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Issuer Choice After *Morrison*

Daniel Hemel†

Should federal securities laws apply to overseas transactions involving shares that are cross-listed on U.S. exchanges? This Comment approaches that question from two directions: Supreme Court doctrine and modern finance theory. As a doctrinal matter, this Comment argues that under the Supreme Court’s 2010 decision in *Morrison v. National Australia Bank Ltd.*, the answer is yes: federal securities laws should apply to all transactions involving shares that are listed for trading on U.S. exchanges, including transactions that occur overseas. From a finance theory perspective, this Comment explains how allowing foreign firms to “opt in” to U.S. securities laws through cross-listing can create an environment in which issuers choose the legal regime that minimizes their capital-raising costs. The *Morrison* majority opinion, if faithfully followed, could mark a step toward a system of “issuer choice.” Yet, federal district courts have strayed from the text of the *Morrison* majority’s holding in ways that may reduce the efficiency of capital markets.

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Introduction

In June 2010, the Supreme Court handed down a sweeping ruling in *Morrison v. National Australia Bank Ltd.* that dramatically limited the geographic reach of U.S. securities fraud laws. The issue in the case was

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1. 130 S. Ct. 2869.
whether investors who purchased shares of National Australia Bank ("NAB") on a Sydney stock exchange could proceed with a lawsuit against the bank and several of its former employees alleging that the defendants had made "deceptive" statements in violation of § 10(b) of the Securities Exchange Act.\(^2\) In a long list of decisions dating back to the 1960s, federal courts had allowed foreign investors to pursue § 10(b) claims arising out of transactions that occurred on non-U.S. exchanges.\(^3\) But in Morrison, Justice Scalia, along with four other Justices, reversed more than four decades of lower-court cases and announced a new "transactional test"\(^4\) to determine the geographic scope of § 10(b). This transactional test asks "whether the purchase or sale [1] is made in the United States, or [2] involves a security listed on a domestic exchange." Only if the answer to at least one of these questions is "yes" does § 10(b) apply.

The holding in Morrison marked a departure from the "unpredictable" outcomes in earlier cases, and at the time, it was hailed for its "clarity." Even Justice Stevens, who refused to join the Court’s opinion, acknowledged that "the clarity and simplicity of the Court’s test may have some salutary consequences." With regard to the first part of the transactional test ("whether purchase or sale is made in the United States"), this "clarity" may be overstated. Indeed, as lower courts have noted, the Morrison majority "did not . . . discuss what it means for a purchase or sale to be 'made in the United States.'" But the second part of the transactional test ("whether the purchase or sale . . . involves a security listed on a domestic exchange") seems like it should be relatively easy to apply. One can go to the websites of the American Stock Exchange ("AMEX"), NASDAQ, and New York Stock Exchange ("NYSE") and determine whether a firm’s common stock is listed for trading on those exchanges. Seventy-eight non-U.S. companies have common stock that is

\(^2\) Id. at 2875-76; cf. Securities Exchange Act of 1934, § 10(b), 48 Stat. 891 (codified as amended at 15 U.S.C. § 78j(b) (2006)) (making it unlawful "[t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe").

\(^3\) See, e.g., Gottfried v. Germain (In re CP Ships Ltd. Sec. Litig.), 578 F.3d 1306, 1307, 1313-14 (11th Cir. 2009); Travis v. Anthes Imperial Ltd., 473 F.2d 515, 524 (8th Cir. 1973); Schoenbaum v. Firstbrook, 405 F.2d 200, 208-09 (2d Cir.), rev’d en banc on other grounds, 405 F.2d 215 (2d Cir. 1968).

\(^4\) Morrison, 130 S. Ct. at 2886.

\(^5\) Id.


\(^7\) See, e.g., Cornwell v. Credit Suisse Grp., No. 08 Civ. 3758, 2010 U.S. Dist. LEXIS 76543, at *11 (S.D.N.Y. July 26, 2010) (praising the "clarity, simplicity, certainty and consistency" of the new transactional test).

\(^8\) Morrison, 130 S. Ct. at 2895 (Stevens, J., concurring in judgment).

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directly listed on AMEX,10 227 on NASDAQ,11 and 140 on the NYSE.12 Justice Scalia’s use of the logical disjunctive “or”—“whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange”13—would seem to suggest that transactions involving the common stock of any of these 445 companies would fall within the scope of § 10(b), regardless of whether “purchase or sale is made in the United States.”14

The U.S. District Court for the Southern District of New York, however, has rejected this straightforward reading of Morrison. In two separate decisions handed down during the summer of 2010, Judge Vincent Marrero concluded that § 10(b) does not apply to any transactions on a foreign market, regardless of whether the securities at issue are listed for trading on a U.S. exchange.15 Judge Deborah Batts reaffirmed this conclusion in a January 2011 case involving Royal Bank of Scotland securities.16 In a February 2011 opinion, Judge Richard Holwell also acknowledged that his court’s reading of Morrison was “not . . . free from doubt,”17 but—like his colleagues—he concluded that § 10(b) does not apply to overseas transactions in securities that are cross-listed on domestic and foreign exchanges.18 And in two additional cases, the Southern District has dismissed § 10(b) claims by plaintiffs who purchased common stock abroad when the same stock was directly listed and traded on a U.S. exchange.19 Thus, the two parts of the transactional test (“whether the purchase

12. NYSE Listings Directory, NYSE EURONEXT, http://www.nyse.com/about/listed/lc_ny_isuuetype.html (click on “NYSE-Listed Non-U.S. Companies”; go to the “Issue Type” dropdown menu; select the “Common Stock” option) (last visited Nov. 27, 2010).
14. See id.
18. Id.
19. See In re Celestica Inc. Sec. Litig., No. 07 CV 312, 2010 U.S. Dist. LEXIS 110630, at *2 n.1 (S.D.N.Y. Oct. 14, 2010) (stating that “this Court lacks subject matter jurisdiction over the claims of purported class members who acquired Celestica common stock on foreign markets,” even though Celestica shares were directly listed and traded on NYSE as well as the Toronto Stock Exchange (“TSX”)); Sgalambo v. McKenzie, No. 09 Civ. 10087, 2010 U.S. Dist. LEXIS 79688, at *2, *69 (S.D.N.Y. Aug. 6, 2010) (concluding that Morrison precludes “the claims of any potential class members who purchased Canadian Superior common stock on a foreign exchange,” even though Canadian Superior shares were directly listed and traded on AMEX as well as TSX).
or sale [1] is made in the United States, or [2] involves a security listed on a domestic exchange[20] have collapsed into one. All that counts under the Southern District’s approach is where the transaction occurs. If the transaction occurs abroad, it does not matter whether the security at issue is listed on a U.S. exchange; according to the Southern District’s rule, § 10(b) does not apply.

From a doctrinal perspective, the Southern District’s conclusion is suspect. The Morrison majority would not have incorporated the second prong (listing on a domestic exchange) into the transactional test if the first prong (location of the transaction) were always outcome-determinative.21 From a policy perspective, the Southern District’s conclusion is unfortunate. According to a long literature in law and finance, one reason why foreign firms cross-list their shares on U.S. exchanges is to “bond” themselves to the U.S. securities regime and thus to compensate for weak investor protections in their home countries.22 Once a foreign firm bonds itself to U.S. securities laws, its shares—including shares that trade on home-country markets—experience a dramatic and well-documented rise.23 If Morrison is read to limit § 10(b) to domestic transactions, then hundreds of foreign firms will become “unbound.” This result is bad for minority shareholders since they will lose the investor protections afforded by the U.S. securities regime,24 and it is bad for foreign firms since they will subsequently face higher capital-raising costs. If cross-listing becomes less attractive to foreign firms, then the Southern District’s interpretation of Morrison will harm the U.S. financial services sector as well, since cross-listing leads to underwriting fees for U.S. investment banks and commission fees for U.S. stock brokers.25

23. See infra text accompanying and sources cited in notes 40-52.
24. Cf. John C. Coffee, Jr., Racing Towards the Top?: The Impact of Cross-Listing and Stock Market Competition on International Corporate Governance, 102 COLUM. L. REV. 1757, 1780 (2002) (stating that when a foreign firm is subject to U.S. securities laws, “investors acquire the ability to exercise effective and low-cost legal remedies, such as class actions and derivative actions, that are simply not available in the firm’s home jurisdiction”).
The Southern District’s decisions are especially significant because the district is “the traditional stronghold of federal securities litigation.” Moreover, the Second Circuit’s decision to affirm or reverse the Southern District’s decisions will have ramifications for all federal securities suits, as “that Court of Appeals [is] regarded as the ‘Mother Court’ in this area of law.” This Comment argues that the Second Circuit should overrule the Southern District’s doctrine on cross-listed securities: § 10(b) should apply to any transaction involving a foreign firm’s shares if those shares are listed for trading on a U.S. exchange, and plaintiffs who purchase cross-listed securities abroad ought to be able to recover in U.S. courts. If the Second Circuit (or the Supreme Court) fails to address this issue, the SEC should recommend that Congress rewrite the securities laws to allow foreign firms to bond themselves through cross-listing. Foreign equity issuers should have the option of subjecting all their common shares to § 10(b). The Southern District’s decisions deny foreign issuers this choice.

I. The Basics of Bonding

Foreign firms can access U.S. equity markets by issuing American Depositary Receipts (“ADRs”) in conjunction with a U.S. financial institution or by directly listing their ordinary shares on a U.S. exchange. An ADR is a dollar-denominated certificate backed by the stock of a foreign firm. A U.S. bank keeps the foreign firm’s stock in its vault, and an investor who holds an ADR has the right to exchange the receipt for shares in the foreign firm. The


28. One judge in the Southern District of New York has urged higher courts or the legislative branch to resolve the lingering uncertainty regarding the meaning of Morrison. See In re Vivendi Universal, S.A. Sec. Litig., No. 02 Civ. 05571, 2011 U.S. Dist. LEXIS 17514, at *50 (S.D.N.Y. Feb. 17, 2011) (“[R]esolution of these issues is fairly the province of the Supreme Court or Congress.”).

29. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 929Y, 124 Stat. 1376, 1871, the SEC must “conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Securities and Exchange Act of 1934 ... should be extended to cover ... securities transactions occurring outside the United States” and must submit recommendations to the House and Senate by January 2012. The SEC could use this study as a vehicle to advocate for preserving the private right of action of investors who hold foreign shares of cross-listed firms.

Investor can exercise that right upon paying a conversion fee. Some ADRs are "unsponsored," which means that they were issued by a U.S. bank "in response to market demand" but without the contractual consent of the foreign firm. Others are "sponsored," which means that they were created through a formal arrangement between the foreign firm and the U.S. depositary bank. Issuers of sponsored ADRs generally file a Form F-6 registering their ordinary shares with the SEC, although these shares are registered "[n]ot for trading, but only in connection with the registration of American Depositary Shares." Alternatively, foreign firms can bypass the ADR route and offer their common stock for trading on AMEX, NASDAQ, or NYSE. As mentioned above, approximately 445 firms follow this latter capital-raising strategy.

Although the cross-listing of foreign securities on U.S. exchanges dates back to the pre-World War I era, and ADRs existed even before the stock market crash of 1929, foreign firms' equity-raising activities in the United States have accelerated in recent years. Between 1990 and 2005, the number of foreign firms that listed their ordinary shares or ADRs on U.S. exchanges increased by 164%. These ADR sponsorships and cross-listings have generated significant positive returns for shareholders in the United States and violations of U.S. Securities Law?, 44 COLUM. J. TRANSNAT'L L. 241, 245 n.15 (2005), but the two terms differ in meaning. An ADR is the "actual physical certificate" stating that the holder owns a certain number of American Depositary Shares ("ADSS"), see Depositary Receipt Services: FAQs, CITIGROUP, http://www.citibank.com/adr/faq/faq.asp (last visited Feb. 12, 2011), whereas an ADS is "the actual unit traded on the basis of the ADR," see American Depositary Share, FIN. TIMES LEXICON, http://lexicon.ft.com/term.asp?t=American-Depositary-Share--ADS (last visited Feb. 12, 2011). For example, a foreign firm might deposit ten ordinary shares with a U.S. financial institution, and the depositary institution might issue one ADS on the basis of those ten ordinary shares. An investor might purchase ten ADSs but might use a single certificate (the ADR) to represent that investment. In this example, the ADR holder (with one receipt representing ten ADSS) would have a stake in the foreign firm equivalent to that of an investor who purchased 100 ordinary shares on a non-U.S. exchange.

33. See id.
36. See supra notes 10-12.
abroad. By one estimate, foreign firms whose securities trade on U.S. exchanges exhibit a valuation premium over non-cross-listed foreign firms of approximately 37% (controlling for other factors, including the firm's book value). Given that the mean book value of the firms in this sample is approximately $47.3 billion, even a small percentage-point increase in valuation as a result of cross-listing—multiplied across hundreds of cross-listed firms—would suggest that the sum of shareholder value created by the cross-listing phenomenon over the past two decades is at least in the eleven-digits, if not higher.

The most common explanation for the “cross-listing premium” is the “bonding hypothesis.” This hypothesis holds that “[i]ssuers migrate to U.S. exchanges because by voluntarily subjecting themselves to the United States’s higher disclosure standards and greater threat of enforcement (both by public and private enforcers), they partially compensate for weak protection of minority investors under their own jurisdictions’ laws. . . .”


41. Cf. Craig Doidge, G. Andrew Karolyi & René M. Stulz, Why Do Foreign Firms Leave U.S. Equity Markets, 65 J. FIN. 1507, 1519 tbl.1, 1550 tbl.A1 (2010) (reporting the mean value of cross-listed firms’ assets as $59.1 billion and the mean debt-to-asset ratio of cross-listed firms as 0.20, which indicates that the book value of equity—for example, assets minus debt—is 0.80 x $59.1 billion = $47.3 billion).

42. The summary statistics on cross-listed firms refer to a sample of approximately 650 issuers. See id. at 1518. Multiplying the book value per firm of $47.3 billion by 650 firms yields $30.75 trillion. If cross-listing adds only one tenth of one percent to the value of these firms, then 0.001 x $30.75 trillion = $30.75 billion. Thus, even extraordinarily conservative estimates for the size of the cross-listing premium indicate that the dollar amounts at stake are massive.

43. Analyses of the “cross-listing premium” typically do not distinguish between, on the one hand, ADRs, and, on the other hand, ordinary shares that are directly listed for trading on U.S. exchanges. Before Morrison, the geographic reach of § 10(b) depended on “(1) an ‘effects test,’ ‘whether the wrongful conduct had a substantial effect in the United States or upon United States citizens,’ and (2) a ‘conduct test,’ ‘whether the wrongful conduct occurred in the United States.’” Morrison v. Nat’l Austl. Bank Ltd., 130 S. Ct. 2869, 2879 (2010) (quoting SEC v. Berger, 322 F.3d 187, 192-93 (2d Cir. 2003)). Neither of these tests turned on the form in which a foreign firm’s equity was traded in the United States.

44. Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. FIN. ECON. 305 (1976). Jensen and Meckling identify “bonding costs” as expenditures by the owner or manager of a firm to guarantee to outside equity investors that the owner/manager will not behave opportunistically with respect to minority or noncontrolling shareholders. See id. at 325. For a controlling shareholder who is raising equity from minority investors, bonding may reduce capital costs because investors are willing to pay more for their minority stakes (they are willing to accept a smaller return) if the controlling shareholder has taken steps ex ante (before the sale of stock) that reduce her own incentives to behave opportunistically ex post (after the sale). Section 10(b) can be seen as a “bonding cost” within the Jensen and Meckling framework: a controlling shareholder may opt to expose herself to § 10(b) actions because by doing so, she makes minority investors more confident that she will work to maximize cash flows for the firm.

controlling shareholder has less incentive to extract rents from minority investors if opportunistic behavior exposes the controlling shareholder to legal action in U.S. courts, and a controlling shareholder has less ability to extract rents undetected if the firm is subject to SEC disclosure rules. Knowing this, investors may be willing to pay more for minority stakes in cross-listed firms than for otherwise-comparable stakes in firms that are only subject to foreign investor protection and disclosure regimes. Assuming that a controlling shareholder wants to raise as much equity capital as possible while selling as small a percentage of her firm as possible, she may choose to cross-list in order to maximize the price she receives for the shares that she sells.

Numerous empirical analyses have reached results consistent with this hypothesis. For example, Doidge and his coauthors find that the effect of cross-listing on share price is larger for firms from home countries whose investor protection regimes are weakest. This finding suggests that the marginal benefits from increased investor protection are at least partially driving cross-listing premiums: if cross-listing bumps up a firm’s share price because it increases the level of investor protection, then one would think that the bump would be greater when the increase in investor protection is more dramatic. Dyck and Zingales reach similar conclusions by measuring the size of the controlling block premium for non-cross-listed and cross-listed foreign firms. The controlling block premium is the difference between the price-per-share paid by investors who acquire a controlling stake in a firm and the price-per-share paid by investors who acquire minority interests. When legal protections for minority investors are weaker, the controlling block premium is expected to be larger because the controlling shareholder has more opportunities to extract rents from minority investors. Consistent with the bonding hypothesis, Dyck and Zingales find that cross-listing reduces block premiums (in other words, cross-listing narrows the gap between the controlling stakeholder’s price-per-share and the minority investor’s price-per-share). Moreover, this effect is

46. See Doidge et al., supra note 40, at 231 (finding that cross-listing premiums are larger for foreign firms from countries with weak shareholder protections than for firms from countries with strong shareholder protections); see also Alexander Dyck & Luigi Zingales, Private Benefits of Control: An International Comparison, 59 J. Fin. 537, 565-66 (2004) (finding that cross-listing is associated with an increase in the value of minority shares relative to controlling stakes); Paul M. Vaaler & Burkhard N. Schrage, Legal System and Rule of Law Effects on US Cross-Listing To Bond by Emerging-Market Firms 28-29 (Oct. 7, 2009) (unpublished manuscript), available at http://carlsonschool.umn.edu/assets/151377.pdf (“[O]ur empirical results indicate that emerging-market firms exhibit behavior consistent with the bonding hypothesis.”).

47. William A. Reese, Jr. & Michael S. Weisbach, Protection of Minority Shareholder Interests, Cross-Listings in the United States, and Subsequent Equity Offerings, 66 J. Fin. Econ. 65 (2002) (reaching results that are generally consistent with this finding); see id. at 102 (“[F]irms from countries with weak shareholder protection appear to cross-list, among other reasons, for the purpose of voluntarily bonding themselves to US securities and market regulations, allowing them to raise capital more easily at home and elsewhere outside the US.”).


49. See id. at 538.

50. Id. at 557-58.
most dramatic for cross-listing firms from home countries whose investor protections are least stringent.51

The positive effect of cross-listing on share price is not limited to the shares in the foreign firms that are traded on U.S. markets. The effect extends to the cross-listing firms' shares on home-country exchanges as well.52 This result suggests that shareholders in the United States and abroad value the investor protections afforded by the U.S. securities regulatory regime.

At first, the robust empirical support for the bonding hypothesis may seem surprising, since the SEC rarely brings enforcement actions against cross-listed firms for violations of U.S. securities laws.53 But the SEC is not the only enforcer of U.S. securities laws. For decades, courts have recognized that investors may bring a private action under § 10(b) of the Securities Exchange Act.54 Courts have extended this right to foreign as well as domestic investors.55 By one count, whereas the SEC initiated enforcement actions against only thirteen cross-listed firms between January 1, 1995, and June 30, 2002, private plaintiffs brought at least seventy-five complaints against cross-listed firms in the same period.56 Foreign firms that issue shares in the United States are almost as likely as domestic issuers to be the target of a private securities suit in federal court.57 Thus, to the extent that the cross-listing premium arises from the "greater threat of enforcement" facing foreign firms

51. Id. at 565; see also id. ("These results provide direct support for the contention of Coffee . . . , Reese and Weisbach . . . , and Doidge et al. . . . of a link between cross listing and private benefits." (citing Coffee, Future as History, supra note 45; Doidge et al., supra note 40; and Reese & Weisbach, supra note 47)). But see Amir N. Licht, Xi Li & Jordan I. Siegel, What Makes the Bonding Stick? A Natural Experiment Involving the Supreme Court and Cross-Listed Firms 32 (Harvard Bus. Sch., Working Paper No. 11-072, 2011), available at http://ssrn.com/abstract=1744905 (finding that cross-listed firms experienced "significantly positive abnormal returns" immediately after the Morrison oral argument and again after the June 2010 decision); id. ("These results challenge the legal bonding hypothesis . . . . Quite to the contrary, the results support the notion that by severing the ties to the U.S. civil liability regime, the Supreme Court did a beneficial service to U.S.-listed foreign firms . . . .").


56. See Siegel, supra note 53, at 342; id. at app. III (unpublished source data).

57. Natalya Shnitser, Note, A Free Pass for Foreign Firms? An Assessment of SEC and Private Enforcement Against Foreign Issuers, 119 YALE L.J. 1638, 1685 (2010) ("In 1996, only 7.1% of companies listed on U.S. exchanges were foreign, while 8.3% of federal filings targeted non-U.S. issuers. By 2007, the percentage of foreign companies on U.S. exchanges had increased to 14.8% while the percent of filings against non-U.S. issuers had reached 13.9%.").
that list their shares on U.S. exchanges, this premium depends critically on private enforcement of U.S. securities laws.\(^{58}\)

The bonding hypothesis does not imply that in all cases, foreign firms generate value for shareholders by subjecting themselves to private enforcement of U.S. securities laws. Some foreign firms may choose to cross-list their common stock on U.S. exchanges in order “to have access to the capital available in the large and liquid American market,” even if they would prefer not to subject themselves to U.S. securities laws.\(^{59}\) This reality may be especially true for firms whose home countries already have strong securities laws, in which case the compliance costs resulting from duplicative regulatory regimes may outweigh the investor-protection benefits. For this reason, several securities law scholars have come to support an “issuer choice” regime, under which foreign firms that cross-list shares on U.S. exchanges could opt into or out of \(\S\) 10(b) and the other elements of U.S. securities law.\(^{60}\) Foreign firms that sought only the liquidity benefits of a U.S. listing would have that option, whereas firms that wanted to bond themselves to U.S. securities laws could choose to subject themselves to SEC disclosure requirements as well as public and private enforcement actions.

II. \textit{Morrison v. National Australia Bank Ltd.}

Although the “issuer choice” commentary is primarily concerned with allowing foreign firms to opt out of U.S. securities laws, recent events have made it increasingly difficult for foreign firms to opt in. This difficulty arises

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58. The “legal bonding” hypothesis discussed in the text is distinct from the “reputational bonding” hypothesis presented by Jordan Siegel, among others. \textit{Cf.} Siegel, \textit{supra} note 53, at 356 (discussing reputational bonding). The reputational bonding hypothesis holds that “investment bankers, analysts, and active institutional shareholders play a certification role as ‘reputational intermediaries’ for firms selling securities to the markets.” G. Andrew Karolyi, Corporate Governance, Agency Problems and International Cross-Listings: A Defense of the Bonding Hypothesis 7 (June 2010) (unpublished manuscript) (on file with author). For instance, foreign firms from countries with weak shareholder protections may choose prestigious investment banks to underwrite their U.S. cross-listings; these underwriters may vouch for the quality of the cross-listed security and scrutinize the issuer carefully at the public offering stage. See Gilberto Loureiro, \textit{The Reputation of Underwriters: A Test of the Bonding Hypothesis}, 16 J. CORP. FIN. 516 (2010) (presenting empirical evidence consistent with this claim). Investors in the United States and abroad may value this extra level of screening and may be willing to pay more for shares of firms that have been “certified” by reputational intermediaries. This Comment takes no position on whether “legal bonding” or “reputational bonding” provides a better explanation for the observed cross-listing premium, and as Karolyi notes, the two versions of the bonding hypothesis may be “complementary.” \textit{See} Karolyi, \textit{supra} note 58, at 15-16, 19-20. My argument is simply that foreign firms who want to engage in legal bonding through U.S. cross-listings should have the option to do so.


from the district courts’ interpretation—or, as this Comment argues, their misinterpretation—of the Supreme Court’s opinion in *Morrison.*

In *Morrison,* three Australian plaintiffs who purchased NAB common stock on a Sydney exchange alleged that the bank had misled investors as to the performance of NAB’s U.S.-based mortgage servicing subsidiary. NAB’s common stock is not listed on any U.S. exchange, although NAB’s sponsored ADRs are traded on the NYSE. The *Morrison* majority held that § 10(b) did not apply to the plaintiffs in the case because their complaint “involve[d] no securities listed on a domestic exchange” and because “all aspects of the purchases complained of . . . occurred outside the United States.” Under *Morrison,* sponsoring ADRs on a U.S. exchange does not bond a foreign firm to the U.S. securities regime.

By the time *Morrison* reached the Supreme Court, the proposed plaintiff class did not include investors who purchased NAB ADRs on the NYSE. Thus, the *Morrison* majority did not decide whether domestic plaintiffs who purchased ADRs on AMEX, NASDAQ, or NYSE could bring § 10(b) actions against foreign firms. In the months since *Morrison,* several district courts have indicated that *Morrison* does not preclude purchasers of ADRs from proceeding with securities fraud suits against foreign firms. But as a practical matter, it seems likely that class-action attorneys will shy away from securities fraud suits against foreign firms if the potential plaintiff class is limited to ADR purchasers because the potential payout would be limited to the damages incurred by ADR purchasers.

The billion-dollar question is whether plaintiffs who purchased common stock on a non-U.S. exchange can recover damages under § 10(b) if the common stock is cross-listed for trading on a U.S. market. As mentioned above, the *Morrison* majority seems to have answered this question affirmatively, although district courts applying *Morrison* have reached the

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61. 130 S. Ct. 2869 (2010).
62. *Id.* at 2875-76.
63. *Id.* at 2875.
64. *Id.* at 2888.
65. *Id.* at 2876 n.1.
opposite result. The answer to this question will determine the force with which § 10(b) bonds foreign firms. If the potential class can include all owners of a foreign firm’s common stock who suffer damages as a result of securities fraud, regardless of whether the plaintiffs purchased their shares in the United States or abroad, then private enforcement actions will be much more lucrative and much more likely to be pursued. If investors who purchased their shares abroad cannot join § 10(b) actions, then the tide of private actions against foreign firms that cross-list their common stock may ebb.

III. (Mis)Interpreting Morrison

As of yet, this billion-dollar question has no clear answer. Three competing interpretations have arisen. Under the first interpretation (the “registered securities theory”), § 10(b) applies to all transactions that are registered on a U.S. exchange, regardless of where those transactions occur. Under the second interpretation (the Southern District’s approach), § 10(b) only applies to transactions that occur inside the United States, regardless of where the securities at issue are listed. Under the third interpretation (the “listed-for-trading theory”), § 10(b) applies to transactions in securities that are listed for trading on a U.S. exchange, even if the plaintiff purchased those securities somewhere else. All three interpretations have their supporters. But only the third interpretation is consistent with the Morrison majority’s holding. And only the third interpretation advances the objective of issuer choice.

A. The “Registered” Securities Theory

Plaintiffs’ attorneys have argued that “Justice Scalia used ‘registered’ and ‘listed’ interchangeably” in his Morrison opinion and that § 10(b) therefore applies to securities that are registered on a U.S. exchange, “[n]o matter whether the purchaser is foreign or domestic, no matter where the transaction occurred.” As mentioned above, many ADR sponsors also register their securities on U.S. exchanges.

68. See supra notes 13-15.


70. Some commentators describe this first interpretation as the “listed securities theory.” See, e.g., George T. Conway, Postscript to ‘Morrison v. National Australia Bank,’ N.Y.L.J., Oct. 14, 2010, at 5, available at http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=120247318925; Warren & Platkov, supra note 21. However, as discussed infra in Section III.C, the “registered securities theory” and the “listed-for-trading theory” yield sharply contrasting conclusions in many cases, and lumping them together in a single category obfuscates important distinctions between the two approaches.


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ordinary shares on U.S. exchanges, although the ordinary shares are not listed for trading in the United States. Under the registered securities theory, a foreign firm that sponsored an ADR program and registered the underlying common stock with the SEC would thus enable all of its common stock holders across the globe to sue in U.S. federal court under § 10(b). The problem with this interpretation is that the NAB shares at issue in Morrison were in fact registered—though not listed for trading—on the New York Stock Exchange.

George Conway, the attorney who represented respondent NAB in Morrison before the Supreme Court, has noted that if this registered securities theory were right, “the Supreme Court got the result in National Australia wrong, and the plaintiffs in National Australia should have been allowed to sue.” In other words, the registered securities theory interprets the Court’s language in Morrison in such a way as to contradict the Court’s disposition of Morrison. Not surprisingly, the Southern District has rejected the registered securities theory.

B. The Southern District’s Doctrine

A second view, which Judge Marrero adopted in In re Alstom, acknowledges that “isolated clauses of the [Morrison majority] opinion may be read as requiring only that a security be ‘listed’ on a domestic exchange for its purchase anywhere in the world to be cognizable under the federal securities laws.” But instead of engaging with these clauses, the district court disregards them. Instead, it points to a passage in which the Morrison majority opines that “the focus of the Exchange Act is . . . upon purchases and sales of securities in the United States.” Since “§ 10(b)’s focus would not encompass purchases and sales of covered securities that occur outside of the United States,” then according to this logic, § 10(b) does not apply to overseas transactions either.

72. See text accompanying supra notes 34-35.
74. Conway, supra note 70, at 5.
77. Id. at *17 (quoting Morrison, 130 S. Ct. at 2884).
78. Id.
79. The flaw in this logic is that many laws accomplish objectives that lie outside their “focus.” For instance, the Racketeer Influenced and Corrupt Organizations Act (“RICO”) was initially focused on the Mafia, see DANIEL R. FISCHEL, PAYBACK: THE CONSPIRACY TO DESTROY MICHAEL
While this view clashes with the text of the *Morrison* majority's opinion, it has garnered some support among academics and practitioners. Richard Painter, Douglas Dunham, and Ellen Quackenbos—who coauthored an amicus brief supporting the respondents in *Morrison*—have made the bold claim that *Morrison* is an example of a case in which "courts don't say what they mean." According to Painter and his coauthors, "the Supreme Court did not mean to extend the reach of Section 10(b) to foreign transactions in securities ‘listed on an American exchange,’ even if the terms of the transactional test—read at face value—may yield that conclusion." Under this interpretation, the *real* holding in *Morrison* is that § 10(b) does not apply extraterritorially, and the Court's language about "securities listed on domestic exchanges" simply shows that the Justices misunderstood the facts of the case.

The problem with this view, of course, is that "Justice Scalia usually means what he says," and the burden of persuasion should rest with the camp that contends otherwise. Perhaps, if our only available options were the flawed "registered securities theory" and the didn't-say-what-they-mean approach, lower courts might reasonably disregard elements of the *Morrison* majority's holding. But, there is a third way.

C. The Listed-for-Trading Theory

Rather than accepting the contention of the plaintiff's bar that “listed” is synonymous with “registered,” and rather than disregarding the test of the *Morrison* majority opinion, a third option is to do what judges so often do when faced with ambiguity: turn to the dictionary. Among all the Court's members,

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82. *Id.* at 10.

83. *Id.* (“The Supreme Court’s unequivocal holding is that Section 10(b) does not apply extraterritorially.”); *cf.* *Morrison*, 130 S.Ct. at 2883 (“[T]here is no affirmative indication in the Exchange Act that § 10(b) applies extraterritorially, and we therefore conclude that it does not.”).

84. *See* Painter et al., *supra* note 81, at 10 (stating that the Supreme Court was “incorrect” in its “statement that the transactions in Morrison did not involve stock listed on an American exchange”); *cf.* *Morrison*, 130 S. Ct. at 2888 (“This case involves no securities listed on a domestic exchange . . . .”). Judge Holwell has also entertained the idea that "perhaps Justice Scalia simply made a mistake" in the writing of *Morrison*. *In re* Vivendi Universal, S.A. *Sec. Litig.*, No. 02 Civ. 05571, 2011 U.S. Dist. LEXIS 17514, at *48 (S.D.N.Y. Feb. 17, 2011).

Issuer Choice After Morrison

"Justice Scalia has been the most willing to employ dictionaries,"86 and although judicial resort to dictionary definitions typically occurs in the context of statutory interpretation,87 patent claim construction,88 trademark genericide controversies,89 and contract disputes,90 it seems especially appropriate to use dictionaries to shed light on the textualist Justice Scalia’s choice of words.

Black’s Law Dictionary defines a “listed security” as a “security accepted for trading on a securities exchange.”91 The New Oxford American Dictionary defines “listed” as “admitted for trading on a stock exchange.”92 Other lexicons93 (and the SEC94) concur. If “listed” means “accepted for trading,” then the outcome in Morrison matches the terms of the transactional test: NAB’s ordinary shares were never “listed” (that is, admitted for trading) on the NYSE. According to this reading, § 10(b) would no longer apply to overseas transactions involving ordinary shares of firms (for example, NAB) that only list their ADRs—not their ordinary shares—for trading on U.S. exchanges. Yet, § 10(b) would still apply to the 445 non-U.S. companies whose ordinary shares (rather than ADRs) that are directly listed for trading on AMEX, NASDAQ, and NYSE.95 Appealingly, this interpretation does not necessitate the intellectual acrobatics required by the registered securities theory and the Southern District’s doctrine.96

86. See Note, Looking It Up: The Supreme Court’s Use of Dictionaries in Statutory and Constitutional Interpretation, 107 HARV. L. REV. 1437, 1439 n.14 (1994) (tabulating dictionary references by each Justice over the 1988-1992 period and noting that Justice Scalia made reference to dictionaries in twenty-three of his opinions over that span, while Justice O’Connor, the next most dictionary-dependent Justice, referred to dictionaries on fifteen occasions).
90. See In re Enviroydne Indus., 29 F.3d 301, 305 (7th Cir. 1994).
91. BLACK’S LAW DICTIONARY 1477 (9th ed. 2009).
92. See NEW OXFORD AMERICAN DICTIONARY 1019 (3rd ed. 2010).
94. See 17 C.F.R. § 240.3b-1 (2011) (“The term listed means admitted to full trading privileges . . . .”).
95. See supra notes 10-12.
96. Irving Warren and Margarita Platkov also argue that dictionaries can shed light on the Morrison majority’s holding, and they also conclude that the word “listed” implies “listed and traded.” See Warren & Platkov, supra note 21 (emphasis added). Warren and Platkov, however, do not follow their argument to its logical conclusion. Instead, they write:

The common sense definitions of “listed” alone may not answer all of the questions that Morrison has raised. For example, they may not answer questions as to a dual-listed and traded stock, as addressed by Sgalambo v. McKenzie, where a Canadian issuer’s common
IV. Why Cross-Listing Common Stock Should Bond a Foreign Firm

There are three independent policy-related reasons why the courts ought to adopt the listed-for-trading approach and apply § 10(b) to all transactions involving the common stock of firms that directly cross-list their shares for trading on a U.S. exchange, regardless of where that transaction takes place. First, excluding all non-U.S. transactions from the scope of § 10(b)—even when those transactions involve shares of firms whose common stock is also listed for trading on a U.S. exchange—would frustrate the goals of the U.S. regulatory regime. For example, federal courts allow private enforcement of anti-insider trading laws by plaintiffs who “trad[ed] contemporaneously with the insider.” 97 The plaintiff does not have to show that she purchased a security from (or sold a security to) the insider. As the Second Circuit has stated, “it would make a mockery of the [insider trading regime] if we were to permit the fortuitous matching of buy and sell orders to determine whether a duty to disclose had been violated.” 98 Why, then, should we allow insiders to trade cross-listed securities with impunity as long as they relegate their transactions to foreign exchanges? The effect on U.S. markets would be the same as if they had made the trades directly on AMEX, NASDAQ, or NYSE. In other words, if § 10(b) does not apply to overseas transactions involving common stock listed on a U.S. exchange, then for those securities, § 10(b) may become a dead letter, even with regard to transactions that do occur on a domestic exchange, because potential violators have the opportunity to engage in cross-exchange regulatory arbitrage.

Second, if investors who purchase a foreign firm’s common stock on a U.S. exchange retain the right to sue under § 10(b) while investors who buy the foreign firm’s common stock on an overseas exchange do not, then the effect of Morrison is to create two classes of common stock where firms have chosen to issue only one. Consider the case of UBS, the global investment bank headquartered in Switzerland. 99 Common-equity interests in UBS trade as

stock (which was not listed so as to support an ADR program) was traded on both U.S. and Canadian exchanges.

Id. (citing Sgalambo v. McKenzie, No. 09 Civ. 10087, 2010 U.S. Dist. LEXIS 79688, at *1 (S.D.N.Y. Aug. 6, 2010)). Yet, the authors never explain why their definition of “listed” does not resolve Sgalambo, a case in which the securities at issue were Canadian Superior common stock that was listed and traded on both AMEX and the Toronto Stock Exchange. See supra note 19. It would seem that if the same securities were listed and traded on U.S. and Canadian exchanges, then the transactions on the Canadian exchange involve[d] a security listed on a domestic [U.S.] exchange,” see Morrison, 130 S. Ct. at 2886, and the transactions therefore fall within § 10(b)’s ambit. Perhaps the more accurate statement would be: the common sense definition of “listed” that Warren and Platkov endorse does answer Sgalambo, but it does not yield the same answer that the Southern District reached.

98. Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 236 (2d Cir. 1974).
99. UBS shares are the subject of an ongoing class action in the Southern District of New York. Plaintiffs and defendants in that action have filed memoranda of law addressing the application of Morrison to GRSs. See Lead Plaintiffs’ Memorandum of Law in Opposition To UBS Defendants’
Global Registered Shares ("GRSs"), which means that "the same share purchased on the SIX Swiss Exchange can be sold on the New York Stock Exchange or vice versa." A security is "not a discrete piece of solid property" but a "bundle of rights." One of these rights (at least under U.S. securities law) is the right to recover damages if the issuer violates § 10(b). If UBS shareholders who purchase GRSs in New York have this right of recovery while UBS shareholders who purchase GRSs in Switzerland do not, then the total value of the bundle for the former class of shareholders is greater than the total value of the bundle for the latter class. Simply by purchasing a UBS share in Switzerland and reselling it in the United States, an arbitrageur adds a valuable right to the bundle. In the short term, such an interpretation of § 10(b) might favor the U.S. financial sector because the migration of GRSs from foreign to domestic exchanges would yield fee income for U.S.-based brokers. But in the long term, such an interpretation might frustrate the intentions of the foreign firms that issue GRSs with the goal of creating a truly global market for their shares.

Third, and most importantly, if § 10(b) does not apply to foreign transactions involving shares of firms that cross-list their common stock for trading on U.S. exchanges, then foreign firms will not be able to bond themselves to U.S. securities laws effectively, even if they want to do so. After Morrison, Dodd-Frank amended the Securities Exchange Act to enable SEC enforcement of antifraud laws with regard to certain foreign securities transactions. But recall that the SEC takes enforcement action against cross-
listed firms only infrequently.\textsuperscript{105} Unless cross-listing makes a foreign firm liable to a broad class of private plaintiffs, then bonding is an empty gesture rather than a credible commitment to abide by U.S. law.

Fortuitously, if federal courts hold that § 10(b) applies to foreign transactions involving shares of firms that cross-list their common stock for trading on U.S. exchanges, then the courts will have created a de facto issuer choice regime. ADRs will offer access to U.S. capital markets without significant civil liability. Direct listing will enable foreign firms to bond themselves to the U.S. system of public and private antifraud enforcement. Firms that value the liquidity of U.S. stock exchanges—but not the legal liability associated with § 10(b)—can choose to sponsor ADRs. Meanwhile, firms that want to commit to stronger investor protections can take the direct-listing route.

Admittedly, since pre-\textit{Morrison} case law did not establish a clear distinction between directly cross-listed ordinary shares, on the one hand, and ADRs, on the other,\textsuperscript{106} some firms that sponsored ADRs with the intention of bonding themselves to U.S. securities laws might have to go through the process of cancelling their ADR programs and listing their ordinary shares directly on a U.S. exchange. However, this process is not unduly arduous. For example, UBS terminated its ADR program in preparation for its GRS offering in 2000;\textsuperscript{107} ADR sponsors that wanted to bond themselves to U.S. securities laws in the post-\textit{Morrison} world could follow the same procedures. Although the distinction between ADR and common stock does not necessarily track past expectations, it does allow for an issuer choice regime on U.S. exchanges going forward.

\textbf{Conclusion}

In sum, this Comment has argued that foreign firms should be able to opt in to the U.S. securities regime by cross-listing their common stock for trading on a U.S. exchange. Interpreted in this light, \textit{Morrison} marks a step toward an issuer choice regime. The \textit{Morrison} majority's transactional test allows firms to (a) bond themselves to U.S. securities laws by cross-listing common stock for trading or (b) gain the liquidity advantages of U.S. capital markets without legal liability under § 10(b) by sponsoring ADRs.

So far, the Southern District has read \textit{Morrison} to preclude all claims arising from transactions that occur on foreign markets—even when those transactions involve common stock that is cross-listed for trading on a U.S. exchange. To the extent that legal bonding has allowed foreign firms to

\begin{itemize}
\item \textsuperscript{105} See supra note \textsuperscript{56} and accompanying text.
\item \textsuperscript{106} See supra note \textsuperscript{43}.
\item \textsuperscript{107} See Lead Plaintiffs' Memorandum, UBS, supra note \textsuperscript{99} at 7-9.
\end{itemize}
generate shareholder value through cross-listings over the last several decades, this interpretation of *Morrison* threatens to erase that value.

The Southern District’s interpretation may produce short-term gains for foreign firms that find themselves as defendants in § 10(b) class actions, since potential plaintiff classes (and thus potential payouts) will be significantly smaller. But over the long term, the Southern District’s interpretation of *Morrison* may make it more difficult for foreign firms to lower their capital costs through cross-listing, in which case the firms themselves, their shareholders, and the U.S. financial sector will be worse off.