Assessing the Cost of Regulatory Protections: Evidence on the Decision to Sell Securities Outside the United States

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Abstract

This paper examines the factors that affect the decision of U.S. companies to issue securities offshore compared with inside the United States. Utilizing a data set of 1,444 domestic private placements and offshore offerings from 1993 to 1997, the paper reports that firms that experienced a private securities fraud lawsuit in the past resort to foreign sources of capital more frequently. Similarly, companies in standard industrial classification groups that are targeted more often with private securities fraud litigation are also more likely to issue securities offshore than to conduct domestic private placements. Not all issuers, however, choose to exit the U.S. regime. The paper employs past experience with a SEC investigation as a proxy for the amount of risk that the issuer may pose to investors. Issuers with private securities fraud litigation experience that also encountered a past SEC investigation are more likely to raise capital through a domestic offering, consistent with the hypothesis that some issuers choose to raise capital in the United States when the bonding and signaling value of the U.S. legal liability regime outweighs the costs associated with antifraud liability.

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The U.S. securities regulatory regime imposes a variety of information disclosure and antifraud mandatory requirements on issuers. Two competing views exist on the benefits of the mandatory regime. Under the first view, the mandatory application of the U.S. securities laws provides net positive benefits to investors (the "mandatory regulation hypothesis").[1] Without mandatory regulation, opportunistic issuers may employ a lower level of regulatory protections in an effort to extract value from new investors in the company. Similarly, self-interested managers may seek to adopt a lower level of protections to facilitate the appropriation of value from shareholders. In contrast, under the second view, issuers may have sufficient incentives to adopt voluntarily regulatory protections that benefit investors (the "voluntary regulation hypothesis"), rendering mandatory regulation unnecessary.[2] Rational investors will adjust the price they are willing to pay for the issuer's securities based on the value of adopted investor protections. Issuers that voluntarily choose a higher valued protection, therefore, receive a greater price for their issued securities. Other issuers may find the U.S. regime not worthwhile and choose to exit to other more value-maximizing regimes. Through a comparison of U.S. issuers that raised capital offshore with U.S. issuers that raised capital within the United States, the paper provides a test of the mandatory and voluntary regulation hypotheses.

A U.S. issuer may choose from a variety of means to raise capital through the securities markets. The paper focuses on choices that may affect the availability of Rule 10b-5 of the Securities Exchange Act of 1934 (Exchange Act) antifraud liability and exposure to possible Secu-

[1] See, e.g., Merritt Fox, Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment, 85 Va. L. Rev. 1335 (1999).

[2] See Stephen J. Choi & Andrew Guzman, Portable Reciprocity: Rethinking the International Reach of Securities Regulation, 71 S. Cal. L. Rev. 903 (1998). For others that make a similar point for competition among securities regulatory regimes in the context of domestic state law see Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 Yale L. J. 2359 (1998). The motivation behind portable reciprocity finds its roots in the state corporate law race-to-the-top versus race-to-the-bottom debate. For a discussion of the race-to-the-bottom hypothesis see Lucian Arye Bebchuk, Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law, 105 Harv. L. Rev. 1437 (1992); see also William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 Yale L.J. 663 (1974) (contending that state corporate law competition results in a race to the bottom). For a discussion of the race-to-the-top argument see Daniel Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 Nw. U. L. Rev. 913, 919-20 (1982); see also Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251, 258 (1977) (making the argument that state corporate law competition results in a race to the top).

rities and Exchange Commission (SEC) enforcement actions.[3] Although other antifraud provisions exist, the presence of Rule 10b-5 liability in almost all types of securities transactions exposes issuers to the possibility of both private fraud litigation as well as SEC enforcement actions. Even without mandatory disclosure, for example, many private placement issuers construct public offering-style memorandum under the shadow of possible Rule 10b-5 liability.[4] To test the incentive of issuers to avoid Rule 10b-5 liability, the paper focuses on one area under the securities laws where issuers are able to reduce, although not eliminate, exposure to Rule 10b-5: offshore offerings.[5]

Against offshore offerings, the paper compares domestic private placements. Domestic private placements represent the next closest alternative to raise capital while still facing Rule 10b-5 private liability in addition to possible SEC enforcement actions. Nevertheless, some issuers may face a choice only between a registered U.S. public offering and an offshore offering. Issuers that seek to sell a large dollar amount of securities to a great number of individual investors may choose only between a registered U.S. public offering and an offshore offering. U.S. public offerings represent a greater level of mandatory information disclosure and antifraud liability. The comparison between only offshore and private placement offerings may therefore understate the incentive of U.S. issuers to avoid the U.S. regime and bias the paper's results to-

[3] Rule 10b-5 provides liability for materially misleading statements and omissions where necessary to make any statements made not misleading in connection with the purchase or sale of securities, among other requirements. Rule 10b-5 states that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
> (1) to employ any device scheme, or artifice to defraud,
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
> in connection with the purchase or sale of any security.

Rule 10b-5, Exchange Act.

[4] See William Carney, Issuer Choice of Securities Regulation Regimes: Review and Comments (forthcoming Virginia Journal of International Law, 2001).

[5] As discussed below, the reduction of exposure to Rule 10b-5 is not due directly to the operation of Regulation S of the Securities Act. Rather, case law driven limitations on subject matter jurisdiction, choice of law provisions, and the difficulties of maintaining a class action involving foreign plaintiff-investors lower the likelihood of a Rule 10b-5 action stemming from an offshore offering.

ward finding no significant difference for issuers offering securities abroad. As discussed below, nevertheless, offshore offerings are closely matched with domestic private placements in terms of offering amount size as well as the total assets and market capitalization of the issuers.

The paper's data set consists of 1,444 offshore offerings and domestic private placements of equity securities and securities convertible into equity by Exchange Act reporting companies from 1993 to 1997.[6] Utilizing the data set, the paper uses two proxies for the importance of anti-fraud liability in an issuer's decision on where to raise capital. First, the paper reports that an issuer's past experience with private securities fraud litigation in the United States correlates with the decision to sell securities abroad. Issuers with private fraud action litigation experience may face a heightened probability of facing a subsequent action (Romano, 1991). Second, firms in standard industrial classification (SIC) groups that are targeted more frequently with securities fraud lawsuits are significantly more likely to issue securities offshore rather than to pursue a domestic private placement. Firms in SIC groups where plaintiffs' attorneys have made the sunk cost investment to learn about the industry may face an increased risk of private fraud litigation.

Despite evidence that avoidance of antifraud liability may factor into the decision of companies to raise capital abroad, the question remains whether choice in regulation is beneficial or harmful to investors. In particular, the paper tests whether companies seek to offer securities abroad to defraud foreign investors. U.S. issuers, as well, may employ foreign investors as conduits to sell overvalued securities into the United States, thereby harming U.S. investors.[7] In contrast, more benign motivations may drive U.S. issuers to sell securities abroad. U.S. issuers, for instance, may seek to sell abroad due to the cost of potential non-meritorious securities litigation associated with offerings in the United States. Alexander (1991) and Bohn and Choi (1996) provide evidence of frivolous securities litigation targeting issuers of initial public offerings. Even where suits are not frivolous, the cost of imposing liability may outweigh the benefits from deterring fraud. Arlen and Kraakman (1997), for example, contend that imposing strict liability on a firm for the actions of its managers may reduce the incentives of the firm to police for viola-

[6] The periodic filings include annual Form 10-K, quarterly Form 10-Q, and occasional Form 8-K. See Section 13(a), Exchange Act; Regulation 13A (providing rules on periodic disclosure requirements of Exchange Act registered companies), Exchange Act; Forms 10-K, 10-Q, 8-K, Exchange Act.

[7] See Choi (2000).

tions compared with a more negligence duty-based regime. The choice of an offshore offering over a domestic private placement, therefore, may increase the welfare of the issuer and investors by eliminating unnecessarily costly U.S. regulations consistent with the voluntary regulation hypothesis. Other issuers, in contrast, may actively seek to expose themselves to the U.S. antifraud regime to increase the credibility of their offering to investors, thereby obtaining a higher securities offering price, also consistent with the voluntary regulation hypothesis.

To determine whether the choice to reduce U.S. regulatory protections is beneficial to investors, the paper focuses on those issuers in the data sample that experienced a private securities fraud suit prior to the offering.[8] As one proxy of the risk that such issuers pose investors, the paper gathered data on the past SEC investigation history of the issuers. For each issuer that experienced pre-offering fraud litigation, SEC filings on Westlaw and Lexis and reports on PR-Newswire are searched from 10 years prior to the offering up to the start of the offering to determine whether the SEC initiated a fraud-related informal or formal investigation or enforcement-related action (collectively referred to as "SEC investigations").[9] To the extent the SEC brings only meritorious actions, issuers with a prior SEC investigation pose a higher risk to investors. Of the 86 offshore offerings conducted by an issuer with pre-offering private fraud litigation experience, 16.3% also involved an issuer that faced a SEC investigation prior to the offering. In comparison, of the 81 domestic private placements that involved an issuer with pre-offering private fraud litigation, 35.8% also had an issuer with prior SEC investigation experience (difference significant at the 1% level). To the extent a prior SEC investigation correlates with an increased risk of a fraudulent offering, offshore offerings posed a reduced risk of fraud compared with domestic private placements.

Similarly, plaintiffs fared worse on the merits against offshore offering issuers in pre-offering private fraud litigation than plaintiffs in litigation targeting domestic private placement issuers. Of the offshore offering issuers with private fraud litigation experience, 25.8% obtained a dismissal or pro-defendant judgment. In comparison, of the domestic private placements in-

[8] Issuers with pre-offering fraud action experience are defined as those issuers that faced a private securities fraud-related action anywhere from 10 years prior to the offering up to the start of the offering.

[9] Both SEC investigations related to and unrelated to the prior private securities litigation are tracked as a signal to investors that the issuer may pose a heightened risk of fraud.

volving an issuer with private fraud litigation experience, only 12.3% obtained a dismissal or pro-defendant judgment in its favor (difference significant at the 10% level). Evidence therefore exists that offshore offerings may provide a means for issuers that find U.S. antifraud liability to be non-value-maximizing to avoid such liability while still raising capital. Similarly, evidence exists that issuers presenting a heightened risk of fraud for investors benefit from exposure to the U.S. regime as a means of bonding the truthfulness of their disclosures and signaling their value to investors. The paper's evidence is consistent with the hypothesis that issuers sort themselves according to the regime that best maximizes the value of their offering to investors.

The paper also examines the discount at which offshore offerings and domestic private placements of common stock are sold to investors relative to the secondary market price at the start of the offering. To the extent issuers use the U.S. regime to bond the issuers' credibility, offshore offerings should receive a greater discount compared with domestic private placements. The paper presents evidence that the mean offering discount from the secondary market price at the start date of the offering is 29.4% for the paper's sample of common stock offshore offerings and 17.4% for domestic private placements of common stock. Several disparate factors, nevertheless, may affect the discount. Investors, for example, may possess more information on issuers with a large market capitalization and a correspondingly large analyst following. To control for such differences, the paper estimates an ordinary least square model of the offering discount for solely the offshore offerings. Predicted offshore discounts are then obtained using the model for the domestic private placement offerings to determine the discount that the offerings would have received had they been conducted offshore. The mean predicted offshore discount is 6.3 percentage points greater than the actual discount for the domestic private placements. For domestic private placement issuers with both prior private fraud litigation and SEC investigation experience, the mean predicted offshore discount is 21.2 percentage points greater than the actual discount.

Section 1 provides a summary of the relevant securities laws pertaining to offshore offerings and domestic private placements. Section 2 offers a description of the paper's data set. Section 3 examines the factors that determine whether a U.S. issuer chooses to sell securities abroad

or through a domestic private placement. Section 4 analyzes whether issuers that avoid U.S. securities regulation through an offshore offering do so as a means to increase investor welfare by reducing exposure to non-value maximizing aspects of the U.S. securities regime or, in the alternative, to engage in fraud to the detriment of investor welfare.

1. Regulation of Non-Public Offerings

The U.S. securities regulatory regime seeks to protect investors and to safeguard the integrity of capital markets through mandatory information disclosure and antifraud liability, among other measures. Issuers seeking to raise capital through a public offering in the United States must comply with complex rules that both restrict the amount of information issuers may disclose prior to the offering and require the mandatory disclosure of information in a formal registration statement filed with the SEC and distributed in part to investors.[10] Issuers and other parties connected with the offering also face heightened antifraud liability under Sections 11 and 12(2) of the Securities Act of 1933 (Securities Act).[11] Issuers, in turn, may avoid many of the securities regulations governing public offerings through either an offshore offering or a domestic private placement (collectively referred to as "non-public offerings").

Offshore offerings avoid the public offering registration requirements through the operation of Regulation S of the Securities Act.[12] Regulation S represents a policy choice to respect territorial boundaries:[13] where securities transactions takes place within the United States, the

[10] For instance, a public offering requires the filing of a registration statement with the SEC and the delivery of a prospectus to each offeree. Section 5 of the Securities Act controls the public offering process. See Section 5, Securities Act. See generally James D. Cox, Robert W. Hillman, Donald C. Langevoort, Securities Regulation: Cases and Materials 276 – 308 (2d. ed, 1997) (describing the public offering process under U.S. securities laws).

[11] See Sections 11 and 12(a)(2) of the Securities Act and Rule 10b-5 of the Exchange Act.

[12] Regulation S is contained in Rules 901 through 905 of the Securities Act. See Rules 901-905, Securities Act.

[13] See SEC, Offshore Offers and Sales, Securities Act Release No. 33-6779, 1988 WL 239804, *9 (S. E. C.) [hereinafter, the 1988 Proposing Release] ("The Regulation proposed today is based on a territorial approach to section 5 of the Securities Act. Under such an approach, the registration of securities is intended to protect the U.S. capital markets and all investors purchasing in the U.S. market, whether U.S. or foreign nationals.").

The SEC adopted Regulation S in 1990. See SEC, Offshore Offers and Sales, Securities Act Release No. 33-6863, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,534 (Apr. 24, 1990) [hereinafter the "Adopting Release"]. See also Guy P. Lander, Regulation S – Securities Offerings Outside the United States, 21 N.C. J. Int'l L. & Com. Reg. 339 (1996) (providing a summary of the original Regulation S).

U.S. securities regime applies.[14] Conversely, where transactions occur wholly outside the United States then the securities regulatory regimes of other countries are assumed to apply and the offering is exempt from the registration requirements under the Securities Act. To ensure that only offerings outside the United States receive an exemption from the registration requirements of the Securities Act, Regulation S imposes a number of transaction-related restrictions.[15] Issuers, for example, may not register any transfers of their securities unless made through a registered offering, an exemption from registration, or under the terms of Regulation S.[16] Restrictions are also placed on the ability of foreign purchasers to resell into the United States. For the time period of the paper's data set, foreign investors faced a 40-day restricted period during which resales into the United States are prohibited.[17]

In contrast, the requirements for a domestic private placement do not focus on territorial boundaries. Instead, the availability of a private placement is contingent upon the investment sophistication of the purchasers and the dollar amount of the offering, among other factors. Offerings made to investors able to "fend for themselves" for example may receive an exemption under Section 4(2) of the Securities Act from the public registration requirements.[18] Providing a safe harbor for Section 4(2), among other provisions, Regulation D of the Securities Act imposes bright-line limitations on the number and types of investors as well as the offering amount permissible in a private placement.[19] Issuers seeking to engage in a private placement through the

[14] Regulation S also prohibits U.S. issuers from engaging directed selling efforts within the United States. See Rule 902(c), Securities Act (defining "directed selling efforts").

[15] The transactional restrictions under the current version of Regulation S for U.S. issuers of equity last for a one-year "distribution compliance period". See Rule 903(b)(3), Securities Act.

[16] See Rule 903(b)(3)(iii)(4), Securities Act. Issuers are also required to place a legend on issued securities indicating that the securities were sold through Regulation S and are unregistered. See Rule 903(b)(3)(iii)(3), Securities Act.

[17] The current version of Regulation S makes it clear that securities purchased under Regulation S are considered "restricted". See Rule 905, Securities Act. Initial investors of a Regulation S offering, in turn, may not resell restricted securities back into the United States without complying with either the public offering registration requirements of the Securities Act or an exemption from the registration requirements. For example, Rule 144 of the Securities Act provides an exemption for investors that have held their securities for at least one year, among other requirements. See Rule 144, Securities Act.

[18] See, e.g., SEC v. Ralston-Purina, 346 U.S. 119, 125 (1953) (holding that a non-public offering for purposes of Section 4(2) of the Securities Act is "an offering to those who are shown to be able to fend for themselves"). See also James D. Cox et al., Securities Regulation: Cases & Materials 378 – 90 (2d ed. 1997) (describing a Fifth Circuit line of cases expanding on *Ralston Purina*).

[19] Regulation D also implements private placements under Section 3(b) of the Securities Act. See Section 3(b), Securities Act.

safe harbor under Rule 506 of Regulation D, for example, may sell an unlimited amount of securities to any number of accredited investors and a maximum of 35 non-accredited purchasers, among other requirements.[20] As with offshore offerings under Regulation S, purchasers in a private placement bear restrictions on their ability to resell freely into the U.S. public secondary market. During the time period of the data sample, most private placement investors faced a 2-year holding period.[21]

Significantly, for Exchange Act reporting companies, the relief provided through either an offshore offering or a domestic private placement is limited. Regardless of whether a company engages in a securities offering, Exchange Act reporting companies must comply with periodic filing requirements.[22] Companies, for instance, must routinely disclose financial and business-related information to the capital markets through Form 10-K, 10-Q, and 8-K filings with the SEC. In addition, Rule 10b-5 antifraud liability applies to the information contained in such periodic filings, exposing the companies to the possibility of private civil litigation.[23]

For the purposes of this paper's empirical tests, nevertheless, it is important to note that Exchange Act reporting companies may relieve themselves of significant regulatory requirements through an offshore offering compared with a domestic private placement. First, issuers that conduct a domestic private placement may need to provide certain limited information to purchasers of the offering. For example, issuers that seek to offer and sell securities under the

[20] See Rule 506(b)(2), Securities Act. Rule 501(a), in turn, defines an accredited investor to include many institutional investors, top management of the issuer, and individual investors that meet minimum wealth and income criteria. See Rule 501(a), Securities Act. The limit on the number of purchasers under Rule 506 of Regulation D does not apply to accredited investors. See 501(e), Securities Act. Private placement issuers therefore may sell to an unlimited number of accredited investors.

[21] In early 1997, the SEC promulgated new rules reducing the holding period under Rule 144 for resales of restricted securities to one year. See SEC, Revision of Holding Period Requirements in Rules 144 and 145, Rel. Release No. 33-7390, 17 CFR Part 230 (Feb. 20, 1997).

[22] The Exchange Act imposes periodic information reporting requirements for certain issuers, commonly known as "Exchange Act reporting companies". Companies listed on a national securities exchange must register and comply with the SEC's periodic information disclosure requirements. See Section 13(a), Exchange Act; Section 12(b), Exchange Act; see also Section 3(a)(1), Exchange Act (defining "exchange" for the purposes of the Exchange Act). As well, companies whose total assets exceed $10 million and have a class of equity security (other than an exempted security) held of record by more than 500 shareholders must register the securities under the Exchange Act and thereby come under the periodic reporting requirements of Section 13(a). See Section 13, Exchange Act; Section 12(g), Exchange Act; see also Rule 12g-1 (raising the asset requirement to $10 million).

[23] Rule 10b-5 itself does not explicitly provide for a private cause of action. Nevertheless, courts have long interpreted Rule 10b-5 to provide private litigants the ability to obtain damages. See, e.g., Blue Chip Stamples v. Manor Drug Stores, 421 U.S. 723, 753 – 55 (1975) (limiting the implied cause of action under Rule 10b-5 to actual purchasers or sellers of securities involved in the transaction in question).

Regulation D private placement safe harbor to non-accredited investors must provide information pursuant to Rule 502(b) of the Securities Act, including updated financial statements and information related to the securities transaction.[24] In comparison, issuers that offer securities through an offshore offering under Regulation S are not required to provide investors any information under U.S. securities laws. Instead, the securities laws of the jurisdiction in which the offshore offering takes place may impose varying information disclosure requirements.

Second, issuers in domestic private placements and offshore offerings face differential exposure to antifraud liability. Issuers that conduct a domestic private placement always face the possibility of Rule 10b-5 liability for materially misleading statements. In contrast, federal courts within the United States apply varying standards for when to grant subject matter jurisdiction for Rule 10b-5 violations that occur as part of an offering outside the United States. Some courts, for example, focus on whether "conduct" related to the fraud occurred within the United States.[25] Among such courts, the definition of conduct varies. Several courts require only preparatory conduct while others require significant conduct greater than merely preparatory.[26] Yet other courts focus on whether the fraud in the offering has "effects" within the United States.[27]

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[24] See Rule 502(b), Securities Act. Note that when securities are sold under Regulation D to only accredited investors, Regulation D imposes no specific information disclosure requirements. See Rule 502(b)(2), Securities Act. As well, offerings pursuant to Rule 504 under Regulation D need not comply with the information disclosure requirements of Rule 502(b). See Rule 504(b), Securities Act. Nevertheless, Exchange Act reporting companies are prohibited from relying on Rule 504 private placements. See Rule 504(a)(1), Securities Act.

[25] For a discussion of the current extraterritorial reach of American antifraud securities liability, see Stephen J. Choi & Andrew T. Guzman, The Dangerous Extraterritoriality of American Securities Laws, 17 Nw. J. of Int'l Law & Bus. 207, 215 - 219 (1996).

[26] See Bersch v. Drexel Firestone Inc., 519 F.2d 974, 993 (2d Cir. 1975) (stating that "merely preparatory acts" are insufficient to establish jurisdiction and requiring that acts within the United States directly caused the losses to foreigners outside the United States); Zoelsch v. Arthur Anderson, 824 F.2d 27, 33 – 34 (D.C. Cir. 1987) (interpreting the Second Circuit's test to mean that jurisdiction will lie in American courts where the domestic conduct satisfies the requisite elements for liability under Section 10 of the Exchange Act or Rule 10b-5). But see SEC v. Kasser, 548 F.2d 109, 114 (3d Cir. 1977) (granting jurisdiction "where at least some activity designed to further a fraudulent scheme occurs within this country"), cert. denied, 431 U.S. 938 (1977).

[27] The mere fact that United States securities markets may experience an indirect effect has not been held as sufficient to generate subject matter jurisdiction. See Bersch, 519 F.2d at 989.

In Schoenbaum v. Firstbrook, 405 F.2d 200, 208 (2d Cir. 1988), cert. denied, 395 U.S. 906 (1969), the Second Circuit found subject matter jurisdiction over a derivative suit involving a Canadian corporation and Canadian and U.S. defendants (including some of the corporation's directors). The derivative suit alleged that the Canadian and U.S. defendants defrauded the corporation through the purchase of the corporation's securities at a bargain price. In finding subject matter jurisdiction, the Second Circuit emphasized the need to apply jurisdiction extraterritorially "in order to protect domestic investors who have purchased foreign securities on American Exchanges" and "to protect the domestic securities market from the effects of improper foreign transactions in American securities." Id. Sales of heavily discount securities to insiders, for example, may harm all shareholders in the firm through dilution of the per share value.

Offerings made solely to foreign investors outside the United States where information disclosed to the foreign investors is not released into the U.S., for example, would present only a minimal amount of effects within the United States.[28] Although somewhat uncertain, the application of the conduct and effects tests for offshore offering results in a reduced probability of a court applying subject matter jurisdiction for antifraud liability. In addition, some courts have eschewed applying antifraud liability where the investors of an offshore offering can be shown to have clearly sought to avoid the U.S. securities laws through the offshore offering.[29]

Even where subject matter jurisdiction exists, courts allow parties ex ante to provide contractually for choice of law and forum-selection clauses that limit the application of U.S. antifraud liability. Lloyd's of London, for example, was sued under U.S. securities laws by several of its "Names" based in the United States. Lloyd's of London's contractual arrangement with its Names, however, provided for British choice of law and British forum-selection clauses. Courts in several U.S. federal circuits have upheld Lloyd's forum-selection and choice of law clauses.[30] Although the Lloyd's of London line of cases involved a foreign company-defendant and U.S. investor-plaintiffs, the rationale of the decisions – focusing on the international nature of the

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Unlike the *Schoenbaum* case, sales of securities to solely foreign investors through Regulation S in situations where the foreign investors bear the economic risk of ownership and are defrauded present no direct harm to U.S. investors. In fact, U.S. shareholders in the issuer are benefited from sales of overvalued securities to foreign investors. For example, consider Ajax, a U.S. issuer with a fundamental value of $100 per share and 100,000 shares outstanding. Assume that Ajax then defrauds foreign investors, selling 100,000 additional shares at an overvalued price of $200 per share. Post-offering, Ajax's shares will then have a fundamental value of $150 per share. Although foreign investors are harmed, U.S. shareholders are in fact benefited from the fraud.

[28] On the other hand, some courts have emphasized the U.S. identity of the issuer as an important factor in addition to the conduct and effects tests. For example, in Int'l Inv. Trust v. Cornfeld, 619 F.2d 909 (2d. Cir. 1980), Judge Friendly writing for the Second Circuit found subject matter jurisdiction for offshore transaction involving a wholly-owned foreign subsidiary of an American corporation. In finding subject matter jurisdiction, Judge Friendly wrote, "[w]e think Congress would have been considerably more interested in assuring against the fraudulent issuance of securities constituting obligations of American rather than purely foreign businesses." Id. at 920. On the other hand, in *Zoelsch*, Judge Bork writing for the D.C. Circuit declined to find subject matter jurisdiction for an offshore offering that in substance raised funds for a U.S.-based investment partnership. See Zoelsch, 824 F.2d 27, 34.

[29] In MCG, Inc. v. Great Western Energy Corp., 896 F.2d 170 (5th Cir. 1990), the court held that an American investor that sought to structure a transaction through a shell entity to appear "foreign" to satisfy the requirements for an offshore offering could not then seek to have Rule 10b-5 antifraud liability applied against the U.S.-incorporated issuer. See id. at 8 ("Having gone to such lengths to structure a transaction not burdened by the securities law, plaintiffs cannot expect to wrap themselves in their protective mantle when the deal sours.").

[30] See generally Alan R. Palmiter, Toward Disclosure Choice in Securities Offerings, 1999 Colum. Bus. L. Rev. 1, 78 – 81 (describing the Lloyd's of London cases).

choice of law and forum selection clauses – apply to transactions involving a U.S. issuer and foreign investors.[31]

Private plaintiff attorneys within the United States may also choose systematically not to pursue a class action where a significant fraction of the class consists of foreign investors.[32] Courts, for example, may hesitate to certify a class action including foreign plaintiffs to the extent notice to the foreign plaintiffs is difficult.[33] The possibility that foreign courts may not recognize the judgment of a U.S.-based court may lead U.S. courts to deny class certification with respect to foreign plaintiffs.[34] Foreign investors also represent unique distributional issues for plaintiffs' attorneys engaging in a class action; plaintiffs' attorneys, for example, may have more difficulty locating, providing notice to, and distributing settlement awards to foreign investors. Outside of a class action, foreign investors individually pursuing a U.S. antifraud claim may also face higher transportation and language translation costs.

The lower likelihood of private antifraud litigation from foreign-based investors compared with U.S.-based investors, in turn, reduces the issuer's exposure to antifraud litigation for two types of disclosure. First, issuers engaged in confidential information disclosure to potential

[31] The Lloyd's of London cases cite The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972), where the Supreme Court stated that courts should presumptively enforce choice of law and choice of forum clauses arising out of "freely negotiated private international agreement[s]." Id. at 12-13, 92 S.Ct. at 1914. The Supreme Court in *Bremen* reasoned that "[t]he elimination of all [ ] uncertainties [regarding the forum] by agreeing in advance ... is an indispensable element in international trade, commerce, and contracting." Id. at 13-14, 92 S.Ct. at 1915. Moreover, the Supreme Court in *Bremen* made clear that the party seeking to void a forum selection clause faces "a heavy burden of proof." Id. at 17, 92 S.Ct. at 1917.

Applying *Bremen*, for example, in Haynsworth v. The Corporation, 121 F.3d 956 (5th Cir. 1997), the Fifth Circuit stated that "[p]ublic policy weighs strongly in favor of Bremen, because uncertainty as to the forum for disputes and applicable law 'will almost inevitably exist with respect to any contract touching two or more countries.'" Id. at 962 (citing Scherk v. Alberto-Culver Co., 417 U.S. 506, 94 S.Ct. 2449, 2455, 41 L.Ed.2d 270, 516 (1974)). Key to the presumption of enforceability, therefore, is not the precise identity of the issuer or investors but rather that their identities cut across international boundaries.

[32] In Kaufman v. Campeau Corporation, 744 F. Supp. 808 (S.D. Ohio 1991), the federal district court ordered that Canadian shareholders who bought their stock on Canadian exchanges be excluded from a class action involving U.S. investors against Campeau Corporation, a Canadian corporation with U.S. subsidiaries trading on the National Market System.

[33] See Bersch v. Drexel Firestone Inc., 519 F.2d 974, 993 – 98 & n.47 (2d Cir. 1975). The Second Circuit in *Bersch* noted that "The management of a class action with many thousands of class members imposes tremendous burdens on overtaxed district courts, even when the class members are mostly in the United States and still more so when they are abroad." See id. at 996.

[34] See id. at 996 – 97.

investors in an offering may avoid Rule 10b-5 liability for the confidential disclosures.[35] Second, issuers may reduce their exposure to Rule 10b-5 liability for periodic disclosures distributed to the entire secondary market. For example, an issuer that conducts a private placement for U.S. investors potentially exposes itself to antifraud liability not only to investors that engage in secondary market transactions in the issuer's securities but also to the private placement investors for material misstatements and certain omissions in their recent Exchange Act reporting filings. The same issuer that conducts an offshore offering to foreign investors continues to face the risk of liability from U.S. investors engaging in secondary market transactions; higher costs of pursuing litigation, however, may remove foreign investors in the issuer's offering as possible plaintiffs for misleading statements in the issuer's periodic disclosures. Particularly for issuers that offer a large amount of securities relative to their average trading volume, an offshore offering may therefore offer significant relief from Rule 10b-5 liability.

One final difference exists between domestic private placements and offshore offerings. Offerings that take place within the United States face the possibility of a SEC enforcement action against either the issuer or various securities professionals that assist in the offering. Offshore offerings, in contrast, face a much-mitigated risk of possible SEC enforcement to protect the interests of defrauded foreign investors. The SEC's market surveillance activities focus primarily on U.S. markets, leading to a reduced probability of uncovering fraudulent activity overseas. The SEC also faces greater information gathering costs when fraud occurs overseas, particularly in relation to foreign intermediaries that may assist in the offshore offering. As with private antifraud actions, the SEC also must convince a court that it has subject matter jurisdiction over fraud occurring abroad. Finally, the SEC's stated enforcement priorities during the 1990s focused on the municipal bond market, mutual funds and investment advisors, the internet, insider trading, financial fraud, and securities offerings, among other areas.[36] The SEC did not, however, make the protection of foreign investors purchasing in an offshore offering a stated

[35] The SEC recently reduced the ability of issuers to engage in selective disclosures to prospective private placement investors. See Securities and Exchange Commission, Selective Disclosure and Insider Trading, Rel. No. 34-43154, Aug. 15, 2000, 2000 WL 1239722 (S.E.C.).

[36] See William R. McLucas, Thomas C. Newkirk, Joan E. McKown, Alma M. Angotti, Nancy E. Allin, 29th Annual Institute on Securities Regulation: Recent SEC Enforcement Cases, 1023 PLI/Corp 625.

priority.[37] Issuers that seek to bond themselves using U.S. antifraud liability, therefore, may seek to issue inside the United States to expose themselves to a potential SEC enforcement action.

To verify the claim that SEC enforcement is skewed toward policing harms that may directly affect U.S. investors through a private placement in comparison with harms affecting only foreign investors in an offshore offering, the paper tabulated the number of reported SEC enforcement-related actions involving antifraud liability and either a private placement or an offshore offering. Data on reported enforcement activity is obtained from CCH's Federal Securities Law Reporter for the time period from 1991 to 1999. Among the reported SEC actions, 34 related to a domestic private placement and only 5 related to an offshore offering. Moreover, among the 5 offshore offering-related actions, 1 also involved a domestic private placement and 3 involved the immediate flowback of securities into the United States where the true economic risk of ownership remained with U.S. investors. Only 1 of the offshore related actions involved foreign investors that obtained economic ownership of issued securities; moreover, the foreign investors were shell corporations formed as part of a scheme for insiders of the U.S. issuer to sell heavily discounted securities to offshore entities in which the insiders owned a controlling interest.[38] None of the offshore offering-related SEC enforcement actions directly related to the protection of foreign investors.

Table 1 summarizes U.S. disclosure and antifraud liability differences for public offerings, domestic private placements, and offshore offerings.

[Insert Table 1 Here].

[37] In the mid-1990s, the SEC did focus on the flowback of securities sold abroad back into the United States in situations where the economic risk of ownership never left the United States. See SEC, Problematic Practices Under Regulation S, Securities Act Release No. 33-7190, 1 Fed. Sec. L. Rep. (CCH) ¶ 3059C (June 27, 1995) [hereinafter, Problematic Practices Release] (describing a number of harms to U.S. investors from Regulation S offerings). Nevertheless, the SEC's focus on offshore offerings was primarily to protect U.S. investors and not the initial foreign purchasers of the offshore offering.

[38] See In the Matter of Windswept Environmental Group, Inc., Release Nos. 33-7780; 34-42165; Administrative Proceeding File No. 3- 10107 (November 22, 1999).

2. Sample Description and Summary Statistics

The data set consists of offshore offerings and domestic private placements conducted by Exchange Act reporting U.S. issuers from January 1, 1993 to December 31, 1997. Offerings of four different types of equity and securities convertible into equity are tracked, including: (1) common stock, (2) non-convertible preferred stock, (3) convertible preferred stock, and (4) convertible debt securities.

Offshore offerings are identified through searches of SEC filings on Lexis and Westlaw as well as the SEC's EDGAR database.[39] Prior to November 1996, the SEC did not specifically require issuers to disclose their offshore offerings. Issuers, as a result, disclosed information on offshore offerings in one of their SEC filings or financial statements only to the extent the offerings were "material" to the understanding of some other required information disclosure item.[40] For example, some issuers disclosed information on their offshore offerings in their required discussion on capital resources under Item 303 of Regulation S-K.[41] Then from November 1996 until December 1998, the SEC required issuers to reveal all equity-related offshore offerings under Item 9 of Form 8-K within 15 days of the offering.[42] Offshore offerings prior to November 1996 therefore comprise only a subset of the entire universe of offshore offerings. This subset, moreover, may be biased toward offerings where the issuer believed that disclosure of the offering outweighed any negative effects from disclosure. Nevertheless, due to the materiality requirement for SEC filings, the search uncovered the majority of larger size offerings.

Information on U.S. firms conducting a domestic private placement from January 1, 1993 to December 31, 1997, in turn, was obtained from the Securities Data Company Private Placement Database. Searches on Lexis, Westlaw and the SEC's internet version of the EDGAR database were conducted to identify additional domestic private placements of equity and securities

[39] The SEC's EDGAR database is located on the internet at http://www.sec.gov/edgarhp.htm.

[40] See Rule 408, Securities Act.

[41] Issuers may also voluntarily disclose their offshore offerings under Item 5 of Form 8-K to the extent the offering was "important". See Item 5 of Form 8-K, Exchange Act.

[42] See Item 9 of Form 8-K, Exchange Act. See SEC Release No. 34-37801 (1996). Item 9 of Form 8-K requires issuers of equity Regulation S securities to report the information mandated under Item 702 of Regulation S-B, including the offering date, the amount of securities, the total offering price, and the principal underwriters among other information.

convertible into equity. Offerings by issuers that also engaged in an offshore offering during the sample period were then eliminated, leaving 751 equity-related domestic private placements.

Summary statistics of the offshore offerings and private placements by year and type of offered securities are presented in Panels A and B of Table 2.

[Insert Table 2 Here]

Note that the majority of offerings are for common stock. From Panel C of Table 2 also note that little difference exists in the propensity of a firm to engage in a domestic private placement compared with an offshore offering for common stock offerings. Nevertheless, a greater proportion of the convertible preferred offerings occur within the United States while a greater fraction of the convertible debt offerings occur offshore (test of the null hypothesis that the domestic private placement and offshore offering distributions among different types of securities are identical: $\div^2 = 98.141$; prob. < 0.005).

Common stock offerings tend to be for a smaller offering amount, with a mean of $12.5 million. As Panel D of Table 2 reports, companies that trade on NASDAQ tend to engage in a greater proportion of the non-public offerings than those traded on the New York Stock Exchange (NYSE). On the other hand, issuers listed on the NYSE offer a much larger dollar amount of securities with an average offering amount of $140.4 million.

The SIC code groups of the non-public offering issuers are also tracked. Panel E of Table 2 details the 2-digit SIC codes of the non-public offering issuers. From Panel E of Table 2 note that 12.33% of the offerings are clustered in SIC 28 (Chemicals and Allied Products) and 11.61% are in SIC Code 73 (Business Services). Also note that SIC codes 35 (Industrial and Commercial Machinery and Computer Equipment) and 36 (Electrical Equipment and Components) in combination account for 15.35% of the offerings. The differences among the various 2-digit SIC code groups are statistically significant at the 0.5% level ($\div^2 = 3364.5$; prob. < 0.005).

Panel F of Table 2 reports on the five 3-digit SIC codes with the greatest frequency of offerings. Note that 153 offerings are made by issuers in SIC code 283 (Drugs) representing

11.0% of the non-public offerings. In addition, the computer-related SIC codes 357 and 737 in combination account for 187 offerings, representing 13.5% of the non-public offerings.

3. Test of the Decision to Issue Securities Abroad

This section tests the hypothesis that issuers choose to raise capital through an offshore offering at least in part to escape the U.S. regulatory regime. Compared with a public offering of securities, private placements under U.S. securities law present issuers with less stringent disclosure and antifraud requirements. A domestic private placement therefore represents the next closest alternative to an offshore offering for an issuer to raise capital while still remaining within both the U.S. regime and the domestic capital markets. The gain from exiting the U.S. regime to an issuer is therefore measured through a comparison of offshore offering issuers against issuers engaging in a domestic private placement.

The comparison between offshore offerings and domestic private placements, nevertheless, may introduce bias into the paper's test results. Investors in domestic private placements, for example, typically are able to "fend for themselves". Where offshore foreign investors are systematically less sophisticated, the comparison may not correctly measure the impact of regulatory differences on the decision to issue securities abroad. An issuer, for example, that seeks to sell to a broad range of unsophisticated investors faces a choice only between an offshore offering and U.S. public offering. To the extent a U.S. public offering offers a greater level of regulatory protections, the comparison between only offshore and private placement offerings understates the incentive of U.S. issuers to avoid the U.S. regime and biases the paper's results toward finding no significant difference for issuers offering securities abroad.

In addition, the comparison between domestic private placements and offshore offerings may result in a biased assessment of the importance of fraud-related factors to the extent the initial decision to raise a specific amount of capital also depends on the same fraud-related factors. Nevertheless, the paper assumes that the decision to raise a particular dollar amount of capital is independent of the decision on the particular method used to raise the capital. Modigliani and Miller (1959) provide one justification for this assumption. To the extent firm value does not

depend on a firm's capital structure, the need to raise capital will turn solely on the presence of investment projects within the firm that require funding and not on the different possible means of raising capital.

Table 3 presents a comparison of characteristics of issuers engaged in offshore offerings and domestic private placements.

[Insert Table 3 Here].

Note from Panel A that the characteristics of the offshore offering and domestic private placements are comparable. The mean offering amount for offshore offerings is $36.4 million and $29.2 million for domestic private placements (difference not statistically significant).[43] Likewise, the total asset size and market capitalization for both offshore offering and domestic private placement issuers are similar and indicate that mostly small capitalization companies engage in such offerings. The mean assets for offshore offering issuers is $577.4 million and $876.8 million for domestic private placements issuers (difference not statistically significant). The mean market capitalization (measured for the year prior to the offering) is $355.1 million for offshore offering issuers and $320.7 million for domestic private placement issuers (difference not statistically significant). On the other hand, the median offering amount, market capitalization, and assets for the offshore offering issuers are all lower than the median levels for the domestic private placement issuers. The difference in medians, as assessed using the Wilcoxon rank-sum (Mann-Whitney) test, is significant at the 1% level for all three comparisons. Figures 1, 2, and 3 provide a graph of the offering amount, market capitalization, and asset size distributions of the domestic private placement and offshore offering issuers. If anything, therefore, the summary statistics present evidence that offshore offerings are smaller in size than the domestic private placements. To the extent more sophisticated investors tend to invest in smaller offerings (as compared with large public offerings), the summary statistics provide evidence against the

[43] To the extent the data sample is comprehensive for the total population of domestic private placements and offshore offerings from 1993 to 1997, the t-test of the difference in sample means may not be appropriate.

possibility that public offerings, and not private placements, represent the next closest alternative to offshore offerings.

On the other hand, the offshore offering issuers display significant corporate governance differences. As tracked through SEC Disclosure and reported in Panel A of Table 3, offshore offering issuers have a greater fraction of corporate officers on their board (significant at the 5% level) and a lower fraction of their outstanding common stock in the hands of directors and officers (significant at the 5% level).[44] Offshore offering issuers also have a lower fraction of their outstanding common stock in the hands of institutional investors as tracked by CDA/Spectrum (significant at the 5% level). A greater fraction of offshore offerings are also made with registration rights for the investors; the difference with private placement offerings however is statistically insignificant.

To gauge the significance of the U.S. regulatory regime on the issuer's choice between conducting an offshore or domestic private placement offering, the experience of each issuer as a defendant in private securities fraud litigation within the United States is tracked. Prior history with a securities fraud lawsuit may translate into a higher probability of private litigation with respect to a subsequent offering. Plaintiffs' attorneys, for example, may have already expended resources learning about the company, reducing the marginal cost of pursuing a subsequent lawsuit. A company that faced a prior meritorious action, as well, may contain structural factors – such as a management team willing to engage in fraud – that makes subsequent fraud more likely. Plaintiffs' attorneys may therefore monitor more closely the actions of a company that previously had a meritorious lawsuit filed against it. Similarly, a company that settled a prior frivolous lawsuit may be perceived as an easy target among plaintiffs' attorneys seeking to extort a settlement. In a study of shareholder suits brought against a random sample of 535 public corporations, Romano (1991) finds that past experience with shareholder litigation – particularly where the litigation results in a large settlement award – correlates significantly with an in-

[44] Share ownership is obtained from the reported "beneficial ownership" contained in the company's SEC proxy filing. Rule 13d-3 of the Exchange Act (17 C.F.R. § 240.13d-3) defines a beneficial owner to include "any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares" voting power or investment power in a security. A person who has the right to acquire beneficial ownership of a security within sixty days through the exercise of any option or warrant is also considered a beneficial owner or the security.

creased probability of a subsequent shareholder suit. To the extent issuers with experience as a defendant in a private securities fraud lawsuit expect a higher subsequent probability of litigation, they will view the U.S. securities regime as imposing a greater cost than compared with other issuers.

The paper identifies private securities fraud litigation experience for each non-public offering issuer through searches of Exchange Act reporting filings on Westlaw and Lexis and press releases through PR-Newswire. In addition, data on private securities fraud lawsuits are obtained from Stanford Law School's Securities Class Action Clearinghouse.[45] Prior fraud actions, involving securities offerings, periodic information disclosure, and acquisitions among others, are tracked from 10 years before the offering up to the start of the offering.

Panel B of Table 3 reports the private fraud litigation experience of the offshore offering and private placement issuers. From Panel B, note that offshore offering issuers in the data sample had greater experience with securities fraud actions in the United States than did domestic private placement issuers. Panel B of Table 3 reports that 86 offerings representing 12.5% of the total offshore offerings involved an issuer with pre-offering securities fraud litigation experience. In comparison, 81 private placements involved issuers with pre-offering fraud litigation experience, representing 10.8% of the total domestic private placements. The difference, however, is statistically insignificant.

To the extent fear of antifraud liability drives companies to issue securities offshore, one would expect this motivation to apply particularly to larger offering amounts. Conducting an offering offshore involves higher fixed costs than an offering inside the United States.[46] Where an issuer is engaged in only a small offering, the reduced exposure to antifraud liability may not exceed the fixed costs of engaging in an offshore offering. Panel C of Table 3 reports the pre-offering private fraud litigation experience of the non-public offerings categorized by the offering amount size quartile for the sample.[47] Note that for the smallest offering amount quartile,

[45] The Securities Class Action Clearinghouse is located on the internet at http://securities.stanford.edu.

[46] An offshore issuer, for example, faces language translation costs as well as the need to hire foreign counsel among other costs.

[47] The Offer Amount 1st Quartile is defined to include offerings where the offer amount is less than 1.5 million dollars. The Offer Amount 2nd Quartile is defined to include offerings where the offer amount is greater than or equal to 1.5 million dollars and less than 5 million dollars. The Offer Amount 3rd Quartile is defined to in-

defined to include offerings of less than 1.5 million dollars, domestic private placement offerings involve issuers with a higher incidence of past private fraud litigation compared with offshore offerings (significant at the 10% level). At the third and fourth largest offering amount quartiles, in contrast, offshore offerings involve issuers with a higher incidence of past private fraud litigation (significant at the 5% level). Evidence at a summary statistic level exists, therefore, that fear of U.S. antifraud liability may factor into the decision to issue securities abroad for larger offering amounts where issuers benefit the most from avoiding liability.

As an alternative specification, Panel D of Table 3 reports the pre-offering private fraud litigation experience of the non-public offerings categorized by the offering amount to market capitalization ratio quartile for the sample.[48] From Panel D note that the comparison between domestic private placements and offshore offerings with respect to pre-offering private fraud litigation incidence is qualitatively the same as for Panel C. At higher offering amount to market capitalization ratio quartiles, offshore offerings involve issuers with a higher incidence of past private fraud litigation. Nevertheless, the difference is significant at the 5% level only for the third largest quartile.

Issuers in particular SIC code groupings with a high frequency of securities fraud litigation may also seek to sell abroad to reduce their exposure to liability. Plaintiffs' attorneys may focus on particular industry groupings due to the high fixed costs of learning about a particular industry. Bohn and Choi (1996) found that certain 2-digit SIC code groups experienced a disproportionate number of securities fraud class actions following an initial public offering. The three 2-digit SIC code groupings Bohn and Choi (1996) reported to contain the highest frequency of securities fraud class actions – SIC 35 (Industrial Machinery and Equipment), SIC 36 (Elec-

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clude offerings where the offer amount is greater than or equal to 5 million dollars and less than 17.5 million dollars. The Offer Amount 4th Quartile is defined to include offerings where the offer amount is greater than 17.5 million dollars. The four quartiles are based on the distribution of offering amounts for the entire sample of offshore offerings and domestic private placements.

[48] The Offer Amount/Market Capitalization 1st Quartile is defined to include offerings where the offer amount to market capitalization ratio is less than 0.050. The Offer Amount/Market Capitalization 2nd Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than or equal to 0.050 and less than 0.112. The Offer Amount/Market Capitalization 3rd Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than or equal to 0.112 and less than 0.223. The Offer Amount/Market Capitalization 4th Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than 0.223. The four quartiles are based on the distribution of offering amount to market capitalization ratios for the entire sample of offshore offerings and domestic private placements.

tronic and Other Electronic Equipment), and SIC 73 (Business Enterprises) – are compared across offshore offering and private placement issuers in Panel E of Table 3.[49] From Panel E note that 9.4% of the offshore offerings are from firms whose primary 2-digit SIC is group 35; in contrast, only 6.0% of private placements are from SIC code 35 (difference significant at the 5% level). Similarly, 9.3% of the offshore offerings are from SIC code 36 compared with only 4.9% of the private placements (difference significant at the 5% level). The difference for offerings where the issuer is a member of SIC code 73, in contrast, is not statistically significant.

Panel E of Table 3 also reports the fraction of offshore offering and private placement issuers that are members of the 3-digit SIC 357 group, reported in Bohn and Choi (1996) as the three-digit SIC group with the highest frequency of securities fraud class actions.[50] From Panel E note that 5.8% of the offshore offerings are from SIC 357 (Computer and Office Equipment) compared with 3.3% of the private placements (difference significant at the 5% level). Comparison of the SIC code groups conducting non-public offerings therefore provides evidence at a summary statistic level consistent with the hypothesis that U.S. issuers may choose to conduct an offshore offering as opposed to a domestic private placement due to a fear of an antifraud action under the U.S. securities laws.

As an alternative proxy for the importance of particular SIC code groups, Panel F of Table 3 reports on two measures for the intensity of private fraud litigation by SIC code groups. Panel F first reports on the frequency of fraud litigation for the 2-digit SIC code group of the non-public offering's issuer. The frequency is obtained from Bohn and Choi and is defined as the total number of fraud class actions in the relevant 2-digit SIC code group targeting an initial public offering that took place from 1975 to 1986, the time period of the Bohn and Choi study. To the extent plaintiffs' attorneys face a fixed cost in specializing in a particular industry, the absolute number of suits in a 2-digit SIC code group provides a measure for the intensity of plaintiffs' attorney interest in the industry. Second, Panel F reports on the incidence of securities fraud class actions for 2-digit SIC code group of the non-public offering's issuer. The incidence

[49] See Bohn & Choi (1996: 940-941).

[50] In the sample of all initial public offerings from 1975 to 1986, Bohn and Choi found that 10% of the firms within SIC 357 experienced a securities fraud class action deriving out of their offering. See Bohn & Choi (1996: 942-43).

is defined as the fraction of initial public offerings that faced a private fraud class action for the relevant 2-digit SIC code group as obtained from Bohn and Choi. Note from Panel F that both the frequency and incidence measures of fraud suit intensity are greater for offshore offering issuers compared with domestic private placements (significant at the 5% level).

4. Testing the Motivation Behind Offshore Offerings

The fact that issuers decide to sell securities offshore in part to avoid the U.S. securities regime does not address the question of whether offshore offerings are beneficial or harmful for investors. Issuers may desire to avoid U.S. securities regulation for at least two possible reasons. First, the costs of the U.S. antifraud regime may outweigh its benefits for certain issuers. An issuer, for example, may be particularly vulnerable to non-meritorious lawsuits and therefore seek to issue securities offshore to avoid the cost of such potential lawsuits. To the extent the first motivation is true, this provides evidence that the U.S. regulatory regime is not value maximizing for at least a subset of U.S. firms. Second, issuers may seek to engage in an overseas offering to defraud investors. Where the laws of other countries provide less antifraud protection than the United States' regime, issuers may more easily engage in fraud.

This section tests the motivation of issuers in their choice of regime through an examination of: (1) the characteristics of the pre-offering fraud litigation for offshore and private placement issuers; (2) the post-offering litigation experience of the issuers; and (3) the offering discount negotiated with investors.

4.1 Pre-Offering Fraud Litigation Characteristics

To test the hypothesis that issuers choose to offer securities offshore partly to escape the non-value maximizing application of U.S. antifraud liability, the paper compares characteristics of the set of offerings conducted by issuers that experienced a pre-offering securities fraud lawsuit consisting of a total of 167 offerings. Issuers with a past SEC investigation history are taken as posing a higher risk to investors. Both SEC investigations related to and unrelated to the prior private securities litigation are tracked as a signal to investors that the issuer may pose a

heightened risk of fraud. SEC filings on Westlaw and Lexis and reports on PR-Newswire are also examined to determine whether the private securities fraud litigation was brought as a class action, the last reported resolution of the litigation and the number of years from the filing to the resolution of the suit (Resolution Time). Where the litigation resulted in a settlement, the settlement amount where available is obtained.

[Insert Table 4 Here].

Note from Panel A of Table 4 that 16.3% of the offshore offerings with pre-offering private fraud litigation experience involved an issuer with a prior SEC investigation. In comparison, 35.8% of the domestic private placements with pre-offering private litigation experience involved an issuer with a past SEC investigation history (difference significant at the 1% level). Offshore offering issuers also had a reduced settlement rate (difference significant at the 10% level) and a conversely higher rate of dismissal or pro-defendant judgment (difference significant at the 10% level). Pre-offering private fraud litigation for offshore offering issuers consisted of fewer class actions and reached resolution in a shorter time period (difference statistically insignificant, however). The mean settlement amount was also lower for offshore issuers compared to private placement issuers with pre-offering private fraud litigation experience (difference statistically insignificant).

The impact of private pre-offering fraud litigation on the corporate governance structure of the issuers is also tracked using two variables. First, whether the CEO changed during the time period of the private litigation is determined through examination of the issuer's SEC proxy filing for the year prior to the start of the fraud litigation and for 2 years after the start of the litigation (New CEO). In addition, the age of the CEO prior to the filing of the lawsuit is also obtained from the SEC proxy filings (CEO age). Second, the fraction of corporate officers on the board is compared one year prior to the start of the litigation and two years after the start of the litigation are obtained from proxy filings. The change in the fraction of corporate officers on the board between the two time periods is then calculated.

From Panel B of Table 4 note that offshore offering issuers experienced a slightly greater turnover in the CEO position during the time period around the filing of the suit (difference not statistically significant). For both domestic private placement and offshore offering issuers with pre-offering fraud experience, the fraction of corporate officers on the board of directors decreased. The decrease is greater in magnitude for domestic private placement issuers; the difference, moreover, is statistically significant at the 10% level. Some evidence exists, therefore, that the pre-offering litigation for domestic private placement issuers resulted in greater corporate governance changes than for offshore offering issuers, consistent with the hypothesis that more of the pre-offering private fraud actions for the offshore offering issuers were non-meritorious.

Experience with a particular plaintiffs' attorney may also influence the decision of an issuer with pre-offering fraud experience to issue securities offshore compared to a private placement. To the extent a particular plaintiffs' attorney has expended the fixed cost expense of learning about a particular issuer, the plaintiffs' attorney faces a reduced marginal cost to bring subsequent fraud suits. Larger, well-financed plaintiffs' attorneys may also expend resources to track former litigation defendants as potential future targets.

Panel C of Table 4 reports whether the pre-offering litigation for both private placement and offshore offering issuers involves Milberg, Weiss, Bershad, Hynes & Lerach (Milberg Weiss), the most active plaintiffs' attorney firm in the sample time period, as one of the lead plaintiffs' attorneys. Milberg Weiss is one of the lead attorneys in 41.3% of the offshore offering issuers' pre-offering fraud lawsuits and 31.6% of the private placement issuers' pre-offering fraud lawsuits. The difference, however, is not statistically significant. Rankings for plaintiffs' and defense attorneys are also obtained from Forbes magazine based on the number of cases handled from 1988 to mid-1995.[51] Whether one of the lead plaintiffs' or defense attorney firms involved in the pre-offering fraud litigation is one of the top five plaintiffs' or defense firms as determined through the Forbes rankings is reported in Panel C (denoted as Top 5 plaintiffs' at-

[51] See Nancy Rutter, Bill Lerach Thinks of Himself as Robin Hood In a Class-Action Suit, Forbes, Oct. 9, 1995, at 116. The Top 5 plaintiffs' attorney firms listed in the Forbes article are: Milberg, Weiss, Bershad, Hynes & Lerach (193 cases), Berger & Montague (87 cases), Abbey & Ellis (73 cases), Wolf, Popper, Ross, Wolf & Jones (59 cases), and Barrack, Rodos & Bacine (57 cases). The Top 5 defense attorney firms are: Wilson, Sonsini, Goodrich & Rosati (50 cases), Skadden, Arps, Slate, Meagher & Flom (45 cases), Gibson, Dunn & Crutcher (29 cases), Heller, Ehrman, White & McAuliffe (22 cases), and Paul, Weiss, Rifkind, Wharton & Garrison (16 cases).

torney or Top 5 defense attorney).[52] Note that a Top 5 plaintiffs' attorney is involved in 63.0% of the pre-offering fraud litigation for offshore offering issuers compared with 47.4% for private placement issuers (difference not statistically significant).

Table 5 provides a more detailed breakdown of the Top 5 plaintiffs' attorney firms.

[Insert Table 5 Here].

Issuers may choose to offer securities abroad for a number of reasons unrelated to fraud-related factors. Companies may issue securities in geographical markets where they engage in business operations. Companies seeking to enter a new foreign market may desire to establish shareholder ties within those countries. Greater shareholder awareness of the issuer may lead to greater demand for the issuer's goods and services. Furthermore, a presence in a foreign country's capital market may lead the foreign government to act more favorably to the issuer. As discussed in Choi (2000), insiders may also influence a company to sell securities abroad in a discounted sale to themselves or to block shareholders sympathetic to management. Managers may find it easier to disguise sales to themselves or related parties offshore. For example, insiders at two NASDAQ small cap companies, Comprehensive Environmental Systems, Inc. and ICIS Management Group Inc., attempted to sell discounted stock offshore to entities controlled by the insiders and then to resell the sale of these securities to brokerage accounts in the U.S. owned by the insiders.[53]

To provide a multivariate test controlling for various factors that affect the decision to raise capital offshore, the paper estimates a logit model. The logit model includes independent variables to assess the motivation of companies choosing to avoid U.S. securities regulation

[52] The identities of the lead plaintiffs' and defense attorneys are obtained, where available, from searches using the Westlaw and Lexis federal and state court decision databases as well as PR-NEWSWIRE, NEXIS, and SEC-Online databases.

[53] See Crime: Former SEC Lawyer, Others Indicted on Charges Over Reg S Securities, 28 Securities Regulation & Law Report 1242, October 11, 1996. Similarly, the chairman and CEO of Members Services Corp was convicted of securities fraud after causing Members to sell 1.4 million shares of unregistered stock under Regulation S to several entities controlled by the chairman. The chairman then sold the Regulation S shares into the U.S. through the offshore entities into the United States at a substantial profit. See Federal Securities & Corporate Developments, 28 Securities Regulation & Law Report 605, May 10, 1996.

through an offshore offering including: (1) variables related to the risk of subsequent private fraud litigation, including both the SIC code grouping of the issuer and the prior private fraud litigation experience of the issuer. The pre-offering SEC investigation experience, among other variables, is also included to gauge the importance of the risk of fraud on the decision where to raise capital. In addition, (2) control variables are added to the model related to other factors that may influence the decision on the part of an issuer to sell securities abroad or through a domestic private placement. The paper estimates the logit model presented below (where OFFSHORE = 1 for an offshore offering and 0 for a domestic private placement):[54]

$$prob(OFFSHORE = 1) = \Lambda(a + X_1 b_1 + X_2 b_2 + X_3 b_3 + X_4 b_4 + X_5 b_5 + X_6 b_6 + e)$$

X_1 – Private Securities Fraud Litigation (Pre-Offering Fraud)
X_2 – Pre-Offering Fraud x SEC Investigation Interaction Term
X_3 – SEC Investigation Experience
X_4 – SIC Code Grouping
X_5 – Variations on Fraud-Related Risk Variables
X_6 – Control Variables

The base logit model (reported as Model 1 in Table 6) first includes variables related to the risk of the offering to investors. The base logit model includes a dummy variable (X_1) for a private securities fraud lawsuit targeting the issuer at any time from 10 years prior to the offering up to the start of the offering (Pre-Offering Fraud). Past experience with private fraud litigation is taken as a proxy for the issuer's expected cost of antifraud liability for offerings inside the United States. An interaction term between Pre-Offering Fraud and a dummy variable for whether a SEC investigation occurred prior to the offering (X_2) is also added to the model. Issuers that faced a SEC investigation, all other things being equal, may pose a greater risk of fraud to investors. A dummy variable for SEC investigation (X_3) is also added to separate out the impact of past experience with a SEC investigation alone without the presence of prior pri-

[54] Ë(·) is defined as $[1 + \exp(-\hat{a}'X)]^{-1}$. In the model, a is the constant intercept term and e is the zero mean stochastic disturbance term.

vate fraud litigation.[55] The base logit model also includes dummy variables (X_4) for the two-digit SIC 35 (Industrial Machinery and Equipment), SIC 36 (Electronic and Other Electronic Equipment), and SIC 73 (Business Enterprises) groups.

Several variations are then estimated of the base logit model to assess further the importance of the fraud-risk related variables (X_5). Model 1 is re-estimated using the sample of domestic private placements and only those offshore offerings conducted by an issuer that did not also engage in a U.S.-targeted offering within five years prior to the offshore offering (reported as Model 2 of Table 6). Because the paper's sample of offshore offerings contain some issuers that also engaged in a relatively recent domestic offering of securities, the logit model may understate the differences between firms that choose to conduct solely an offshore offering and those that engage in domestic private placements. Certain U.S. issuers, as well, may choose to raise capital abroad to diversify their shareholder base, taking advantage of foreign investors interested in diversifying their portfolio compared with U.S. investors already saturated with the issuer's shares. Issuers may also choose to engage in an offshore offering because their sources of U.S. capital are overtaxed. Removing issuers that made a U.S.-targeted offering within 5 years of the offshore offering reduces the incidence of such types of offerings in the sample.

Model 1 is re-estimated with the addition of an interaction term between Pre-Offering Fraud and a dummy variable for whether the pre-offering fraud litigation was dismissed or resulted in a judgment for the defendants (reported as Model 3 of Table 6). Lawsuits that are dismissed or that result in a pro-defendant judgment are more likely to be non-meritorious.

Model 1 is re-estimated with the addition of an interaction term between Pre-Offering Fraud and a dummy variable for whether one of the lead plaintiffs' attorneys is a Top 5 plaintiffs' attorney (reported as Model 4 of Table 6). Issuers may seek to sell securities abroad to the

[55] Among those issuers without a pre-offering history with a private antifraud action, SEC investigation experience is infrequent:

Variable	Private Placement	Offshore Offering	p-value [a]
Fraction with SEC investigation experience	0.008	0.017	0.130

** 5% level; * 10% level.

extent past experience with a well-financed plaintiffs' attorney may increase the risk of a subsequent suit for an offering inside the United States.

Model 1 is re-estimated with the addition of an interaction term between Pre-Offering Fraud and a dummy variable for whether the offering occurred after the Private Securities Litigation Reform Act of 1995 (PSLRA) (reported as Model 5 of Table 6). To the extent the PSLRA reduces the incentive of plaintiffs' attorney to pursue a frivolous lawsuit, fewer U.S. issuers may use an offshore offering to escape U.S. regulation.

Model 1 is finally re-estimated with the addition of the standard deviation of raw returns for the one-year period prior to the offering date as an independent variable in Model 6 of Table 6. Firms with a higher variation of their stock market return may be more likely to take into account potential U.S. antifraud liability. To the extent plaintiffs' attorneys focus on the stock price drop in their decision to bring suit, firms with a higher stock market return variance face a greater risk of attracting the attention of plaintiffs' attorneys.

The base logit model then includes a variety of controls in the X_6 variable. First, the natural log of market capitalization, the fraction of shares in the hands of institutional investors, and the number of shareholders are added to the model. All other things being equal, one would expect that companies with a greater shareholder following, market capitalization, and institutional shareholder base will have more analysts tracking the company and therefore less asymmetric information with respect to the market. To the extent foreign investors start at a greater informational disadvantage relative to U.S. investors in valuing a U.S. issuer, the presence of analysts will reduce the informational disadvantage of foreign investors by a greater amount and thereby increase the probability of issuers choosing to sell securities abroad.

Second, the natural log of the offering amount is added to the logit model. Because domestic private placements restrict the ability of issuers to sell large dollar amounts of securities into the United States through either direct limitations on the offering amount or restrictions on the number of non-accredited purchasers, issuers with relatively larger offerings may tend to choose an offshore offering. On the other hand, as a substitute mechanism to control for the risk of fraud, offshore issuers may systematically sell to smaller numbers of more sophisticated in-

vestors. The natural log of the offering amount, therefore, may be reduced for offshore offerings compared with domestic private placements.

Third, companies may also choose to sell securities abroad because their business activities occur overseas. This may take the form of either factories or other productive enterprises abroad or overseas export markets to which the company sells. To capture this possibility, for each offshore offering and private placement, the number of countries in which the issuer either conducted operations or sold products and services is collected through examination of the "Business Description" section of each firm's SEC 10-K filing concurrent with the offering year (World Contacts).[56] The World Contacts variable is then included in both logit models. One would expect that companies with a greater international presence would have an increased likelihood of selling securities abroad.[57]

Fourth, to control for the possibility that insider-favored sales may drive overseas offerings as discussed in Choi (2000), the logit model includes the fraction of corporate officers on the board as well as the fraction of outstanding shares owned by officers and directors as independent variables. Firms with a higher degree of insider board representation, all other things being equal, will be more likely to sell discounted securities to insiders. On the other hand, firms where managers own a significant fraction of shares will be less willing to bear the cost of selling discounted shares, all other things being equal.[58]

[56] The article calculates the number of world contacts as follows: For each specific country mentioned in the Form 10-K filing, the number of world contacts is increased by 1. Where the issuer's Form 10-K only discussed a particular continent, the average number of contacts other issuers in the article's sample had in the particular continent conditional on the issuers' having at least one contact is used as the number of contacts for that continent. For example, in the entire sample, companies that listed at least one country in Europe on average listed 5 European countries. Issuers that listed Europe, therefore, have their number of world contacts increased by 5.

[57] On a summary statistic level, offshore offering issuers did not have a statistically significant different number of contacts with the world then private placement issuers

Table: Comparison of the Offshore Offering versus Domestic Private Placement Issuers

Variable	Private Placement	Offshore Offering	p-value [a]
World Contacts	6.567	6.263	0.4629

** 5% level; * 10% level .

[a] The p-value is the value of a two-sided t-test of the difference in mean values between the private placement and offshore offering samples.

[58] As discussed later, a possible non-linearity may exist in the relationship between insider share ownership and the decision to issue securities offshore.

Fifth, the base logit model also includes a dummy variable for whether the offering is for common stock to control for any differences based on the type of security issued.

[Insert Table 6 Here].

From Table 6 note first that the coefficient on the dummy variable for Pre-Offering Fraud Action experience is positive in all six models. Moreover, the coefficient is significant at the 5% level in Models 1, 3 and 6, at the 10% level in Models 2 and 5, and insignificant in Model 4. In comparison, the interaction term between Pre-Offering Fraud and the dummy variable for the presence of a SEC investigation is negative and significant at the 5% level in Models 1 through 5 and at the 10% level in Model 6. The results from Table 6 therefore provide evidence that issuers may not all value U.S. regulatory protections equally. To the extent a SEC investigation acts as a proxy for the heightened risk of the offering for investors, the results from Table 6 provide evidence that issuers posing such a risk tend to offer securities through a domestic private placement, obtaining the bonding and signaling benefits of the U.S. regime. Other issuers that fear non-meritorious fraud lawsuits and that do not pose a heightened risk of fraud, on the other hand, may choose to issue securities abroad. Both choices on the part of issuers are consistent with the voluntary regulation hypothesis that an issuer will subject itself to regulation where the joint benefits to the issuer and investors from such regulation exceeds the costs.

In contrast, the dummy variable for a prior SEC investigation is positive but statistically insignificant in all six models. Although the presence of a SEC investigation in combination with a past private fraud action increases the probability of a domestic offering, a SEC investigation alone does not. The relatively low incidence of SEC investigation experience for firms without prior private fraud litigation experience may explain the statistically insignificant result. In addition, not all SEC investigations are alike. Some may lead to an eventual civil or criminal legal proceeding; others may end without any finding of wrongdoing. The paper's data only indicates the existence of some SEC investigation-related action without information on the result of the investigation. The presence of a past private antifraud action may therefore signal a more

consequential SEC action or alternatively, a SEC action more directly related to the protection of investor welfare.

Note from Model 2 in Table 6 that the omission of offshore offerings where the issuer conducted a prior U.S.-targeted offering within 5 years of the offshore offering in Model 2 does not qualitatively change the results of the other models. The coefficient on the dummy variable for Pre-Offering Fraud is positive and significant at the 10% level in Model 2. As well, the coefficient on the interaction term between Pre-Offering Fraud and the dummy variable for a past SEC investigation is negative and significant at the 5% level in Model 2.

Note also that the coefficient on the interaction term between Pre-Offering Fraud and the dummy variable for a dismissal or pro-defendant judgment for the pre-offering lawsuit is positive in Model 3. The positive coefficient is consistent with the hypothesis that issuers that faced a frivolous suit in the U.S. tend to make greater use of offshore offerings. Nevertheless, the coefficient on the interaction term between Pre-Offering Fraud and the dismissal or pro-defendant judgment dummy variable is not statistically significant.

Past experience with a Top 5 plaintiffs' attorney law firm also increases the likelihood of an offshore offering. The coefficient on the interaction term between Pre-Offering Fraud and the dummy variable for a Top 5 plaintiffs' attorney law firm is positive and significant at the 5% level in Model 4. On the other hand, the coefficient on the interaction term between Pre-Offering Fraud and the dummy variable for the impact of the Private Securities Litigation Reform Act is negative although statistically insignificant as reported in Model 5 of Table 6.

The standard deviation of returns for the one-year prior to the offering is also a significant factor in the decision to go abroad. From Model 6 of Table 6 note that the coefficient on the standard deviation of returns is positive and significant at the 5% confidence level. Firms with a higher standard deviation of returns are more likely to issue securities offshore, consistent with the hypothesis that fear of U.S. antifraud liability may drive some firms to issue securities outside the United States.

For each model in Table 6 a likelihood-ratio test is performed comparing the model against an identical model with the exclusion of dummy variables for prior private fraud litiga-

tion or SEC investigation experience or any interaction terms with the dummy variables. The null hypothesis that the fraud related variables as a group are insignificant is rejected at the 5% and 10% confidence levels for the models.[59]

Table 7 reports the calculated shift in probability of an offshore offering using Model 1 of Table 6 for offerings with only pre-offering private fraud litigation experience and with both pre-offering private fraud and SEC investigation experience. Note that the presence of pre-offering private litigation experience alone raises the probability of going offshore by 16.2 percentage points (using mean values for the other independent variables). The presence of both pre-offering private fraud litigation and a prior SEC investigation, in contrast, results in a 15.1 percentage point decrease in the probability of conducting an offshore offering.

Not reported, additional variations of Model 1 from Table 6 are estimated. First, Model 1 is fitted with year dummy variables using 1993 as the base year. The coefficient on the Pre-Offering Fraud variable is positive and significant at the 5% level while the coefficient on the interaction term between Pre-Offering Fraud and the SEC investigation dummy variable is negative and significant at the 5% level. The year dummy variables are all positive and significant at the 5% level.

Second, Model 1 is fitted with interaction terms between Pre-Offering Fraud and a dummy variable for the type of fraud allegation in the pre-offering fraud litigation using general disclosure fraud as the base case.[60] None of the Pre-Offering Fraud x type of fraud allegation

[59] Model 1, for example, predicts whether an offering is offshore or domestic with 63.6% accuracy. Without the Pre-Offering Fraud and SEC Investigation dummy variables and any interaction terms with these variables, Model 1 predicts with only 61.3% accuracy. The addition of the fraud-risk related variables increases the accuracy of the model by 2.3 percentage points.

[60] The following table provides a breakdown of the allegations in the pre-offering private fraud actions:

Type of Pre-Offering Fraud Action Allegation	Number of Private Placements	Percentage of Private Placements [a]	Number of Offshore Offerings	Percentage of Offshore Offerings [b]
General Disclosure Fraud	47	67.1%	54	71.1%
Fraud Related to Public Offering	14	20.0	10	13.2
Fraud Related to Private Placement	2	2.9	0	0.0
Fraud Related to Acquisition	3	4.3	8	10.5
Other	4	5.7	4	5.3
Total	70	100.0%	76	100.0%

[a] Percentage of private placements where allegation is known.

[b] Percentage of offshore offerings where allegation is known.

interaction terms are statistically significant. The coefficient on the Pre-Offering Fraud variable is positive and significant at the 5% level. In contrast, the coefficient on the interaction term between Pre-Offering Fraud and the SEC investigation dummy variable is negative and significant at the 5% level.

Third, to control for possible a possible non-linearity in the relationship between director and officer share ownership and the probability of an offshore offering, Model 1 is also re-estimated with the addition of a squared term for the fraction of common stock owned by directors and officers. Not reported, the coefficient on the Pre-Offering Fraud dummy variable is positive and significant at the 5% level. The coefficient on the interaction term between Pre-Offering Fraud and the SEC investigation dummy variable is negative and significant at the 5% level.

Fourth, Model 1 is re-estimated using the Pre-Offering Fraud and SEC Investigation dummy variables and the Pre-Offering Fraud x SEC Investigation interaction term determined over the 5 years prior to the offering date rather than the prior 10 years. To the extent more recent fraud-related actions have a greater impact on both the fear of subsequent litigation on the part of managers and the risk of fraud facing investors, the use of fraud-related variables measured over the 5 years prior to the offering should result in more significant coefficients. In the re-estimated model, however, the coefficient on the Pre-Offering Fraud variable is positive and significant at only the 20% level. In contrast, the coefficient on the interaction term between Pre-Offering Fraud and the SEC investigation dummy variable remains negative and significant at the 5% level.

To take into account the possibility that the desire to avoid antifraud liability is more important for larger offerings, four additional variations of Model 1 from Table 6 are estimated and reported in Table 8. Model 1 of Table 8 replaces the dummy variable for Pre-Offering Fraud with four interaction dummy variables between Pre-Offering Fraud and the offering amount quartiles described in Panel C of Table 3. Model 2 of Table 8 makes the same replacement with

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The $\div^2$ test cannot reject the null hypothesis that the private placement and offshore offering distributions among pre-offering fraud action allegations are identical ($\div^2 = 5.187$; prob. = 0.269).

interaction terms between Pre-Offering Fraud and the offering amount quartiles and adds both a dummy variable for the presence of a SEC investigation and an interaction term between Pre-Offering Fraud and the presence of a SEC Investigation. Model 3 of Table 8 replaces the dummy variable for Pre-Offering Fraud with four interaction dummy variables between Pre-Offering Fraud and the offering amount/market capitalization quartiles described in Panel D of Table 3. Model 4 of Table 8 makes the same replacement with interaction terms between Pre-Offering Fraud and the offering amount/market capitalization quartiles and adds both a dummy variable for the presence of a SEC investigation and an interaction term between Pre-Offering Fraud and the presence of a SEC Investigation.

[Insert Table 8 Here].

First note from Models 1 and 2 of Table 8 that the effect of Pre-Offering Fraud on the likelihood of a firm making an offshore offering is greatest and statistically significant (at the 5% level) only for the largest offer amount quartile. The results of Table 8, therefore, confirm the results from Panel C of Table 3 that past history with a private antifraud action correlates more strongly with offshore offerings for larger dollar amount offerings. Similarly, note from Model 4 that the effect of Pre-Offering Fraud is greatest and statistically significant for the 3rd and 4th offer amount/market capitalization quartiles (significant at the 5% level for the 3rd quartile and the 10% level for the 4th quartile). In Model 3, none of the offer amount/market capitalization quartiles are statistically significant. Second, as reported in Models 2 and 4 of Table 8, even when controlling for the different offer amount and offer amount/market capitalization quartiles, the coefficients on the interaction terms between Pre-Offering Fraud and a prior SEC investigation are still negative and significant at the 5% level. Although issuers with a prior history with private fraud litigation are more likely to sell securities offshore, those issuers that pose a particularly high risk to investors – as signaled through a past history of a SEC investigation – choose to expose themselves to the more stringent U.S. antifraud regime.

For each model in Table 8, a likelihood-ratio test is performed comparing the model against an identical model with the exclusion of dummy variables for prior private fraud litigation or SEC investigation experience or any interaction terms with the dummy variables. For Models 1 and 2, the null hypothesis that the fraud related variables as a group are insignificant is rejected at the 5% confidence level. The likelihood-ratio test, however, fails to reject the null hypothesis for Models 3 and 4.

4.2 Post-Offering Litigation Experience

To the extent issuers seek to raise capital offshore to reduce their exposure to potential non-meritorious litigation, one may expect a systematic difference in the post-offering litigation experience of issuers that conduct a domestic private placement compared with an offshore offering. The post-offering private securities fraud litigation experience for each offshore offering issuer is tracked through examination of SEC filings on Westlaw and Lexis as well as press releases on PR-Newswire. Only private securities fraud litigation filed during the first three years after the start of the offering are followed. Note that all types of post-offering private fraud litigation are tracked regardless of whether the litigation relates to the non-public offering to gauge the overall risk of the issuer to investors. Panel A of Table 9 reports the incidence of post-offering private securities fraud litigation for both domestic private placement and offshore offering issuers categorized by the pre-offering fraud experience of each issuer.

[Insert Table 9 Here].

From Panel A of Table 9 note that issuers that conduct an offshore offering where the issuer has pre-offering fraud experience are more likely to also experience a post-offering private securities fraud lawsuit. For 22.1% of the offshore offerings involving an issuer with pre-offering fraud experience, the issuer also faced a post-offering private securities fraud action. In contrast, for 8.6% of the private placements involving an issuer with pre-offering fraud experi-

ence, the issuer also faced a post-offering private securities fraud action (difference significant at the 5% level).

The results in Panel A, nevertheless, are consistent with two possible hypotheses. First, offshore offering issuers with pre-offering fraud experience may represent an enhanced likelihood of actual fraud to all investors in the market. The post-offering fraud suit experience of such issuers may therefore result directly from the raised level of actual fraud among such issuers. Second, offshore offering issuers with pre-offering fraud experience may present relatively low-cost targets for plaintiffs' attorneys interested in pursuing non-meritorious litigation. Although an offshore offering reduces the exposure of such issuers to post-offering litigation, the high level of interest among plaintiffs' attorneys seeking to bring a non-meritorious suit results in a higher post-offering incidence of litigation than for other types of issuers.

To distinguish between the two possible hypotheses explaining post-offering private securities fraud litigation incidence, the paper examined the post-offering SEC investigation experience of each offerings' issuer for a period of up to three years after the offering. The post-offering SEC investigation track record was obtained from SEC filings on Westlaw and Lexis as well as press releases on PR-Newswire. All types of post-offering SEC investigations were tracked, regardless of their relation to the non-public offering to assess the issuer's overall risk to investors. Panel B of Table 9 reports the breakdown of post-offering SEC investigations.

Note that for 3.5% of the offshore offerings involving an issuer with pre-offering fraud action experience, the issuer also encountered a post-offering SEC investigation. In comparison, for 2.5% of the domestic private placements involving an issuer with pre-offering fraud action experience, the issuer also faced a post-offering SEC investigation. This difference, however, is not statistically significant. Although offshore offering issuers with pre-offering fraud action experience face a significantly greater level of post-offering private antifraud actions, such issuers do not face an elevated level of SEC investigations. To the extent SEC investigations proxy for the risk of the issuer to investors, the results in Panel B are consistent with the hypotheses that offshore offerings issuers with pre-offering private fraud litigation experience did not pre-

sent a significantly higher actual risk of fraud to investors. Instead, such issuers may have exited the U.S. regime to avoid the cost of non-meritorious lawsuits.

At least two problems exist with the collection of post-offering SEC investigations, however. First, some of the issuers in the sample may have dissolved or otherwise ceased to exist during the first three years after the offering. To the extent offshore issuers with a prior private pre-offering fraud litigation history are more likely to dissolve, a downward bias may exist in the number of post-offering SEC investigations. Second, the use of offshore offerings may have reduced the exposure of the offshore issuers to possible SEC enforcement with respect to the offerings. Although the SEC may investigate other aspects of the offshore issuers' activities (e.g., periodic disclosures), the paper cannot rule out the possibility that the offshore issuers would have had a significantly higher level of SEC investigation activity if they had issued securities domestically.

4.3 Comparison of the Offering Discount

This section examines the discount that purchasers of non-public offerings of common stock receive relative to the secondary market price measured at the start date of the offering to distinguish between possible issuer motivations in avoiding U.S. securities regulation through an offshore offering.[61] Examination of the offering discount provides one gauge of the value of U.S. securities regulatory protection for investors. In particular, this section tests the hypothesis that issuers choosing to remain within the U.S. regulatory regime receive a reduced offering discount and therefore benefit from this choice. Without the assistance of U.S. antifraud liability to bond the value of the offering, investors may require a greater discount to invest in an offshore offering. Panel A of Table 10 reports summary information on the actual offering discount for domestic private placements and offshore offerings of common stock.

[61] The offering discount is defined as:

$$\text{Offering Discount} = \frac{\text{U.S. Secondary Market Price at Start of Offering} - \text{Offering Price}}{\text{U.S. Secondary Market Price at Start of Offering}}$$

[Insert Table 10 Here].

The comparison of the mean offering discount for offshore offerings and domestic private placements provides evidence that investors face a greater risk of fraud from offshore offerings. For the set of common stock offerings in the sample, for example, offshore offerings experienced a 29.4% mean discount while private placements into the United States received only a 17.4% mean discount (difference significant at the 1% level). The 17.4% discount for domestic private placements in the paper's sample is consistent with other studies of U.S. private placements. Hertzel, Linck, and Rees (1999) in a study of 183 equity private placements in the United States, for example, report a mean discount of 15.9%. Issuers that voluntarily choose to remain within the United States therefore receive a reduced offering discount of 12 percentage points.

The difference in the mean discount for offshore offerings and domestic private placements, however, may be due to factors other than differences in regulatory protections. Investors may desire a discount to compensate for the illiquidity imposed for securities purchased through a non-public offering. Larger offerings that provide the possibility of a secondary market offshore may require a reduced discount compared to smaller offerings without such a possibility, for example. Investors may also demand a greater discount based on the risk investors perceive from participating in such an offering. Companies better followed by investment analysts, for example, may pose a lower risk of fraud than unknown companies without such a following.

To control for various factors that may affect the offering discount, the paper follows a two-step process. First, an ordinary least squares model of the offering discount is estimated for only offshore offerings of common stock. Second, the discount investors would demand for the domestic private placements had they been offered offshore (called the "predicted offshore discount") is calculated from the estimated model. The model is presented below:[62]

[62] In the model, a is the constant intercept term and e is the zero mean stochastic disturbance term. The model had an adjusted R^2 equal to 0.1369 with 191 observations (t-statistic in parenthesis).

DISCOUNT = 0.061 – 0.067LNMKTCAP – 0.058LNOMKT – 0.001SHLDERS – 0.048BINSIDER
(3.859) (-3.904) (-3.532) (-0.017) (-0.396)

+ 0.106MDHOLD –0.069MDHOLD^2 + 0.007TOBINQ – 0.242YR94 – 0.218YR95 – 0.323YR96
(0.304) (-0.135) (1.883) (-1.855) (-1.682) (-2.525)

$$DISCOUNT = á + â_1LNMKTCAP + â_2LNOMKT + â_3SHLDERS + â_4BINSIDER + â_5MDHOLD + â_6MDHOLD\text{^}2 + â_7TOBINQ + â_8YEAR\_DUMMIES + â_9SIC\_DUMMIES + å$$

The model incorporates five categories of variables affecting the offering discount including variables on: (a) liquidity; (b) the degree of information asymmetry between investors and the company's management; (c) the incentive of managers to use a non-public offering to engage in opportunistic, discounted securities sales to related entities; (d) the Tobin's Q measure for the issuer; and (e) dummy variable controls for the year of the offshore offering and the 2-digit SIC code of the issuer.

First, securities sold through either an offshore offering or a private placement are generally not freely transferable inside the United States. Investors therefore will demand a discount for the illiquidity risk they bear from a non-public offering.[63] Importantly, the precise degree of illiquidity will depend on that availability of information on the issuer and the interest of institutional investors in the issuer's securities. Investors, for example, may conduct immediate resales pursuant to Rule 144A of the Securities Act (requiring, among other things, that the resales are made to Qualified Institutional Buyers (QIBs).[64] The greater the market capitalization, the easier

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$$– 0.333YR97 + 0.046SIC13 – 0.017SIC28 – 0.122SIC35 + 0.072SIC36 – 0.050SIC38 – 0.130SIC48 + 0.014SIC73 + 0.275SIC80 + å$$
(-2.617) (0.473) (-0.262) (-1.877) (1.214) (-0.743) (-0.948) (0.192) (1.774)

In addition, the model is re-estimated with only those offshore offerings involving an issuer that did not conduct a U.S.-targeted offering within 5 years of the offshore offering. Issuers that conduct both U.S. and offshore offerings may use an offshore offering for purposes other than to exit the U.S. regime (adj. R^2 = 0.0800; 159 observations). In the re-estimated model, the predicted offshore discount for the domestic private placement firms is equal to 25.6%. The difference between the actual discount and the predicted offshore discount is significant at the 1% level.

[63] Compared with private placements, offshore offerings during the data set's time period impose a reduced liquidity risk due to the ability of foreign investors to resell after only 40-days valid for the offshore offerings in the paper's data time period. All other things being equal, therefore, one would expect a lower offering discount for offshore offerings due to illiquidity.

[64] Rule 144A(a)(1) of the Securities Act defines a Qualified Institutional Buyer as an institutional entity that "in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity . . . ." Rule 144A(a)(1)(i), Securities Act. Dealers registered pursuant to Section 15 of the

time investors will have in finding a QIB willing to trade the issuer's securities. The OLS model therefore includes the natural log of the issuer's market capitalization (LNMKTCAP).

Foreign investors, as well, may conduct resales to other foreign investors pursuant to Rule 905 of the Securities Act. The restrictions on resales into the United States placed on securities sold through an outside the United States, therefore, impose a greater illiquidity risk on investors of companies without a substantial overseas trading market for the securities. The greater the offering amount relative to the market capitalization, the more likely that a trading market may develop overseas. The OLS model therefore includes the natural log of the offering amount to market capitalization ratio as an independent variable (LNOMKT).

Second, the offering discount depends on the informational disadvantage at which investors may find themselves. Managers, for example, may systematically offer securities when the secondary market overvalues the issuer (Myers and Majluf, 1984), leading investors to require a greater offering discount in compensation. Investors at a large informational disadvantage, in turn, may have a greater fear that the offered securities are overvalued. The model uses the natural log of the issuer's market capitalization and the number of shareholders (SHDLERS) as a control for the degree of informational asymmetry. The greater the market capitalization and number of shareholders, the larger is the likelihood that one or more securities analysts follow the issuer and transmit information on the company to the rest of the market.

Third, as Choi (2000) discusses, to the extent the identity of the purchaser is hard to determine in an offshore offering, managers may use an offshore offering to engage in self-dealing, resulting in an increased overall discount for such offerings. To control for this possibility, the fraction of board seats held by officers (BINSIDER) as well as the fraction of outstanding common stock beneficially owned by directors and officers are added to the model (MDHOLD). Firms with greater concentrations of insiders on the board are more likely to engage in sales on favored terms to insiders. Conversely, firms where the insiders already own a significant portion of the equity will be less likely to use offshore offerings to sell themselves securities at a dis-

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Exchange Act must meet only a $10 million requirement. See Rule 144A(a)(1)(ii), Securities Act. For the securities of non-Exchange Act reporting issuers, the purchaser has the right to demand certain specified information at its discretion. Rule 144A(d)(4), Securities Act.

count. As discussed earlier in the paper, a possible non-linearity exists in the relationship between insider ownership of equity and the discount in an offshore offering. The model therefore includes a squared term for insider beneficial ownership of equity (MDHOLD^2).

Fourth, the model includes the Tobin's Q (TOBINQ) measure of how much the market values the issuer's assets over its book value.[65] All other things being equal, investors will demand a greater discount from firms that present a higher risk. Investors, nevertheless, may already discount the secondary market price for the risk, reflected as a lower Tobin's Q. When the issuer sells securities abroad, the secondary market price may then display no further discounting. Firms with a low Tobin's Q, therefore, may not experience as great a discount. In the alternative, a high Tobin's Q may indicate that the firm has a large amount of growth opportunities. To the extent such growth opportunities are risky, investors may demand a greater discount than for a firm whose valuation is less dependent on such opportunities.

Finally, the model includes dummy variables for the year of the offering (with 1993 as the base year) to control for year-specific effects (YEAR_DUMMIES). The model also includes dummy variables for whether the issuer of the offering is a member of one of the two-digit SIC code groups with at least 3% of the total number of non-public offerings in the sample to control for industry-specific effects (SIC_DUMMIES).

Panel B of Table 10 reports summary statistics on both the actual discount and the predicted offshore discount for the domestic private placements. From Panel B of Table 10 note that the mean and median predicted offshore discounts are greater than the mean and median actual discounts for domestic private placements. The mean predicted offshore discount is 6.3 percentage points greater than the actual discount.[66] The difference between the mean predicted offshore discount and actual discount is significant at the 1% level. The mean offering amount for domestic private placements of common stock is $16.87 million, giving domestic private place-

[65] Tobin's Q is defined as (market value of equity + book-value of long-term debt + book-value of short-term debt + preferred stock at carrying value) divided by book value of assets.

[66] Note that the predicted offshore discount may understate the amount of discount due to regulatory differences. Securities purchased through a domestic private placement faced a two-year holding period during which resales into the public capital markets are restricted for the sample time period. In comparison, offshore offerings of equity securities faced only a 40-day restricted period before resales may commence in the United States during the sample time period. All other things being equal, therefore, one would expect a lower offshore discount in comparison with a domestic private placement.

placement issuers an average gain of $1.06 million from issuing securities inside the United States.

Despite the higher mean discount for offshore offerings, substantial differences exist in the regulatory regime of foreign countries. Although the U.S. regime is widely recognized as the most stringent across the world, other regions including most notably Europe, employ a comparable level of securities disclosure requirements combined with a lack of private class actions.[67] Panel A of Table 11 presents the actual mean offshore discounts for the different regions, where known. The geographical location of the majority of offshore offerings in the data set, however, is unknown.[68] Moreover, because issuers voluntarily self-report the geographical location of the offering, the sub-sample of offerings where the geographical location is known may not be representative of the entire sample of offerings.

[Insert Table 11 Here].

Nevertheless, to obtain a sense of the predicted offshore discount for different regions offshore, the paper re-estimated the offshore discount model with the addition of dummy variables for Europe, Canada, Asia, and Latin America (with Other regions, including Africa and the Middle East, as the base).[69] Predicted offshore discounts were then obtained for the domestic

[67] See Per Henrik Lindblom, Individual Litigation and Mass Justice: A Swedish Perspective and Proposal on Group Actions in Civil Procedure, 45 Am. J. Comp. L. 805, 817 – 22 (1997) (describing the lack of private class action style litigation in Europe). For a description of the securities regulatory regimes of the United Kingdom, France, Germany, Italy, Canada, Mexico, Japan, and Australia see Marc I. Steinberg and Lee E. Michaels, Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity, 20 Mich. J. Int'l L. 207 (1999). One of the primary differences between U.S. and European disclosures lies with accounting standards. As well, although Europe provides issuers with comparable disclosure requirements as within the United States, issuers are not subject to private class actions within Europe.

[68] The geographical regions for only 192 out of the 693 offshore offerings are known:

Region	Number of Offerings	Fraction of Offerings (Where Region Known)
Asia	20	0.104
Europe	125	0.651
Canada	15	0.078
Latin America	36	0.188
Other	9	0.047

[69] The model had an adjusted R^2 equal to 0.1400 with 191 observations (t-statistic in parenthesis).

private placements assuming the offerings were conducted in, alternatively, the different offshore regions. Panel B of Table 11 presents the predicted offshore discounts for the different regions. Note that for all the offshore regions except for Canada, the predicted offshore discount is greater than the actual discount for the domestic private placement issuers. Moreover, the difference is greatest for offerings to Latin America and the Other regions (difference significant at the 1% level). Given a mean offering amount for domestic private placements of common stock of $16.87 million, domestic private placement issuers would have borne a $0.42 million additional cost on average for offerings to Europe. In contrast, domestic private placement issuers would have experienced an additional cost of $1.55 million on average for offerings to the Other regions.

As one final test of the hypothesis that higher risk issuers voluntarily choose to remain within the U.S. regime to avoid a large offshore discount, the paper re-estimates the offshore discount model with the addition of dummy variables capturing the issuer's past private and public fraud action experience. A dummy variable for the presence of a private fraud action (PREFRAUD) within ten years of the offshore offering is included. Similarly, a dummy variable for the presence of a public SEC investigation within ten years of the offshore offering is included (SEC). To capture firms that faced both a public and private fraud-related action, a PREFRAUD x SEC interaction term is also added to the model. Insufficient variation exists between the

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DISCOUNT = 0.580 – 0.059LNMKTCAP – 0.053LNOMKT – 0.001SHLDERS – 0.024BINSIDER
(3.623) (-3.249) (-3.144) (-0.174) (-0.196)

+ 0.108MDHOLD – 0.090MDHOLD^2 + 0.006TOBINQ – 0.206YR94 – 0.191YR95 – 0.280YR96
(0.311) (-0.177) (1.646) (-1.562) (-1.460) (-2.143)

– 0.282YR97 + 0.025SIC13 – 0.011SIC28 – 0.122SIC35 + 0.088SIC36 – 0.053SIC38 – 0.151SIC48
(-2.159) (0.250) (-0.164) (-1.843) (1.465) (-0.761) (-1.098)

+ 0.005SIC73 + 0.279SIC80 – 0.068EUROPE – 0.131CANADA – 0.072ASIA – 0.022LAMER + å
(0.071) (1.797) (-1.338) (-1.368) (-0.789) (-0.299)

In addition, the model is re-estimated with only those offshore offerings involving an issuer that did not conduct a U.S.-targeted offering within 5 years of the offshore offering. Issuers that conduct both U.S. and offshore offerings may use an offshore offering for purposes other than to exit the U.S. regime (adj. R^2 = 0.0760; 159 observations). In the re-estimated model, the predicted offshore discount for the domestic private placement firms assumed to target Europe is equal to 22.2%. The difference between the actual discount and the predicted offshore discount is significant at the 5% level.

dummy variables for a prior SEC investigation and the different reported geographical regions. The re-estimated model, as a result, excludes the geographical region dummy variables.[70]

From the re-estimated model, the paper then calculates the predicted offshore discount for the domestic private placement firms. To examine the direct impact of fraud risk on the discount, the paper divides the sample of domestic private placements based on the risk of fraud they pose to investors. In particular, firms that faced both a prior SEC investigation and a prior private fraud action pose the greatest risk to investors of fraud. The sample is therefore divided based on whether the interaction term PREFRAUD x SEC is equal to 1 (classified as "high-risk" offerings) or 0 (classified as "low-risk" offerings). To the extent U.S. securities regulatory protection reduce the risk of high-risk offerings, investors will not demand as great an increase in the discount compared with low-risk offerings. Table 12 reports of the actual discount and the predicted offshore discount for domestic private placement offerings based on their degree of fraud risk.

[Insert Table 12 Here].

From Table 12 note that the actual discount for domestic private placements does not vary significantly between the high and low-risk categories of offerings. The actual discount for

[70] The model had an adjusted R^2 equal to 0.1256 with 191 observations (t-statistic in parenthesis).

DISCOUNT = 0.607 – 0.068LNMKTCAP – 0.058LNOMKT – 0.001SHLDERS – 0.050BINSIDER
(3.751) (-3.914) (-3.503) (-0.055) (-0.416)

+ 0.112MDHOLD –0.077MDHOLD^2 + 0.018PREFRAUD + 0.111PREFRAUD x SEC + 0.085SEC
(0.318) (-0.150) (0.269) (0.302) (0.324)

+ 0.007TOBINQ – 0.245YR94 – 0.212YR95 – 0.317YR96 – 0.328YR97 + 0.047SIC13 – 0.019SIC28
(1.919) (-1.835) (-1.600) (-2.427) (-2.491) (0.476) (-0.306)

– 0.137SIC35 + 0.073SIC36 – 0.051SIC38 – 0.134SIC48 + 0.015SIC73 + 0.269SIC80 + å
(-2.015) (1.224) (-0.757) (-0.965) (0.199) (1.679)

In addition, the model is re-estimated with only those offshore offerings involving an issuer that did not conduct a U.S.-targeted offering within 5 years of the offshore offering. Issuers that conduct both U.S. and offshore offerings may use an offshore offering for purposes other than to exit the U.S. regime (adj. R^2 = 0.0760; 159 observations). In the re-estimated model, the predicted offshore discount for the domestic private placement firms assumed to target Europe is equal to 25.9%. The difference between the actual discount and the predicted offshore discount is significant at the 1% level.

low-risk offerings is 17.4% while the actual discount for high-risk offerings is 17.1% (difference statistically insignificant). The lack of difference in the actual discount is consistent with the hypothesis that U.S. securities regulations reduce the risk of high-risk offerings, leading investors not to demand a greater discount. On the other hand, the predicted offshore discount varies significantly. The predicted offshore discount for low-risk offerings is 22.4% while the predicted offshore discount for high-risk offerings is 38.3% (difference significant at the 1% level). The differential in the predicted offshore discount for high-risk offerings is consistent with the hypothesis that regulatory protections offshore provide a lower level of investor protections. Although inside the United States investors do not demand a greater discount for offerings where the issuer has a high-risk past history, offshore investors demand on average a 15.9 percentage point greater discount. The mean offering amount for high-risk domestic private placements of common stock is $16.90 million, giving high-risk domestic issuers an additional potential loss of $2.69 million on average had they chosen to issue outside the United States compared with low-risk domestic issuers.

To the extent different regions provide a different discount compared to offerings in the United States, however, the variation among predicted offshore discounts may not be due to fraud-related factors but rather the selection of a different geographical region for the offering. For example, offerings reported as taking place in Asia received a mean actual discount of 26.6%. It is possible that, for example, a prior SEC investigation correlates with offshore issuers selecting non-European geographical regions. The reduced discount, therefore, may not be due to the prior SEC investigation itself but rather exist because of the correlation between a prior SEC investigation and the selection of a non-European geographical region.[71]

The offering discount measured using the secondary market price at the start date of the offering may also include a discount for the expected negative market reaction to news of the offering. Kang et al. (1995) find a –1.35% negative abnormal return for the announcement for

[71] No evidence of such a correlation, nevertheless, exists in the data sample. Of the 24 offshore offerings involving an issuer with a past SEC investigation, the geographical region for 20 of the offerings is unknown. Among the known offerings, 2 target Europe (representing 1.6% of the reported European offerings) and 3 target non-European regions (representing 4.6% of the non-European offerings). The difference in incidence for offerings involving an issuer with a past SEC investigation is not statistically significant between Europe and the non-European regions (prob. = 0.2201).

offshore U.S. convertible debt issues. On the other hand, Wruck (1989) finds a positive secondary market reaction to news of a domestic equity private placement. The paper therefore recalculates the offering discount minus the expected market reaction (termed the "residual discount") to gauge the importance of fraud-risk related factors in the negotiated discount without regard to the expected market reaction. As a proxy for the expected market reaction, the paper uses the actual 8-week cumulative excess return after the start date of the offering estimated using the market model.[72] The 8-week time window is constructed to coincide with the end of the 40-day restricted period relevant for offerings during the article's sample time period. The market is assumed at the latest to learn about the offering once resales commence from abroad into the United States.[73]

Use of the calculated residual discount provides results similar to the paper's tests using the full negotiated offering discount. The actual mean residual discount for low-risk offerings is 15.6% while the actual mean residual discount for high-risk offerings is 16.0% (difference statistically insignificant). The lack of a statistically significant difference is consistent with the lack of difference for the actual offering discount between high and low-risk domestic offerings. To determine the predicted residual offshore discount, the model in Table 12 is re-estimated using the residual offshore discount as the dependent variable. Using the model, the predicted mean residual offshore discount for low-risk offerings is 19.6% while the predicted mean residual off-

[72] The market model treats the return for any security as a function of the total market return. For security i, for example, the expected return for time period t (R_{it}) is equal to:

$$R_{it} = a + b_i R_{mt} + e_{it}$$

Where R_{mt} is the market return and e_{it} is the zero mean disturbance term. A value-weighted return based on all the securities trading on the exchange in which the issuer's securities are listed is used for the market return. The value-weighted return for all NASDAQ securities is used for securities trading on NASDAQ. For each security, returns from -260 trading days to -20 trading days prior to the start of the offering are used to estimate the parameters of the market model. Daily secondary market returns are obtained from the Center for Research on Security Prices ("CRSP").

[73] The market, of course, may learn of the offering at a point earlier than 8-weeks after the start of the offering. After November 18, 1996, for instance, the SEC required issuers to reveal all equity-related Regulation S offerings under Item 9 of Form 8-K within 15 days of the offering. See Item 9 of Form 8-K, Exchange Act. See SEC, Periodic Reporting of Unregistered Equity Sales, Release No. 34-37801 (October 10, 1996). For offerings conducted after the SEC's 1996 reforms, therefore, the paper's event windows may be larger than necessary. As a result, the expanded event windows may bias against finding a significant abnormal market reaction.

shore discount for high-risk offerings is 27.9%. Although a 8.3 percentage point difference exists between the predicted residual offshore discounts for high and low-risk offerings had they gone abroad, the difference is significant at only the 20% confidence level.

5. Conclusion

The paper presents evidence consistent with the hypothesis that at least a subset of U.S. firms issue equity abroad to avoid exposure to U.S. fraud litigation. Issuers with a past history of private securities fraud litigation and issuers in industries particularly prone to class action suits are more likely to go overseas. Some issuers may find that the costs outweigh the benefits associated with the U.S. antifraud liability regime, due to non-meritorious lawsuits for example. On the other hand, issuers with a past history of private securities fraud litigation that also faced a past SEC investigation are more likely to issue equity within the United States. Such firms may value the U.S. legal regime as a means of bonding themselves to make only completely truthful statements to investors. Alternatively, the selection of the U.S. legal regime may help signal the quality of the issuer's offering to investors to the extent offerings posing a higher risk of fraud face an increased cost from selecting the U.S. regime.

The paper's results are subject to a number of caveats. First, the logit model of the decision to offer securities offshore may fail to control for all relevant factors. Many issuers, for example, base their decision as to where to raise capital upon factors unrelated to regulatory considerations, including for example the liquidity of different markets. The paper's hypothesis, nevertheless, is not that all issuers view antifraud liability as the most significant or even a primary consideration. Rather, the paper's hypothesis is that for the subset of issuers where antifraud liability makes a difference, issuers choose where to offer securities based on the regime that best maximizes value to investors.

Second, even to the extent issuers may use offshore offerings to mitigate the risk of antifraud liability that may result in frivolous litigation, other aspects of the U.S. regime may remain beneficial for investors. In particular, insiders may use offshore offerings to conceal sales of securities at discounted prices to entities affiliated with the insiders. The paper's findings relate

only to the value of U.S. antifraud regulatory provisions for purchasers during an offering. Nevertheless, regulators may seek to target specifically managerial opportunism in offshore offerings. For example, as I have argued elsewhere (Choi, 2000), regulators may force managers to disclose in-depth information on the identity of the offshore purchaser as well as specific details on the intended use of the proceeds from the offering. With more specific provisions targeting managerial opportunism, regulators may then allow issuers more freely to exit other aspects of the U.S. securities regime designed to protecting purchasing investors in an offering.

Third, the paper focuses only on the choice between offshore offerings and domestic private placements. Issuers, in fact, may choose from a variety of options to raise capital including public offerings and debt financing. Each alternative represents a different level of exposure to the U.S. regulatory regime. Further study examining the antifraud litigation experience of issuers that choose the greater regulatory protections associated with a subsequent U.S. registered public offering may help verify the possibility that certain issuers adopt the U.S. regime to signal that they are acting truthfully with investors.

The paper nonetheless offers evidence that concern with possible exposure to U.S. antifraud liability affects the decision on the part of issuers to raise capital either offshore or within the United States. Moreover, the paper's evidence supports the voluntary regulation hypothesis that issuers bear good incentives to select investor protections based on the preferences of potential investors. In particular, issuers that pose an increased risk of fraud, as signaled through past experience with both a private fraud action and a SEC investigation, tend to remain within the U.S. regime voluntarily.[74] Some issuers, of course, may continue to seek to engage in fraud under a voluntary system of regulation; investors, as well, may not accurately interpret the signal sent from the selection of a particular regulatory regime of the risk of fraud. Nevertheless, the

[74] The paper's results are consistent with anecdotal evidence in support of the voluntary regulation hypothesis. In Germany, the Neuer Markt, a subsidiary of the Deutsche Bourse, experienced rapid growth in the number of listed companies and trading volume in large part due to the imposition through private contract of U.S.-style disclosures for listed companies. See Vanessa Fuhrmann, Playing by the Rules: How Neuer Markt Gets Respect, Wall St. J., Aug. 21, 2000, at C1. Similarly, Jackson and Pan (2000) conducted a series of in-depth interviews with 50 European financial professionals in 1999 to determine the factors that affect the choice among different European securities markets. Jackson and Pan report that the interviewed financial professionals indicated that increased securities disclosure above the level legally required is commonly required due to market forces.

paper's results raise the possibility that regulators may wish to consider expanding the circumstances under which issuers may opt out of antifraud liability.

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Table 1
Summary of the Disclosure and Antifraud Requirements Placed on Different Types of Offerings under the U.S. Securities Laws

	Public Offering	Private Placement	Offshore Offering
Required Disclosure	• Extensive disclosure as required under, among others, Forms S-1, S-2, or S-3 of the Securities Act	• Limited disclosure under Rule 502(b) of the Securities Act to the extent securities offered to non-accredited investors for certain private placements	• None
Private Antifraud Liability	• Sections 11, 12(a)(2) of the Securities Act • Rule 10b-5 of the Exchange Act	• Rule 10b-5 of the Exchange Act	• Rule 10b-5 subject matter jurisdiction only if conduct or effects inside the United States • Forum-selection and choice of law clauses limit liability exposure • Greater difficulty in maintaining a class action with foreign class members. Individual foreign plaintiffs face higher transportation and litigation costs
SEC Enforcement	• Possible SEC Enforcement	• Possible SEC Enforcement	• Resources devoted primarily to transactions where U.S. investors potentially may be harmed (e.g., through rapid resales of offshore securities back into the United States).

Table 2
Sample Summary Statistics

Panel A: Frequency of Non-Public Offerings From 1993 to 1997

Year of Offering	Total Number of Issuers	Total Number of Offerings	Number of Offshore Offering Issuers	Number of Offshore Offerings	Number of Private Placement Issuers	Number of Private Placement Offerings
1993	139	150	26	30	113	120
1994	187	205	76	86	111	119
1995	195	219	105	120	90	99
1996	359	440	170	244	189	196
1997	362	430	159	213	203	217
Total	1242	1444	536	693	706	751

Panel B: Breakdown of Offerings by Security Type

Security	Number of Offerings	Percentage of Total Non-Public Offerings	Mean Offering Amount ($ millions)	Median Offering Amount ($ millions)
Common	784	54.3%	12.5	3.0
Preferred Non-Convertible	23	1.6	23.8	8.3
Preferred Convertible	330	22.9	51.4	9.8
Debt Convertible	307	21.3	59.0	7.5
Total	1444	100.0%	30.0	8.3

Panel C: Breakdown of Offerings by Security and Offering Type

Security	Number of Private Placements	Percentage of Total Private Placements	Number of Offshore Offerings	Percentage of Total Offshore Offerings
Common	403	53.7%	381	55.0%
Preferred Non-Convertible	19	2.5%	4	0.6%
Preferred Convertible	230	30.6%	100	14.4%
Debt Convertible	99	13.2%	208	30.0%
Total	751	100.0%	693	100.0%

Panel D: Breakdown of Non-Public Offerings by Securities Exchange

	Number of Offerings	Percentage of Total Non-Public Offerings	Mean Offering Amount ($ millions)	Median Offering Amount ($ millions)
NYSE	158	11.0%	141.0	80.6
AMEX	80	5.5	13.4	4.9
NASDAQ	1204	83.5	19.7	4.0
Total	1442	100.0%	32.5	5.0

Panel E: Breakdown of Non-Public Offerings by 2-Digit SIC Code

SIC Code	Frequency	Percentage	SIC Code	Frequency	Percentage
1	1	0.07%	45	15	1.08%
7	2	0.14	47	2	0.14
10	21	1.51	48	75	5.41
13	53	3.82	49	33	2.38
14	4	0.29	50	41	2.96
15	3	0.22	51	28	2.02
17	4	0.29	53	5	0.36
20	16	1.15	54	6	0.43
22	1	0.07	55	8	0.58
23	6	0.43	56	5	0.36
24	5	0.36	58	28	2.02
25	5	0.36	59	23	1.66
26	5	0.36	60	13	0.94
27	12	0.87	61	14	1.01
28	171	12.33	62	2	0.14
29	2	0.14	63	22	1.59
30	12	0.87	64	10	0.72
31	2	0.14	65	13	0.94
32	3	0.22	67	32	2.31
33	8	0.58	70	7	0.5
34	11	0.79	72	2	0.14
35	111	8.00	73	161	11.61
36	102	7.35	75	3	0.22
37	17	1.23	76	1	0.07
38	109	7.86	78	6	0.43
39	21	1.51	79	26	1.87
40	7	0.50	80	49	3.53
41	1	0.07	82	5	0.36
44	6	0.43	83	4	0.29
			87	27	1.95

Panel F: Three-Digit SIC Code Breakdown for Top 5 SIC Code Groups with Largest Number of Offerings

SIC Code	Frequency for Private Placements	Frequency for Offshore Offer-ings	Frequency for all Non-Public Offerings
283 (Drugs)	101	52	153
737 (Computer Programming, Data Processing)	72	49	121
384 (Surgical, Medical, And Dental Instruments And Apparatus)	43	33	76
357 (Computer And Office Equipment)	25	41	66
131 (Crude Petroleum And Natural Gas)	23	27	50

Table 3
Comparison of the Domestic Private Placement and Offshore Offerings

Panel A: Summary Characteristics of the Domestic Private Placement and Offshore Offerings

Variable	Private Placements Mean	Offshore Offerings Mean	p-value [a]	Private Placements Median	Offshore Offerings Median	p-value [b]
Assets ($ millions)	876.827	577.368	0.466	29.516	18.997	0.000**
Market Capitalization ($ millions)	320.743	355.096	0.662	60.512	32.527	0.000**
Offering Amount ($ millions)	29.236	36.431	0.155	8.200	2.290	0.000**

Variable	Private Placements	Offshore Offerings	p-value [a]
Fraction of Officers on the Board of Directors	0.350	0.403	0.000**
Fraction of Common Shares held by Directors and Officers	0.229	0.201	0.005**
Fraction of Common Shares held by Institutional Investors	0.169	0.125	0.001**
Fraction with Registration Rights	0.136	0.155	0.288

** 5% level; * 10% level.

[a] The p-value is the value of a two-sided t-test of the difference in mean values between the private placement and offshore offering samples.

[b] The p-value is the value of two-sample Wilcoxon rank-sum (Mann-Whitney) test of the difference between the medians.

Panel B: Comparison of the Domestic Private Placement and Offshore Offering Issuer's Private Fraud Action Experience

Variable	No. of Private Placements	Fraction of Total Private Placements	No. of Offshore Offerings	Fraction of Total Offshore Offerings
Presence of a Pre-Offering Fraud Action	81	0.108	86	0.125

p-value of difference in means is 0.301 (statistically insignificant). The p-value is the value of a two-sided t-test of the difference in mean values between the private placement and offshore offering samples.

Panel C: Comparison of the Domestic Private Placement and Offshore Offering Issuer's Private Fraud Action Experience Broken Down by Offer Amount Quartile

Variable	Fraction of Private Placements	Fraction of Offshore Offerings	p-value [a]
Offer Amount 1st Quartile	0.106	0.043	0.063*
Offer Amount 2nd Quartile	0.067	0.076	0.802
Offer Amount 3rd Quartile	0.101	0.279	0.000**
Offer Amount 4th Quartile	0.164	0.261	0.050**

** 5% level; * 10% level.

Offer Amount 1st Quartile is defined to include offerings where the offer amount is less than 1.5 million dollars.

Offer Amount 2nd Quartile is defined to include offerings where the offer amount is greater than or equal to 1.5 million dollars and less than 5 million dollars.

Offer Amount 3rd Quartile is defined to include offerings where the offer amount is greater than or equal to 5 million dollars and less than 17.5 million dollars.

Offer Amount 4th Quartile is defined to include offerings where the offer amount is greater than 17.5 million dollars. The four quartiles are based on the distribution of offering amounts for the entire sample of offshore offerings and domestic private placements.

Panel D: Comparison of the Domestic Private Placement and Offshore Offering Issuer's Private Fraud Action Experience Broken Down by Offer Amount to Market Capitalization Quartile

Variable	Fraction of Private Placements	Fraction of Offshore Offerings	p-value [a]
Offer Amount/Market Capitalization 1st Quartile	0.128	0.078	0.191
Offer Amount/Market Capitalization 2nd Quartile	0.103	0.128	0.533
Offer Amount/Market Capitalization 3rd Quartile	0.098	0.220	0.006**
Offer Amount/Market Capitalization 4th Quartile	0.127	0.162	0.418

** 5% level; * 10% level.

Offer Amount/Market Capitalization 1st Quartile is defined to include offerings where the offer amount to market capitalization ratio is less than 0.050.

Offer Amount/Market Capitalization 2nd Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than or equal to 0.050 and less than 0.112.

Offer Amount/Market Capitalization 3rd Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than or equal to 0.112 and less than 0.223.

Offer Amount/Market Capitalization 4th Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than 0.223. The four quartiles are based on the distribution of offering amount to market capitalization ratios for the entire sample of offshore offerings and domestic private placements.

Panel E: Comparison of SIC Groups for Private Placement and Offshore Offering Issuers

Variable	Fraction of Private Placements	Fraction of Offshore Offerings	p-value [a]
SIC 35 (Ind. and Comm. Machinery and Computer Equip.)	0.060	0.094	0.014**
SIC 36 (Electrical Equip. and Components)	0.049	0.093	0.001**
SIC 73 (Business Services)	0.121	0.101	0.229
SIC 357 (Computer and Office Equipment)	0.033	0.058	0.021**

** 5% level; * 10% level.

[a] The p-value is the value of a two-sided t-test of the difference in mean values between the private placement and offshore offering samples.

Panel F: Comparison of Private Fraud Class Actions from Bohn and Choi (1996) Study for the Issuer's 2-Digit SIC Group

Variable	Mean for Private Placements	Mean of Offshore Offerings	p-value [a]
Number of Private Fraud Class Actions from Bohn and Choi (1996) for the Issuer's 2-Digit SIC Group	3.772	4.614	0.0167**
Incidence of Private Fraud Class Actions from Bohn and Choi (1996) for the Issuer's 2-Digit SIC Group	0.028	0.031	0.0171**

** 5% level; * 10% level.

Bohn and Choi (1996) report on the incidence of private securities fraud class actions arising out of an initial public offering for firms that went public from 1975 to 1986.

[a] The p-value is the value of a two-sided t-test of the difference in mean values between the private placement and offshore offering samples.

Table 4
Comparison of Private Placement and Offshore Offerings
(For the Sub-Sample Involving a Pre-Offering Fraud Issuer)

Panel A: Characteristics of the Pre-Offering Private Fraud Action

Variable	Private Placement	Offshore Offering	p-value [a]
Fraction with SEC investigation experience	0.358	0.163	0.0037**
Fraction that resulted in settlement	0.862	0.727	0.0582*
Fraction with dismissal or pro-defendant judgment	0.123	0.258	0.0507*
Fraction consisting of a Class Action	0.952	0.912	0.3623
Mean Resolution Time (in years)	2.280	2.063	0.3054
Mean Settlement Amount ($millions)	5.545	5.470	0.9575

** 5% level; * 10% level.

Panel B: Corporate Governance Changes at Time of Pre-Offering Fraud Action

Variable	Private Placement	Offshore Offering	p-value [a]
Fraction with a new CEO two years after filing of suit	0.484	0.452	0.7152
Mean CEO age at filing of suit	52.0	49.8	0.2456
Mean change in fraction of officers on the board of directors	-0.065	-0.013	0.0945*

** 5% level; * 10% level.

Panel C: Attorney Characteristics for Pre-Offering Private Fraud Action

Variable	Private Placement	Offshore Offering	p-value [a]
Fraction with Milberg, Weiss, Bershad, Hynes & Lerach	0.316	0.413	0.3639
Fraction with Top 5 Plaintiffs' attorney as a Lead Attorney	0.474	0.630	0.1543
Fraction with Top 5 Defense Attorney as a Lead Attorney	0.062	0.081	0.6253

** 5% level; * 10% level.

Top 5 Plaintiff's and Defense attorney firm rankings obtained from Forbes Magazine listing of the market leaders in class litigation from 1988 to mid-1995 (ranked by number of cases). See Nancy Rutter, Bill Lerach Thinks of Himself as Robin Hood In a Class-Action Suit , Forbes, Oct. 9, 1995, at 116. The Top 5 plaintiffs' attorney firms listed in the Forbes article are: Milberg, Weiss, Bershad, Hynes & Lerach (193 cases), Berger & Montague (87 cases), Abbey & Ellis (73 cases), Wolf, Popper, Ross, Wolf & Jones (59 cases), and Barrack, Rodos & Bacine (57 cases). The Top 5 defense attorney firms are: Wilson, Sonsini, Goodrich & Rosati (50 cases), Skadden, Arps, Slate, Meagher & Flom (45 cases), Gibson, Dunn & Crutcher (29 cases), Heller, Ehrman, White & McAuliffe (22 cases), and Paul, Weiss, Rifkind, Wharton & Garrison (16 cases).

[a] The p-value is the value of a two-sided t-test of the difference in mean values between the private placement and offshore offering samples.

Table 5
Summary of Top 5 Plaintiffs' attorneys Firms Involved in the Sample's Pre-Offering Fraud Actions

Top 5 Plaintiffs' attorney firm rankings obtained from Forbes Magazine listing of the market leaders in class litigation from 1988 to mid-1995 (ranked by number of cases). The Top 5 plaintiffs' attorney firms listed in the Forbes article are: Milberg, Weiss, Bershad, Hynes & Lerach (193 cases), Berger & Montague (87 cases), Abbey & Ellis (73 cases), Wolf, Popper, Ross, Wolf & Jones (59 cases), and Barrack, Rodos & Bacine (57 cases). See Nancy Rutter, Bill Lerach Thinks of Himself as Robin Hood In a Class-Action Suit, Forbes, Oct. 9, 1995, at 116.

Plaintiffs' attorney Firm	Private Placement Frequency	Percentage of Private Placements (where lead atty known)	Offshore Offering Frequency	Percentage of Offshore Offerings (where lead atty known)
Milberg, Weiss, Bershad, Hynes & Lerach	12	31.5%	19	41.3%
Berger & Montague	1	2.6%	6	13.0%
Abbey & Ellis	2	5.3%	8	17.4%
Wolf, Popper, Ross, Wolf & Jones	1	2.6%	6	13.0%
Barrack, Rodos & Bacine	5	13.1%	6	13.0%
Total	18	47.4%	29	63.0%

Table 6
Logit Model of the Decision to Conduct an Offshore Offering

The dependent variable in all six maximum likelihood logit models treats companies that engaged in an offshore offering as 1 and companies that conducted solely a private placement within the United States as 0.

Independent Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Log of Market Capitalization	0.126*	0.027	0.124	0.123	0.126*	0.195**
	(1.658)	(0.301)	(1.626)	(1.605)	(1.643)	(2.424)
Log of Offering Amount	-0.354**	-0.618**	-0.354**	-0.362**	-0.353**	-0.300**
	(-4.781)	(-6.686)	(-4.783)	(-4.887)	(-4.764)	(-3.883)
Number of Shareholders	0.000	0.003	0.000	0.001	0.000	-0.001
	(0.143)	(0.364)	(0.179)	(0.235)	(0.118)	(-0.008)
Fraction of Shares held by Institutional Investors	0.806*	-1.652**	0.818*	0.816*	0.807*	0.910*
	(1.744)	(-2.195)	(1.770)	(1.748)	(1.746)	(1.919)
World Contacts	-0.004	0.004	-0.005	-0.003	-0.004	-0.003
	(-0.419)	(0.306)	(-0.440)	(-0.255)	(-0.422)	(-0.324)
Fraction of Board Comprised of Officers	1.942**	1.888**	1.940**	1.962**	1.944**	2.166**
	(3.827)	(3.057)	(3.821)	(3.850)	(3.831)	(4.086)
Fraction of Common Stock held by Directors and Officers	-1.014**	-1.018*	-1.017**	-0.971**	-1.018**	-0.856*
	(-2.288)	(-1.884)	(-2.294)	(-2.187)	(-2.295)	(-1.876)
Dummy Variable for Common Stock Offering	-0.355**	0.032	-0.345**	-0.363**	-0.358**	-0.359**
	(-2.053)	(0.155)	(-1.991)	(-2.095)	(-2.068)	(-2.026)
Dummy for SIC 35	0.372	0.146	0.378	0.293	0.372	0.439
	(1.220)	(0.382)	(1.239)	(0.954)	(1.219)	(1.421)
Dummy for SIC 36	1.004**	0.913**	1.005**	1.028**	1.003**	1.107**
	(3.143)	(2.443)	(3.146)	(3.201)	(3.144)	(3.400)
Dummy for SIC 73	0.073	-0.318	0.082	0.057	0.078	0.049
	(0.283)	(-0.979)	(0.318)	(0.220)	(0.302)	(0.185)

Table 6 Continues on Next Page

Table 6 Continued

Dummy for Pre-Offering Fraud Action	0.677** (2.458)	0.598* (1.768)	0.607** (2.111)	0.309 (0.974)	0.764* (1.809)	0.627** (2.255)
Pre-Offering Fraud x SEC Investigation	-1.952** (-2.011)	-2.922** (-2.003)	-1.918** (-1.976)	-2.293** (-2.290)	-1.955** (-2.014)	-1.763* (-1.806)
Dummy for SEC Investigation	0.657 (0.872)	0.862 (0.940)	0.659 (0.875)	0.681 (0.899)	0.655 (0.869)	0.517 (0.683)
Pre-Offering Fraud x Dismissal or Judgment for Defendants	.	.	0.612 (0.802)	.	.	.
Pre-Offering Fraud x Top 5 Plaintiffs' Attorney	.	.	.	1.102** (2.159)	.	.
Pre-Offering Fraud x Post-PSLRA Reform	.	.	.	.	-0.133 (-0.273)	.
Standard Deviation of Past 1-Year Returns	.	.	.	.	.	10.609** (3.143)
Constant	-0.416 (-1.144)	-0.071 (-0.166)	-0.414 (-1.136)	-0.409 (-1.122)	-0.413 (-1.132)	-1.542** (-3.097)
Number of Observations	711	592	711	711	711	689
Pseudo R2	0.080	0.211	0.081	0.085	0.080	0.091
Log Likelihood	-452.789	-318.634	-452.452	-450.314	-452.752	-433.265
Likelihood Ratio Test [a]	$\div^2(3) = 8.57$**	$\div^2(3) = 6.65$*	$\div^2(4) = 9.24$*	$\div^2(4) = 13.52$**	$\div^2(4) = 8.64$*	$\div^2(3) = 7.27$*
	prob.=0.0356	prob.=0.0839	prob.=0.0553	prob.=0.0090	prob.=0.0706	prob.=0.0637

** 5% level; * 10% level. (z-statistic in parenthesis).

[a] The likelihood ratio test compares the fitted logit model against the same logit model without the Pre-Offering Fraud and SEC Investigation dummy variables and any interaction terms with these variables.

Table 7

Change in the Probability of an Offering Securities Offshore Due to Fraud-Related Factors

Change in probabilities are calculated using the logit model reported in Model 1 of Table 6. Two sets of changes in probabilities are calculated: first using the mean values for all non-fraud-related independent variables; second using the median values for all non-fraud-related independent variables. All mean and median values are for the 711 observations used in Model 1 of Table 6.

Fraud-Related Dummy Variable Values	Change to Probability Using Mean Values	Change to Probability Using Median Values
Pre-Offering Fraud = 0 and SEC Investigation = 0	Base	Base
Pre-Offering Fraud = 1 and SEC Investigation = 0	+0.162	+0.168
Pre-Offering Fraud = 1 and SEC Investigation = 1	–0.151	–0.137

Table 8
Logit Model of the Decision to Conduct an Offshore Offering

The dependent variable in all four maximum likelihood logit models treats companies that engaged in an offshore offering as 1 and companies that conducted solely a private placement within the United States as 0. Offer Amount 1st Quartile is defined to include offerings where the offer amount is less than 1.5 million dollars. Offer Amount 2nd Quartile is defined to include offerings where the offer amount is greater than or equal to 1.5 million dollars and less than 5 million dollars. Offer Amount 3rd Quartile is defined to include offerings where the offer amount is greater than or equal to 5 million dollars and less than 17.5 million dollars. Offer Amount 4th Quartile is defined to include offerings where the offer amount is greater than 17.5 million dollars. Offer Amount/Market Capitalization 1st Quartile is defined to include offerings where the offer amount to market capitalization ratio is less than 0.050. Offer Amount/Market Capitalization 2nd Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than or equal to 0.050 and less than 0.112. Offer Amount/Market Capitalization 3rd Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than or equal to 0.112 and less than 0.223. Offer Amount/Market Capitalization 4th Quartile is defined to include offerings where the offer amount to market capitalization ratio is greater than 0.223.

Independent Variables	Model 1	Model 2	Model 3	Model 4
Log of Market Capitalization	0.112 (1.469)	0.120 (1.559)	0.149* (1.884)	0.155* (1.948)
Log of Offering Amount	-0.398** (-5.205)	-0.403** (-5.233)	-0.383** (-4.928)	-0.383** (-4.911)
Number of Shareholders	0.000 (0.173)	0.000 (0.046)	0.001 (0.257)	0.000 (0.160)
Fraction of Shares held by Institutional Investors	0.883* (1.890)	0.886* (1.874)	0.819* (1.780)	0.808* (1.742)
World Contacts	0.001 (0.125)	-0.001 (-0.091)	-0.002 (-0.164)	-0.004 (-0.375)
Fraction of Board Comprised of Officers	1.925** (3.761)	1.933** (3.760)	1.908** (3.745)	1.915** (3.747)
Fraction of Common Stock held by Directors and Officers	-0.996** (-2.244)	-0.958** (-2.150)	-1.048** (-2.370)	-1.017** (-2.295)
Dummy Variable for Common Stock Offering	-0.321* (-1.855)	-0.326* (-1.876)	-0.351** (-2.041)	-0.359** (-2.072)
SIC 35 (Ind. and Comm. Machinery and Computer Equip.)	0.437 (1.436)	0.388 (1.261)	0.455 (1.500)	0.406 (1.331)
SIC 36 (Electrical Equip. and Components)	0.994** (3.092)	0.982** (3.040)	0.989** (3.094)	0.982** (3.064)
SIC 73 (Business Services)	0.039 (0.150)	0.055 (0.209)	0.035 (0.135)	0.049 (0.189)

Table 8 Continues on Next Page

Table 8 Continued

Pre-Offering Fraud x Offer Amount Quartile 1	-0.356 (-0.561)	-0.087 (-0.127)	.	.
Pre-Offering Fraud x Offer Amount Quartile 2	-0.955 (-1.456)	-0.812 (-1.218)	.	.
Pre-Offering Fraud x Offer Amount Quartile 3	0.375 (0.987)	0.628 (1.565)	.	.
Pre-Offering Fraud x Offer Amount Quartile 4	1.270** (3.110)	1.685** (3.679)	.	.
Pre-Offering Fraud x Offer Amount to Market Cap Ratio Quartile 1	.	.	-0.229 (-0.429)	0.019 (0.034)
Pre-Offering Fraud x Offer Amount to Market Cap Ratio Quartile 2	.	.	0.349 (0.751)	0.605 (1.236)
Pre-Offering Fraud x Offer Amount to Market Cap Ratio Quartile 3	.	.	0.666 (1.573)	0.986** (2.132)
Pre-Offering Fraud x Offer Amount to Market Cap Ratio Quartile 4	.	.	0.668 (1.465)	0.848* (1.797)
Pre-Offering Fraud x SEC Investigation	.	-2.238** (-2.249)	.	-1.969** (-2.015)
Dummy Variable for SEC Investigation		0.691 (0.907)	.	0.668 (0.884)
Constant	-0.344 (-0.941)	-0.367 (-0.999)	-0.452 (-1.236)	-0.470 (-1.281)
Number of Observations	711	711	711	711
Pseudo R2	0.085	0.092	0.076	0.082
Log Likelihood	-450.305	-446.668	-454.554	-451.772
Likelihood Ratio Test [a]	$\div^2(4) = 13.54$** prob.=0.0089	$\div^2(6) = 20.81$** prob.=0.0020	$\div^2(4) = 5.04$ prob.=0.2831	$\div^2(6) = 10.60$ prob.=0.1014

** 5% level; * 10% level. (z-statistic in parenthesis).

[a] The likelihood ratio test compares the fitted logit model against the same logit model without the Pre-Offering Fraud and SEC Investigation dummy variables and any interaction terms with these variables.

Table 9

Post-Offering Litigation Experience of the Private Placement and Offshore Offering Issuers

Panel A: Post-Offering Private Securities Fraud Litigation

Table entries correspond to the fraction of offerings with post-offering private securities fraud litigation experience. For each offering, the issuer's post-offering private securities fraud litigation experience for a period of up to three years after the offering is determined through examination of SEC filings on WESTLAW and LEXIS as well as press releases on PR-NEWSWIRE.

	Pre-Offering Fraud Action Not Present	Pre-Offering Fraud Action Present
Private Placement	0.113	0.086
Offshore Offering	0.108	0.221

The p-value of a two-sided t-test of the difference in mean values between the private placement with pre-offering fraud action experience and the offshore offering with pre-offering fraud action experience samples is equal to 0.0164 (significant at the 5% level).

The p-value of a two-sided t-test of the difference in mean values between the offshore offering without pre-offering fraud action experience and the offshore offering with pre-offering fraud action experience samples is equal to 0.0029 (significant at the 1% level).

The p-value of a two-sided t-test of the difference in mean values between the private placement without pre-offering fraud action experience and the offshore offering with pre-offering fraud action experience samples is equal to 0.0046 (significant at the 1% level).

Panel B: Post-Offering SEC Investigation Experience

Table entries correspond to the fraction of offerings with post-offering SEC investigation experience. For each offering, the issuer's post-offering SEC investigation for a period of up to three years after the offering is determined through examination of SEC filings on WESTLAW and LEXIS as well as press releases on PR-NEWSWIRE. SEC investigations include formal and informal SEC investigations as well as SEC enforcement actions.

	Pre-Offering Fraud Action Not Present	Pre-Offering Fraud Action Present
Private Placement	0.023	0.025
Offshore Offering	0.042	0.035

The p-value of a two-sided t-test of the difference in mean values between the private placement with pre-offering fraud action experience and the offshore offering with pre-offering fraud action experience samples is equal to 0.7014.

The p-value of a two-sided t-test of the difference in mean values between the offshore offering without pre-offering fraud action experience and the offshore offering with pre-offering fraud action experience samples is equal to 0.7666.

The p-value of a two-sided t-test of the difference in mean values between the private placement without pre-offering fraud action experience and the offshore offering with pre-offering fraud action experience samples is equal to 0.4749.

Table 10

Discounts for Common Stock Offerings as a Fraction of the Secondary Market Price Measured at the Offering Date

Panel A: Comparison of the Discounts for Common Stock Domestic Private Placements and Offshore Offerings

The offering discount is defined as (the U.S. secondary market price at the start date of the offering minus the offering price) divided by the U.S. secondary market price at the start date of the offering. A more positive offering discount therefore corresponds with a greater discount.

Type of Offering	Number of Observations	Mean	Median	25% Quartile	75% Quartile
Domestic Private Placement	190	0.174	0.165	0.064	0.290
Offshore Offerings	232	0.294	0.272	0.128	0.445

The p-value from a two-sided unpaired t-test of the difference in mean values between the private placement and offshore offering samples is equal to 0.0000 (significant at the 1% level).

Panel B: Comparison of the Actual Discount and Predicted Offshore Discount for Domestic Private Placement Common Stock Offerings

The Predicted Offshore Discount is obtained through a two-step process. First the below model for the offshore discount is estimated using only offshore offerings in the data sample (Adj R2 = 0.1369; 191 observations).

$$DISCOUNT = \acute{a} + \hat{a}_1 LNMKTCAP + \hat{a}_2 LNOMKT + \hat{a}_3 SHLDERS + \hat{a}_4 BINSIDER + \hat{a}_5 MDHOLD + \hat{a}_6 MDHOLD\text{^}2 + \hat{a}_7 TOBINQ + \hat{a}_8 YEAR\_DUMMIES + \hat{a}_9 SIC\_DUMMIES + \mathring{a}$$

Second, predicted offshore discounts are obtained for the domestic private placements using the estimated model.

The paired comparison is between the actual and predicted offshore discounts for domestic private placements where data on both discounts exists for each domestic private placement.

Type of Offering	Number of Observations	Mean	Median	25% Quartile	75% Quartile
Domestic Private Placement	190	0.174	0.165	0.064	0.290
Predicted Offshore Discount	232	0.237	0.221	0.116	0.333
Domestic Private Placement (paired)	153	0.154	0.164	0.037	0.273
Predicted Offshore Discount (paired)	153	0.224	0.219	0.114	0.312

The p-value from a two-sided unpaired t-test of the difference in mean values between the actual discount and predicted offshore discount for domestic private placements of common stock is equal to 0.0029 (significant at the 1% level).

The p-value from a two-sided paired t-test of the difference in mean values between the actual discount and predicted offshore discount for domestic private placements of common stock is equal to 0.0021 (significant at the 1% level).

Table 11

Predicted Offshore Discount for Domestic Private Placement Common Stock Offerings (by Geographical Region Where Known)

Panel A: Comparison of the Common Stock Offering Discount for the Offshore Offerings by Geographical Region (Where Known):

Offering Location	Number of Observations	Mean	Median	25% Quartile	75% Quartile
Europe	53	0.186	0.143	0.049	0.275
Canada	9	0.136	0.111	0.000	0.220
Asia	11	0.266	0.373	0.200	0.511
Latin America	17	0.307	0.345	0.242	0.375
Other	5	0.596	0.621	0.533	0.804

Panel B: Comparison of Actual Discount and Predicted Offshore Discount for Different Offshore Regions

The Predicted Offshore Discount is obtained through a two-step process. First the below model for the offshore discount is estimated using only offshore offerings in the data sample (Adj R2 = 0.1400; 191 observations).

DISCOUNT = á + $\hat{a}_1$LNMKTCAP + $\hat{a}_2$LNOMKT + $\hat{a}_3$SHLDERS + $\hat{a}_4$BINSIDER + $\hat{a}_5$MDHOLD + $\hat{a}_6$MDHOLD^2 + $\hat{a}_7$TOBINQ + $\hat{a}_8$YEAR_DUMMIES + $\hat{a}_9$SIC_DUMMIES + $\hat{a}_{10}$REGION_DUMMIES + å

Second, predicted offshore discounts are obtained for the domestic private placements using the estimated model. For each geographic region, the appropriate dummy variable is set equal to 1. For example, to obtain the predicted discount for offerings into Europe, the EUROPE dummy variable is set to 1 for all the domestic private placements.

Offering Location	Mean Predicted Discount	Median Predicted Discount	Difference in Actual Discount and Predicted Offshore Discount Means	p-value
Europe	0.198	0.187	0.025	0.2245
Canada	0.135	0.123	-0.039	0.0559*
Asia	0.194	0.183	0.020	0.3232
Latin America	0.244	0.233	0.071	0.0006**
Other	0.266	0.255	0.092	0.0000**

The p-value from a two-sided unpaired t-test of the difference in mean values between the actual discount and the predicted offshore discount for private placement offerings.

Table 12

Comparison of the Actual Discount and Predicted Offshore Discount for Domestic Private Placement Common Stock Offerings (Categorized by PREFRAUD x SEC)

The Predicted Offshore Discount is obtained through a two-step process. First the below model for the offshore discount is estimated using only offshore offerings in the data sample (Adj R2 = 0.1256; 191 observations).

$$DISCOUNT = \alpha + \beta_1 LNMKTCAP + \beta_2 LNOMKT + \beta_3 SHLDERS + \beta_4 BINSIDER + \beta_5 MDHOLD + \beta_6 MDHOLD\text{^}2 + \beta_7 PREFRAUD + \beta_8 PREFRAUD \times SEC + \beta_9 SEC + \beta_{10} TOBINQ + \beta_{11} YEAR\_DUMMIES + \beta_{12} SIC\_DUMMIES + \varepsilon$$

Second, predicted offshore discounts are obtained for the domestic private placements using the estimated model. Both the actual discount and predicted offshore discounts are categorized by where (A) the interaction term PREFRAUD x SEC is equal to 0 (denoted as "low-risk") and (B) where the interaction term is equal to 1 (denoted as "high-risk").

Type of Offering	Number of Observations	Mean	Median	25% Quartile	75% Quartile
(A) Domestic Private Placement	180	0.174	0.164	0.058	0.302
(B) Domestic Private Placement	10	0.171	0.172	0.153	0.215
(A) Predicted Offshore Discount	145	0.224	0.216	0.113	0.313
(B) Predicted Offshore Discount	8	0.383	0.389	0.236	0.508

The p-value from a two-sided t-test of the difference in actual discount mean values between categories (A) and (B) is equal to 0.9741.

The p-value from a two-sided t-test of the difference in the predicted offshore discount mean values between categories (A) and (B) is equal to 0.0064 (significant at the 1% level).

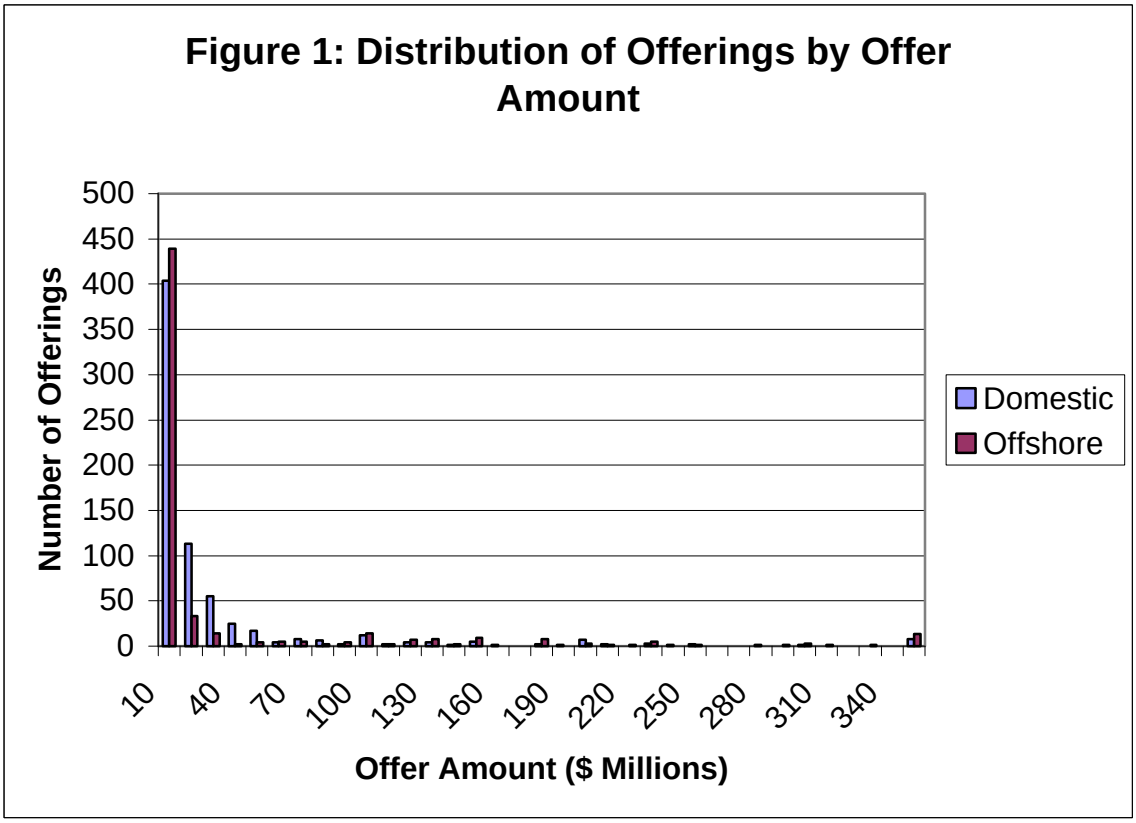
Figure 1: Distribution of Offerings by Offer Amount
Number of Offerings
500
450
400
350
300
250
200
150
100
50
0
10
40
70
100
130
160
190
220
250
280
310
340
Offer Amount ($ Millions)
Domestic
Offshore

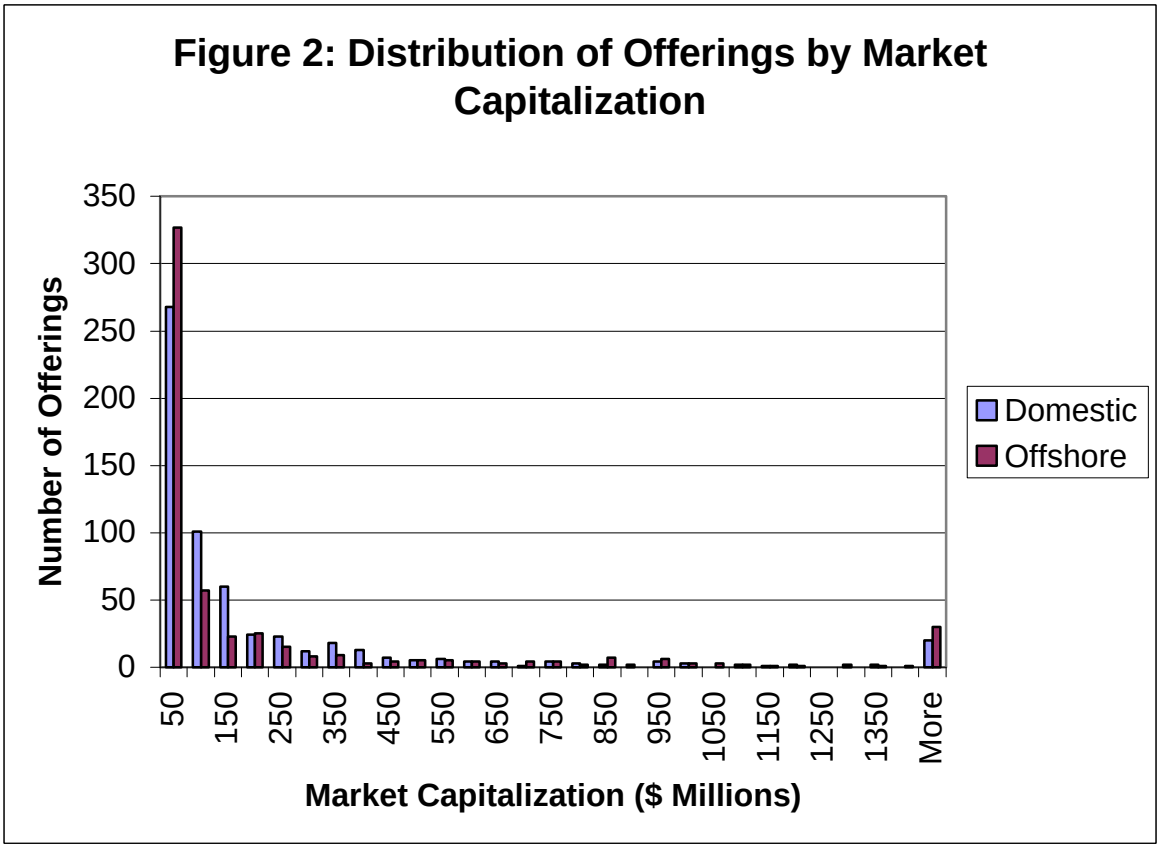
Figure 2: Distribution of Offerings by Market Capitalization
Number of Offerings
350
300
250
200
150
100
50
0
50
150
250
350
450
550
650
750
850
950
1050
1150
1250
1350
More
Market Capitalization ($ Millions)
Domestic
Offshore

Figure 3: Distribution of Offerings by Asset Size