmented into local capital markets. See Robert C. Merton, Presidential Address: A Simple Model of Capital Market Equilibrium with Incomplete Information, 42 J. Fin. 483, 485 (1987); see also infra note 86.

n28. This author was probably the first to publish this hypothesis. See Coffee, The Future As History, supra note 15, at 674. Obviously, others may have independently arrived at the same idea at more or less the same time. See, e.g., Rene M. Stultz, Globalization, Corporate Finance, and the Cost of Capital, J. Applied Corp. Fin., Fall 1999, at 8, 15 (arguing that globalization allows companies voluntarily to commit to higher disclosure standards to economize on the costs of raising funds in public capital markets).

n29. The two best examples of such markets are the Neuer Markt in Germany and the Novo Mercado in Brazil. Each is discussed infra in notes 189-224 and the accompanying text. Although these efforts have been serious and sustained, it remains unclear whether they will be successful.

n30. See Public Company Accounting Reform and Investor Protection Act of 2002, Pub. L. No. 107-204, *116 Stat. 745.*

n31. In particular, section 301 of the Public Company Accounting Reform and Investor Protection Act of 2002 ("Act") mandates independent audit committees, each of whose members must satisfy a statutory standard of independence. As discussed later, this will be a formidable requirement for many European and civil law corporations to satisfy because they lack independent boards. The Act also requires numerous additional disclosures and certifications by corporate officers under oath. See infra notes 279-284 and accompanying text.

n32. A distinction needs to be drawn here between competition for listings, which is intense, and competition for trading supremacy in the same security, which is rare. Thus, the NYSE, Nasdaq, and the Amex have long competed for listings, but until recently did not trade the same stocks. Nasdaq and some regional exchanges do now trade NYSE-listed stocks, but have only a small percentage of such trading. In 2000, the NYSE handled 82.88% of all trading on the consolidated tape of NYSE-listed stocks; the five regional exchanges processed 8.82%; and Nasdaq captured 8.30%. Blume, supra note 18, at 17.

n33. See Di Noia, supra note 6, at 43-44 (citing J. Harold Mulherin et al., Prices as Property: The Organization of Financial Exchanges from a Transaction Cost Perspective, *34 J. L. & Econ. 591, 608 (1991)).*

n34. Formed in 1885, the Consolidated Stock and Petroleum Exchange was a substantial competitor to the NYSE almost up to World War I, but was eventually defeated by the NYSE, which sought to prohibit other brokers from trading on its rival. See Michie, supra note 2, at 204-08, 254-55, 260-61; see also Di Noia, supra note 6, at 43-44.

n35. Di Noia, supra note 6, at 44. The LSE did not require the firms it traded to request listing formally; rather, it proceeded without their request. Id. at 54.

n36. See id. at 54.

n37. Basically, the European exchanges moved from a call auction procedure to a faster quote-driven trading technology. Id.

n38. See Poser, supra note 4, at 502-03 (discussing the LSE's recent problems). The merger was thwarted by other developments, but the privately owned LSE remains a potential takeover target today.

n39. Stijn Claessens et al., Stock Markets in Transition Economies 17 (World Bank, Financial Sector Discussion Paper No. 5, 2000), available at http://www.fee.uva.nl/fm/PAPERS/Claessens/chapters/stock markets.htm (on file with the Columbia Law Review) [hereinafter Claessens et al., Stock Markets].

n40. Id. A more recent study finds that, as of March 2001, there were 1,951 "active" depository receipt programs from 1,524 firms in 80 countries. Claessens et al., Migration, supra note 3, at 9.

n41. Claessens et al., Stock Markets, supra note 39, at 17. In 1999, some $ 533 billion in ADRs was listed on the NYSE. Claessens et al., Migration, supra note 3, at 2.

n42. Gerald F. Davis & Christopher Marquis, Are U.S. Stock Markets a Pathway to Global Governance Convergence? 3 (Acad. of Mgmt., Working Paper, 2001) (on file with the Columbia Law Review).

n43. Michael Gruson, Global Shares of German Corporations and Their Dual Listings on the Frankfurt and New York Stock Exchanges, *22 U. Pa. J. Int'l Econ. L. 185, 187 n.2 (2001).*

N44. See Claessens et al., Migration, supra note 3, at 2. This amount represented 17% of the trading in the corresponding local markets. Id.

n45. In 2000, a total of 23.3 billion shares of non-U.S. stocks was traded on the NYSE, an increase of 53% from 1999. The dollar value of shares of non-U.S. companies traded on the NYSE as a percentage of the total value traded rose to 10.3% in 2000, as compared to 7.7% in 1999. Troy L. Harder, Comment, Searching for a Level Playing Field: The Internationalization of U.S. Securities Disclosure Rules, 24 Hous. J. Int'l L. 345, 347 n.5 (2002). Similarly, between 1995 and 2000, over 800 foreign issuers registered their securities with the SEC. Id. (citing study by SEC's Division of Corporation Finance). Davis and Marquis report that the total equity capital raised in the United States through the issuance of depository receipts during the 1990s was $ 133 billion. See Davis & Marquis, supra note 42, at 3. Finally, in 2000, some $ 29 billion was raised in new equity through 115 depository receipts offerings in the U.S. and European markets, a 32% increase over 1999. Claessens et al., Migration, supra note 3, at 2.

All this is in sharp contrast to the European experience over the same interval. U.S. cross-listings on European exchanges declined over the 1986 to 1997 interval, and foreign firms cross-listing on European exchanges did not make subsequent equity offerings at a higher rate than a control group. See Pagano et al., supra note 21, at 11-12.

n46. This table is an updated version of a table originally prepared by Professors Jonathan R. Macey and Maureen O'Hara, but has been extended to cover later years. Jonathan R. Macey & Maureen O'Hara, The Economics of Stock Exchange Listing Fees and Listing Requirements, 11 J. Fin. Intermediation 297, 302 (2002). Data for 2001 and 2002 have been added from the NYSE's web site. NYSE, Complete List of Non-U.S. Companies - 2001, at http://www.nyse.com/pdfs/forlist0209.pdf (on file with the Columbia Law Review); NYSE, Quick Facts: NYSE Press Room (July 31, 2002), at http://www.nyse.com/marketinfo/quickfacts.html (on file with the Columbia Law Review).

n47. For this assessment, see Cybo-Ottone et al., supra note 4, at 263. Although the NYSE has a significantly greater market capitalization than the LSE ($ 12.4 trillion versus $ 2.9 trillion), the LSE lists many more securities (over 12,000). See Poser, supra note 4, at 500-02. Unlike the NYSE, the LSE has not sought to emphasize higher listing or disclosure standards as a competitive strategy.

n48. Cybo-Ottone, Di Noia, and Murgia offer the assessment that "listing on NYSE seems to signal commitment to a shareholder value approach," which the listing foreign firm often advertises in the press. Cybo-Ottone et al., supra note 4, at 263. In contrast, listing on the LSE carries no such signal and is not advertised by firms listing thereon. A cross-listing on the NYSE also leads to a substantially greater increase in analyst coverage than does a listing on the LSE. See H. Kent Baker et. al., International Cross-Listing and Visibility, 37 J. Fin. & Quantitative Analysis 495, 498 (2002). Finally, a listing on the NYSE costs substantially more, both initially and annually, than a cost-listing on the LSE. Id. at 499-500. Hence, to justify paying more, firms cross-listing on the NYSE must expect to gain more than from a similar listing on the LSE.

n49. Claessens et al., Migration, supra note 3, at 11. This growth reflected both prices for existing stocks and new listings.

n50. The highest ratio of market capitalization to GDP was in Hong Kong, where it was 383% in 2000, and the lowest ratio was in Bangladesh, where it was only 2.5%. Id.

n51. The World Bank study finds that this growth was the highest in what it terms "middle-income" countries (such as much of East Asia and Latin America). In "middle-income" countries, the ratio of market capitalization listed abroad to total capitalization increased from single digit numbers in 1989 to a peak of over 62% in 1999. Id. at 12. This ratio declined to around 50% in 2000. Id. at 26 fig.2.

n52. Id. at 13.

n53. Id. at 2.

n54. Id. at 13, 27 fig.3.

n55. Kent Hargis, International Cross-listing and Stock Market Development in Emerging Economies, 9 Int'l Rev. Econ. & Fin. 101, 101 (2000).

n56. Darius P. Miller, The Market Reaction to International Cross-Listings: Evidence from Depositary Receipts, 51 J. Fin. Econ. 103, 113 (1999).

n57. Hargis, supra note 55, at 102.

n58. Id. at 103.

n59. This table is taken from a fuller table in Hargis. Id. at 102 tbl.1.

n60. This table understates the full migration of trading to the United States because it compares the trading in the security that cross-lists to the total trading of all securities in the home country. Other studies that have focused just on trading in the securities covered by depository programs have found that as much as 75% of the trading in those securities shifts to the United States. See Ian Domowitz et al., International Cross-Listing and Order Flow Migration: Evidence From an Emerging Market, 53 J. Fin. 2001, 2002 (1998) ("Foreign listing is likely to have a significant impact on the domestic Mexican market because foreign investors (mostly U.S. nationals) account for more than 27 percent of holdings and up to 75 percent of trading in our sample period.").

n61. Raymond Colitt, Brazil Pins Its Hopes on Reform, Fin. Times, Nov. 1, 2001, at 46 [hereinafter Colitt, Reform]; Smith, supra note 25.

n62. Raymond Colitt, Brazil Aims to Boost Capital Markets, Fin. Times, Oct. 17, 2001, at 14 [hereinafter Colitt, Capital Markets]. By 2002, the daily trading average had climbed back to $ 200 million, which still represents an 80% decline. Smith, supra note 25.

n63. Smith, supra note 25. The transfer tax amounted to 0.38% of the value of each stock exchange transaction. Colitt, Capital Markets, supra note 62.

n64. This is the principal causal explanation given by the President of Brazil's capital markets regulatory agency. See Jose Luis Osorio, Committed to Reform, LatinFinance, Nov. 2001, at 56, 56. Mr. Osorio is President of Brazil's Commiss<tild a>o De Valores Mobiliarios (CVM), the Brazilian equivalent of the American Securities and Exchange Commission. The author also interviewed Mr. Osorio in S<tild a>o Paulo in April 2002.

n65. Miller, supra note 56, at 104 (noting that 209 of 289 issuers establishing sponsored depository receipt facilities in 1994 were from emerging market countries).

n66. Craig Karmin, Foreign Concerns' New Issuance of ADRs Fell Sharply This Year, Wall St. J., Dec. 19, 2001, at C13.

n67. Id.

n68. By one estimate, in 1994, 77% of the total equity capital raised by firms in emerging market countries was raised in the depository receipt market. Vihang R. Errunza & Darius P. Miller, Market Segmentation and the Cost of Capital in International Equity Markets, 35 J. Fin. & Quantitative Analysis 577, 581 (2000).

n69. For example, the Mexican market is open from 9:30 am to 5:00 pm EST in the United States and thus fully overlaps with trading on the NYSE and Nasdaq. See Domowitz et al., supra note 60, at 2003.

n70. See generally Melek Pulatkonak & George Sofianos, The Distribution of Global Trading in NYSE-Listed Non-U.S. Stocks (NYSE, Working Paper No. 99-03, 1999) (on file with the Columbia Law Review) (finding that a market's "time-zone distance from the U.S." best predicts the likelihood that trading will flow back to the United States; that is, markets within, or near, U.S. time zones will experience the largest trading volume loss because of cross-listing).

n71. Osorio, supra note 64, at 56.

n72. Id.

n73. Edward B. Rock, Greenhorns, Yankees, and Cosmopolitans: Venture Capital, IPOs, Foreign Firms, and U.S. Markets, 2 Theoretical Inquiries L. 711, 717 (2001) (quoting Nasdaq's website).

n74. Id.

n75. See Claessens et al., Migration, supra note 3, at 12.

n76. Rock, supra note 73, at 725.

n77. See Karmin et al., Vision Test, supra note 1.

n78. Id.

n79. See Phred Dvorak & Craig Karmin, Nasdaq Japan: Failure Carries Many Aspects, Wall St. J., Aug. 19, 2002, at C1.

n80. Id.; see also Karmin et al., Vision Test, supra note 1.

n81. Karmin et al., Vision Test, supra note 1 (quoting NYSE Chairman Richard Grasso, who stated, "We're not going to plant our flag in Tokyo.").

n82. Id.

n83. For a brief overview of these developments, see Poser, supra note 4, at 502-04.

n84. See Miller, supra note 56, at 104; Craig Doidge et al., Why Are Foreign Firms Listed in the U.S. Worth More? 1-2 (Working Paper, 2001), available at http://papers. ssrn.com/sol3/delivery.cfm/SSRN ID285337 code011001100.pdf?abstractid=285337 (on file with the Columbia Law Review) (finding sharply higher valuations and Tobin's q ratios for foreign firms listed in the United States, even after controlling for various differences); see also 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, 1008 (1987) (indicating firms cross-listing in the United States earn cumulative abnormal returns of 19% in the year before listing).

n85. Foerster & Karolyi, supra note 84, at 1008-09; Narayanan Jayaraman et al., The Impact of International Cross Listings on Risk and Return: The Evidence From American Depository Receipts, 17 J. Banking & Fin. 91, 96-97 (1993); Gordon J. Alexander et al., Note, Asset Pricing and Dual Listing on Foreign Capital Markets: A Note, 42 J. Fin. 151, 151 (1987).

n86. See, e.g., Merton, supra note 27, at 485 (setting forth original theory of market segmentation's effect); Alexander et al., supra note 85, at 157-58 (arguing that the expected return on a dually listed security is different from its expected return when it is listed on a single market). These studies predict, or are at least consistent with a finding, that cross-listing between two segmented markets leads initially to a higher equilibrium market price and a lower expected return thereafter.

n87. See Foerster & Karolyi, supra note 84, at 988-95 (finding that abnormal returns to cross-listing firms initially rose, but later declined post-listing).

n88. Id. at 993-95; see also Alexander et al., supra note 85, at 157-58 (also finding post-listing decline).

n89. See Miller, supra note 56, at 104.

n90. Id. The Miller Study utilized a sample consisting of 181 foreign issuers that announced their first depository receipts program between 1985 and 1995. Id. at 108.

n91. Id. at 105.

n92. Id. at 104. Miller indicated that "abnormal returns largest for firms that list on major U.S. exchanges such NYSE or NASDAQ, rather than on OTC 'pink sheets' or PORTAL." Id.

n93. Very few other jurisdictions recognize the class action, and virtually none has any experience with it in the securities law context. Equally important, U.S. law accepts the contingent fee and the practice of awarding relatively high fee awards to the successful attorney in a class action. Finally, the "American Rule" on fee shifting, under which each side generally bears its own expenses, means that an unsuccessful plaintiff does not face liability for the defendant's typically greater expenses. All these elements combine to create an entrepreneurial system of private enforcement in the United States that is not paralleled elsewhere. See generally John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, *86 Colum. L. Rev. 669, 677-84 (1986)* (analyzing the unique legal rules in the United States that give rise to an entrepreneurial system of private enforcement).

n94. Although there have been hints of forthcoming change, the SEC continues to require foreign issuers that file financial information with it also to file a reconciliation to U.S. GAAP, as promulgated by the Financial Accounting Standards Board (FASB). *International Accounting Standards, Securities Exchange Act Release No. 33-7801, 17 SEC Docket 1551, 1555* (Feb. 16, 2000). For an overview, see generally Maureen Peyton King, Note, The SEC's (Changing?) Stance on IAS, *27 Brook. J. Int'l L. 315 (2001)* (discussing SEC's continuing policy of refusing to accept International Accounting Standards as an alternative to U.S. GAAP). Any issuer, foreign or domestic, that lists on a U.S. exchange is required to register with the SEC pursuant to section 12(b) of the Securities Exchange Act of 1934 and to enter the periodic disclosure system established by section 13 of that Act. In the case of foreign issuers, this obligation requires the filing of Form 20-F. See Form 20-F, Securities Exchange Act of 1934, *17 C.F.R. 249.220f (2002)*. Form 20-F must be filed annually within six months after the end of the issuer's fiscal year. Id.

n95. When firms cross-list in the United States, they obtain significantly increased coverage from securities analysts and more accurate forecasting of future earnings. See generally Mark H. Lang et al., ADRs, Analysts, and Accuracy: Does Cross Listing in the U.S. Improve a Firm's Information Environment and Increase Market Value? 20 (NYSE, Working Paper No. 2002-06, Apr. 2002), available at http://www.nyse.com/pdfs/2002-06.pdf (on file with the Columbia Law Review) (finding that firms that cross-list obtain greater analyst coverage and their earnings forecasts prove more accurate than those relating to non-cross-listing firms). Increased analyst attention is not simply a function of the greater depth and liquidity of U.S. markets. The LSE is also deep and liquid, but a cross-listing on the LSE does not produce the same level of analyst attention. One recent study finds that a cross-listing on the NYSE is associated with a 128% increase in the number of analysts following the firm, whereas a similar listing on the LSE correlates with only a 48% increase in the average number of analysts following the firm. See H. Kent Baker et. al., International Cross-Listing and Visibility, 37 J. Fin. & Quantitative

Analysis 495, 498 (2002). Although any explanation of this differential is speculative, it may be that securities analysts are more prepared to follow firms that make more detailed financial disclosures, and more extensive disclosures are required to list on the NYSE than on the LSE. The NYSE, however, also requires a greater market capitalization, and a NYSE listing entails considerably greater initial and annual costs. Id at 499-500. These greater costs suggest that non-U.S. firms cross-listing on the NYSE must expect to get more from such a listing than from a cheaper cross-listing on the LSE, and this expectation is at least consistent with the bonding thesis.

n96. See infra notes 261-265 and accompanying text.

n97. An American Bar Association study, released in 2002, has concluded that "foreign issuers can easily obtain an exemption from corporate governance listing requirements." ABA Section of Bus. Law, Comm. on Fed. Reg. of Sec., Special Study on Market Structure, Listing Standards and Corporate Governance, *57 Bus. Law. 1487 (2002)* [hereinafter ABA Special Study]. As a practical matter, all that is required for a waiver from the NYSE's corporate governance requirements is an opinion from "an independent counsel licensed in the issuer's home country [that] opines that the issuer's governance practices are not prohibited in its domicile jurisdiction." Id. at 27. As a result, the NYSE's listing rules that preclude a domestic issuer from diluting the voting power of minority shareholders, such as through the subsequent issuance of supervoting stock and other techniques, do not apply to the foreign issuer, which remains free to engage in such tactics. See infra notes 261-276 and accompanying text. This is an example of the kind of regulatory arbitrage that even a partial system of "issuer choice" permits. See supra notes 8-10 and accompanying text.

n98. See Self-Regulatory Organizations; *Order Approving Proposed Rule Changes by the American Stock Exchanges, Inc. and New York Stock Exchange, Inc. to Amend the Exchanges' Listing Standards for Foreign Companies, Securities Exchange Act Release No. 24,634, 38 SEC Docket 947, 948, 952* (June 23, 1987); see also Roberta S. Karmel, The Future of Corporate Governance Listing Requirements, *54 SMU L. Rev. 325, 333-36 (2001)* (discussing waivers from exchange corporate governance requirements available to foreign firms).

n99. For a summary of recent reforms in Latin American emerging markets, see infra notes 204-229 and accompanying text. This barrier is new principally because emerging markets have only sought to utilize listing requirements as a means of addressing corporate governance over the last several years, generally after earlier efforts to secure legislative reform failed.

n100. Theoretical research has argued that a commitment to increased disclosure (and thus to reduced informational asymmetries) would produce a lower cost of capital. See generally Stanley Baiman & Robert E. Verrecchia, The Relation Among Capital Markets, Financial Disclosure, Production Efficiency, and Insider Trading, 34 J. Acct. Res. 1, 2 (1996) (finding that "cost of capital falls because more disclosure encourages investment by individuals who may have future liquidity needs"); Diamond & Verrecchia, supra note 14, at 1325 (arguing that reducing information asymmetry by disclosing more information can reduce cost of capital).

n101. Christian Leuz & Robert Verrecchia, The Economic Consequences of Increased Disclosure, 38 J. Acct. Res. 91, 121 (Supp. 2000).

n102. Lang et al., supra note 95, at 20; Baker, supra note 48, at 498 (finding 128% increase in average number of analysts covering the firm after a cross-listing on the NYSE).

n103. Id. at 22-23 (finding the firms that experience the greatest improvement in analyst coverage also experience the greatest valuation benefits from cross-listing).

n104. Warren B. Bailey et al., The Economic Consequences of Increased Disclosure: Evidence from International Cross-Listings (Dice Center, Working Paper No. 2002-4, Mar. 13, 2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract id=304560 (on file with the Columbia Law Review).

n105. Miller, supra note 56, at 111. The Miller Study uses the standard econometric techniques employed in event study methodology. Id. at 109-11. For a fuller and accessible discussion of these techniques, see Ronald Gilson & Bernard Black, The Law and Finance of Corporate Acquisitions 185-220 (2d ed. 1995). The event under study is the announcement of a cross-listing on a U.S. market. To calculate its impact, researchers first measure the return on each individual stock on the day of announcement, which is calculated in terms of the percentage price change from the prior day's trading. An arithmetic average is then computed to yield the mean return. However, because these returns could be influenced by aggregate movements in the broader stock market on that day, event studies correct for this possibility by subtracting the market return for that day from the average return for the studied stocks; the difference (whether positive or negative) is known as the "abnormal return." The sum of the abnormal returns on all the stocks studied is the "cumulative abnormal return" or "CAR." Id. Miller finds the abnormal returns around the announcement date in his study to be "positive and significant," amounting to 0.0115 (t = 3.87). Miller, supra note 56, at 111. Tests of statistical significance (or "t-statistics") estimate the possibility that an observed abnormal return could be the product of chance or random occurrences. If, for example, an abnormal return is found to be statistically significant at the 5% level, this means that there is only a 5% probability that the abnormal return was the product of chance (or, phrased differently, there is a 95% probability that the association between the event studied and the abnormal return was not the product of chance). On this basis, Miller's results appear highly significant. In addition, he finds that "the increase in share value around the announcement date appears permanent," with the post-announcement cumulative abnormal return between the second day after the announcement and the twenty-fifth day after the announcement being 0.0071 (t = 0.84). Id. Over the 125-day post-listing period that he observed, the average abnormal return was 0.0030 (t = 0.16). Id. at 111-12.

n106. See Foerster & Karolyi, supra note 84, at 982 (indicating post-listing "expected returns should fall as an additional built-in risk premium compensating for these barriers dissipates").

n107. Miller, supra note 56, at 114 tbl.4, 115. The average abnormal returns around the announcement date for foreign firms that listed on the over-the-counter or "pink sheet" market (i.e., a Level I facility) was 0.0127 (t = 2.83), which was positive and significant, but less than one half the average abnormal returns of firms listing on the NYSE or Nasdaq. Id.; see infra note 108.

n108. Miller, supra note 56, at 114 tbl.4, 115. The average abnormal returns around the announcement date for foreign firms listing on the NYSE and Nasdaq was 0.0263 (t = 6.64). Id. This was twice the level of abnormal returns for firms listing only in the over-the-counter market. Id.; see supra note 107.

n109. The average abnormal returns around the announcement date for foreign firms listing on PORTAL was actually negative (-0.0109) (t = -1.47), but was statistically insignificant. Miller, supra note 56, at 114 tbl.4, 115. The difference between a NYSE or Nasdaq listing and a PORTAL listing was 3.72% (t-statistic of difference = 6.49). Id. at 115.

n110. Rule 144A exempts resales from the registration requirements of the Securities Act of 1933 that are made by the initial purchasers of securities to QIBs, who, to qualify for that status, generally must manage a portfolio in excess of $ 100 million. Private Resales of Securities to Ins*titutions, 17 C.F.R. 230.144A (2002).* PORTAL is an electronic secondary market operated by the National Association of Securities Dealers (NASD) on which only QIBs may trade.

n111. Disagreement persists as to whether U.S. GAAP provides more or better disclosure than International GAAP (or IAS). See Christian Leuz, IAS versus US GAAP: A (New) Market Based Comparison 2 (Working Paper, 2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract id=257348 (on file with the Columbia

Law Review) (arguing that they are functionally equivalent). The issue of the differences between IAS and U.S. GAAP dominates the current agenda of the International Accounting Standards Committee. Yet, even if IAS and U.S. GAAP are of similar quality, many emerging market issuers use accounting principles that do not comply with IAS, and thus in these cases a U.S. listing necessarily implies a substantial upgrade in the quality of the financial disclosures provided.

n112. Form 20-F is the SEC form for foreign issuers corresponding to Form 10-K, which domestic issuers must file once they become subject to section 13 or 15(d) of the Securities Exchange Act of 1934. Unlike domestic issuers, foreign private issuers need only file Form 20-F within six months after the end of their fiscal year. Basically, Form 20-F requires the same financial information as Form 10-K, but permits the foreign issuer to file this information in accordance with non-U.S. GAAP, if a reconciliation to U.S. GAAP is included. See Item 17 to Form 20-F.

n113. *17 C.F.R. 240.12g3-2(b) (2002)*. This rule exempts a foreign issuer who otherwise would be required to register and become a "reporting company" under section 12(g) of the Securities Exchange Act of 1934 if the foreign issuer (i) is not listed on an exchange or Nasdaq, and (ii) agrees to file with the SEC the same documents and information it files with its home country regulators or home stock exchange or that it otherwise distributes, or is required to distribute, to its security holders. Id. Hence, firms listing on Nasdaq must become "reporting companies," and in the case of foreign issuers this requires them to file Form 20-F.

n114. Rule 12g3-2(b) does not apply to firms listed on Nasdaq after October 5, 1983. Id. 240.12g3-2(d)(3).

n115. Miller, supra note 56, at 111-13, 117 (finding positive abnormal returns on announcement of cross-listing in a U.S. market and greater returns on announcement of a capital raising depository receipt facility - i.e., a Level III facility).

n116. Id. at 117. Foreign firms raising capital in a public equity offering (i.e., a Level III facility) "experienced a positive and significant stock price reaction of 0.0323 (t = 5.67)." Id.

n117. For example, one study finds that public equity offerings by U.S. firms decrease shareholder wealth by an average of 3%. See Ronald W. Masulis & Ashok N. Korwar, Seasoned Equity Offerings: An Empirical Investigation, 15 J. Fin. Econ. 91, 102 (1986). The standard interpretation for this pattern is that when a seasoned firm announces an intent to make a public offering, the market takes this announcement as a signal that the firm does not consider its stock to be underpriced (and may consider it to be fully priced or more). In effect, the market realizes that the firm possesses asymmetric information about its future prospects and sees this announcement as implicitly revealing that these future prospects will not improve in the short term.

n118. See Miller, supra note 56, at 117 (finding small negative price reaction to a Rule 144A private placement by a foreign firm). In contrast, an earlier study of U.S. firms making private placements finds that they result in an average increase in shareholder wealth of 4%. See Karen Hopper Wruck, Equity Ownership Concentration and Firm Value: Evidence from Private Equity Financing, 23 J. Fin. Econ. 3, 8 (1989).

n119. *15 U.S.C. 77k* (2000).

n120. *17 C.F.R. 240.10b-5 (2002)*; *Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194-214 (1976)* (requiring showing of scienter in Rule 10b-5 actions).

n121. A foreign issuer making its first offering in the United States will typically use Form F-1, which will require it to provide current information as of a date close to the effective date of the registration statement. In contrast, a Form 20-F provides less historical information and can become relatively stale because it need not be filed until six months after the close of the issuer's fiscal year. For example, as of May 2002, a foreign issuer's last public filing on Form 20-F need only cover the year ending December 31, 2000, while a domestic issuer already would have had to file its Form 10-K covering its 2001 fiscal year.

n122. This suggestion has been made to me by my colleague, Professor Jeffery Gordon. Although I am doubtful that the announcement of a public offering signals the existence of undisclosed, positive information, it is possible that such an offering by a foreign issuer signals the issuer's intent to abide by a different set of corporate governance policies than it has previously observed, including a policy of full disclosure.

n123. Section 11 of the Securities Act of 1933 imposes strict liability on the issuer for material misstatements or omissions in a registration statement without regard to proof of fraudulent intent or reliance by the plaintiff, and it also accords the issuer no affirmative defense of due diligence. *15 U.S.C. 77k.*

n124. See Miller, supra note 56, at 115. Emerging market issuers had a three-day announcement period abnormal return of 0.0154 (t = 2.39), while developed market firms had a similar period return of 0.0087 (t = 2.84). Id.

n125. Id.

n126. Id. at 117.

n127. See Foerster & Karolyi, supra note 84, at 994 tbl.4. Although Asian firms underperform other firms (but to a statistically insignificant extent) both in their stock market performance during the year prior to listing and during the window period surrounding the listing, in this study, they were almost unique in their positive post-listing performance. Id. On average, other firms declined (and to a statistically significant degree) during the year following U.S. listing, but Asian firms and European firms other than those in the United Kingdom had a modest positive market reaction. Id. The implication is apparently that stock prices of Asian firms do behave differently, possibly because their shareholders are more exposed.

n128. See Stijn Claessens et al., Disentangling the Incentive and Entrenchment Effects of Large Shareholdings, 57 J. Fin. (forthcoming Dec. 2002) [hereinafter Claessens et al., Entrenchment]; Michael Lemmon & Karl Lins, Ownership Structures, Corporate Governance, and Firm Value: Evidence From the East Asian Financial Crisis, (William Davidson Inst., Working Paper No. 393, Apr. 2001), available at http://papers.ssrn.com/sol3/delivery.cfm/SSRN ID265108 code010411100.pdf?abstractid=265108 (on file with the Columbia Law Review).

n129. See Simon Johnson et al., Corporate Governance in the Asian Financial Crisis, 58 J. Fin. Econ. 141, 142 (2000) (presenting evidence that weakness of legal mechanisms that prevent the expropriation of minority shareholders correlated with the degree of stock market declines in the Asian financial crisis).

n130. Doidge et al., supra note 84, at 1.

n131. Id.

n132. Id.

n133. Id. at 21.

n134. Id. at 24.

n135. For the original assertion of this view by LLS&V, see Rafael La Porta et al., Legal Determinants of External Finance, 52 J. Fin. 1131, 1132 (1997) [hereinafter La Porta et al., External Finance]; see also sources cited supra note 15. For a similar view taken by other authors, see Asli Demirguc-Kunt & Vojislav Maksimovic, Law, Finance and Firm Growth, 53 J. Fin. 2107, 2108 (1998).

n136. See generally Rafael La Porta et al., Investor Protection and Corporate Valuation, 58 J. Fin. Econ. 3 (2000); La Porta et al., External Finance, supra note 135.

n137. William A. Reese, Jr. & Michael S. Weisbach, Protection of Minority Shareholder Interests, Cross-Listings in the United States, and Subsequent Equity Offerings, 66 J. Fin. Econ. 65, 66-67 (2002).

n138. In their sample, Reese and Weisbach find that 111 equity offerings were effected by firms that listed on the NYSE or Nasdaq during the two years following their U.S. listing, but only 46 offerings were made by these same firms during the two years prior to their cross-listing in the United States. Id. at 91. Not only did the rate thus more than double, but the proceeds in these subsequent offerings were "about 4.2 times as high as the proceeds from the 46 offerings in the two years prior to the cross-listing." Id.

n139. See id. at 95-101. As they explain, "firms with weak [shareholder] protection at home will bond themselves to protect shareholders' interests all over the world by cross-listing in the U.S. prior to issuing equity outside the U.S." Id. at 95.

n140. Id. at 92. In particular, "the average new equity issue from a French civil law country is more than three times as large as one from an English common law country." Id.

n141. See Pagano et al., supra note 21, at 7.

n142. Id. at 25.

n143. Id.

n144. Id.

n145. See Andrew Karolyi, DaimlerChrysler AG, The First Truly Global Share 15 (Working Paper, 2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract id= 185133 (on file with the Columbia Law Review); see also Pulatkonak & Sofianos, supra note 70. Pulatkonak and Sofianos find "great variability in the U.S. share of global trading," Pulatkonak & Sofianos, supra, at 1, but generalize that the U.S. market share is higher in the case of emerging market stocks than in the case of stocks that have a developed home market. Specifically, they find that where the foreign issuer has a "developed home market," the U.S. market share is reduced by 30%. Id. at 2. Obviously, this finding can have multiple causes, including the weaker legal protections available in many emerging markets, but relative liquidity and trading costs is probably the simplest explanation.

n146. See Karolyi, supra note 145; see also Frederick Harris et al., DCX Trading in New York and Frankfurt: Corporate Governance Affects Trading Costs of International Dual-Listings (Working Paper, 2002) (on file with the Columbia Law Review).

n147. Harris et al., supra note 146, at 1. See generally Karolyi, supra note 145. One additional factor should be noted: Right after the merger, Standard & Poor announced that DCX (the merged company) would be dropped from the S&P 500 index. Id. at 6. Although this led indexed investors to sell DCX, it gave no relative advantage to the Frankfurt market and indeed arguably only created a level playing field.

n148. When Daimler-Benz agreed to reconcile its accounting to U.S. GAAP for purposes of listing on the NYSE, its 1993 net income fell from Deutsche Marks (DM) 615 million under German GAAP to a loss of DM 1,839 million under U.S. GAAP. Dennis Logue & James Seward, Challenges to Corporate Governance: Anatomy of a Governance Transformation: The Case of Daimler-Benz, 62 Law & Contemp. Probs., Summer 1999, at 87, 92.

n149. See Jordan Siegel, Can Foreign Firms Bond Themselves Effectively By Renting U.S. Securities Laws? 15 (MIT, Working Paper No. 12797, 2001), available at http://biz. korea.ac.kr/aicg/paper 2nd/Can Foreign Firms bond themselves Effectively.pdf (on file with the Columbia Law Review) (finding few SEC enforcement or private class actions brought against foreign issuers listing in U.S. markets).

n150. Id. at 16. The SEC did, however, initiate some fifty-four legal actions against foreign firms over this same period, but only five of these were listed firms.

n151. Id. This computation was based on a search of LEXIS records. Obviously, many decisions are not reported by the court to LEXIS.

n152. An important and much noticed recent SEC enforcement action was *In re E.ON AG, Securities Exchange Act Release No. 43,372, 73 SEC Docket 974* (Sept. 28, 2000). There, the SEC sued a German corporation, Veba AG, for misleading statements (made in Germany) in which it falsely denied the existence of merger negotiations with another German corporation, which negotiations eventually resulted in the creation of the third largest German industrial holding company. The defendants quickly agreed to a settlement with the SEC.

n153. Two recent examples show the same fact pattern involved in the preceding footnote being litigated by private plaintiffs in class actions: (1) *Buxbaum v. Deutsche Bank AG, 196 F. Supp. 2d 367, 377 (S.D.N.Y. 2002)* (denying defendants' motion for summary judgment in a class action alleging that Deutsche Bank made misleading statements in connection with its merger with Bankers Trust); and (2) In re Alcatel Alsthom Sec. Litig., MDL 1263 (E.D. Tex. 2001) (approving $ 75 million settlement paid by Alcatel to former shareholders of DSC Communications Corp., which Alcatel acquired in a stock-for-stock merger based on allegedly inflated financial statements). Although the Alcatel settlement is not reported on LEXIS or Westlaw, a $ 75 million settlement is substantial and will come to the attention of the extremely entrepreneurial plaintiff's bar that privately enforces the federal securities laws in the United States.

n154. See Franklin E. Zimring & Gordon J. Hawkins, Deterrence: The Legal Threat in Crime Control 101-03, 144-45 (1973) (discussing potential lawbreakers' incomplete information about risk of apprehension and consequent use of subjective factors in estimating chances of apprehension).

n155. Ananth Seetharaman et al., Litigation Risk and Audit Fees: Evidence from U.K. Firms Cross-Listed on U.S. Markets, 33 J. Acct. & Econ. 91, 93 (2002). This study specifically rejects the possibility that this fee increase could be explained by the auditor being required to perform more work when the U.K. firm entered the U.S. market. Id. at 101-07.

n156. Id. at 93, 113.

n157. See *Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994)* (holding that Rule 10b-5 does not reach aiding and abetting a securities violation). Auditors can be used by the SEC, and by private investors under other causes of action, but their overall liability was greatly reduced by the Central Bank decision.

n158. Professor Siegel finds that there have been some notable frauds perpetrated by foreign firms cross-listing in the United States. See Siegel, supra note 149, at 14. This point is not disputed, but its import is unclear.

n159. See supra notes 130-134 and accompanying text.

n160. Tobin's q is the ratio of a firm's market value to the replacement cost of its assets. See Stephen A. Ross et al., Corporate Finance 37-38 (5th ed. 1999). A low Tobin's q is generally viewed as a measure of poor management or low investor confidence in the firm.

n161. See supra notes 141-144 and accompanying text.

n162. See Mark Landler, German Technology Stock Market to be Dissolved, N.Y. Times, Sept. 27, 2002, at W1. See also infra notes 189, 193-197 and accompanying text.

n163. See infra notes 198, 277-287 and accompanying text.

n164. Cally Jordan & Mike Lubrano, How Effective Are Capital Markets in Exerting Governance on Corporations?: Lessons of Recent Experience with Private and Public Legal Rules in Emerging Markets 13 (4th Ann. Fin. Mkts. & Dev. Conf., Working Paper, 2002) (on file with the Columbia Law Review).

n165. "Tag along" rights entitle the minority shareholders in a company to receive the same proportionate premium over share value as the controlling shareholders receive; in effect, they require the controlling shareholder to share any control premium. See infra notes 223-224 and accompanying text.

n166. Jordan & Lubrano, supra note 164, at 13-14. The charter amendment was actually adopted after the public offering, but the controlling shareholders had earlier promised to adopt the charter provision in the registration statement for the firm's initial public offering. The institutional investors were satisfied with this promise because of the potential U.S. securities law liability if the promoters had reneged on their promise, as disclosures in the issuer's prospectus regarding the promised charter amendment would have been rendered materially inaccurate.

n167. See supra notes 94-97 and accompanying text.

n168. For a brief overview of this trend, see Karmel, supra note 98, at 348-49.

n169. See Nicola Hobday, LSE Shares Dip on Market Debut, Daily Deal, July 20, 2001, available at http://www.thedeal.com/NASApp/cs/ContentServer?pagename=theDeal/TDDArticle/TDStandardArticle&c=TDDArticle&cid=1003865130171 (on file with the Columbia Law Review).

n170. To function as an exchange, an applicant must register as a "national securities exchange" under section 5 of the Securities Exchange Act of 1934 and have its application approved by the SEC. See *15 U.S.C. 78e* (2000).

n171. This is the conclusion reached by Professor Karmel, a former SEC Commissioner. See Karmel, supra note 98, at 347-48.

n172. See Claessens et al., Stock Markets, supra note 39, at 1.

n173. For a more detailed review of the Czech and Polish approaches, see John C. Coffee, Jr., Privatization and Corporate Governance: The Lessons from Securities Market Failure, *25 J. Corp. L. 1, 9-23 (1999).*

n174. See Rick Jervis, Stock Exchanges in Central and Eastern Europe Are Shrinking Due in Part to Slow Privatization, Wall St. J., July 16, 2001, at C16 (noting postponement of first scheduled Czech IPO).

n175. See Claessens et al., Stock Markets, supra note 39, at 2.

n176. Id. at 4 fig.2.

n177. Id. at 3.

n178. Id. Market turnover in Latin America averages around 50%. Id. Several transitional markets in Central Asia have turnover ratios under 5% and are effectively illiquid. Id.

n179. Id.

n180. Id. This is true even in the case of some large countries, such as the Ukraine. Id.

n181. Id.

n182. Id. at 3, 7.

n183. See Jervis, supra note 174 (discussing failing stock markets of Central and Eastern Europe).

n184. See Claessens et al., Stock Markets, supra note 39, at 16.

n185. See id. (predicting that, even under ideal circumstances, only the Czech Republic, Hungary, Kazakhstan, Macedonia, Moldova, Poland, Romania, the Slovak Republic, and Slovenia would achieve this level).

n186. Id. at 18.

n187. Id.

n188. Id.

n189. See Leuz, supra note 111, at 8-9 (crediting Neuer Markt's success to strict disclosure and listing requirements).

n190. Vanessa Fuhrmans, Playing by the Rules: How Neuer Markt Gets Respect, Wall St. J., Aug. 21, 2000, at C1.

n191. See Leuz, supra note 111, at 8-9.

n192. Id. at 8.

n193. Fuhrmans, supra note 190.

n194. Jack Ewing et al., The Neuer Markt: Can It Hang On?, Bus. Wk. (Int'l Ed.), July 30, 2001, at 18, available at *2001 WL 2208284* (on file with the Columbia Law Review); see also Alfred Kueppers, A Busy Bidder in Germany Highlights Flaws in Neuer Markt's Efforts to Challenge Nasdaq, Wall St. J., Aug. 6, 2001, at C11 [hereinafter Kueppers, Busy Bidder] (providing illustrations of how "speculators and market manipulators" exploited Neuer Markt's weaknesses); Alfred Kueppers, Deutsche Boerse Sets Up New Rules for Neuer Markt, Wall St. J., July 19, 2001, at A19 [hereinafter Kueppers, New Rules] (noting that "a series of scandals and insolvencies tarnished the four-year-old growth exchange").

n195. Kueppers, New Rules, supra note 194; see also Alfred Kueppers, Deutsche Boerse Sets Delisting Terms for Penny Stocks, Wall St. J., July 23, 2001, at A12 (adopting "one euro" standard as minimum trading price for purposes of delisting).

n196. Neal E. Boudette & Alfred Kueppers, Frustrated Neuer Markt Members Push for Tightening Listing Rules, Wall St. J., July 11, 2001, at C12.

n197. Silvia Ascarelli & G. Thomas Sims, German Exchange Unplugs Neuer Markt, Wall St. J., Sept. 27, 2002, at A12; Mark Landler, German Technology Stock Market to be Dissolved, N.Y. Times, Sept. 27, 2002, at W1.

n198. Landler, supra note 197. In particular, quarterly financial reporting and compliance with international accounting standards will remain mandatory.

n199. Kueppers, Busy Bidder, supra note 194.

n200. See supra notes 58-64 and accompanying text. The daily trading volume on the S<tild a>o Paulo Stock Exchange fell from $ 1 billion to less than $ 150 million (or over 85%) during this period. Colitt, Capital Markets, supra note 62.

n201. See Jordan & Lubrano, supra note 164, at 21.

n202. Legislative reform was later enacted in Brazil. See infra notes 215-222 and accompanying text.

n203. Craig Karmin & Jonathan Karp, Brazilian Market Tries Friendly Approach: Novo Mercado's Rules Aim to Help Minority Holders, Wall St. J., May 10, 2001, at C1.

n204. See Jordan & Lubrano, supra note 164, at 22.

n205. Id. (noting that "[in] anticipation of the Novo Mercado," Brazil strengthened the legal standing of voluntary arbitration, making the enforcement of arbitral awards easier).

n206. See id. at 20-22 & n.49.

n207. Id. at 23. The first firm to list on the Novo Mercado was Companhia de Concessoes Rodoviarias (CCR), a highway concession manager. Because CCR is in the business of buying highway concessions from many of its founders - firms that dominated the Brazilian highway construction industry - strong corporate governance was perceived as a necessity from the start and special provisions were inserted in its charter concerning the approval of self-dealing transactions. Id. at 14.

n208. Id. at 23. Jordan and Lubrano point out that while these results may be disappointing, they can be explained to a significant degree by uncertainty in the Brazilian economy following the economic crisis in Argentina and a domestic energy crisis. Against this backdrop, few firms have been willing to undertake a public offering or make other long-term economic commitments. Id. at 23 n.52.

n209. Brazil did enact corporate governance reform legislation in November 2001, well after the creation of the Novo Mercado. Id. at 10 & n.25.

n210. See id.; see also sources cited supra notes 124-137.

n211. See Barham, supra note 24, at 41.

n212. Id. That is, if only one-third of the company's equity is represented by voting shares, then 17% will constitute a majority of this one-third.

n213. See id. (reporting that large writedowns might be taken "for labor, environmental or tax charges" in order deliberately to reduce earnings).

n214. Id. at 42. The American acquirer was J.C. Penney & Co.

n215. During the first half of 2001, over a third of the trading in Brazilian shares occurred on the NYSE. See Colitt, Reform, supra note 61, at 46; see also supra notes 59-63 and accompanying text.

n216. See Barham, supra note 24, at 42. Existing Brazilian companies were, however, grandfathered in the case of this provision.

n217. Id.

n218. Id.

n219. Id.

n220. See Colitt, Capital Markets, supra note 62.

n221. Barham, supra note 24, at 42.

n222. Id.

n223. Some anectodal evidence exists that the former discount between ON and PN shares has begun to shrink in light of these reforms. See id. at 43 (discussing Petrobras, the Brazilian national oil company and largest publicly held company).

n224. For evidence that decisionmakers think in these terms, see Smith, supra note 25, which describes the chairman's efforts to revitalize Bovespa and analysts' and industry participants' belief that those efforts help reverse decline. Also, the closing of thirteen brokerage firms in S<tild a>o Paulo during 2001 would obviously have added to this sense of impending market collapse. See id.

n225. See supra notes 58-60 and accompanying text.

n226. John Authers, Mexico Moves to End Share Class Warfare: New Rules on Tender Offers Will Boost the Voting Rights of Minority Stockholders, Fin. Times (N. Am. ed.), May 2, 2002, at 24.

n227. Id.

n228. Grupo Elektra, Mexico's largest electronics retailer, announced in April 2002 that it would convert its non-voting shares into a single voting structure. Id.

n229. Id. (quoting Renato Grandmont, Deutsche Bank Securities, New York).

n230. See, e.g., Bernard Black, Does Corporate Governance Matter?: A Crude Test Using Russian Data, *149 U. Pa. L. Rev. 2131, 2132-33 (2001)* (using data sample of sixteen large Russian public companies and finding results suggesting that governance strongly impacts market value); Art Durnev & E. Han Kim, To Steal or Not to Steal: Firm Attributes, Legal Environment, and Firm Valuation (Univ. of Mich. Bus. Sch., Working Paper, 2002), available at http://www.bus.umich.edu/research/mitsui/symp02docs/steal-notsteal.doc (on file with the Columbia Law Review) (using data sample of 859 firms from 27 countries and finding firms with higher corporate governance rankings are valued higher); Leora F. Klapper & Inessa Love, Corporate Governance, Investor Protection, and Performance in Emerging Markets 21-22 (World Bank, Policy Research Working Paper No. 2818, 2002), available at http://papers.ssrn.com/sol3/delivery.cfm/SSRN ID303979 code020319500.pdf?abstractid=303979 (on file with the Columbia Law Review) (using data sample of 374 firms from 14 emerging markets and finding correlation between strong governance and higher market value).

n231. Durnev & Kim, supra note 230, at 2, 33.

n232. Id. at 34. The CLSA governance score used by Durnev and Kim was developed by Credit Lyonnais, which has performed a similar study on a smaller data set reaching closely similar conclusions.

n233. Huddart et al., supra note 9, at 238. This theory may too easily assume that insider trading can still be conducted on "high disclosure" exchanges.

n234. See supra notes 146-148 and accompanying text.

n235. For discussions of the advantages of the new global share, see Gruson, supra note 43, at 196-98; Karolyi, supra note 145, at 7-16, 26.

n236. The NYSE's core participants - brokers and specialists - profit to the extent that a stock is traded on the NYSE. To be sure, the NYSE gains a listing fee, but these are likely to be set based on trading volume. As discussed infra at note 253, this may suggest that the listing fees that U.S. exchanges charge foreign firms should be increased.

n237. For example, the NYSE has sought to convince the SEC to permit it to list issuers that do not comply with U.S. GAAP and has waived corporate governance standards that it requires in the case of domestic companies. See supra note 98 and accompanying text.

n238. Hence, so-called "tag along" rights profoundly restrict the controlling shareholder's ability to receive such a control premium based on its voting power because such rights entitle all shareholders (whether or not they have voting rights) to share proportionally in the premium.

n239. Bloomfield & O'Hara, supra note 9, at 448-52.

n240. Id. at 426; see also Gordon Gemmill, Transparency and Liquidity: A Study of Block Trades on the London Stock Exchange Under Different Publication Rules, 51 J. Fin. 1765, 1766-67 (1996) (explaining how delayed publication created a tendency for large transactions to gravitate towards the least transparent available market).

n241. Bloomfield & O'Hara, supra note 9, at 426.

n242. See supra notes 189-208 and accompanying text.

n243. Doidge, Karolyi, and Stulz emphasize this example as the principal reason for non-U.S. issuers to migrate to U.S. exchanges. Doidge et al., supra note 84, at 9.

n244. Pagano et al., supra note 21, at 2.

n245. The author has made this argument at length elsewhere and will not embellish it here. See Coffee, The Future As History, supra note 15, at 676-82.

n246. Id. at 677 & n.129.

n247. La Porta, Lopez-de-Silanes, and Shleifer conclude that "a New York listing is prohibitively expensive for many companies." La Porta et al., Corporate Ownership, supra note 15, at 512. If so, regional exchanges have a niche.

n248. See supra notes 211-229 and accompanying text. Brazil's less successful efforts at legislative reform are described in Jordan & Lubrano, supra note 164, at 10-13.

n249. Assume that a firm has both Class A and Class B shares and that only the Class A shares have voting rights, while the cash flow rights belong 25% to Class A and 75% to Class B. Today, an acquiring corporation would logically direct its control premium exclusively to the holders of the Class A shares. But if "tag along" rights exist, either under the corporation's charter or applicable law, this premium would have to be shared with the Class B shareholders, with the same premium paid to all. This reform could cost the Class A shareholders 75% of the premium that would otherwise have gone to them alone and will predictably be resisted by them.

n250. Jonathan Macey and Hideki Kanda, The Stock Exchange As a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges, *75 Cornell L. Rev. 1007, 1010-24 (1990)* (arguing that the traditional functions of a stock exchange can be unbundled so that competition can develop for these individual services).

n251. Essentially, ECNs are less regulated electronic markets that are not required to register or qualify as exchanges under the Securities Exchange Act of 1934. They are, however, required by the SEC to register as broker-dealers under the same act. The term "Electronic Communications Network" is defined in Rule 11Ac1-1(8) under the Securities Exchange Act of 1934. Dissemination of quotations, *17 C.F.R. 240.11Ac1-1(8) (2002)*. By recent estimates, ECNs now handle roughly 45% of the trading on Nasdaq, but a much lower percentage of the trading on the NYSE. Kate Kelly, SEC Clears New Nasdaq Trading Platform, Wall St. J., Aug. 29, 2002, at C1 (finding that ECNs' share of Nasdaq trading is 45%, Nasdaq's share is 30%, and remaining 25% is internalized by major brokerage firms).

n252. This strategy was followed by the Consolidated Stock and Petroleum Exchange when it challenged the NYSE in the late nineteenth century. See supra notes 33-36 and accompanying text.

n253. One partial answer to this problem is to charge higher listing fees to foreign firms than domestic firms, in part because foreign firms gain more from U.S. listings than do domestic firms and in part because more of their trading volume is likely to be diverted elsewhere.

n254. Much depends on the extent of flow back. While trading in the shares of DCX shifted dramatically to Frankfurt following the Daimler-Benz merger with Chrysler, see supra notes 146-148 and accompanying text, the reverse has been true recently in Latin America. See supra notes 55-64, 69-70 and accompanying text. If flow back is less likely in the case of emerging markets, there might be a greater incentive for U.S. exchanges to market bonding services to such issuers.

n255. Today, modern information technology enables the global brokerage firm to execute orders quickly around the world. For a description of this process, see Karmin et al., Vision Test, supra note 1.

n256. Some evidence suggests that brokers are already overtaking exchanges in making foreign securities accessible to investors within their jurisdiction. Professor Howell Jackson and Eric Pan report that brokers in Europe have developed cross-border linkages between markets that "have reduced the need of European issuers to make special efforts to reach retail investors in other European countries." Jackson & Pan, supra note 13, at 655. Thus, rather than a French issuer listing on the LSE, it can rely on British brokers directly placing orders for its stock on the Paris Bourse through French brokers for its British retail investors. See id. at 656 n.2.

n257. Lang et al., supra note 95, at 20.

n258. Arguably, the Neuer Markt's controversy-plagued recent history may suggest to some that enhanced disclosure without increased enforcement does not succeed, or at least produces predictable waves of scandals. See supra notes 189-199 and accompanying text.

n259. See supra notes 97-99 and accompanying text.

n260. ABA Special Study, supra note 97, at 9.

n261. Id. at 11; see also Joel Seligman, Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy, *54 Geo. Wash. L. Rev. 687, 693-97 (1986)* (discussing events leading up to NYSE's adoption of one share, one vote rule).

n262. New York Stock Exchange Listed Company Manual 303.01 (1999) [hereinafter NYSE Manual]; see also ABA Special Study, supra note 97, at 23-26 (surveying various listing rules that have been used by NYSE, Nasdaq, and Amex). The NYSE rules largely parallel those of Nasdaq and the Amex, and all were adopted under SEC prodding in the late 1990s.

n263. ABA Special Study, supra note 97, at 21-23. An important exception, whose scope currently remains unresolved, exists for "broad-based option plans" that include both officers and non-officer employees. At present, the SEC appears to be pushing all the exchanges to adopt a common consensus position. Id.

n264. NYSE Manual, supra note 262, 312.03(c); see also ABA Special Study, supra note 97, at 24.

n265. NYSE Manual, supra note 262, 313.00. The National Association of Securities Dealers takes the same position with regard to Nasdaq. National Association of Securities Dealers, Inc., Manual Rule 4351, at 5336 (2001).

n266. See ABA Special Study, supra note 97, at 26-27.

n267. Securities Exchange Act Release No. 24,634, *52 Fed. Reg. 24,230* (June 23, 1987).

n268. See supra notes 42-49 and accompanying text (contrasting percentages in 1990 and 2000). Also, investors who purchased ADRs were thought to care little about voting rights, because such rights were procedurally difficult to exercise in the case of ADRs.

n269. The German two-tier board structure differs dramatically from the structure of the Anglo-American board of directors. Essentially, it consists of a lower or "managing board" that runs the business and is composed exclusively of inside executives and an upper or "supervisory board," which monitors the managing board and is half elected by shareholders and half by employees and labor. For an overview, see Thomas J. Andre, Jr., Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards, *70 Tul. L. Rev. 1819, 1820-30 (1996).*

n270. ABA Special Study, supra note 97, at 27.

n271. See supra text and table accompanying note 46.

n272. This is true both for Latin American and Israeli companies. See supra notes 55-59, 73-76 and accompanying text.

n273. This phenomenon is not limited to Latin America. Professor Amir Licht has reached a similar conclusion about the impact of U.S. stock market standards on the efforts of the Tel Aviv Stock Exchange to upgrade its governance standards, which efforts were undercut, he concludes, by the "watered-down" standards that U.S. exchanges made applicable to foreign issuers. Amir N. Licht, David's Dilemma: A Case Study of Securities Regulation in a Small Open Market, 2 Theoretical Inquiries L. 673, 675 (2001).

n274. This is also Professor Licht's express finding. Id. at 674-75.

n275. See NYSE, Corporate Accountability & Listing Standards Committee Report (June 6, 2002), available at http://www.nyse.com/about/report.html (on file with the Columbia Law Review). This report was prepared at the request of SEC Chairman Harvey Pitt and proposes a number of useful and in some cases significant reforms, which are beyond this Article's scope.

n276. Id. at 22.

n277. A bright-line rule could simply look to whether the majority of the trading occurs in the United States.

n278. This Article does not consider the SEC's authority to mandate listing standards for foreign companies that are equivalent, or at least similar, to domestic companies, because in part the current SEC would have little interest in mandating standards for the NYSE (or any other exchange). Although the SEC has broad authority under section 19(c) of the Securities Exchange Act of 1934, *15 U.S.C. 78s*(c) (2000), to amend the NYSE's rules, a significant obstacle is the D.C. Circuit's decision in Business Roundtable v. SEC, which held that the SEC lacked authority to impose a "one share, one vote" listing standard on all exchanges. *905 F.2d 406, 407 (D.C. Cir. 1990).* That case was, however, grounded on principles of federalism, which require deference to state corporate law. These same principles do not logically apply (or at the least do not apply as forcefully) in the case of the foreign issuer, because deference to foreign corporate law is in no sense implicit in our constitutional scheme of federalism.

n279. Among the principal provisions of the Public Company Accounting Reform and Investor Protection Act of 2002 (the Act), Pub. L. No. 107-204, *116 Stat. 745,* that would impose new requirements on foreign issuers are the following: (1) section 301 ("Public company audit committees") (mandating audit committees composed exclusively of directors meeting a statutory standard of independence); (2) section 302 ("Corporate responsibility for financial reports") (requiring sworn declarations from senior financial officers); (3) section 303 ("Improper influence on conduct of audits") (criminalizing actions to "coerce, manipulate, or mislead" the firm's auditors); (4) section 304 ("Forfeiture of certain bonuses and profits") (requiring forfeiture of incentive or equity compensation received, or stock trading profits made, during the initial twelve month period covered by an earnings restatement); (5) section 306 ("Insider trades during pension fund black-out periods") (restricting the ability of directors and executive officers to sell during certain "black-out" periods when holders of individual account plans are prohibited from trading); (6) section 307 ("Rules of professional responsibility for attorneys") (requiring securities attorneys to report "a material violation of securities law or breach of fiduciary duty or similar violation" to chief legal counsel, chief executive officer, and, under specified circumstances, to board of directors); and (7) section 402 ("Enhanced conflict of interest provisions") (barring most loans by firms to their corporate executives).

n280. Section 301 overshadows the other sections of the Act because many of these other provision have little impact on foreign corporations. For example, foreign issuers do not typically make loans to their executives, or have "black-out" periods; hence, sections 402 and 306, respectively, will have less bite in their case. Although section 304 will make earnings restatements more costly for executives in all firms, foreign issuers have generally not been as frequently forced by their auditors to make earnings restatements. Nor are foreign attorneys as apt to feel compelled to report misconduct to their firm's board, because they do not regularly practice before the SEC and hence do not fear suspension by it.

n281. Under German law, for example, the supervisory board (or Aufsichtsrat) is expected to appoint and, if necessary, remove the corporation's managing board (or Vorstand), which consists of its principal executive officers, but the supervisory board does not make or review most business decisions. Under the Co-Determination Act of 1976, supervisory boards of companies with 2,000 or more employees must have an equal number of representatives of shareholders and labor. Thomas J. Andre, Jr., Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany, *73 Tul. L. Rev. 69, 84-85 (1998).* Thus, the supervisory board is only half shareholder-elected and is not an organ necessarily committed to the shareholders' interests. Some critics have also reported that the "supervisory board has never been strong... . The board is not a serious monitoring mechanism inside the firm." Mark J. Roe, Political Preconditions to Separating Ownership from Corporate Control, *53 Stan. L. Rev. 539, 548 (2000).* Roe further suggests that shareholders do not wish to delegate enhanced powers to the supervisory board because to do so would only strengthen "labor's voice and authority inside the firm." *Id. at 568.*

n282. Section 301 of the Act amends section 10A of the Securities Exchange Act of 1934 *(15 U.S.C. 78f)* by adding a new section (m)(2) thereto, which contains the quoted language.

n283. See section 301 of the Act, which adds new section 10A(m)(3)(C) to the Securities Exchange Act of 1934 to permit the Commission to exempt from the independence requirements of section 10A(m)(3)(B) "a particular relationship with respect to audit committee members."

n284. See section 301 of the Act, which adds new section 10A(m)(3)(B) to the Securities Exchange Act of 1934 to prohibit an audit committee member from receiving "any consulting, advisory or other compensatory fee from the issuer." The problem with this language as applied to the managing board of civil law corporations with two-tier boards is that they are entirely insiders; in addition, even the shareholder-elected members of the supervisory board often have close economic ties to the corporation and its controlling shareholders. Finally, the labor representatives on the supervisory board by definition receive salaries from the corporation, which would disqualify them, unless exempted by the SEC.

n285. Some twenty-four German corporations, including DaimlerChrysler, Bayer, and Deutsche Telekom, have written the SEC to request an exemption from the Act, and one firm, Porsche, has suspended its plans to list on the NYSE. See Mark Landler, Porsche Is Balking at U.S. Auditing Rule, N.Y. Times, Aug. 21, 2002, at W1. It is far from clear, however, that the SEC has the authority to grant the requested exemption.

n286. The real deficiency in the extension of the audit committee to most European firms is that the audit committee was designed to monitor management, which is the essential monitoring problem under common law systems of dispersed ownership. Yet, in the system of concentrated ownership that characterizes most civil law jurisdictions, controlling shareholders naturally perform that function. Instead, the need under a system of concentrated ownership is for an organ that can monitor the controlling shareholders. To the extent that the controlling shareholders elect half of the supervisory board, such directors are hardly independent of them.

n287. The most practical solution for the short run would be to exempt the supervisory board, or any committee thereof, from section 301's independence requirements. Alternatively, the SEC might permit special outside monitors to review with the corporation's auditors its accounting policies and results (this would enable corporations subject to co-determination laws from having to negotiate with their labor representatives).

n288. See supra notes 209-229 and accompanying text.

n289. See supra note 9 and accompanying text.

n290. The author has discussed this theme elsewhere at greater length. See Coffee, The Future as History, supra note 15, at 692-97.

n291. See Utpal Bhattachayra & Hazem Daouk, The World Price of Insider Trading, 57 J. Fin. 75, 97 (2002) (finding 7% reduction in cost of equity when insider trading prohibition is enforced).

n292. See supra notes 15-17 and accompanying text.

n293. That it would experience some discount seems a safe conclusion, but that this discount would be appropriate to compensate minority investors for the increased risk of expropriation seems unprovable.

n294. The author has argued elsewhere that normative consensus may be the critical factor underlying "strong" corporate governance. See John C. Coffee, Jr., Do Norms Matter? A Cross-Country Evaluation, *149 U. Pa. L. Rev. 2151, 2154-71 (2001).*

n295. See Coffee, Rise of Dispersed Ownership, supra note 15, at 34-39.

n296. The "issuer choice" model derives from a theoretical model of jurisdictional competition for citizens. See Tiebout, supra note 8, at 419-20. This model assumes that the "consumer-voter" moves to the jurisdiction that best matches the citizen's preferences for expenditures and taxes. Id. at 419. Obviously, citizens are deterred by high taxes, and thus the threat of citizen flight deters high taxation. Unlike the citizens in this model, corporations do not truly leave their jurisdiction when they cross-list on a foreign exchange. Rather, their shares typically continue to trade on their home exchange, and they continue to do business in their home jurisdiction, where they have many shareholders. Because they thus make a "pseudo flight" to a foreign jurisdiction, they are not comparable to the actors in a Tiebout-style model, and efficient outcomes do not necessarily result.

n297. See notes 15-17 and accompanying text. For the most recent evidence that the development of a country's legal system predicts access by firms within it to external finance, see Asli Demirguc-Kunt and Vojislav Maksimovic, Funding Growth in Bank-based and Market-based Financial Systems: Evidence from Firm-Level Data, 65 J. Fin. Econ. 337 (2002).

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