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# RHETORIC AND REALITY: A HISTORICAL PERSPECTIVE ON THE REGULATION OF FOREIGN PRIVATE ISSUERS

*Steven M. Davidoff**

*If America's markets aren't competitive, investors lose . . . . If America's markets are not transparent and open, investors lose.*

—Christopher Cox, Chairman Securities and Exchange Commission[1]

*Rhetoric can drive reform. Watch-words like "mutual recognition" and "global competition" have masked a political economy story which has driven the Security and Exchange Commission's deregulation of foreign private issuers. While the substantive result may have been appropriate, the overall SEC regulatory process did not produce a nuanced and holistic regulatory product. Instead, the SEC promulgated one-size-fits-all regulation for foreign private issuers. Despite the differing risk profiles and regulatory posture, Filipino or Chinese issuers listed only in the United States are now regulated in equal measure as a U.K. issuer listed on the London Stock Exchange and the New York Stock Exchange. This Article's historical analysis highlights these issues as well as the difficulty of implementing more rigorous and insulating regulatory techniques such as cost–benefit analysis in light of the rhetoric and politics of regulation. The relevance of this story is front and center as we face SEC regulatory action related to the financial crisis.*

## I. INTRODUCTION

Mutual recognition, competitiveness, harmonization, and coordination. These words are the rhetoric of international securities regulation. They are akin to phrases like low-calorie, fortified, or doctor-recommended. These phrases become social goods in and of themselves. What could possibly be awry with such self-satisfying terms? But there can be many wrongs. Low calorie can simply be

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1. Stephen Labaton, *S.E.C. Eases Regulations on Business*, N.Y. TIMES, Dec. 14, 2006, at C6.



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malnourishing. Doctor recommended can be malpractice. Fortified? Fortified with what?

The rhetoric of such smooth sounding phrases can mask similar misdeeds in the regulatory arena. Rhetoric can drive regulatory agendas in the name of social welfare but can also make for less than satisfying regulatory results. More particularly, these words and their salience serve as carriers of regulatory change driven by political considerations. The fulsome rhetoric of social good forces through this change, but the political drivers result in less than holistic and nuanced regulatory products. The administrative rule-making process—itself fraught with terms like cost–benefit analysis—can, instead, be subject to the same political vicissitudes as the legislative process.[2]

This description fits the recent rule-making of the Securities and Exchange Commission (SEC) with respect to the regulation of foreign private issuers. Watch-words, like "mutual recognition" and "global competition," masked a political economy and interest group story, which has resulted in private benefits to a core group of business constituencies.[3] The results have been paraded as a net social good under the aegis of these phrases.

This Article is more skeptical of the process. The story of U.S. regulation of foreign listings in the new millennium is one of focused efforts by key interest groups, which have resulted in the steady deregulation of foreign private issuers in the name of "competitiveness." But this has skewed the regulatory process, creating a one-size-fits-all regulation for foreign private issuers. Filipino or Chinese issuers listed only in the United States are regulated at the same level as a U.K. issuer listed on the London Stock Exchange (LSE) and the New York Stock Exchange (NYSE). In other words, regulation has been promulgated in heed of general principles but without attendance to details.[4] As so

2. Cost–benefit analysis is an oft-advocated regulatory tool. *See* CASS R. SUNSTEIN, THE COST–BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION (2002). It is not without its detractors and remains controversial. *See* FRANK ACKERMAN & LISA HEINZERLING, PRICELESS: ON KNOWING THE PRICE OF EVERYTHING AND THE VALUE OF NOTHING (2003); *see also* Matthew D. Adler and Eric A. Posner, *Cost–Benefit Analysis: Legal Economic, and Philosophical Perspectives*, 29 J. LEGAL STUD. 837 (2000).

3. This point is not new; many academics have written about the SEC and public choice theory on a more general basis. *See* S.M. PHILLIPS & J.R. ZECHER, THE SEC AND THE PUBLIC INTEREST 21–23 (1981); James J. Park, *The Competing Paradigms of Securities Regulation*, 57 DUKE L.J. 625 (2007); John C. Coates IV, *Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis*, 41 VA. J. INT'L. L. 531 (2001); Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909 (1994); *see also* George Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

4. *See* Christopher Brummer, *Stock Exchanges and the New Markets for Securities Laws*, 75 U. CHI. L. REV. 1435 (2008); Steven M. Davidoff, *Regulating Listings in a Global Market*, 86 N.C. L. REV. 89 (2007).

often happens with legislation, the rhetoric has driven the regulatory agenda. The consequence is that regulation has been devalued beyond economic necessity, creating incentives for foreign issuers to list in the United States in order to extract regulatory advantages to the detriment of retail investors.

This is not to say that regulators are being deceptive or otherwise improperly regulating, nor that all of this regulation is a net economic loss. Rather, the mask of rhetoric has resulted in a march towards direct goals. This is a classic political economy story. The results have been in part good and in part bad, but they have resulted in wholesale, rather than nuanced, regulation tailored to the rhetoric surrounding this issue. The goal of regulation—to prevent negative externalities and ease economic frictions—has been lost due to expediency and political jockeying.

This may be an inevitable part of the regulatory process, but the international securities regulatory product could be fine-tuned. If this is too much, it may be better to recognize that the political process can infuse the regulatory process as much as the legislative one. In the early days of the SEC, competition was equated with ensuring that domestic issuers were subject to regulation equivalent to but not more stringent than foreign private issuers.[5] Today, in the name of globalization, competition has evolved into a movement to deregulate foreign private issuers without regard to domestic ones.

This is true even of the SEC's corporate finance division—a thoughtful body actively engaged with the securities bar and academia. Recognizing this development is helpful in proposing and enacting future securities regulation outside the international arena. It is also useful for those who may be futilely advocating more rigorous and insulating regulatory techniques such as cost–benefit analysis. This topic is again relevant due to the latest wave of regulatory action under the rhetoric of "investor protection" in the wake of the financial crisis.

## II. THE SEC AND THE REGULATION OF FOREIGN PRIVATE ISSUERS

### *A. The Origins of Foreign Private Issuer Regulation*

Today's foreign private issuer regulation stems from the SEC's 1977[6]

5. *See infra* Part II.A.

6. Other key dates were the 1964 Exchange Act amendments, which extended the registration requirements for foreign private issuers, and the SEC's subsequent adoption of Rule 12g3-2 in 1967, which allowed for a safe-harbor if the issuer did not voluntarily seek out a stock exchange listing. Additionally, in 1976, the SEC released its first solicited comments on improving Form 20-F disclosure. *See* Means of Improving Disclosure by Certain Foreign Private Issuers, Exchange Act Release No.

proposal to adopt Form 20-F and Exchange Act reporting rules mandating an integrated disclosure scheme for foreign private issuers substantially equivalent to domestic issuers.[7] A year before this release, the SEC requested public comment on the issue of requiring more "meaningful" disclosure for foreign private issuers. Of the fifty-four comment letters, forty-nine were critical of the proposal.[8] The letters largely criticized the rules on the grounds that "increased disclosure burdens would deter use of the United States capital markets; consequently, international capital movements would be impaired."[9]

In response, the SEC stated that the comment letters did not "coincide with those of public investors," as they "reflected the views of interested parties other than foreign issuers, stock exchanges and broker–dealers who would be most directly affected thereby."[10] The "protection of investors" militated towards this move:

> [t]hese proposed amendments . . . constitute, the Commission believes, a balanced approach toward rectifying that competitive imbalance and providing more timely and meaningful information to investors, thus promoting the maintenance of fair and honest markets. The Commission further believes that improved information about foreign issuers may facilitate the free flow of capital among nations.[11]

The "competitive balance" was not what we would assume would be the SEC's principal concern. Today it would ensure that the SEC calibrates regulation to attract and maintain foreign listings. The competitive concern to the SEC in 1977, though, was the need to facilitate the "free flow of capital among nations," as well as to reduce "any competitive disadvantages reporting domestic issuers possibly suffer in relation to reporting foreign issuers."[12] In other words, the SEC decided in 1977 that notions of competitiveness warranted raising disclosure requirements for foreign private issuers to a level similar to domestic issuers. The competitive position the SEC wanted to preserve was that of U.S. domestic issuers vis-à-vis international competitors.

The SEC desired to enhance domestic competitiveness, but this release also established a path dependency which would take hold.

13,056, [1976–1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,830 (Dec. 10, 1976) [hereinafter 1976 FPI Release].

7. Foreign Private Issuers—Proposed Rules, Forms and Guidelines—Corresponding to Domestic Requirements, Exchange Act Release No. 14,128, [1977–1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,361 (Nov. 2, 1977) [hereinafter 1977 FPI Release].

8. *Id.* at 88,698. *See also* 1976 FPI Release, *supra* note 6.

9. 1977 FPI Release, *supra* note 7, at 88,699.

10. *Id.* at 88,697–98.

11. *Id.* at 88,698–99.

12. *Id.* at 88,698.

There would be an integrated disclosure system for foreign private issuers, but that system would take into account the special needs of foreign private issuers. Even though the release would create an integrated regime, it would still maintain the exemption for foreign private issuers from the Exchange Act's quarterly and event-driven reporting requirements.[13] The need to put domestic issuers on par with foreign private issuers would be implicitly balanced against the special requirements of foreign private issuers.

In the early years of foreign securities regulation this competitive balance was still tilted towards leveling the playing field between U.S. and foreign issuers. In 1977, this resulted in foreign private issuer disclosure being enhanced. These proposed rules were officially adopted in 1979.[14] The competitive parity policy the rules enabled was reiterated in 1983. In that year the SEC closed the exemption from registration for NASDAQ quoted foreign private issuers despite 133 comment letters protesting the rule's adoption.[15] The ability of foreign private issuers to be listed or quoted on a U.S. exchange without registering their shares with the SEC was thus severely limited.

In 1982, the SEC also adopted an integrated disclosure system for foreign private issuers offering securities. The SEC stated that "in developing the proposals the Commission sought to balance the policies of protecting investors by requiring substantially the same disclosure from domestic and foreign issuers and of promoting the public interest by encouraging foreign issuers to register their securities with the Commission."[16] Again disclosure parity was echoed: "ultimately, both domestic and foreign issuers should be subject to virtually identical disclosure requirements."[17] This and the 1983 elimination of the NASDAQ exemption were the last hurrahs. The perceived competitive need to draw more foreign private issuers to the U.S. listing market would push the SEC to reweigh its interest group balancing.

This balance began shifting in the 1980s. During this time period, a

13. *Id.* at 88,706.

14. Rules, Registration and Annual Report Form for Foreign Private Issuers, Exchange Act Release No. 16,371, [1979–1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,363 (Nov. 29, 1979). The SEC received sixty-one more comments letters, which were again, almost uniformly opposed to the action. The SEC also rejected these comments. *Id.* at 82,550.

15. Foreign Securities, Exchange Act Release No. 33-6493, [1983–1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,435, at 86,294 (Oct. 6, 1983). *See also* Exchange Act Rule 12g3-2(d)(3), 17 C.F.R. § 240.12g3-2(d) (2010).

16. Adoption of Foreign Issuer Integrated Disclosure System, Exchange Act Release No. 19,258, [1982–1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) (Dec. 6, 1982).

17. This principle was also reiterated in the proposing release for these rules. *See* Integrated Disclosure System for Foreign Private Issuers, Exchange Act Release No. 18,279, [1981–1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,054, at 84,643 (Nov. 20, 1981).

new architecture was set in place.[18] The disclosure requirements for foreign private issuers would be reduced. Rules were promulgated or maintained for foreign private issuers to be exempt from filing quarterly reports, proxy requirements, § 16 requirements, and Form 8-K requirements.[19] A mutual recognition scheme for Canadian issuers was also promulgated because "U.S. requirements reportedly continue to deter foreign companies from entering the U.S. markets."[20] A concept release on facilitating multi-jurisdictional offers was issued in 1985; Regulation S was adopted in 1990; Rule 144A was codified in 1990; and the SEC began to embrace IOSCO disclosure principals following a 1986 conference in Paris. This continued into the 1990s with the adoption of Universal Shelf Registration for foreign private issuers and cross-border exemptions for merger and acquisition (M&A) transactions.[21]

As a result, foreign private issuers, who wanted to use the U.S. exchanges for a listing, quotation, or otherwise offer securities to the U.S. public, would be subject to Form 20-F reporting requirements. These reporting requirements required reconciliation with U.S. generally accepted accounting principles (U.S. GAAP) and Williams Act takeover strictures. For those who simply wanted to stay away from U.S. markets, Exchange Act Rule 12g3-2(b) maintained an open avenue to a listing on the pink sheets without requiring SEC registration.[22]

18. For a history of these developments, see Edward F. Greene & Linda C. Quinn, *Building on the International Convergence of Global Markets: A Model for Securities Law Reform*, *in* INTERNATIONAL SECURITIES MARKETS 2003: EMERGING BEST PRACTICES FOR A RAPIDLY EVOLVING REGULATORY SCHEME app'x. I (PLI Corp. Law and Practice Course Handbook Series No. B0-01TL, 2003) WL 1372 PLI/Corp 561.

19. *See* Franklin R. Edwards, *Listing of Foreign Securities on U.S. Exchanges*, *in* MODERNIZING U.S. SECURITIES REGULATION: ECONOMIC AND LEGAL PERSPECTIVES (Lehn & Kahmphuis, Jr. eds., 1992).

20. Multijurisdictional Disclosure, Exchange Act Release No. 27,055, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,432, at 80,286 (Aug. 4, 1989). At the time there were one hundred fifty foreign securities traded on a U.S. exchange and two hundred ninety-one quoted on NASDAQ, ninety-nine of which were on the National Market System. *Id.* at 80, 284. The multijurisdictional disclosure system was adopted in 1991 with a release which echoed similar principles. *See* Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Exchange Act Release No. 29,354, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,812 (Jul. 1, 1991).

21. Perhaps a seminal statement of the SEC approach at this time was embodied in Policy Statement of the Securities and Exchange Commission on the Regulation of International Securities Markets, Securities Act Release No. 6807 [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,341 (Nov. 1988). The SEC stated "[a]s regulators seek to minimize differences between systems, the goal of investor protection should be balanced with the need to be responsive to the realities of each marketplace." *Id*. at 89,576.

22. *See* 17 C.F.R. § 240.12g3-2(b) (2010); *see also* Edward F. Greene et al., *Hegemony or Deference: U.S. Disclosure Requirements in the International Capital Markets*, 50 BUS. LAW. 413

This was a species of mutual recognition. Integrated disclosure would still be maintained, but beyond that regulation for these issuers would largely come from their home regulator. This made sense at the time because the overwhelming majority of foreign private issuers were European and already regulated by their domestic regulator. During this time period, the U.S. retail capital markets were considered more advanced. A listing on the U.S. capital markets was viewed as raising the equity premium for a foreign company's stock. This may have been a result of multiple reasons such as bonding, liquidity, or capital markets arbitrage.[23] Regardless of reasoning, it was clear that the U.S. offered an attractive retail market for European issuers. This was not reciprocated for U.S. issuers. Domestic issuers largely retained a sole listing in the United States and did not venture abroad.[24]

The cause of the SEC's changing view of competitiveness was attributable to shifting market forces. During this time, the NYSE prominently advocated for lighter regulation of foreign private issuers,[25] and large numbers of foreign private issuers actually began listing in the United States[26] Chart I.A demonstrates the rise in foreign listings from 1985 through 1995:

(1995).

23. Why issuers cross-list is the subject of much debate. *See, e.g.*, Doidge et al., *Private Benefits of Control, Ownership and the Cross-Listing Decision* (Nat'l Bureau of Econ. Research, Working Paper No. 11162, 2005), *available at* http://ideas.repec.org/p/nbr/nberwo/11162.html; Amir Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141 (2003); William Reese, Jr. & Michael S. Weisbach, *Protection of Minority Shareholder Interests, Cross-Listings in the United States, and Subsequent Equity Offerings*, 66(1) J. FIN. ECON. 65 (2001).

24. *See* John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1765 (2002); Marco Pagano et al., *The Geography of Equity Listing: Why Do Companies List Abroad?*, 57 J. FIN. 2651, 2652 (2002).

25. *See, e.g.*, James L. Cochrane, *Are U.S. Regulatory Requirements for Foreign Firms Appropriate?*, 17 FORDHAM INT'L L.J. S58 (1994); *see also* Roberta S. Karmel & Mary S. Head, *Barriers to Foreign Issuer Entry Into U.S. Markets*, 24 LAW & POL'Y INT'L BUS. 1207 (1993).

26. *See* Greene & Quinn, *supra* note 18, at 619.

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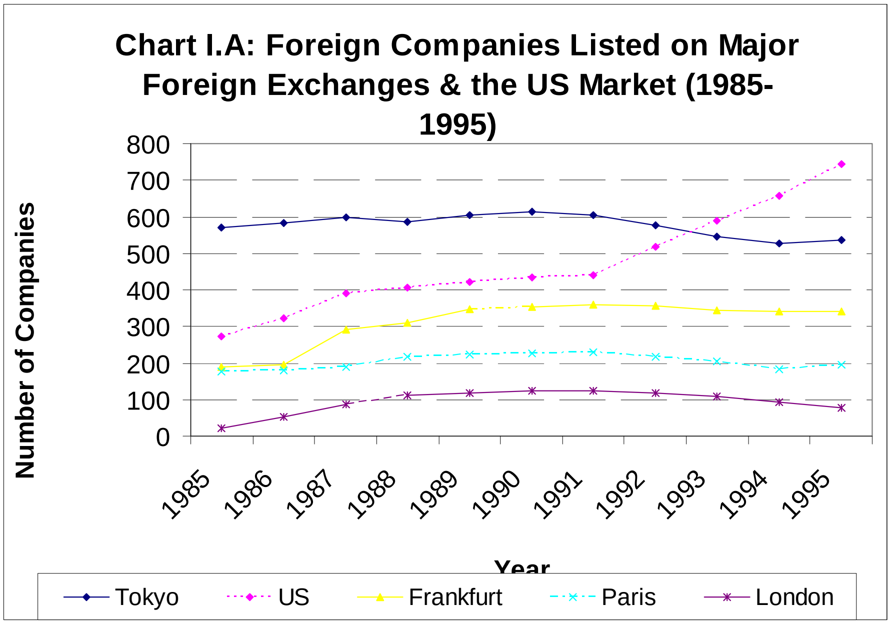


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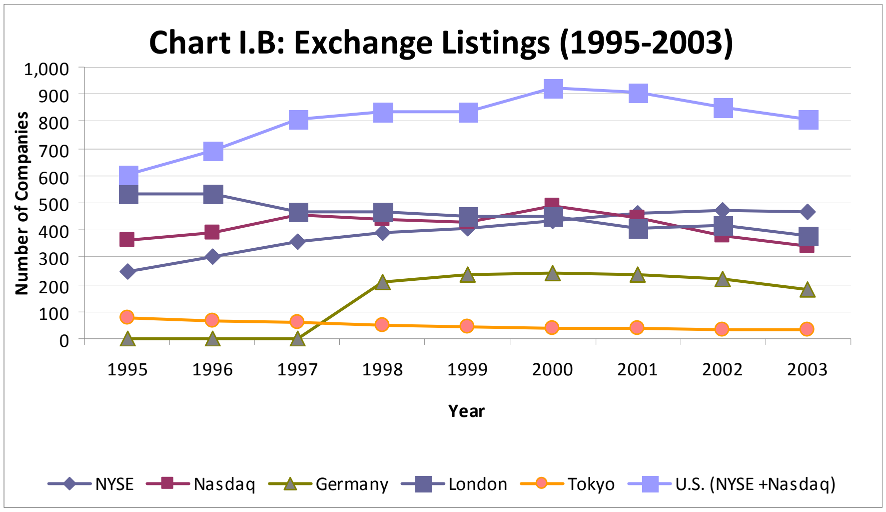
Countervailing interests towards heightened regulation included the public protection of investors and the need for equal competitive footing between domestic and foreign issuers. The public interest lobby representing these two interests in the international securities realm was small. In the absence of any strong opposing interests, interest group politics pushed the SEC towards the deregulation of foreign private issuers. Unlike in 1977, the SEC was unable to ignore these interests. It also helped that the SEC's new regulation was in line with the rhetoric of "competitiveness," as defined by the market at the time

### *B. The Technology Bubble and International Securities Regulation*

The technology bubble started a gold rush. Foreign private issuers flocked to the United States to capitalize on a market bubble equity premium. The consequences were three-fold. First, a record number of small foreign private issuers, mainly in the technology industry, listed in the United States. Second, foreign private issuers increasingly spurned a listing in their domestic market, making the U.S. stock market their primary, if not only, listing. Third, foreign private issuers from outside

27. Div. of Corp. Fin., U.S. Sec. Exch. Comm'n, Financing Trends in the United States Securities Markets (1995).

Europe emerged as a significant source of U.S. listings. Chart I.B shows the rise in U.S. listings from 1995 to 2003:

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The figures in Chart I.B demonstrate the increase in foreign private issuers registered with the SEC during the time of the technology bubble. During this time period, the type of issuer and their reason for listing changed. These issuers were smaller and more geographically diverse than issuers from prior decades. These new foreign issuers came to the United States in search of a market-skewed equity premium rather than for status, an acquisition currency, liquidity, or other reasons earlier foreign private issuers cited for listing in the United States.

These foreign companies were like many domestic technology companies during the technology bubble; they should never have listed in the United States. In the wake of the bubble and the increased regulatory costs imposed by Sarbanes–Oxley, many smaller technology companies were left with a U.S. listing they did not desire and could not maintain. But the U.S. securities law system at the time could best be described as a lobster trap or the Hotel California. Once you listed, it was almost impossible to deregister and remove your listing. You could check in any time, but you could never leave.[29] This led to a large cadre

28. World Fed. of Exchs., Number of Companies with Shares Listed, http://www.world-exchanges.org/statistics/annual (follow "1996" hyperlink; then follow "Equity Markets" hyperlink; then follow "Number of Companies with Shares Listed" hyperlink; repeat through 2003) (last visited Feb. 20, 2011).

29. *See* Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of*

of trapped foreign private issuers.

This phenomenon coincided with a second problem caused by the popping of the technology bubble: foreign private issuers stopped coming to the United States. This development provided ammunition to outside interest groups promoting deregulation of foreign private issuers listed in the United States. These interest groups attributed the listing shortage to Sarbanes–Oxley, asserting that it created a hostile regulatory regime and environment.[30]

The issue was far more complex. Issuers tend not to cross-list, but when they do they have historically listed in the United States. In the wake of the technology bubble and the accompanying worldwide recession, companies stopped cross-listing and engaging in initial public offerings. In 2004, Hong Kong had only ten foreign companies listed.[31] This number remained unchanged as of 2008. The Tokyo Stock Exchange declined from thirty such listings in 2004 to sixteen in 2008. The only bright spot was the LSE's Alternative Investment Market (AIM), which became a refuge for small companies. The flow to AIM was seen as a primary example of U.S. noncompetitiveness.[32] However, many of these companies would not have qualified to list in the U.S.[33]

The decline in foreign issuers listing in the United States was furthered by the rise of private and more complete equity markets, which provided an alternative capital raising outlet. In the private realm, the market for foreign equity offered via Rule 144A exempt offerings in the U.S. exploded. In 2006, Rule 144A equity offerings by foreign private issuers amounted to $162 billion.[34] It was clear that a viable market alternative now existed in the United States to raise capital outside the public listing markets. Claims of U.S. non-competitiveness were further buttressed by academic studies, which found a decline in U.S. equity premiums contemporaneous with the adoption of Sarbanes–Oxley.[35] To

*Mandatory Disclosure*, 23 CARDOZO L. REV. 675 (2002).

30. *See infra* Part II.C.

31. *See* World Fed. of Exchanges, Annual Number of Listed Companies: 2008, http://www.world-exchanges.org/statistics/annual/2008/equity-markets/number-listed-companies-0 (last visited Sept. 27, 2010).

32. *See* MICHAEL R. BLOOMBERG & CHARLES E. SHUMER, SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP (2006), *available at* http://www.abanet.org/buslaw/committees/CL116000pub/materials/library/NY_Schumer-Bloomberg_REPORT_FINAL.pdf.

33. Davidoff, *supra* note 4, at 145.

34. Steven M. Davidoff, *Paradigm Shift: Federal Securities Regulation in the New Millennium*, 2 BROOK. J. CORP. FIN. & COM. L. 339, 340 (2008); William K. Sjostrom Jr., *The Birth of Rule 144A Equity Offerings*, 56 UCLA L. REV. 409, 412 (2008).

35. *See, e.g.*, Craig Doidge et al., *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time*, 91 J. FIN. ECON. 253 (2009); Kate Litvak, *The Effect of the Sarbanes–Oxley Act on Non-U.S. Companies Cross-Listed in the U.S.*, 13 J. CORP. FIN. 195 (2007);

the extent non-U.S. issuers came to the United States in search of an equity premium, any such premium had disappeared or diminished. The studies were not uniform, and could be criticized for their econometric techniques, but still it appeared that the vaunted U.S. equity premium had diminished, if not disappeared.

### *C. The Interest Group Response to Perceived U.S. Non-Competitiveness*

The discontent of "trapped" foreign private issuers was eclipsed by the outcry of domestic issuers against the new strictures of Sarbanes–Oxley. In the wake of Sarbanes–Oxley, a skein of academic literature, supported by industry commentary expressed an opinion that provisions of the Act were ham-handed, over-broad, and too costly.[36] This literature focused particularly on the costs imposed upon issuers by Sarbanes–Oxley's § 404 requirements.[37]

The purpose of this Article is not to re-debate Sarbanes–Oxley, but rather to examine how the post-Sarbanes–Oxley rhetoric shaped the SEC's regulation of foreign private issuers. This rhetoric was driven to a large extent by four ad-hoc committees and organizations which issued reports analyzing the efficacy of the Sarbanes–Oxley Act. These committees and organizations were the: (1) SEC Advisory Committee on Smaller Public Companies; (2) Committee on Capital Markets Regulation; (3) McKinsey & Company Study; and (4) Commission on the Regulation of U.S. Capital Markets in the 21st Century.

Roberta Romano in her article *Does the Sarbanes–Oxley Act Have a Future?* undertakes an in-depth survey of the four organizations' work,[38] but for the purposes of this Article, it is worth addressing their principal recommendations as it related to or discussed foreign private issuers and the need for competitive U.S. capital markets.

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Kate Litvak, *The Long-Term Effect of the Sarbanes–Oxley Act on Cross-Listing Premia*, 14 EUR. FIN. MGMT. 875 (2008); Joseph D. Piotroski & Suraj Srinivasan, *Regulation and Bonding: The Sarbanes–Oxley Act and the Flow of International Listings*, 46 J. ACCT. RES. 383 (2008); Luigi Zingales, *Is the U.S. Capital Market Losing Its Competitive Edge?* (The Initiative on Global Markets, The Univ. of Chicago Graduate Sch. of Bus., Working Paper No. 1, 2007).

36. *See, e.g.*, Larry Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes–Oxley Act of 2002*, 28 J. CORP. L. 1 (2002); Roberta Romano, *The Sarbanes–Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).

37. *See* ADVISORY COMM. ON SMALLER PUB. COS., SEC, FINAL REPORT OF THE ADVISORY COMMITTEE ON SMALLER PUBLIC COMPANIES TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION (2006), *available at* http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf [hereinafter SPC FINAL REPORT]; *see also* Joseph A. Grundfest & Steven E. Bochner, *Fixing 404*, 105 MICH. L. REV. 1643 (2007); Peter Iliev, *The Effect of SOX Section 404: Costs, Earnings, Quality, and Stock Prices*, 65 J. FIN. 1163 (2010).

38. Roberta Romano, *Does the Sarbanes–Oxley Act Have a Future?*, 26 YALE J. ON REG. 229 (2009).

The SEC Advisory Committee primarily focused on Sarbanes–Oxley's affect on domestic issuers.[39] The committee's primary recommendation was an opt-in solution for small private issuers and § 404 of Sarbanes–Oxley. In supporting this position the committee stated:

> A number of data points lead us in this direction . . . .
>
> - Some companies are either going dark or going private or considering doing so;
> - The London Exchange's Alternative Investment Market (AIM) for smaller public companies is gaining momentum;
> - Foreign new listings in the United States during 2005 dropped considerably from the previous year;
> - Foreign issuers are departing from the U.S. market (and their institutional investors are voting for their going offshore); and
> - U.S. investors continue to invest in foreign securities even though the issuers are not subject to internal control requirements like those promulgated under Section 404.
>
> Without deciding whether Section 404 is beneficial for investors in smaller public companies, we believe that in light of our reasons for recommending exemptive relief for these companies unless and until an appropriate framework for assessing their internal control is developed, permitting them to comply or take advantage of the relief is the appropriate course of action to recommend.[40]

In other words, the protection of investors was trumped by the efficacy of deregulation in the name of competitiveness. The competitive threat was the mostly foreign threat of non-U.S. issuers listing and raising capital abroad resulting in U.S. investors investing in such companies. The linkage was curious as small U.S. issuers were quite unlikely to go abroad to raise capital, and historically, non-U.S. issuers were similarly unlikely to seek a U.S. listing.[41] The perceived loss of U.S. international competitiveness in this case justified against the investor protection balance set by the committee.

The Committee on Capital Markets Regulation (CCMR) was formed in September 2006. The CCMR was a private creation but was apparently formed at the suggestion of then Secretary of Treasury Hank Paulson.[42] The CCMR acted expeditiously and issued its first interim report on November 30, 2006.[43] The tenor of the report is best reflected

39. SPC FINAL REPORT, *supra* note 37.

40. *Id.* at 41–42 (internal citations omitted).

41. Davidoff, *supra* note 4.

42. Romano, *supra* note 38, at 244.

43. COMM. ON CAPITAL MKTS. REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (2006), *available at* http://www.capmktsreg.org/pdfs/

by its statement in the executive summary that the "evidence presented . . . suggests that the United States is losing its leading competitive position as compared to stock markets and financial centers abroad."[44] The report stated that this was due to four reasons:

> (i) an increase in the integrity of and trust in major foreign public markets resulting from more transparency and better disclosure; (ii) a relative increase in the liquidity of foreign and private markets, thus making it less necessary to go to the U.S. public equity capital markets for funding; (iii) improvements in technology, making it easier for U.S. investors to invest in foreign markets; and (iv) differences in the legal rules governing the U.S. public markets and the foreign and private alternatives.[45]

The CCMR made a number of recommendations with respect to regulation of both domestic and foreign issuers, but in the international securities realm made a relatively modest recommendation that new foreign private issuers should be allowed to reserve the right to deregister and that current foreign private issuers should be allowed to exclude institutional investors for purposes of calculating their U.S. shareholder base.[46] The report's low-key recommendation was presumably based on a countervailing tension cited in its report to balance deregulation of foreign private issuers against "protecting retail investors."[47]

The CCMR issued a second report on December 4, 2007.[48] The report labeled itself "a second wake-up call" and began by stating that "[b]y any meaningful measure, the competitiveness of the U.S. public equity market has deteriorated significantly in recent years."[49] The committee did not make any recommendation in this report but highlighted the U.S. competitive decline it found. The alarmed tone of its second report was a bit surprising because the main recommendation of the report—at least to the extent it dealt with foreign private issuers—had been adopted in March of 2007. This may have been due to the institutionalization of the CCMR at Harvard Law School, and an apparent reassessment of its prior recommendations. Nonetheless, the CCMR has continued this siren call up to this date, claiming that the

11.30Committee_Interim_ReportREV2.pdf.

44. *Id.* at ix.

45. *Id.* at 4–5.

46. *Id.* at 66.

47. *Id.* at 7, 50.

48. COMM. ON CAPITAL MKTS. REGULATION, THE COMPETITIVE POSITION OF THE U.S. PUBLIC EQUITY MARKET (2007), *available at* http://www.capmktsreg.org/pdfs/The_Competitive_Position_of_the_US_Public_Equity_Market.pdf.

49. *Id.* at v, 1.

U.S. competitive position is in perilous decline.[50]

The McKinsey & Company Study was commissioned by New York City's Economic Development Corporation and was supported by New York City Mayor Michael Bloomberg and Senator Charles Schumer. The report was issued on January 22, 2007 and sounded similar alarm bells about the decline of U.S. competitiveness.[51] The study stated "[t]he threat to US and New York global financial services leadership is real. . . . It is clear that the country and the City need to take this threat seriously."[52] The study found that America was failing to compete on a real and a "perceptions" basis, and the study made eight "critically important" near-term and long-term recommendations.[53] The first recommendation was for relaxation of Sarbanes–Oxley's requirements, particularly with respect to § 404 and its application to small issuers.[54] Embedded in this recommendation was another recommendation that the SEC should "exempt foreign companies that comply with the corporate governance standards of SEC-approved foreign regulators from also having to comply with the requirements of Sarbanes–Oxley."[55] The second recommendation—securities litigation reform—was the bug-bear of many.[56] The other significant recommendation with respect to foreign private issuers was to "[r]ecognize IFRS without reconciliation and promote convergence of accounting and auditing standards."[57] This report was a direct blow against regulation of foreign private issuers. Accordingly, the mention of retail investors and protection of their interests was absent from the report. Not surprisingly, given that a consulting firm was retained to prepare this report with a specific goal in mind—U.S. capital markets competitiveness—there were no countervailing interests to consider.

The final study was the Commission on the Regulation of U.S. Capital Markets in the 21st Century established by the U.S. Chamber of Commerce in February of 2006. The committee issued its report in

50. *See, e.g.*, COMM. ON CAPITAL MKTS. REGULATION, AMID PLUNGING IPO ACTIVITY IN 2008, CCMR FINDS THAT U.S. PUBLIC EQUITY MARKET COMPETITIVENESS CONTINUES ITS DECLINE (2008), *available at* http://investment.verticalnews.com/articles/936560.html.

51. MICHAEL R. BLOOMBERG & CHARLES E. SHUMER, SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP (2007), *available at* http://www.nyc.gov/html/om/pdf/ny_report_final.pdf.

52. *Id.* at 10.

53. *Id.* at 19–28.

54. *Id.* at 99.

55. *Id.* at 99–100.

56. *Id.* at 100.

57. *Id.* at 109–110.

March 2007.[58] The report argued that "[u]nfortunately, the competitive position of our capital markets is under strain—from increasingly competitive international markets and the need to modernize our legal and regulatory frameworks."[59] The report noted the tension between "protecting investors and promoting capital formation" but highlighted the same figures as the McKinsey report and the CCMR to show that companies were no longer opting to list in the United States in the same number as in prior years.[60] The report was more receptive to countervailing evidence than either the McKinsey study or the CCMR reports. The report stated:

> One study from Ernst & Young notes that, during the first half of 2006, there were 77 IPOs that listed outside their domicile country, yet only 17 of these actually represented "in-play" IPOs, or those presenting competitive opportunity for U.S. markets. Of those 17, 11 did list on a U.S exchange. This suggests that the competitive position of the United States for in-play IPOs has not dramatically deteriorated, despite the larger shifts in capital market dynamics.[61]

The committee largely focused on domestic issues but recommended substituted compliance.[62] This was an idea put forth by Ethiopis Tafara and Robert J. Peterson in 2007.[63] Substituted compliance, as proposed by Tafara and Peterson, is a system wherein foreign stock exchanges and broker–dealers apply to the SEC for an exemption from SEC registration. This exemption would be premised on oversight and compliance with the laws of a foreign jurisdiction with comparable securities laws.[64] This was not full mutual recognition because it did not include listings—only brokers and exchanges. Still, it was a significant step towards this goal. The committee also recommended increasing convergence between U.S. GAAP and International Financial Reporting Standards (IFRS) as well as a system of mutual recognition for all IFRS issuers.[65]

These reports demonstrate that the discourse surrounding foreign

58. COMM'N ON THE REGULATION OF U.S. CAPITAL MKTS. IN THE 21ST CENTURY, U.S. CHAMBER OF COMMERCE, REPORT AND RECOMMENDATIONS (2007), *available at* http://library.uschamber.com/sites/default/files/reports/0703capmarkets_full.pdf [hereinafter COMM'N REPORT].

59. *Id.* at 4.

60. *Id.* at 1, 17.

61. *Id.* at 20 (internal citations omitted).

62. *Id.* at 36–40.

63. Ethiopis Tafara & Robert J. Peterson, *A Blueprint for cross-border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31 (2007).

64. *Id.* at 32.

65. COMM'N REPORT, *supra* note 58, at 47–48.

private issuer regulation was phrased as a need to keep U.S. markets competitive. This competition required reducing regulation on non-U.S. issuers. To the extent that the protection of "retail investors" or other domestic interests mitigated the status quo or increased regulation, the requirement of competitiveness militated against these interests.

The competitiveness of the United States in attracting foreign private issuers was used as evidence to argue for reduced burdens on small issuers. In part this was because the foreign private issuer market appeared to provide the best evidence for an argument that the United States capital markets were in decline. However, these are different markets, and equating the two is a subtle matter. There were increased burdens placed on smaller issuers, but these may have been unrelated to the actions and regulation of foreign private issuers. It may not have even been the proper connection. Lately, the decline in small issuer initial public offerings (IPOs) is attributed more to market structure, the rise of online brokerages, and the decline in volume of investment banking analyst research rather than Sarbanes–Oxley.[66] This alternative explanation is supported by the fact that the decline in small issuer IPOs traces back before the passage of Sarbanes–Oxley and the decline in foreign private issuer listings. The decline of both was nonetheless an easy touchstone to argue for a roll-back of Sarbanes–Oxley. Equating the two and tying the two issues to a United States in competitive decline was both politically astute and fit the rhetoric of the four reports.

Roberta Romano documents a rise in news discourse, and congressional attention to the Sarbanes–Oxley Act in tandem with the creation and reports of these committees. The purpose of her article is to analyze the news and legislative atmosphere spurring and surrounding potential legislative reform of Sarbanes–Oxley. Two of the phrases she tracks in the national news media are clearly those of rhetorical flourish: "Market Competitiveness" and "Foreign-Market Competitiveness."[67] Not surprisingly, she finds that the phrase "Market Competitiveness" appeared in national newspapers only four times in 2004, but seventy-five in 2006.[68] She finds three and fifty-seven mentions of "foreign market competitiveness" in 2004 and 2006, respectively.[69] She attributes this rhetorical atmosphere to an increase in willingness by

66. DAVID WEILD & EDWARD KIM, GRANT THORNTON LLP, MARKET STRUCTURE IS CAUSING THE IPO CRISIS (2009), *available at* http://www.grantthornton.com/staticfiles/GTCom/Public%20companies%20and%20capital%20markets/Files/IPO%20crisis%20-%20Sep%202009%20-%20FINAL.pdf.

67. Romano, *supra* note 38, at 312.

68. *Id.*

69. *Id.*

legislators to reconsider Sarbanes–Oxley.[70]

### *D. The SEC Response*

The SEC, under the stewardship of Christopher Cox, responded. The SEC undertook four significant actions with respect to foreign private issuers from 2005 to 2008. These actions were:

1. The SEC delayed the application of Sarbanes–Oxley's Rule 404 for several years to allow for foreign private issuers to prepare for the requirement and for implementing regulation on the subject;[71]
2. The rules governing cross-border tender offers, exchange offers, rights offerings, and business combinations were relaxed to further accommodate these transactions;[72]
3. The SEC adopted rules allowing for the deregistration and delisting of foreign private issuers and Rule 12g32-b was further amended to accommodate for exemptions there under;[73] and
4. Non-U.S. issuers were allowed to use IFRS for their U.S. reporting requirements.[74]

The last two actions were particularly consequential. The biggest impediment to a U.S. listing has always been the U.S. GAAP reconciliation requirements. European issuers had to spend months, sometimes years, working with local auditors to prepare these statements.[75] Local auditors from global accounting firms were attempting to learn and implement U.S. GAAP by correspondence with their U.S. counterpart offices. The consequence was that the U.S. GAAP reconciliation requirements were the principal impediment to a

70. *Id.* at 305–06.

71. *See* Robert G. DeLaMater, *Recent Trends in SEC Regulation of Foreign Issuers: How the U.S. Regulatory Regime is Affecting the United States' Historic Position as the World's Principal Capital Market*, 39 CORNELL INT'L L.J. 109, 118 (2006).

72. *See* Guidance and Revisions to the cross-border Tender Offer, Exchange Offerings and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions, Exchange Act Release No. 58,597, [2008 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 88,286 (Sep. 19, 2008) [hereinafter Cross-Border Release].

73. Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(G) and Duty to File Reports Under Section 13(A) or 15(D) of the Securities Exchange Act of 1934, Exchange Act Release No. 55,540, [2006–2007 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,785 (Mar. 27, 2007) [hereinafter Deregistration Adopting Release].

74. Use of IFRS Without GAAP Reconciliation, Exchange Act Release No. 57,026, [2007–2008 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 88,032 (Dec. 21, 2007) [hereinafter IFRS Adopting Release].

75. I practiced as a corporate attorney in Europe from 2000 to 2005, and I can assure you that it was an excruciatingly slow and inexact process.

U.S. listing.[76] Perversely some large market European issuers deliberately listed in the United States for anti-takeover purposes.[77] This made it almost impossible for one of their non-U.S. listed counterparts to bid for them as they would inherit the U.S. GAAP registration requirements, which were impracticable to comply with in a timely manner.

The relaxation of this entry listing requirement was complimented by eliminating the restrictions on exit from the U.S. markets. The adoption of new Exchange Act rules in March 2007 allowed non-U.S. issuers to freely delist and terminate their registration under § 12(g), thus absolving them from any duty to file reports under § 13(a) or § 15(d) of the Exchange Act.[78] Approximately seventy-five foreign private issuers deregistered their shares in the fifteen month period after the rule's adoption.[79] In September 2008, the SEC relaxed the Rule 12g32-b exemption by eliminating the written application and paper submission requirements.[80] This further stream-lined the U.S. market exit process. The SEC now had a solution for foreign private issuers who complained bitterly about § 404 and other U.S. regulations—you are free to go at any time.

The consequence was to open the toll road into and out of the United States. Foreign private issuers could now, with relative ease, list and delist from the United States. Some foreign acquirers, when listing, stated the clear intent to delist in a year, registering only for purposes of an acquisition. This most prominently occurred in the $144 billion business combination of the French companies Suez and Gaz de France. Suez specifically stated in its 571 page registration statement that it would deregister the shares it was registering and listing once the one-year time period under Rule 12g32-b elapsed.[81]

This was a marked departure from almost thirty years of SEC rule-making, which had at least required U.S. GAAP and imposed real substantive elements on foreign private issuers accessing the U.S. retail market. It was an inevitable result of the SEC departure from equivalent

76. *See* Kun Young Chang, *Reforming U.S. Disclosure Rules in Global Securities Markets*, 22 ANN REV. BANKING & FIN. L. 237, 241 (2003).

77. *See* Amir N. Licht, *Genie in a Bottle? Assessing Managerial Opportunism in International Securities Transactions*, 2000 COLUM. BUS. L. REV. 51, 93–94.

78. Deregistration Adopting Release, *supra* note 73.

79. Craig Doidge et al., *Why Do Foreign Firms Leave U.S. Equity Markets?*, 65(4) J. OF FIN. 1507, 1516 (2010).

80. Deregistration Adopting Release, *supra* note 73.

81. *See* Posting of Steven M. Davidoff to N.Y. Times DealBook, http://dealbook.blogs.nytimes.com/2008/06/17/french-deal-american-red-tape/ (June 17, 2008, 11:00 AM).

disclosure between foreign private issuers and domestic issuers towards a competitive advantage in drawing these issuers to the United States. It was also recognition of the difficulty of maintaining fences around global capital.

### *E. Analysis of the Releases*

The rhetoric driving this expansive rule-making was echoed in the adopting and proposing releases for these SEC actions. Take the new deregistration requirements long advocated by practitioners and foreign private issuers. In the first proposing release issued on December 23, 2005, the SEC asserted that "market globalization" and "advances in information technology" had resulted in a significant increase in "foreign companies that have engaged in cross-border activities and sought listings in U.S. securities markets."[82]

The statement seems to be typical of our time—capital markets are globalizing and changing. Who could argue with that? What was notable about this release was that nowhere did it mention the interests or protection of "retail investors." As for global competition, this was both an implicit and explicit premise behind the rule proposal. The SEC release cited as the primary justification for the proposed rule-making criticism by representatives of foreign companies and foreign industry associations of the requirement that a foreign private issuer could not deregister unless it was below the "300 U.S. resident shareholder" test.[83] The SEC also considered the effect of these rules on competition as required by § 23(a)(2) of the Exchange Act. The SEC concluded that:

> [b]y providing increased flexibility for foreign private issuers regarding our Exchange Act reporting system, the proposed rules would encourage foreign companies to participate in U.S. capital markets as Exchange Act reporting companies to the benefit of investors. In so doing, the proposed rules should foster increased competition between domestic and foreign firms for investors in U.S. capital markets.[84]

The release was also distinguishable for its failure to mention retail investor protection and countervailing investor protection considerations. Instead, the requirements of "globalization" and

82. Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(G) and Duty to File Reports Under Section 13(A) or 15(D) of the Securities Exchange Act of 1934, Exchange Act Release No. 53,020, [2005–2006 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,515, at 82,837 (Dec. 23, 2005).

83. *Id.* at 82,837–38.

84. *Id.* at 82,860–61.

"competition" drove this rule-making.[85] Foreign interests and the need to bring their listings to the United States militated this rule revision. It was no longer 1977. To the extent the interests of retail investors were relevant, the rule would bring more competition between domestic and foreign competitors for U.S. capital. No supporting citation was provided to this principle.

This was reiterated in the second proposing release issued on December 22, 2006.[86] The primary purpose of the newly reproposed rule was to put forth a more friendly foreign private-issuer test based on average daily trading volume. This alternative test was instead of two others. The first was that the foreign private issuer be a well-known seasoned issuer and have been a reporting issuer in the United States for the prior two years. The second was a hybrid U.S. public float and U.S. trading volume test.[87] These alternative tests had been criticized in the majority of the fifty comment letters the SEC received in response to the first release, on the grounds that they would unduly inhibit a significant "portion of U.S. registered foreign private issuers from exiting the Exchange Act."[88]

The interests of retail investors now made their appearance. The SEC justified this rule change when weighed against the need to protect retail investors because:

> [w]e believe the reproposed rules appropriately provide meaningful protection of U.S. investors by permitting the termination of Exchange Act registration and reporting only by foreign registrants in whose U.S. registered securities relative U.S. market interest is low. We believe the proposed conditions governing eligibility to use the trading volume-based measure, along with the other proposed conditions concerning prior Exchange Act reporting, the prohibition against recent registered U.S. offerings, and required foreign listing should further serve to protect U.S. investors.[89]

In other words, the SEC's protective concern was ensuring that only foreign private issuers with limited trading volume could deregister. This may have been a valid interest, but any countervailing interests were not discussed. Such interests could have encompassed the effects

85. *Id.* at 82,838–40.

86. Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(G) and Duty to File Reports Under Section 13(A) or 15(D) of the Securities Exchange Act of 1934, Exchange Act Release No. 55,005, [2006–2007 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,735 (Dec. 22, 2006).

87. *Id.* at 84,001.

88. *Id.*

89. *Id.*

of such a departure on U.S. investors who were stuck holding securities with lesser protections than initially required at the time of the investors' purchase. Instead, the argument had been channeled by the SEC staff into a question of what would be in the best interests of foreign private issuers. The SEC adopted these rules with some amendments to make them more foreign private issuer friendly, and they became effective on June 4, 2007.[90]

The other significant, indeed revolutionary, SEC action during this time with respect to foreign private issuers was the adoption of rules allowing foreign private issuers to meet their accounting disclosure requirements with financial statements prepared in accordance with IFRS as issued by the International Accounting Standards Board. The adoption of a release allowing foreign private issuers to use IFRS was the culmination of almost twenty years of study on the matter. The current effort had begun in February 2000 when the SEC issued a Concept Release on International Accounting Standards. The proposing release specifically cited the goal of harmonization. This was affirmed by SEC Chairman Cox, who in February 2006 stated his commitment to the "Roadmap" provided by SEC Chief Accountant, Donald Nicolaisen, in April 2005. The roadmap had set forth the goal of achieving one set of high quality, globally accepted accounting standards.[91] The proposing release detailed these efforts in five pages as part of a historical path for a "robust process for convergence."[92]

What was the justification for this change? The SEC revisited the parity argument previously raised in 1977. It is worth quoting from at length:

> Given the dual considerations of investor protection and even-handedness towards foreign private issuers, the Commission has framed its consideration of the reconciliation requirement as a balancing of two policy concerns: investors' need for the same type of basic information when making an investment decision regardless of whether the issuer is foreign or domestic, and the public interest served by an opportunity to invest in a variety of securities, including foreign securities. Investors' need for the same type of basic information implies that foreign and domestic registrants should be subject to the same disclosure requirements. However, the burden on foreign issuers of meeting the

90. Deregistration Adopting Release, *supra* note 73, at 84,472.

91. Donald T. Nicolaisen, *A Securities Regulator Looks at Convergence*, 25 NW. J. INT'L L & BUS. 661 (2005).

92. Acceptance from Foreign Private Issuers of Financial Statements Prepared In Accordance with International Financial Reporting Standards Without Reconciliation to GAAP, Securities Exchange Act Release No. 8818, (Jul. 2, 2007) [hereinafter IFRS Proposing Release], *available at* http://www.sec.gov/rules/proposed/2007/33-8818.pdf.

> identical disclosure standards as domestic issuers might discourage them from offering their securities on the U.S. market. If foreign issuers chose not to offer their securities in the United States, it would deprive U.S. investors of investment opportunities and potentially compel them to purchase foreign securities on foreign markets, where disclosure may be less than that required in filings with the Commission.[93]

The adoption of IFRS was controversial.[94] In response to the proposing release, the SEC received 125 comment letters,[95] many of which highlighted the need to retain U.S. GAAP for investor protection purposes. A subset of these letters raised alarm that IFRS would sow confusion among retail investors. The SEC rejected these concerns stating that "these amendments will help investors to understand international investment opportunities more clearly" than reliance on a multiplicity of accounting standards.[96] If this was a problem, educating investors would enable them to further understand the different accounting rules. The SEC stated:

> Due to the cost to issuers of preparing the reconciliation to U.S. GAAP from IFRS, we believe that the amendments are likely to promote efficiency by eliminating financial disclosure that is costly to produce. We believe that investors would have adequate information on which to base their investment decisions and that capital may be allocated on a more efficient basis.[97]

The competitive rationale underlying the SEC's attempts to lighten the burden on foreign private issuers had dominated.

The proposing and adopting releases put forth a world view where the needs of foreign private issuers due to "globalization" and "competition" necessitated change. To the extent that the needs of retail investors were accounted for, the debate was phrased in terms of the benefits that foreign investors would receive by access to these investments. The needs of domestic issuers for a level playing field, as cited in 1977, had been disregarded for a desire to provide access to these issuers. A justification for this access was ironically the large number of issuers who now had listed in the United States. The parity argument invoked in 1977 was flipped on its head.

The SEC did not cite any countervailing principles. The SEC articulated its needs and priorities, measuring them through the comment

93. *Id.* at 12.

94. *See* Lawrence A. Cunningham, *The SEC's Global Accounting Vision: A Realistic Appraisal of a Quixotic Quest*, 87 N.C. L. REV. 1 (2008).

95. IFRS Adopting Release, *supra* note 74, at 85,758.

96. *Id.* at 85,763.

97. *Id.* at 85,785.

process. The SEC was also particular in recognizing its preferred interest groups. In the case of these two rule-makings, the SEC spun the comments to reflect its agenda.

The SEC is not governed by the government Office of Management and Budget requirements for cost–benefit analysis. Nevertheless, the SEC's adopting releases for IFRS and the deregistration rules contained sections entitled "cost-benefit" analysis. A review of this section in each release reveals that while the SEC attempted to quantify some savings and costs, it was not the rigorous review advocated by many.[98] There was no real weighing or analysis. Reviewing the sections, it appears as results-driven as the remainder of the adopting releases.

It is useful to contrast the SEC's IFRS and deregistration rule-making with the case of the cross-border release and the rules it adopted during this same period. In that release, the SEC sought to update the cross border exemptions it had adopted in 1999. In the case of the cross-border release, twenty-two comment letters were submitted, many of which noted significant problems with imposing U.S. regulation on cross-border transactions and criticizing the manner the SEC determined these exemptions.[99] Despite criticism from law firms and representatives of foreign organizations, the SEC resisted the industry and foreign comment letters and refused to adopt more lenient rules in the name of investor protection. The SEC stated "[w]e believe the revisions appropriately balance the need to protect U.S. investors through the application of protections afforded by U.S. law, while facilitating transactions that may benefit all security holders, including those in the United States."[100] Unlike IFRS and the deregistration release, the SEC struck the balance of investor protection in favor of more regulation.

The difference was likely in the atmosphere of the time and the surrounding interest group rhetoric. The IFRS and deregistration releases were the subject of outside reports and congressional scrutiny. The adoption of these two agendas was covered extensively in the news. They were also trumpeted by the SEC as signs of the organization's responsiveness to threats to U.S. competition and criticism of Sarbanes–Oxley. The European Union lobbied heavily for this rule change.[101] These two actions allowed the SEC to appear responsive to the most vocal and powerful interest groups within the debate.

98. *See infra* note 133.

99. Cross-Border Release, *supra* note 72, at 87,174–79. The SEC comments are available at http://www.sec.gov/comments/s7-10-08/s71008.shtml (last visited Dec. 31, 2009).

100. *Id.* at 87,171.

101. Roberta S. Karmel, *The EU Challenge to the SEC*, 31 FORDHAM INT'L L. REV. 1692 (2008).

In contrast, the cross-border release adopted rules that were the arcane province of the M&A office of the SEC.[102] There was no reporting on the release in the *New York Times* or the *Wall Street Journal*.[103] The attention this rule-change brought was primarily from law firms and some foreign practitioner organizations.[104] In other words, the interest group mix at the time and the public rhetoric surrounding this release was akin to the interest group circumstances existent in 1977 when the SEC began its integration project. The SEC thus again felt safe ignoring this criticism.

In all of this rule-making, not one of the releases cited any committee reports discussed in Section II.C except for the SEC-established one. There is still no doubt that the SEC was operating in an atmosphere in which it was well aware of the public rhetoric surrounding these issues. In speeches and testimony, the SEC commissioners paid heed to these reports and claims of a U.S. capital markets decline.[105] The staff also noted this in conferences and articles. News reports quoted government officials as being aware of and responsive to the change demanded by interest groups.[106] This SEC rule-making was made in an environment ripe for change beneficial toward foreign private issuers.

### *F. The State of Play*

The regulatory landscape for foreign private issuers was substantially reshaped by the time the SEC finished. Sure, the pesky requirement of Sarbanes–Oxley certification embodied in § 404 could not be

102. Brett A. Carron & Steven M. Davidoff, *Getting U.S. Security Holders to the Party: The SEC's Cross-Border Release Five Years On*, 12 U. PA. J. INT'L ECON. L. 455 (2005).

103. Westlaw and Lexis searches with date restriction of 2008 (search: takeover or merger or cross w/2 border and SEC).

104. *See* SEC Comments, http://www.sec.gov/comments/s7-10-08/s71008.shtml (last visited Dec. 31, 2009).

105. *See, e.g.*, Roel C. Campos, Comm'r, Sec. Exch. Comm'n, Remarks Before the Consumer Federation of America Financial Services Conference (Dec. 1, 2006), *available at* http://www.sec.gov/news/speech/2006/spch120106rcc.htm; Roel C. Campos, Comm'r, Sec. Exch. Comm'n, SEC Regulation Outside the United States (Mar. 8, 2007), *available at* http://www.sec.gov/news/speech/2007/spch030807rcc.htm.

106. Senator Evan Bayh et al., Sen. Evan Bayh Holds a Hearing on Financial Regulation (Sept. 30, 2009), *available at* http://findarticles.com/p/news-articles/political-transcript-wire/mi_8167/is_20090930/sen-evan-bayh-holds-hearing/ai_n50936916/pg_5/; *International Cooperation to Modernize Financial Regulation: Hearing Before the Subcomm. on Sec. & Int'l Trade & Fin., Comm. on Banking, Housing, & Urban Affairs* (2009) (testimony of Daniel K. Tarullo, U.S. Fed. Reserve Bd.), *available at* http://www.federalreserve.gov/newsevents/testimony/tarullo20090930a.htm. *See also* Jeffrey Deane &Peter Kern, *Ready for Global Financial Standards?*, PITT. POST-GAZETTE, Mar. 22, 2009, at C1.

eliminated.[107] But foreign private issuers coming to the United States faced a regulatory skein where they could raise capital on the public markets and if desired, escape relatively soon thereafter. Moreover, this capital raising was made significantly easier by the elimination of the U.S. GAAP reconciliation requirement.

As the financial markets have recovered in the wake of the financial crisis, foreign private issuers have returned to the United States. In 2009, fourteen foreign private issuers IPOs were announced raising $10.3 billion.[108] This compares to forty-seven domestic issuers raising $16.70 billion.[109] The source of these issuers was China and outside Europe. Eleven of these IPOs were from mainland China, one from Hong Kong, one from Singapore, and one from Brazil. None were from Europe.[110] At first blush, this data provides affirmation for the "no one is coming here" argument. But the LSE had only two IPOs in 2009. The AIM had nine IPOs in total for the same year. In other words, no one at all was going to London.[111] Worldwide IPO flow shifted primarily to China and secondarily to the United States. The Hong Kong Exchange had twenty-one IPOs and the Shenzen Exchange forty IPOs.[112] Meanwhile the NYSE had thirty-five IPOs and the NASDAQ had twenty-six IPOs.[113]

China may be dominating IPOs, but this is largely the result of rising domestic markets. Given the penchant of issuers to raise capital in their domestic markets, this is to be expected.[114] The U.S. is the only competitor right now for foreign listings. In 2009, the London Stock Exchange received one foreign listing, the AIM two foreign listings and

107. The SEC did act to provide some measure of regulatory relief to small issuers. *See* Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies, Securities Act Release No. 8731, Exchange Act Release No. 54,295, 71 Fed. Reg. 47,060 (proposed Aug. 9, 2006). The Dodd–Frank Wall Street Reform and Consumer Protection Act eliminated the requirements for non-accelerated filers to comply with Section 404. Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 989G, 124 Stat. 1376, 1948 (July 21, 2010). Non-accelerated filers have an aggregate worldwide market value of voting and non-voting common equity held by non-affiliates of less than $75 million. 17 C.F.R. § 240.12b-2 (2010).

108. Dealogic Database (search data on file with author).

109. *Id.*

110. *Id.*

111. Press Release, Thomson Reuters, Thomson Reuters Year-End Equity Capital Markets Review 2009, at 7 (2009), http://financial.thomsonreuters.com/deo/pdf/Prelim_Capital_Markets_Press_Release_4Q09.pdf. Moreover, there has been a flight of foreign issuers from the AIM of late.

112. *Id.*

113. Dealogic Database, *supra* note 108.

114. *See* Sergei Sarkissian, *The Overseas Listing Decision: New Evidence of Proximity Preference*, 17 REV. FIN. STUD. 769 (2004).

the Tokyo Stock Exchange no foreign listings.[115] To the extent there is a global listing market, the United States as of 2009 still dominated, regardless of how small the market is.[116]

If one believes that the need for European issuers to come to the U.S. is diminished due to either a lower premium or maturation of their own markets, these statistics superficially support that view. European issuers are not listing generally, but they are certainly not listing in the United States when they do list. Moreover, issuers are cross-listing less than they previously did before.[117] This may be due to the inevitable maturation of European markets and the recognition that the U.S. market no longer has rents with respect to European issuers. It also may be due to bubble like conditions in prior years, which over-inflated this flow. Added to the mix are U.S. regulations and a litigation environment, which many believe deters these listings. However, if you believe the bonding hypothesis, or perhaps a hot money theory, China's U.S. listing wave appears to provide evidence to meet either one. Chinese issuers are coming to the U.S. to raise capital and list, arriving from a less regulated and developed market to do so. In 2009, Chinese issuers comprised 17.5% of the U.S. IPO market.[118]

These Chinese issuers are undertaking U.S. IPOs using U.S. GAAP prepared financial statements.[119] This is despite the fact that China has publicly announced its endorsement of IFRS and convergence. In other words, the market still values U.S. GAAP. It also may be a countervailing narrative to the need to allow IFRS or otherwise push for global accounting harmonization. Chinese issuers are even filing for IPOs using the much more stringent domestic form of S-1 rather than F-1, presumably for extra credibility.[120] This is grist for the bonding story, and the value U.S. regulation and supervision has historically provided

115. Dealogic Database, *supra* note 108.

116. Langevoort notes that

> the United States no longer has a significant competitive advantage vis-à-vis other world markets in terms of technology, talent, or access to global wealth. In other words, the United States no longer has rents that can compensate for—and thus mask—any suboptimal regulation. Getting the regulatory balance right is therefore increasingly crucial.

Donald C. Langevoort, *U.S. Securities Regulation and Global Competition*, 3 VA. L. & BUS. REV. 191, 196 (2009).

117. Reese, Jr. & Weisbach, *supra* note 23, at 19–20, 39.

118. RENAISSANCE CAPITAL LLC, 2009 GLOBAL IPO MARKET REVIEW AND 2010 OUTLOOK 5 (2010), http://www.renaissancecapital.com/ipohome/review/2009Review.pdf.

119. *See, e.g.*, Duoyuan Global Water Inc., Registration Statement Under the Securities Act of 1933, Form F-1, No. 333-159691, at F-1 (Filed June 24, 2009).

120. Davidoff, *supra* note 4.

to foreign private issuers. The numbers are nonetheless too few to draw any definitive conclusions.

## III. ANALYSIS

Wholesale SEC changes have made it easy for foreign private issuers to enter and exit the U.S. market. Professors Doidge, Karolyi and Stulz found seventy-five firms voluntary deregistered from the U.S. from March 21, 2007 through the end of 2008.[121] This may evidence a flight from U.S. capital markets, but it may also be a result of pent up demand. Doidge and his co-authors found evidence that these deregistering issuers "grow more slowly, need less capital, and experience poor stock return performance" than non-deregistering foreign issuers.[122]

Foreign securities regulation has remained a one-size-fits-all affair. Royal Dutch Shell is regulated at the same level as Chinese Duoyuan Global Water, a hot Chinese IPO on the NYSE in 2009. Royal Dutch Shell is also listed on the LSE; Duoyuan Global is not listed anywhere else. In some sense this has administrative and market appeal. Administratively, a single standard is easier to administer and sell to foreign private issuers. This also allows the market to set varying levels of internalized governance and disclosure.

The chances of successful litigation in the United States against a Chinese issuer are low, and a judgment in the United States is of little value. One would likely have to litigate the issue in China in courts that are unfamiliar and, to put it bluntly, often do not follow the rule of law.[123] Furthermore, foreign private issuers do not comply with disclosure requirements to the same extent. Despite the efforts of some Chinese issuers, Chinese accounting principles are lacking.[124] Chinese issuers often keep multiple sets of books and fudge numbers to meet internal targets.[125] They do this assuming it will all work out in the end. One can believe that once they list in the U.S. and are required to comply with U.S. regulations they get religion, and some appear to do so, but I am skeptical that all do. A perusal of SEC filings by these

121. Craig Doidge et al., *Why Do Foreign Firms Leave U.S. Equity Markets?*, 65 J. OF FIN. 1507, 1516 (2010).

122. *Id.* at 1510–12.

123. *See* Donald C. Clarke, *The Enforcement of United States Court Judgments in China: A Research Note* (George Washington Univ. Law Sch., Pub. Law & Legal Theory Working Paper No. 236, Legal Studies Research Paper No. 236, 2004), *available at* http://ssrn.com/abstract=943922.

124. *See* Posting of Mark Dixon to N.Y. TIMES DEALBOOK, http://dealbook.blogs.nytimes.com/2009/08/17/another-view-shanghai-ed-profits/ (Aug. 17, 2009, 10:00 AM).

125. *See* Leslie P. Norton, *Who's Minding the Minders of Chinese Accounting?*, BARRON'S, Feb. 18, 2008, at 36.

issuers also reveals that their accounting practices are often suspect—some fail to file cash flow statements; others raise cash while having a significant amount of cash already on their balance sheet, which is a sign of possible fraud.[126] A recent piece in *Barron's* on Chinese listings in the United States raised similar concern about their accounting practices.[127] This is particularly true because the financials are prepared locally by Chinese branches of U.S. firms with similar cultural norms.

Foreign private issuers are different. A sensible cost–benefit analysis, even Aristotle's principle of equality, would indicate that the two should be regulated differently. This would be true under other regulatory techniques, such as investor protection or integrity of the market analysis. This Article suggests that if access to the U.S. retail market is provided to foreign private issuers then perhaps the level of regulation should be formally considered. An appropriate implementation of the precautionary principle jibes with this. The risk of a foreign private issuer acting inappropriately or defrauding U.S. investors likely mitigates some level of varying U.S. equivalent regulation. An illustration of this is currently occurring with Novartis's attempt to squeeze-out the minority shareholders of Alcon. Alcon is organized under the laws of Switzerland but is listed only on the NYSE. Consequently, the Swiss Takeover Law and its minority protections do not apply, leaving Alcon's shareholders without the protections they would receive for either a U.S. or Swiss domestic entity. This is a fine example of regulatory arbitrage amidst the current SEC rules for foreign private issuers.[128]

There are also certain issuers who pose more regulatory risk; analysis of that risk may require more regulation. However, in the many releases issued in the past five years concerning international securities regulation, the SEC has not considered this issue, despite comment letters noting this problem.[129] I also presume the SEC staff at the Office of International Affairs knows of these issues.

I believe that the SEC did not consider these differences for four reasons. First, heightened regulation did not fit within the rubric of "competitiveness" and "globalization" that was driving deregulation. Increased regulation would have been an opposite turn and counter to

126. Email from Hedge Fund Investor Arbitraging Chinese Issuers (June 22, 2010) (on file with author).

127. Norton, *supra* note 125.

128. *See* Editorial, *Novartis's Bid For Alcon: Minority Shareholders in Swiss Firms Have Fewer Rights than They Thought*, THE ECONOMIST, Jan. 9, 2010.

129. *See* Steven M. Davidoff, Comment to SEC Exchange Act Release Nos. 33-8917 & 34-57781 (June 23, 2008), *available at* http://www.sec.gov/comments/s7-10-08/s71008-16.pdf.

these concepts. Second, the scandal that drove this deregulation was the Enron/Worldcom debacle, the Sarbanes–Oxley response, and the regulatory and interest group push back. None of these provided a narrative which supported heightened regulation of foreign private issuers despite the fact that several significant scandals at the time involved a foreign private issuer. Third, the interest groups promoting this reform, supported by certain influential members of Congress, were looking for deregulatory actions. Raising regulation of foreign private issuers would not appear responsive to the demands of these interest groups. It was only in the context of the cross-border release, when these interests were absent, that the SEC could more freely act to increase regulation. Finally, path dependency appears to play a significant role. Having set a "one-size-fits-all" legal regime, breaking free of that treatment would have required a political event to justify it—something that was lacking.

It may be argued that the SEC simply did not agree with this thinking. While this argument is currently unknowable, the fact is that the path for foreign private issuers cleared in the past decade has been principally deregulatory. The most significant actions have come in the wake of rhetoric and interest group politics that pushed for these measures. It is doubtful that, in light of these pressures and the SEC's reaction, the SEC would have implemented these measures even if they agreed with this Article's conclusions.

## IV. CONCLUSION

A disclaimer: This Article is not arguing in support of or against the SEC's regulatory actions with respect to foreign private issuers. Many of these steps are sensible and certainly supportable in a world of global capital and diminishing U.S. rents from New York's capital perch. However, the market seems to provide some support for preservation of U.S. GAAP accounting.[130] This latter point is an argument for a flexible regulatory regime with issuer choice above minimum regulatory levels.[131] Rather, this Article argues that the SEC's ambitious rule-making agenda was not driven by any normative regulatory technique but by the political rhetoric of the time. This rhetoric is reflected in the

130. *See* Langevoort, *supra* note 116, at 200–01. Bill Bratton in this symposium outlines many of the problems with IFRS adoption by U.S. issuers. William W. Bratton, *Heedless Globalism: The SEC's Roadmap to Accounting Convergence*, 79 U. CIN. L. REV. 471 (2010).

131. For a discussion of this argument, see Davidoff, *supra* note 4. For a more in-depth look at the issues pushing the SEC towards globalized securities regulation, see Eric C. Chaffee, *The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets*, 5 J. BUS. & TECH. L. 187 (2010).

SEC's rationale for its rule adoptions.

The SEC's failure to fully consider countervailing interests provides further evidence that the SEC's regulatory revisions were driven by politics and rhetoric. The interests of contrary parties such as "retail investors" were transformed so that the benefits—increased access—were emphasized rather than the possible detriments —reduced protection and disclosure. This was possible because these interests, unlike in the small issuer debate, were largely unrepresented in this rule-making process. The SEC's strong actions were further justified by acting outside the small issuer context to support and enhance U.S. competitiveness in a manner responsive to public criticism. The end result may have been correct, but the process did not allow for nuanced analysis.

So what, one may ask? One could argue that the rhetoric of competition is real, and in any event, the SEC arrived at the right result. This conclusion is problematic for a number of reasons. First, the SEC appears to be picking and choosing interest group motivations as well as regulating to the strength of these interests. Shifting rationales undermine the legitimacy of this regulation. It also subjects SEC rule-making to statutory challenge as the Administrative Procedure Act contains an "arbitrary and capricious" standard that the SEC risks violating. Joseph Grundfest has recently highlighted the SEC's shifting positions in the context of proxy access.[132] Second, regulation promulgated in this manner defies the purpose of independent regulatory agencies, which is to set law in response to its mandate and the public interest. While this is a particularly optimistic view of the world, the other regulatory techniques such as cost–benefit analysis might provide more uniformity and perhaps more socially optimal results.[133] This refers to rigorous cost–benefit analysis, not the ex post facto back-of-the-envelope calculations that the SEC appears to have employed in the international regulatory sphere. Finally, the analysis in this Article is portable to other SEC conduct in prior years. It could be applied to hedge fund regulation, Sarbanes–Oxley implementing regulation, or proxy-access regulation.[134] If one were to watch the discourse, the same hortatory terms tend to repeat themselves, and the same blunt force

132. Joseph Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law*, 65 BUS. LAW. 361 (2010).

133. For one SEC Commissioner's view of cost–benefit analysis, see Troy A. Paredes, Speech by SEC Commissioner: Remarks at "The SEC Speaks in 2009" (Feb. 6, 2009), *available at* http://www.sec.gov/news/speech/2009/spch020609tap.htm. *See also* Edward Sherwin, *The Cost–Benefit Analysis of Financial Regu0lation: Lessons from the SEC's Stalled Mutual Fund Reform Effort*, 12 STAN. J. L. BUS. & FIN. 1 (2006).

134. Steven M. Davidoff, *Black Market Capital*, 2008 COLUM. BUS. L. REV. 172.

regulation follows.

The results are clear even from a broad perspective. True revolutionary, path-dependency breaking regulation does not come until there is scandal or crisis.[135] The rhetoric drives the reform; rhetoric driven by a political economy and interest group story.[136] In the mix SEC regulation crowds out congressional regulation; thus, more nuanced or rigorous regulatory techniques are lost.[137] This may be inevitable, but it is sobering for those like Cass Sunstein, director of the Office of Information and Regulatory Affairs, SEC Commissioner Troy Paredes, who advocate more searching regulatory review. This may occur, but it may also be destroyed by more traditional political narratives—even in the independent regulatory agency, and even in such a professional and accomplished place as the corporate finance division of the SEC.

135. *See* Stuart Banner, *What Causes New Securities Regulation? 300 Years of Evidence*, 75 WASH. U. L.Q. 849 (1997).

136. For analysis in other areas, see Andrew J. Yates & Richard L. Stroup, *Media Coverage and EPA Pesticide Decisions*, 102 PUB. CHOICE 297 (2000) (finding that the EPA is responsive to news coverage in assessing a chemical's use for pesticide).

137. Coates IV, *supra* note 3, at 557.