Assessing Regulatory Responses to Securities Market Globalization

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The globalization of securities markets has resulted in a rapid increase in securities transactions that cut across the national borders of more than one country. Individual country regulators can no longer avoid the question of how regulatory authority should be allocated for such transactions. This article assesses a range of alternate responses to globalization. Some have argued that a company's home country should regulate all transactions in the company's securities regardless of the location of the transaction. Others have argued for increased harmonization across different country securities regulatory regimes. The article instead contends that giving issuers a greater degree of freedom to select among the securities regulatory regimes of different countries will result in both more desirable levels of investor protections as well as increased social welfare. Arguments have been raised against a move toward greater issuer choice in securities regulation. The article responds to such criticism, pointing out that the present territorial regime suffers from even greater flaws.

INTRODUCTION

The world securities markets are becoming increasingly interconnected. Growing numbers of companies are seeking to raise capital abroad. A larger fraction of investors are similarly investing their funds outside their home countries. Securities intermediaries, in turn, have kept pace with the globalization of securities markets. Major exchanges are presently forming

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partnerships with one another that cut across international boundaries.[1] Other intermediaries, including large investment banks, have established offices throughout the world.[2]

In the past, when the vast majority of securities transactions involved only residents of the same country, regulators could simply focus on their own individual jurisdictions. Today, an American issuer may issue securities in France to investors located in Israel. Secondary market trading may then extend as far away as Japan. Hence, regulators face the dilemma of how regulatory authority should be allocated for transactions that cut across more than one country.

This article examines possible approaches for allocating regulatory authority in the international securities markets. Countries may do nothing and continue to allocate authority along territorial lines (termed "territorial regulation"). Alternatively, countries may grant issuers a choice in the securities regulations that apply to transactions in the issuers' securities (termed "issuer choice"). Part I assesses territorial regulation compared to issuer choice with respect to various goals of securities regulation. Part II discusses other possible regulatory alternatives.

I. THE ISSUER CHOICE ALTERNATIVE

Countries presently apply their securities laws only to transactions that have some connection with their territorial jurisdiction. U.S. issuers, for example, can avoid the public registration requirements under the Securities Act of 1933 ("Securities Act")[3] to the extent that offers and sales are made

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1 Securities markets in Paris, Amsterdam, and Brussels are combining to form "Euronext." *See* Terzah Ewing & Silvia Ascarelli, *One World, How Many Stock Exchanges?*, Wall St. J., May 15, 2000, at C1. In Spring, 2000, the London Stock Exchange and the Deutsche Boerse entered into merger negotiations to form "iX." *Id.* By Fall 2000, however, merger negotiations failed. *See* Vanessa Fuhrmans & Silvia Ascarelli, *As London Exchange's Merger Agreement Fails, Some Suitors Think About Taking Hostile Route*, Wall St. J., Sept. 25, 2000, at C10. NASDAQ, nevertheless, may eventually make a bid for the London Stock Exchange. *See* Greg Ip, *Nasdaq Looks to Europe: Are Preparations A Prelude to a Bid for London Exchange?*, Wall St. J., Nov. 1, 2000, at C1.

2 Both Goldman Sachs and Morgan Stanley Dean Witter, among other investment banks, have offices located worldwide. For example, an investor may go to Morgan Stanley Dean Witter's website at http://www.msdw.com/institutional/locator/ to obtain a list of all its office locations.

3 15 U.S.C. § 77a (1994).

solely outside territorial United States.[4] Significantly, the present territorial system provides for no centralized decision rule on how to allocate regulatory authority. Rather, each country—to the extent that a given transaction has some connection to it—may regulate that transaction at its own discretion.[5] As a result, multinational securities transactions may be subject to redundant and sometimes conflicting regulation from multiple jurisdictions.

As an alternative, several commentators have called for the introduction of more market-based securities regulation. Professor Roberta Romano, for instance, has called for a securities disclosure regime based on the state corporate law model, whereby individual states would take charge of providing disclosure regimes.[6] Issuers would then have the ability to select the regime of their choice through re-incorporation. In a contemporaneous article, Professor Andrew Guzman and I called for a "portable reciprocity" system under which issuers may choose the regime of any participating country to govern all aspects of securities-related regulation.[7]

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4 Section 5 of the Securities Act, *id.* § 77e, embodies the Securities Act's registration requirement for offers and sales of securities. Commonly known as the gun-jumping rules, the registration process required under section 5 results in the creation of an information disclosure document known as the registration statement and the delivery of a subset of the registration statement, the prospectus, to investors. Disclosures made through either the registration statement or the prospectus then come under heightened antifraud liability pursuant to sections 11 and 12(a)(2) of the Securities Act, *id.* §§ 77k, l(a)(2).

Regulation S of the Securities Act, in turn, provides issuers an exemption from the requirements of section 5 to the extent that they offer and sell securities solely "outside the United States." Regulation S—Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.901-.905 (2000).

5 Section 402 of the Restatement (Third) of the Foreign Relations Law of the United States (1987), recognizes three bases for extraterritorial jurisdiction: (1) territoriality; (2) nationality; and (3) effects within the territory. For a description of the extraterritorial application of U.S. securities laws, see Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Laws*, 17 Nw. J. Int'l L. & Bus. 207 (1996).

6 *See* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 Yale L.J. 2359 (1998).

7 Stephen J. Choi & Andrew Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. Cal. L. Rev. 903 (1998). In contrast, Professor Roberta Romano's proposal focuses solely on information disclosure and antifraud liability and explicitly excludes market professionals. Romano, *supra* note 6, at 2361. Romano argues that market professionals—such as broker-dealers and investment advisors—have owners that may not necessarily desire to maximize shareholder welfare. In addition, no efficient market price mechanism exists to inform unsophisticated investors on the relative value of

The motivating insight behind the issuer choice proposal is simple: rational and informed investors will increase their willingness to pay for securities from issuers that adopt valued investor protections. An issuer that adopts investor protections that benefit investors will then receive higher proceeds from offerings of its securities. The issuer will adopt a particular investor protection scheme if net benefits will exceed costs.[8]

In the framework of an issuer choice model, there exists a variety of possible suppliers of investor protections. First, individual countries may supply desired regulatory protections. Countries enjoy several comparative advantages over private sources of investor protections. Only a state regime can provide and enforce a range of criminal penalties. States also may provide for larger economies of scale than do many private sources of protection. To the extent that a given state regime is stable, investors may also regard protections supplied through that regime as more reliable than privately supplied protections. Regulatory regimes, in turn, will seek to provide investor protections for a variety of reasons, for example, charging a fee from users of their regulations.[9]

Second, private sources can also be suppliers of investor protection. Investment banks, for example, may specialize in certifying the value of particular securities.[10] Investors then will be willing to pay more for an

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different market professionals. *See id.* at 2369-70. Nevertheless, market professionals will have an incentive to structure themselves to maximize the value they may provide investors. Despite non-investor ownership, market professionals connected through contract to investors will receive more compensation to the extent that they are able to provide valued protections. For example, issuers will compensate a market professional to the extent that the professional is able to convince investors of the value of the issuers' securities.

8 The motivation finds its roots in the state corporate law race-to-the-top versus race-to-the-bottom debate. *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); 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). *But see* 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).

9 *Cf.* Ehud Kamar & Marcel Kahan, Price Discrimination in the Market for Corporate Law (unpublished paper, on file with author) (providing evidence that Delaware has market power and engages in price discrimination in the fees it charges companies that incorporate in Delaware).

10 Securities exchanges may also act as a source of investor protections. *See* Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 Va. L. Rev. 669, 690 (1984); Paul G. Mahoney, *The Exchange*

issuer's securities to the extent that an investment bank certifies the value of the securities, leading to higher fees paid to the investment bank. An investment bank may also coordinate with other low cost suppliers of investor protections to provide the most cost-efficient set of investor protections. For instance, a particular securities exchange may provide the lowest-cost means of monitoring for market manipulation; an investment bank, in turn, might associate only with issuers that list on that particular exchange.

In comparing issuer choice against territorial regulation, this article focuses on several possible goals of securities regulation involving: (a) unsophisticated investors; (b) capital-market allocative efficiency; (c) third-party externalities; (d) managerial opportunism; (e) standardization; (f) investor research costs; and (g) administrability.

A. Unsophisticated Investors

In the United States, the federal securities laws were passed during the Great Depression largely in response to perceived abuses in the market that harmed investors and thereby reduced public confidence in the securities markets.[11] Even today, the SEC has repeatedly stated the primacy of investor protection.[12]

Commentators, in contrast, have questioned the need to focus on investors. Professor Homer Kripke, for example, has argued that individual investors

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as Regulator, 83 Va. L. Rev. 1453, 1459 (1997); Adam C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 Va. L. Rev. 925 (1999). *But see* Marcel Kahan, *Some Problems with Stock Exchange Based Securities Regulation*, 83 Va. L. Rev. 1509 (1997) (arguing that exchanges may not provide a superior source of investor protection compared with regulators).

11 *See* Joel Seligman, The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance 39-72 (1995); *see also* Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 Cardozo L. Rev. 909, 924 (1994) ("'The [Securities Act] had two basic purposes: to provide investors with sufficient material information to enable informed investment decisions and to prohibit fraud in connection with the sale of securities.'" *citing* Susan M. Phillips & J. Richard Zecher, The SEC and the Public Interest 9 (1981)).

12 In a recent speech, the Chairman of the SEC, Arthur Levitt, stated:

> Investor protection is our legal mandate.
> Investor protection is our moral responsibility.
> Investor protection is my top personal priority.

Arthur Levitt, *A Question of Integrity: Promoting Investor Confidence By Fighting Insider Trading*, 12(4) Insights 17, 18 (1998).

never read disclosed information.[13] Information disclosure, Kripke argues, should instead be targeted at professional securities intermediaries that will filter such information down to individual investors.[14] Others have argued that for companies trading in an efficient market, individual investors may assume that the market price incorporates all publicly available information on the securities, including information on the legal regulatory regime.[15] Consider a security whose price does not reflect all publicly available information. Institutional investors with good information on the value of the security will then engage in arbitrage trades, which will cause the market price to return toward its fundamental value.[16]

The efficient market hypothesis, however, is not universally applicable.[17] The market, for example, may contain "noise" traders that trade not on information but, rather, on other impulses.[18] Some investors, for example, may systematically trade on fads and momentum. Others may trade for liquidity reasons. To the extent that sufficient numbers of noise traders are present in a given market, even sophisticated investors may hesitate to engage in arbitrage out of fear that the market price may not correct itself for an extended period of time.[19] Sophisticated investors that can predict the behavior of noise

13 *See* Homer Kripke, *The SEC, the Accountants, Some Myths and Some Realities*, 45 N.Y.U. L. Rev. 1151, 1164-70 (1970).

14 *See* Homer Kripke, The SEC and Corporate Disclosure: Regulation in Search of a Purpose 96-116 (1979).

15 Several versions of the efficient market hypothesis exist. The semi-strong version of the efficient capital markets hypothesis posits that the secondary market price of companies reflects all publicly available information on the company. *See* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383 (1970). The article uses the term "efficient market" to refer to a trading market that displays features of a semi-strong efficient market.

16 For a general discussion of the mechanisms of market efficiency, see Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549, 565-92 (1984).

17 Several commentators have argued that markets are not efficient because of investor irrationalities and cognitive limitations in processing information. *See, e.g.*, Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851, 853-54 (1992); Lynn A. Stout, *Are Stock Markets Costly Casinos? Disagreement, Market Failure, and Securities Regulation*, 81 Va. L. Rev. 611, 648-50 (1995).

18 *See, e.g.*, Lawrence H. Summers, *Does the Stock Market Rationally Reflect Fundamental Values?*, 41 J. Fin. 591 (1986); Kenneth R. French & Richard Roll, *Stock Return Variances: The Arrival of Information and the Reaction of Traders*, 17 J. Fin. Econ. 5 (1986).

19 *See* Andrei Shleifer & Lawrence H. Summers, *The Noise Trader Approach to Finance*, 4 J. Econ. Persp. 19 (1990).

traders may actually trade with a trend to take advantage of the predicted price movement, further moving the market price away from its fundamental valuation.[20]

Consequently, the efficiency of the market for a particular company's securities will turn on the composition of investors following the company.[21] Companies that enjoy a large following among investment analysts and a correspondingly low fraction of noise traders will have a greater likelihood of efficient market pricing. Fewer noise traders translates into less pressure on the price to move away from its fundamental value. A greater proportion of sophisticated investment professionals, in turn, increases the amount of money putting pressure on the price towards its fundamental value. In addition, to the extent that a sophisticated investor realizes that a greater fraction of shares is in the hands of other sophisticated investors, the investor will have less fear that the market price may move away from the fundamental value for an appreciable period of time. Each individual sophisticated investor may then commit more money toward arbitraging the price toward its fundamental value. Conversely, companies with a relatively higher fraction of noise investors and fewer investment professionals will be less likely to trade on an efficient market.

Within the United States, a wide range of publicly traded companies may trade on a non-efficient market.[22] Outside the U.S., the lack of professional investment analysts is even more acute. Particularly in developing countries, few professional analysts may follow companies trading in the capital markets.[23] The markets may also offer little liquidity, and thus prices may not accurately reflect contemporary valuations.[24] A regime purporting to

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20 *See* J. Bradford De Long et al., *Positive Feedback Investment Strategies and Destabilizing Rational Speculation*, 45 J. Fin. 379 (1990).

21 *See* Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 Va. J. Int'l L. 563, 616 (1998) (noting that the mechanisms of market efficiency tend to hold "rather poorly" for stocks of small issuers).

22 *See* James D. Cox et al., Securities Regulation: Cases and Materials 40-41 (1st ed. 1991) (citing a 1977 SEC report's findings that "fewer than 1000 of the more than 10,000 companies then filing reports with the SEC were followed closely by one or more analysts at any time. Moreover, neither analysts nor financial institutions closely followed companies with assets less than $50 million. Slightly more than half of the sample would not follow a firm whose assets did not exceed $100 million.").

23 *See, e.g.*, Andrew T. Guzman, *Capital Market Regulation in Developing Countries: A Proposal*, 39 Va. J. Int'l L. 607, 628 (1999).

24 *See id.*

allocate regulatory authority for international securities markets, therefore, must take into account the possibility of non-efficient market companies and unsophisticated investors.

For non-efficient market companies, unsophisticated investors suffer from two possible harms. First, uninformed yet rational investors unable to distinguish among issuers will place the same valuation on all issuers regardless of their true value.[25] Higher-value companies in turn may choose not to raise capital in the market, leading to a lemons problem.[26] Fraudulent, fly-by-night companies may also rush into the market, further exacerbating the lemons problem. In the extreme, unsophisticated investors will find only low-quality, fraudulent investments and may simply exit the investment market. Such investors lose a significant range of possible investment risk-return combinations. Second, not all unsophisticated investors are rational. Investors may suffer from a variety of cognitive biases.[27] To the extent that they are irrational, unsophisticated investors may earn less than a competitive market return on their investments, leading to a drop in overall investor confidence.

Territorial regulation represents one means through which regulators may protect unsophisticated investors. Within the U.S., for example, limited recognition is given to distinctions among efficient and non-efficient market companies. Companies with relatively large market capitalization, among other requirements, can offer securities to the public while incorporating by reference much of the required mandatory information disclosure from previously filed documents with the SEC.[28] Large market-capitalization companies also have the option of conducting a shelf-registration under Rule

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25 The value, moreover, will equal the expected value of an issuer given the range of issuers in the market.

26 *See* George A. Akerloff, *The Market for Lemons: Quality, Uncertainty and the Market Mechanism*, 84 Q.J. Econ. 488 (1970).

27 For example, investors may suffer from endowment effects, putting more value on securities they presently own. Investors may also place too much emphasis on recent or vivid information. Other investors may engage in loss avoidance, placing more emphasis on avoiding a loss than on making a gain. *See* Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 Cal. L. Rev. 627 (1996).

28 For example, to qualify to use the Securities Act Form S-3, 17 C.F.R. § 239.13 (2000), for a public registered offering—the form giving issuers the ability to incorporate the greatest amount of information by reference to previously filed Exchange Act reporting documents—issuers must demonstrate, among other things, that they have a public equity float of at least $75 million in the hands of non-affiliates of the issuer and at least one year of Exchange Act reporting history.

415 of the Securities Act, providing such companies with the ability to time their offerings to take advantage of favorable market windows.[29]

Territorial mandatory regulation nevertheless suffers from a number of problems. First, regulators may make an error in setting the type or degree of regulation. Without a significant market incentive, regulators may also act slowly in correcting errors. The U.S. system, for instance, is not without its flaws. Non-efficient market companies in the United States, for example, may sell securities through private placements to a select group of more sophisticated investors.[30] After a one-year holding period, the initial investors of the non-efficient market company may then resell their securities to any investor, including unsophisticated investors.[31] To the extent that non-efficient market companies have a small dollar amount of total assets and relatively few shareholders, they may avoid the periodic information disclosure requirements of the Securities Exchange Act of 1934 ("Exchange Act").[32] Few investment analysts may also cover small, non-efficient market companies.[33] Unsophisticated investors trading in such securities in the secondary market, therefore, receive a far-reduced level of mandatory information disclosure, despite the increased risk of fraud that smaller, less well-followed companies pose for investors.[34]

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29 17 C.F.R. § 230.415.

30 Through a private placement under Regulation D of the Securities Act, for example, issuers may avoid many of the mandatory disclosure requirements for a registered public offering as well as the heightened antifraud provisions under sections 11 and 12(2) of the Act. The availability of a Regulation D private placement turns on, among other things, the number of non-accredited investors and the offering amount. Regulation D—Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.501-.508.

31 Securities sold through a private placement are then considered "restricted" and may be resold either through a registered public offering or under an exemption from registration. Rule 144 of the Securities Act, for example, provides an exemption for securities held for at least one year, among other requirements. 17 C.F.R. § 230.144 (2000).

32 Under section 12(g) of the Exchange Act, 15 U.S.C. § 78l(g) (2000), issuers engaged in interstate commerce with total assets worth over $10 million and a class of equity securities held by at least 500 shareholders of record must comply with the Exchange Act's periodic disclosure requirements. Rule 12g-1, Securities Exchange Act of 1934, 17 C.F.R. § 240.12g-1 (2000).

33 *See supra* note 22.

34 Nevertheless, Rule 15c2-11 of the Exchange Act, 17 C.F.R. § 240.15c2-11, requires brokers and dealers to keep various firm-specific information on file for companies in which the brokers and dealers "publish any quotation for a security or, directly or indirectly, to submit any such quotation for publication, in any quotation medium."
The territorial nature of present-day mandatory regulation leads to an additional

Second, regulators may have motives other than the protection of investors and capital markets.[35] Individual bureaucrats who expect eventually to seek a job within the securities industry, for example, may attempt to cater to the interests of securities professionals in an effort to increase their future job prospects.[36] Securities professionals with influence may push for overly complex regulations requiring extensive disclosures so that the services of the professionals become indispensable for issuers. Or, alternatively, securities professionals may benefit from more lax, low-cost regulations that increase the volume of new offerings.[37] In either case, no assurance exists that the special interest pressures placed on regulators will result in the socially optimal level of securities regulation.[38]

At first glance, the issuer choice proposal faces similar obstacles with respect to unsophisticated investors.[39] To the extent that investors

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problem: unsophisticated investors may attempt to avoid the protections of a territorial regime. For example, unsophisticated investors may escape the reach of U.S. securities laws through investments outside territorial United States. An unsophisticated U.S. investor may travel outside the United States to invest in securities issued in Indonesia. To the extent that no selling efforts occur within the United States, U.S. securities registration requirements will not apply. Rule 902(h), Securities Act of 1933, 17 C.F.R. § 203.902h (2001). The high transaction costs involved in traveling internationally to invest in securities, of course, may hinder many unsophisticated investors from engaging in such multinational transactions.

35 *See generally* Macey, *supra* note 11 (providing a public choice explanation for the SEC's continued existence despite its obsolescence).

36 *See, e.g.*, George J. Stigler, *The Theory of Economic Regulation*, 2 Bell J. Econ. 3 (1971); Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. Econ. 371 (1983). *See also* Macey, *supra* note 11, at 914 (arguing that obsolescent agencies are more likely to "provide favors to discrete constituencies in order to preserve some measure of support for its continued existence.").

37 *See* Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 Mich. L. Rev. 2498, 2588-89 (1997).

38 In contrast, Professors Howell Jackson and Eric Pan note that the vast majority of securities market professionals they interviewed in Europe characterized the SEC as "highly effective" in its response to the needs of foreign issuers. Howell Jackson & Eric Pan, Regulatory Competition in International Securities Markets: Evidence from Europe in 1999 (unpublished paper, on file with author). It is, however, unclear what to make of Jackson and Pan's results. The SEC, for example, may be responsive given the limited regulatory competition the present territorial regime provides. To the extent that U.S. regulations are viewed as unfavorable, issuers may raise capital outside the U.S. under territorial regulation. The fact that the SEC is partially responsive under territorial regulation, in turn, may mean that a more open system of competition under issuer choice may result in even greater responsiveness.

39 *See* David S. Ruder, *Reconciling U.S. Disclosure Policy with International*

fail to value regulatory protections—because they are either uninformed or irrational—companies will have less of an incentive to adopt protections. Nevertheless, the mere presence of unsophisticated investors does not lead to the conclusion that territorial regulation is necessary. Through securities market intermediaries, including investment banks, securities exchanges, attorneys, and accountants, at least some segment of the unsophisticated investors may distinguish companies of varying quality, in essence renting the sophistication of the intermediaries.[40] To the extent that such investors, as a result, are willing to pay more for the securities of higher value companies, such companies may then compensate intermediaries for their certification services.[41]

The issuer choice proposal, moreover, may increase the number of intermediaries providing investor protection services. Under territorial regulation, intermediaries face obstacles to providing investor protection. Where a particular country imposes too stringent mandatory regulations, intermediaries will not offer any competing, less stringent protections. The possibility that a mandatory form of regulation may displace an intermediary's in-house protections will also chill the creation of privately supplied protections. Some countries may also place liability on intermediaries that seek to assist issuers.[42] To the extent that a country makes an error and sets the liability at too high a level—perhaps encouraging non-meritorious lawsuits—intermediaries may simply exit the market rather than provide any form of investor protection.

Commentators have recognized, however, that a range of different quality intermediaries may exist in the market,[43] and high-quality intermediaries may

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Accounting and Disclosure Standards, 17 Nw. J. Int'l L. & Bus. 1, 9 (1996) (stating that "It is difficult to imagine how an investor would be able to judge the effectiveness of different regulatory regimes, much less quantify that knowledge in a manner allowing the investor to change the purchasing or selling price of a particular security."); James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 Colum. L. Rev. 1200, 1234 (1999) ("Certainly the evidence amassed by researchers suggesting that capital markets are noisy markets, i.e., that stock prices do not on average reflect a security's intrinsic value, does not support subjecting investors to multiple disclosure standards.").

40 *See* Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. Econ. & Org. 53 (1986); Stephen Choi, *Market Lessons for Gatekeepers*, 92 Nw. U. L. Rev. 916 (1998).

41 Alternatively, investors themselves may pay intermediaries a fee.

42 Section 11 of the Securities Act, for example, imposes stringent antifraud liability on underwriters in a public registered offering in the United States. § 11(a), 15 U.S.C. § 77k(a) (1994).

43 Consider securities exchanges. At one end of the spectrum is the New York

use reputation to distinguish themselves. Reputation, however, is imperfect. Professor Bernard Black, for example, has argued that spillover effects exist among different intermediaries.[44] One intermediary's increase in reputation, for example, may benefit the reputation of a totally unrelated intermediary. Therefore, to the extent that investors are not able to distinguish among intermediaries, fly-by-night intermediaries may enter the market to defraud investors.

Significantly, not all investors are alike in ability to distinguish among issuers and intermediaries. Some investors may make sunk-cost investments that reduce their marginal costs of assessing any particular intermediary. Other investors may have only a vague sense of intermediaries as a group. Regulators may therefore improve on the issuer choice regime through a partitioning of the market. For companies that trade in an efficient market, even unsophisticated investors may look to the market price as incorporating information on issuer-selected investor protections. For non-efficient market companies, regulators may seek to partition the market based on the sophistication of investors dealing with particular companies. Partitioning the market based on market efficiency and investor sophistication, in turn, allows regulators to use portable reciprocity where the market provides issuers an incentive to adopt value-maximizing investor protections. Regulators may then continue to apply mandatory regulation for companies where the market fails to protect investors.[45]

B. Allocative Efficiency

The capital markets of most countries are centrally involved in the allocation of scarce resources among competing investment projects. Accurate pricing may lead to the allocation of resources to more valuable investment projects.

Stock Exchange. At the other end is www.stockgeneration.com, an on-line virtual stock exchange under SEC investigation, which promises investors a risk-free, guaranteed monthly return of 10% for certain securities that trade on its exchange. *See SEC Calls 'Virtual Stock Exchange' Fraud*, Yahoo Bus. News, June 15, 2000, *at* http://dailynews.yahoo.com/h/nm/20000615/bs/financial_fraud_dc_1.html.

44 *See* Bernard S. Black, The Legal and Institutional Preconditions for Strong Stock Markets (unpublished paper, on file with author).

45 For a more detailed discussion of the relationship between portable reciprocity and the partitioning of companies based on market efficiency and the sophistication of investors, see Stephen Choi, *Promoting Issuer Choice in Securities Regulation*, 41 Va. J. Int'l L. (forthcoming Summer 2001) [hereinafter Choi; *Promoting Issuer Choice*]; Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 Cal. L. Rev. 279 (2000).

Imagine a world where two companies seek to raise capital. One company will provide investors with a high return. The other company will return poorly. Rational investors unable to distinguish among these companies, however, will place the same valuation on both companies. As discussed above, a lemons problem may then arise. A greater number of lower value companies may appear in the market. At the extreme, fly-by-night companies seeking to defraud investors will increasingly seek to conduct securities offerings. Higher value companies may then choose to forego their investment projects rather than receive the same price for their securities as lower value companies.

Through credible and mandatory information disclosure, territorial regulation may allow investors to distinguish companies with different valuations, enhancing allocative efficiency. Nevertheless, as with the protection of unsophisticated investors, individual country regulators may make a mistake in setting the level of disclosure. Alternatively, regulators may require too much disclosure as a means of increasing their own regulatory importance, imposing unnecessary costs on issuers.

Significantly, the loss of a high-value investment project is not only a loss for society; it also is a loss for the high-value companies. To the extent that a company possesses a truly profitable project, it will have an incentive under an issuer choice regime to communicate to investors the value of its project.[46] Such communication could come in the form of direct information disclosure. A high-value company, for example, could simply disclose to investors that it has a valuable investment project that requires funding to go forward.[47]

Commentators have responded that disclosures alone may not differentiate high-value from low-value companies.[48] For example, a high-value company may need to keep its investment project confidential. The lack of information disclosure may not signal that a company is low value. However, high-value companies still possess other means of signaling their worth. A high-value company, for example, may obtain certification through association with a high-reputation intermediary.[49] To the extent that the intermediary has a high reputation among investors and is therefore perceived as credible,

46 *See, e.g.*, Easterbrook & Fischel, *supra* note 10, at 682-85.

47 To the extent that a low-value company could make the same representation, the high-value company would have an incentive to voluntarily bind itself to a truth-telling mechanism. Under an issuer choice regime, the high-value company could bind itself to antifraud liability, for example.

48 *See, e.g.*, Merritt Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 Va. L. Rev. 1335, 1361-62 (1999).

49 *See* Easterbrook & Fischel, *supra* note 10, at 687-88.

investors will accept the certification even without specific disclosure on the type of investment project underway in the high-value company. Issuer choice, moreover, provides issuers with a range of additional credible means to make this distinction. Through criminal penalties, for example, regimes may increase the ability of high-value companies to bond the credibility of their information disclosures. Issuers that desire such bonding mechanisms may then simply opt into a regulatory regime with the desired level of investor protections.

Critics of issuer choice, in turn, may respond that allocative efficiency under an issuer choice regime may fair worse than under territorial regulation, for one of two reasons: third-party externalities and managerial opportunism.

C. Third-Party Externalities

A range of possible third-party externalities may arise in connection with securities transactions. First, companies may ignore positive externalities to other companies from securities disclosures. When Sega discloses information on the profitability of its game machines, Nintendo and Sony both stand to benefit. Nintendo and Sony, for example, may adjust their pricing strategy based on Sega's profitability, increasing competition against Sega. Sega therefore may be reluctant to disclose such information, ignoring the positive effect on Nintendo and Sony and treating the disclosure as an "interfirm" cost.[50]

Second, investors may ignore the positive effect aggregating their trading volume has on other investors. To the extent that all trades in a particular company's securities are located in one market, for example, the liquidity of the securities will increase.[51] Greater liquidity, in turn, will reduce the risk imposed on market makers and therefore generate a smaller bid-ask spread, lowering trading costs for all investors.[52] To the extent that individual investors fail to capture the full benefits to other investors from the aggregation of their trades, excessive market fragmentation may occur.

Third, both issuers and investors may ignore the value of accurate securities prices on the capital allocation decisions of other non-related

50 *See* James D. Cox, *Rethinking U.S. Securities Law in the Shadow of International Regulatory Competition*, 55 Law & Contemp. Probs. 157, 188 (1992); Easterbrook & Fischel, *supra* note 10, at 685-87; Fox, *supra* note 48, at 1345; George Foster, *Externalities and Financial Reporting*, 35 J. Fin. 521, 523-25 (1980).

51 *See* Yakov Amihud & Haim Mendelson, *A New Approach to the Regulation of Trading Across Securities Markets*, 71 N.Y.U. L. Rev. 1411, 1433-39 (1996).

52 *See id.* at 1426-32.

issuers and investors. For example, an issuer contemplating whether to raise additional capital in the market to pursue a business project may look to the securities prices of other companies in the same industry. Similarly, a company contemplating whether to enter into a new product market may look to the securities prices of companies in this new market to determine whether such entry is profitable.

In addition, a number of externalities exist affecting a host of other interests aside from those of direct capital market participants. Professor Merritt Fox has argued, for example, that labor benefits from accurate securities prices.[53] Accurate securities prices will lead to allocations of capital that raise the real return to investment. Companies with a greater real return, given certain simplifying assumptions, typically will have production functions that result in a higher marginal physical production of labor.[54] Assuming that labor employment rates stay constant, Fox contends that labor is better off from the higher marginal physical production of labor. Because certain capital market participants may ignore this benefit to labor, they may have too few incentives to work toward accurate securities prices.

The mere presence of externalities, however, does not in itself justify territorial regulation. First, not all positive externalities represent a benefit to society. Take information on competitors. Sega may actually want Nintendo and Sony to have good information on Sega's costs and revenues. When shared among companies, such information will make price collusion easier to maintain without detection. Companies, moreover, may find it difficult to provide such information voluntarily to the extent that coordination over information disclosure may signal the existence of a price-fixing scheme to antitrust regulators.

Second, regulators face informational limits on their ability to take into account different externalities.[55] Externalities occur all the time in the marketplace; assessing each externality would require enormous resources. Regulators may also make mistakes. When I purchase a candy bar in San Francisco and throw the wrapper away in Tel Aviv, I am imposing a negative externality onto the people of Tel Aviv. A benevolent central planner may adjust all prices to take into account such externalities. Nevertheless, the error-cost inherent in relying on a central planner as opposed to the market is prohibitively high. As a result, society may optimally ignore many

53 Fox, *supra* note 37, at 2562-69.

54 *Id.*

55 *See* Romano, *supra* note 6, at 2368 (questioning the ability of regulators to determine the optimal amount of mandatory disclosure that takes into account the possibility of interfirm costs among firms).

externalities. The U.S. securities laws, for example, make no specific note of externalities imposed on labor.[56] The fact that an externality exists, therefore, does not necessarily argue for mandatory regulation.

Third, territorial regimes tend to focus on effects solely within their own territories. Such an approach may address externalities for companies whose business and securities market activities are confined solely to one country. However, the question of allocating regulatory authority is most relevant for companies that trade across a number of securities markets around the world. Such companies, in turn, typically have business operations located throughout the world that may affect third parties globally. Territorial regulation will therefore fail to account for the interests of third parties located in other jurisdictions. For example, a regulator engaged in territorial regulation may ignore the benefit that disclosures from a state-run steel monopoly have for steel competitors located in other countries.

In comparison, the issuer choice model may take into account a wide range of externalities. In particular, where externalities involve different capital market participants, either the issuer or a securities market intermediary may act to internalize the externality. Issuers, for example, may internalize the external effects related to securities market liquidity.[57] Aggregating trades of a company's securities in one market may lead to more liquidity. Although particular transacting investors may ignore the liquidity benefit to all other investors, the issuer will not ignore the benefit. To the extent that investors value improved liquidity, they will pay more for the issuer's securities initially. The issuer, as a result, will have an incentive to adopt regulatory devices that improve liquidity to the extent that the benefits from such improvements outweigh the costs to the group of investors in the company's securities.[58] Similarly, a securities exchange could work with groups of companies in the same industry to reduce the interfirm externality problem, offering precise firm-specific disclosures on competing companies only to those companies that make similar disclosures to the exchange.

Given the global nature of securities markets, market intermediaries may also internalize a greater range of externalities compared to individual

56 I performed a Westlaw search looking for any mention of labor welfare or the protection of labor through the SEC administrative materials and found no documents. It is possible, however, that the SEC may have mentioned labor welfare somewhere in its voluminous output of releases and no-action letters. Nevertheless, the protection of labor is clearly not a high priority of the present U.S. securities laws.

57 *See, e.g.*, Amihud & Mendelson, *supra* note 51, at 1445-46.

58 *See id.*

securities regimes. Intermediaries that span several countries have the resources and the global presence to take into account externalities that spill over across national borders. An individual country, for example, may ignore the benefit rapid price discovery has for investors located outside the country. In contrast, a securities exchange with connections to other exchanges throughout the world will not ignore the benefit of a rapid price discovery.

The mere presence of externalities, therefore, does not cut clearly in favor of territorial mandatory regulation. Moreover, private market responses may internalize many capital market externalities.

D. Managerial Opportunism

Commentators have noted the role mandatory disclosure under securities regulation may play in the control of managerial agency costs.[59] Through disclosure, the market learns information on a company that may assist shareholders in bringing a fiduciary duty claim against managers. Information disclosure also may reduce the ability of managers to engage in insider trading. To the extent that information on a given company is already public in the market, the managers will have less of an ability to gain relative to outside investors.

However, even when viewed as a mechanism for controlling managerial opportunism, territorial regulation is flawed. First, managers intent on extracting private benefits of control may avoid regulation under a territorial regime. Managers seeking to engage in insider trading, for example, may simply execute their trades offshore. Insiders at a U.S. company may first issue securities to entities outside the United States in which they own an equity interest, without compliance with U.S. public registration requirements;[60] then, after a one-year holding period, the outside entities may resell into the United States, to the potential detriment of U.S. investors. Because of the foreign identity and location of the insiders' shell corporation, U.S. enforcement officials may find it difficult to trace such insider trading.[61]

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59 *See* Cox, *supra* note 39, at 1236; *see also* John C. Coffee, Jr., *Market Failure and the Economic Case For a Mandatory Disclosure System*, 70 Va. L. Rev. 717, 752 (1984) (arguing that "a mandatory disclosure system should reduce the average agency cost of corporate governance"); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. Chi. L. Rev. 1047 (1995).

60 *See supra* note 4 (discussing Regulation S of the Securities Act).

61 For example, in a scheme that the SEC did uncover, insiders at two NASDAQ small-cap companies, Comprehensive Environmental Systems, Inc. and ICIS Management Group, Inc., were indicted for criminal violation of the securities laws after selling

Second, regulators may make errors in taking into account the benefit to issuers from controlling managerial opportunism. The U.S. securities regime, for example, relaxes disclosure requirements for smaller companies that may fail to trade in an efficient market.[62] Smaller public companies, however, may suffer from even greater levels of managerial opportunism problems than larger companies. Fewer analysts actively follow the securities of smaller market capitalization companies, allowing managers to siphon value from the company for extended periods of time before the market is made aware of such activities.

Even where some amount of regulation may help to control managerial opportunism, the argument for making such regulation mandatory is unclear. Given the problems of territorial regulation, issuer choice may generate potentially more effective protections against managerial opportunism. Consider two time periods. Call T=0 the period of a company's initial incorporation. Call T=1 the period when the company is public and ownership is separated from management. At T=0, managerial opportunism is not a problem. Incorporators of a corporation will have full incentives to implement corporate governance devices that minimize the problem of managerial opportunism. Incorporators that fail to do so will receive a reduced price for the corporation's securities.[63]

Nevertheless, commentators have noted that the cost of drafting a complete contract at T=0 that covers all possible contingencies at T=1 is simply too high.[64] Given an incomplete contract, incorporators may decide to leave managers some degree of flexibility to take into account changed circumstances.[65] Managers may then abuse this flexibility for their own

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stock through Regulation S to entities controlled by the insiders and then directing the sale of these securities to brokerage accounts in the U.S. owned by the insiders. *See Crime: Former SEC Lawyer, Others Indicted on Charges Over Reg. S Securities*, 28 Sec. Reg. & L. Rep. 1242 (1996).

62 *See* Robert J. Haft, *Simplified Securities Act (1933) Registration under Forms SB-1 and SB-2 and Exchange Act (1934) Registration and Reporting for Small Business Issuers*, 2A Venture Cap. & Bus. Fin. § 5.05 (2000).

63 *See, e.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305 (1976).

64 *See, e.g.*, Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 Colum. L. Rev. 1549, 1573 (1989); Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 Harv. L. Rev. 1820, 1830-31 (1989).

65 Professor Jeffrey Gordon also argues that managers may tie a value-reducing midstream change with a value enhancing "sweetener." Gordon, *supra* note 64, at 1577-79. To the extent that the possibility of such a sweetener is known at the time of the initial charter, however, the company's incorporators will take sweeteners and

advantage, switching the company midstream into a regime conducive to managerial opportunism.[66]

Two responses are possible to the problem of midstream changes. First, the value of leaving managers the flexibility to make a midstream shift at T=1 necessarily outweighs the cost of any possible opportunism. If the benefit did not outweigh the cost, initial incorporators would simply "freeze" any selected regime at T=0, denying managers the ability to make a midstream shift. Therefore, the cost of managerial opportunism is bounded by the benefit from flexibility.[67]

Second, nothing under an issuer choice proposal limits initial incorporators to simple "freeze" provisions in the company's charter. Indeed, one benefit of issuer choice is that issuers at T=0 have the ability to opt into regimes with rather complex provisions limiting charter amendments at T=1 in instances where the possibility of managerial opportunism is high.[68] Indeed, incorporators at T=0 concerned about managerial opportunism may simply opt into a regime that is identical to the present U.S. mandatory regime and prohibit any subsequent opting out of the regime. Moreover, compared with territorial regulation, issuer choice places competitive incentives on regimes to construct limits on corporate charter changes that reflect the interests of investors rather than bureaucrats or concentrated interests in the securities industry.

Through issuer choice, furthermore, issuers may take into account the possibility of managers using offshore transactions to evade limitations on their ability to profit at the expense of shareholders. For example, issuers may select only regimes that coordinate with other regimes in tracking

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other similar devices into account in selecting investor protections under portable reciprocity.

66 Professor Roberta Romano, in contrast, questions the assumption that shareholders are unable as a group to block a value-decreasing midstream charter amendment through a vote. Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 Colum. L. Rev. 1599, 1607-13 (1989).

67 In addition, Professor Lucian Bebchuk mentions that shareholder voting often will block midstream shifts that appropriate large amounts of value for managers. Midstream shifts may, therefore, pose only a small-magnitude risk to shareholders. Bebchuk, *supra* note 64, at 1858-59 (observing the importance of limiting midstream shifts that raise the possibility of managerial opportunism).

68 Bebchuk, for example, outlines features of a possible optimal charter amendment model, limiting amendments in cases where managerial opportunism is high. *Id.* at 1848-52. To the extent that the incorporators at the time of the initial charter realize the problem of midstream charter amendments, they will have an incentive under issuer choice to select a regime that offers such optimal limitations on amendments.

insider self-dealing transactions. Issuers may also turn to intermediaries. In contrast to individual regulatory regimes, the operations of intermediaries are not confined to national borders. For example, broker-dealers with offices throughout the globe may assist in tracking insider trades across multiple countries. An issuer choice regime may give intermediaries the necessary scale economies and confidence to make large-scale investments in developing procedures to track insider trading globally without fear of displacement from a mandatory regulatory regime.[69]

E. Standardization

Capital market participants benefit along a number of dimensions from standardization. Standardized disclosures make it easier for investors to engage in comparisons among different companies, leading to greater allocative efficiency in the capital markets.[70] Standardized protections may lead also to greater certainty in the application of investor protections. With a set of standardized regulatory protections, intermediaries in the market may find it easier to develop "add-on" investor protections. For instance, regulators may develop a standardized form of disclosure. Using the standard disclosure, intermediaries may establish easy-to-use mechanisms for investors to compare data quickly across several different companies.[71] Significantly, standardization does not necessarily mean that only one form of securities regulation is universally optimal. Where identifiable segments of investors with different preferences exist, a series of alternate standards may best maximize overall investor welfare.

Issuer choice presents the danger that individual issuers may disregard the social benefits of standardization and diversity in selecting investor protections.[72] First, it is possible to calculate an optimal amount of regulatory

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69 *See supra* text accompanying notes 41-43.

70 In the context of accounting disclosures, Professor James Cox has argued that different accounting standards may leave investors unable to make comparative judgments. Cox, *supra* note 39, at 1211-17.

71 At Excite.com's website http://www.excite.com (visited on June 3, 2000), investors may compare one company against its competitors on the basis of cash flow, revenue, profits, and investment analysts recommendations, among other criteria.

72 *See* Uri Geiger, *Harmonization of Securities Disclosure Rules in the Global Market —A Proposal*, 66 Fordham L. Rev. 1785, 1794 (1998) ("If the standards of many nations were accepted in one market, it would be difficult for investors to compare their investment opportunities."); *see also* Gordon, *supra* note 64, at 1567-69 (discussing the public good aspect of selecting standard form terms in the corporate law context).

diversity.[73] A range of investors may exist in the market with a wide variety of preferred levels of investor protection. Because crafting and maintaining a specific investor protection regime is costly, however, the optimal level of diversity in regulatory protections is limited. The private market may then provide either too much or too little diversity compared with the optimal level. Where regimes compete based on the fees they charge, for example, they will have an incentive to differentiate past the social optimum level of diversity to reduce the impact of price competition in limiting the fees they are able to charge.[74]

Second, take into account the possibility that repeated use of a particular investor protection will generate positive spillover benefits for other users of the same protection. Greater use of an investor protection, for example, may increase the certainty of its application and the ability of investors to compare among investments. In this situation, such spillover or network externalities may result in two possible market defects. To the extent that repeated use provides increased value for a particular form of investor protection, a less desirable protection may become standardized in the market over a more desired protection.[75] Conversely, individual issuers and investors may ignore the benefits repeated use has for a standard and shift away from even a desired standard, leading to too much diversity in investor protections.[76]

Despite the problems with markets in generating standardized forms of protections, a territorial mandatory regime will not necessarily result in a more optimal level of diversity. Where different types of issuers and investors are spread proportionally across all countries, the level of diversity may be less than optimal to the extent that each individual country lacks the resources to develop more than one approach to securities regulation.[77] In contrast, where different types of issuers and investors are spread across

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73 *See generally* Jean Tirole, Theory of Industrial Organization 277-87 (1990) (discussing the economics of product differentiation).

74 Where producers operate a market that competes based on price, offering similar products will result in price competition, leading to marginal cost pricing. *See id.* at 278.

75 *See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 Va. L. Rev. 757, 774-89 (1995).

76 *See id.*

77 *See, e.g.*, Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 Stan. L. Rev. 127, 156 n.42 (1999) (noting that countries typically adopt only one body of corporate rules, "presumably because of the economies of scale involved in having one body of law and the problems arising from (1) the need to decide which body of rules to apply and (2) players trying to manipulate their classifications").

the different countries, the diversity may be greater as each individual country specializes in a particular segment of the securities market.[78] No reason exists, therefore, to believe that individual country regulation will result in a more optimal level of diversity of regulatory regimes.

Issuer choice as well will often satisfy the preferences of investors better than territorial mandatory regulation. For example, assume that two countries exist in the world: Country A and Country B. Country A has a majority of type X investors and a minority of type Y. Country B has a majority of type Y investors and a minority of type X. Assume that under either issuer choice or mandatory regulation, Country A will cater its regulations toward type X investors and Country B will cater toward type Y investors, giving the same level of regulatory diversity. Nevertheless, under territorial regulation, type Y investors in Country A would be unable to obtain the regulatory protections of Country B without also incurring the cost of exiting the capital market of Country A. In contrast, under portable reciprocity, type Y investors could invest in issuers regulated under Country B's regime without exiting the capital market of Country A. The tie between capital markets and the regulatory regime under territorial regulation results in fewer investors obtaining the regulatory regime of their choice.[79]

Commentators have responded that where issuers and investors have a range of preferred regimes, individual country regulators may generate a range of investor protections within the context of a single mandatory regulatory regime.[80] In the United States, for example, the securities laws provide for special regulations governing the public offerings of small business issuers.[81] As well, companies that seek to sell only to relatively sophisticated investors may use private placement to avoid many of the disclosure and antifraud requirements of a registered public offering under U.S. securities laws.[82]

The argument that one country may address the regulatory needs of many

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78 Suppose that all X-investors are together in a particular country and all Y-investors are together in another country. The X-investor country will develop regulations tailored specifically for the X-investors, while the Y-country will generate regulations targeted for the Y-investors.

79 *See* Stephen Choi & Andrew Guzman, *National Laws, International Money: Regulation in a Global Capital Market*, 65 Fordham L. Rev. 1855, 1876 (1997) (discussing the advantages a home country offers its issuers for raising capital apart from the regulatory regime).

80 *See* Fox, *supra* note 48, at 1396.

81 *See supra* note 62.

82 *See supra* notes 30-31.

different constituencies, however, is flawed. Individual countries may lack the scale to implement more than one type of regulatory regime.[83] Not only must bureaucrats design and maintain the different regulatory regimes, but private actors—including attorneys and auditors—must become familiar with each particular regulatory regime. To the extent that the bureaucracy in one country or its pool of attorneys or auditors lack the resources to manage more than one type of regime, market participants in one country will face relatively few regulatory choices.

Issuer choice, in contrast, allows particular types of investor protection regimes to develop scale across national borders. For example, where only a specific minority segment of investors values a particular level of regulatory protection across many different countries, that segment may not receive the protections due to a lack of scale in any one country. Under issuer choice, however, an entrepreneurial country may specialize in providing the desired protections for that minority segment of investors and gain scale through its use across the world.[84]

In addition, issuer choice may generate more regulatory innovation than territorial regulation. Along with the rapid changes in securities market comes a need for flexibility in how to regulate. Significantly, territorial regulators may lack an incentive to engage in innovation tailored to the needs of issuers and investors. Instead, regulators may modify the securities regime over time to further their own interests.[85] In contrast, issuer choice places strong competitive pressure on both public and private suppliers of investor protections to adjust their offerings constantly to fit the preferences of issuers and investors.[86]

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83 *See* Bebchuk & Roe, *supra* note 77, at 156 n.42.

84 Attorneys and auditors, among others, may also face large costs in tracking multiple regimes under an issuer choice system. Nevertheless, individual market participants need to become familiar with only the subset of available regimes that their investor-clientele may find relevant. For example, investors in the United States may consider issuers that adopt regimes from the United States, Great Britain, or Canada. Market participants catering to such investors then must become familiar with only this subset of regimes. Significantly, because varying market participants may gain expertise in different subsets of regimes, the inability of participants to learn a large number of different regimes is not a limit to diversity within an issuer choice system.

85 *See* Macey, *supra* note 11, at 913 (noting "As obsolescence sets in, administrative agencies are likely to replace the publicly articulated goals that provided the initial justification for the creation of the agency with self-serving goals designed to insure that the agency will remain a secure place of employment for the officials who comprise its staff.").

86 A counter-argument exists that mandatory territorial regulation will result in

F. Investor Research Expenditures

Investors routinely expend large amounts of resources on research. Through research, investors may gain an advantage over other investors and enjoy increased trading profits. From a social standpoint, however, investors as a group may engage in an inefficiently low amount of research in certain circumstances and, conversely, an inefficiently high amount of research in others.

First, information is a public good. Once produced, the initial producer of a piece of information may not capture the full benefits of the information.[87] A securities analyst, for example, may expend resources pulling together information from a variety of different sources on the valuation of a particular company. The analyst then may transmit this information to paying clients. Other non-paying users of the information may, nevertheless, arise. Non-paying investors, for example, may observe the initial paying clients placing transactions based on the information. Others may learn of the information from the paying clients and trade based on this information.

Second, securities markets may generate wasteful, duplicated expenditures among investors.[88] Investors seeking to gain an advantage over other investors, for example, will expend resources to uncover information on a company's true fundamental value. To the extent that multiple investors all engage in the same information-gathering, the duplicated costs represent a pure loss to society. Issuer choice may exacerbate the duplicated cost problem. Not only must investors research firm-specific business information, issuer choice makes it necessary for investors to also research the investor protections of each particular issuer.

The territorial approach to securities regulation provides one solution to the public goods nature of information and the problem of duplicated

more innovation in securities market regulation. Consider an individual company attempting to put in place an innovative and unique form of investor protection. Even for companies with the motivation to benefit investors, investors may nevertheless be wary of managers seeking to act opportunistically. Investors may therefore not price new investor protections as highly as well-known protections already in use. Thus, companies will have few incentives to innovate in the provision of investor protections. *See* Gordon, *supra* note 64, at 1569-73. Nevertheless, investors may not have that much difficulty in assessing the value of an innovative regulation. *See* Romano, *supra* note 66, at 1604-05. To the extent that regimes and intermediaries are also the source of many innovations under issuer choice, investors as well will not face the same risk of managerial opportunism.

87 *See* Coffee, *supra* note 59, at 723-33.

88 *See id.* at 733-34.

costs. Through mandatory disclosure requirements, regulators may force companies to provide centralized disclosure of firm-specific information to investors, thereby reducing duplicated information expenditures.[89] Such information disclosure also may subsidize securities analysts seeking to research a particular company's securities, thereby ameliorating the public goods problem of information research.[90]

As with other aspects of mandatory regulation, however, individual country regulators may make a mistake in the amount of information they require. The value of information in the securities markets, for example, has only a short lifespan. To the extent that information decreases rapidly in value, few non-paying users will get much value out of analyst-produced information. Analysts may also control the initial dispersion of the information they produce, limiting distribution to only paying clients that promise not to pass on the information. Even where information has a public good aspect, therefore, providing subsidized disclosure for analysts is only a crude response to the possibility of analysts having too few incentives to produce information, and it may over-subsidize investment research.

Territorial regulation also suffers from the possibility of overlapping regulations from the multiple countries in which an issuer's securities may trade. For instance, two countries may require the same disclosure, but in radically different formats. A company that must conform to the disclosure requirements of both countries might then face at best duplicated costs. At worst, the company will face conflicting mandatory disclosure regulations. For example, one country may prohibit information disclosure of a certain type. During the "quiet" period leading up to a public offering of securities, for example, the U.S. strictly limits the types of disclosures companies may make related to the offering.[91] Other countries, in contrast, may require large amounts of disclosures incompatible with the American quiet-period prohibitions.

In comparison, under the issuer choice proposal, issuers may internalize the cost of research to investors. Providing subsidized research to investment

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89 *See id.*

90 *See id.* at 728-29.

91 During a public offering, for example, section 5(c) of the Securities Act, 15 U.S.C. § 77e(c) (1994), prohibits issuers from engaging in any offers or sales prior to the filing of the registration statement with the SEC. Offers, furthermore, are construed broadly, greatly limiting the ability of issuers and their associates to release information relating to the offering. *See* Securities Act of 1933, § 2(3), 15 U.S.C. § 77b(3); Securities Act Release No. 5009, 34 Fed. Reg. 16,870 (Oct. 7, 1969); Securities Act Release No. 3844, 22 Fed. Reg. 8359 (Oct. 8, 1957).

analysts, for example, may increase the supply of firm-specific information to the market. With subsidized information, sophisticated investors are more likely to determine when the market is mispriced and are also more likely to believe that other sophisticated investors have similar beliefs. Such information may therefore increase the willingness of sophisticated investors to engage in arbitrage trades against the pressure of noise traders.[92] To the extent that noise-trader risk is systematic, reducing that risk for a particular issuer will raise the willingness of investors to pay for such issuer's securities at the time of an offering.

Similarly, issuers may also internalize the benefit from reducing duplicated research costs. Consider a market with a high-value company and a low-value company. Without any information disclosure, some investors may engage in costly research to distinguish the high-value company from the low-value company. Investors that do not engage in such research, therefore, will be at a disadvantage. Hence, in the context of a public offering, uninformed investors might receive a disproportionate share of overvalued securities.[93] In secondary market trading, uninformed investors might mistakenly sell a high-value company's securities for too little to an informed investor. Rational uninformed investors that realize their disadvantage will demand a higher return to compensate for the risk; otherwise, such investors may simply not invest at all in a particular company's securities.[94] Companies that are able to reduce this risk through information disclosure, therefore, will receive a higher price for securities offered to the market. To the extent that the cost of disclosure is less than the increase in the willingness of investors to pay, companies will have an incentive to disclose firm-specific information, including information on adopted investor protections.

G. Administrability

The various merits of an international securities regulatory regime notwithstanding, such a regime must be administrable. This article focuses on two facets of administrability: enforcement and compatibility.

Issuer choice presents significant enforcement challenges.[95] Under issuer

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92 *See supra* notes 17-20 (discussing the impact of noise traders on securities market pricing).

93 *See* Kevin Rock, *Why New Issues Are Underpriced*, 15 J. Fin. Econ. 187 (1986).

94 Importantly, investors at the time of a public offering will take into account the risk they will bear in subsequent secondary market trading.

95 *See* Cox, *supra* note 39, at 1239 (stating that "The most troubling feature of any multiple standard regime would be enforcement.").

choice, issuers can select the regime of one country to apply within the jurisdiction of another country. Regulators of the selected regime might then have to engage in costly enforcement within a foreign jurisdiction. The collection of information across international boundaries, for example, is costly. In addition, regulators may face difficulties in enforcing judgments in foreign jurisdictions. Investors and other parties may face high costs in traveling to foreign countries to enforce their securities protections. Lawmakers of the selected regime may balk at devoting scarce resources to pursuing securities violations that occur abroad and that might have no direct impact on the home country.

The market nature of issuer choice nevertheless counters the enforcement concern. To the extent that regulators are able to charge for their regulatory services, selected regimes will enforce their securities laws across the globe. Issuers therefore will ultimately bear the cost of enforcement. They will thus have an incentive to select regimes where enforcement costs are not exceedingly high. Put another way, an issuer that selects a regime unable or unwilling to enforce its securities laws on the issuer and parties related to the issuer will suffer from a large price discount. Rational investors will treat the selection of an unenforceable regime as equivalent to the selection of a regime providing no investor protections.

Consider a Mexican company that selects the U.S. regulatory regime. The Mexican company will have an incentive to reduce the cost of enforcement through the placement of assets inside the United States and the sale of securities directly into U.S. capital markets. The Mexican company may also restrict transactions to only countries that do not actively hinder the enforcement of U.S. securities laws within their borders. To the extent that enforcement of the U.S. regime is enhanced, investors will pay more for the Mexican company's securities. Regulatory regimes, in turn, will have an incentive to establish mutual enforcement agreements with other jurisdictions to increase the value of their regulatory regimes to issuers.[96]

Significantly, territorial regulation will not necessarily result in lower enforcement costs compared with issuer choice. As securities transactions

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96 The SEC has already established memoranda of understandings with various foreign countries expressing the mutual intent to assist in information gathering and enforcement across international borders. *See* Joel P. Trachtman, *Unilateralism, Bilateralism, Regionalism, Multilateralism and Functionalism: A Comparison with Reference to Securities Regulation*, 4 Transnat'l L. & Contemp. Probs. 69, 86-87 (1994). Issuer choice would heighten the incentive to engage in such cooperation for enforcement to increase the value of any particular country's regime to issuers and investors.

become increasingly global, territorial regulation will face significant international enforcement issues. Multinational transactions, for example, might require territorial regulators to collect information from foreign sources and seek enforcement on parties located abroad. Consider a French issuer that is offering securities into the United States. To the extent that the issuer violates U.S. securities laws, U.S. regulators may need to gather evidence from France and seek to enforce judgments against corporations, corporate officers, or securities market professionals located in France.

Issuer choice also presents the possibility of incompatible regulatory provisions. Individual countries may employ radically different sets of laws governing corporate entities. The United States, Canada, and the United Kingdom all have relatively strong investor protection regimes as well as liquid capital markets. Germany, Japan, and Korea, in contrast, have relatively weak investor protection regimes, coupled with more concentrated shareholdings and less liquid capital markets.[97] In addition, the laws governing corporate activities in any given country may be spread across several subject-matter areas, including bankruptcy, securities regulation, corporate law, and banking law. Moreover, the exact division may vary across countries. An argument exists, therefore, that issuer choice may fail simply because the securities regulatory regime of one country cannot be imported into another country without substantial loss in the effectiveness and value of the overall regulatory regime governing the corporation.[98]

Likewise, Professor Bernard Black has argued that countries might also have radically different cultures and norms related to investor protections.[99] An issuer from a country with a norm of lax investor protections may have layers of management not committed to generating information useful to investors or to otherwise taking into account the interests of investors. Simply imposing a more investor protective regime on the issuer may therefore not induce any change in the behavior of such management.

Nevertheless, at least some subsets of countries have similar regulatory systems and norms. Under issuer choice, issuers would enjoy the ability to choose from among these systems. An issuer in the United States, for example, could select the regime of the United Kingdom. Compared with

97 For a description of differences between countries that tend to favor disperse shareholders compared with countries catering to large-block shareholders, see William W. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference*, 38 Colum. J. Transnat'l L. 213, 218-32 (1999).

98 *See* Fox, *supra* note 48, at 1406-07.

99 *See* Black, *supra* note 44.

the present individual country mandatory approach, issuer choice would therefore provide issuers and investors a choice at least among related regimes, thereby increasing competition. In addition, once issuer choice is put into place, countries will have an incentive to make their laws more modular to attract greater numbers of issuers. Canada, for example, could target small business issuers inside the United States, designing securities regulations specifically for such issuers that are also compatible with the U.S. corporate regulatory structure. Although the U.S. regime already provides some provisions for small business issuers, Canada could develop a comparative advantage through specialization in the regulatory needs of small businesses. Norms, as well, are not necessarily static. For example, an issuer will have strong incentives to align its internal norms with adopted investor protections to increase the amount investors are willing to pay for the issuer's securities. An issuer choice regime will therefore encourage investor protection-oriented norms to gain a foothold in many countries.

II. OTHER REGULATORY POSSIBILITIES

This Part discusses various regulatory alternatives to territorial regulation and issuer choice, including: (a) extraterritorial application of an individual country's securities laws; (b) one global securities regulator; and (c) Professor Merritt Fox's issuer nationality proposal.[100] None of these alternatives, however, are superior to issuer choice.

A. Extraterritoriality

Under the present territorial approach to securities regulation, countries may attempt to extend the reach of their securities laws past their territorial borders. The United States, for example, applies its antifraud laws to transactions that occur outside the U.S. having a significant effect within the U.S.[101]

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100 Other possible approaches are possible, of course. Professor Joel Trachtman has proposed a more "refined" approach that would combine the benefits of competition within a framework that minimizes the negative effects of competition. He proposes, for example, that international bodies could harmonize only the "essential" portions of securities regulation, leaving the rest to competition where beneficial. Joel P. Trachtman, Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation (unpublished paper, on file with author).

101 *See supra* note 5.

Broad extraterritorial application of an individual country's securities regime, on its face, provides some solutions to the problem of territorial mandatory regulation. For example, a country might attempt to raise disclosure standards through the application of its laws extraterritorially. A country also might police the activities of its insiders abroad, reducing the ability of managers to engage in opportunistic activities through overseas transactions. Similarly, through the application of its laws extraterritorially, a country might attempt to force the rest of the world to comply with its laws as the global standard.

Extraterritoriality nevertheless provides only a poor solution to the problems of global securities regulation. First, there is no guarantee that a country attempting to apply its laws extraterritorially is implementing socially optimal regulations. Not all regulations are beneficial to the market, and extraterritoriality may lead to a sub-optimally high level of regulatory protection. A country with too great a level of disclosure and antifraud liability, for example, may attempt to apply its laws to all securities market participants that have even a tangential connection with the country, regardless of their location. In addition, extraterritoriality may place multiple obligations on securities market participants. Such obligations will increase the regulatory costs issuers must bear and might force conflicting and inconsistent obligations on issuers.[102] The overlapping nature of extraterritoriality will also result in countries with higher disclosure and antifraud standards systematically trumping countries with lower requirements.

Second, extraterritoriality applies only haphazardly. Most countries that seek to apply their laws extraterritorially require at least minimal contact with the regulating country. The amount of contact necessary to generate jurisdiction is often unclear.[103] Therefore, when multiple countries seek to apply their laws extraterritorially, market participants face uncertainty costs in determining what laws apply to which transactions. This uncertainty, in turn, will chill some transactions from going forward across international boundaries.

Finally, extraterritoriality does little to assist standardization. Although extraterritoriality allows one country to extend the reach of its regulations past territorial boundaries, to the extent that the regulations fail to cover the entire world, no one world standard will result. Instead, a multitude

102 *See supra* note 91 and accompanying text.

103 *See* Choi & Guzman, *supra* note 5, at 228-29.

of shifting regulations will apply, depending on the mix of countries with which any particular securities transaction has some contact.

B. One World Regulator

In response to the lack of regulatory coordination among individual countries, commentators have called for a transition to a world securities regulatory body.[104] In theory, a benevolent and well-informed world securities regulator might provide the best solution to problems that might arise within a global securities market. To the extent that unsophisticated investors are present in the marketplace, one global regulator would ensure that such investors would be unable to avoid mandatory securities regulation. A global securities regulator also could account for all possible externalities in designing a securities regime and minimize managerial opportunism, including insider self-dealing, regardless of where in the world transactions take place. In addition, one regulator might ensure standardized regulation, aiding comparability among investments for investors.

A global securities regulator, however, would face a number of obstacles in addition to the public choice critique that applies to all mandatory regulation.[105] First, a political obstacle would stand in the way of the formation of a global securities regulator.[106] Countries would have to completely cede their authority to the world securities regulator. Although countries might resist the issuer choice proposal along the same grounds, at least under issuer choice, countries can design their own regulations and enjoy reciprocity with other countries.

Second, regulatory errors would be amplified in the context of a single global regulator. Under territorial regulation, investors and issuers enjoy a limited amount of choice. Issuers and investors that wish to avoid the U.S. regime completely, for example, may simply avoid securities transactions that occur within the territorial United States. Although costly to exit the U.S. capital market, the cost of avoidance sets an upper bound on the level of regulatory error that can occur within U.S. securities regulation. In contrast, issuers and investors under one global securities regulator would not enjoy

104 *See, e.g.*, Geiger, *supra* note 72, at 1800-04.

105 *See supra* text accompanying notes 29-37.

106 For example, the International Accounting Standards Committee is presently establishing a set of international accounting standards acceptable to multiple jurisdictions. The SEC, however, has been less than fully receptive. *See, e.g.*, Cox, *supra* note 39, at 1208-11 (noting that "The criteria the SEC has identified for its possible acceptance of [the International Accounting Standards] are troubling.").

a similar ability to avoid value-decreasing regulations. Instead, to the extent that the global regulator makes a mistake, issuers and investors must bear the consequences, regardless of the degree of regulatory error.[107]

Third, one global regulator would suffer from organizational limits in its ability to keep track of transactions in all the world securities markets. Limits might also exist on the ability of the regulator to tailor different parts of the regime to segments of issuers and investors with varying needs for investor protection. Organizations of any kind at some point experience diseconomies of scale. To the extent that a given organization has one, centralized decision-making body, the decision-makers under one global regulator would face a limit on their ability to process information.[108] A single world regulator might therefore fail to cater to different segments of investors, resulting in less than the optimal level of diversity in investor protection.

Countries could attempt to implement a lesser form of global securities regulation through coordinated regulation among countries.[109] Coordinated regulation, however, presents all the problems of a single global regulator combined with problems inherent in coordination. For example, in a purely coordinated system, innovation will occur only after each individual country independently agrees to the innovation. Any single country, as a result, may hold up efforts at global coordination.[110]

C. Issuer Nationality

Recognizing the infeasibility of one world securities regulator, commentators

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107 Alternatively, issuers and investors may simply choose to exit the capital markets altogether. To the extent that the capital markets provide the lowest cost source of capital for issuers and the highest returns for investors given the risks, both issuers and investors lose from completely exiting the capital markets, however.

108 *See* Bebchuk & Roe, *supra* note 77.

109 The European Union's recent efforts to adopt minimum securities regulatory standards for its Member States are one example of the possibility for regulatory coordination.

110 The European Union, on the other hand, has successfully obtained agreement among Member States to implement and maintain minimum securities regulatory standards. *See, e.g.*, Jackson & Pan, *supra* note 38. One reason for the success of coordination over securities regulation in the European Union is the limited nature of the coordination, which focuses only on minimum standards and allowing countries to implement regulations above this floor. Jackson and Pan note as well that "some degree of variation in rigor" exists among Member States with respect to compliance.

have turned to other regulatory possibilities. Professor Merritt Fox, in particular, has proposed that regulatory authority should be allocated according to the nationality of the issuer in question.[111] Under Fox's proposal, countries must first agree on the nationality of a particular issuer. Once nationality has been determined, the national regulator would then be given the authority to regulate all aspects of the issuer, regardless of territorial boundaries.

The issuer-nationality proposal rests on two key assumptions. First, Fox contends that investor protection is largely irrelevant. Rational investors will discount the price they pay for the risk of fraud, among other risks. As a result, issuers ultimately will bear the cost of the adoption of investor protection devices. Second, Fox believes that third-party externalities as well as managerial opportunism are relatively large in magnitude in the securities markets.[112] Fox also argues that these effects are confined largely to the issuer's home country.[113] A national regulator therefore will internalize all such effects.

The impact of Fox's proposal is the application of a specific country's laws throughout the globe to any jurisdiction in which the securities of one of the country's issuers are traded. Conversely, individual country regulators lose complete control over their own capital markets. Under Fox's proposal, where a company's securities trade in a foreign country, the laws of the company's home jurisdiction will continue to apply even within the foreign country. Thus, under issuer nationality, a French company trading on the New York Stock Exchange would have to comply with French disclosure rules to the exclusion of the U.S. regime.

Issuer nationality is therefore similar to issuer choice in that it raises both the possibility that different regimes could apply across international borders and the problems such a structure would pose for enforcement. Under an issuer choice regime, however, issuers would have a strong incentive to adjust their activities *ex ante* to improve the ability of the selected regime to enforce its securities laws. Where issuers would fail to do so, investors would adjust downward the price they are willing to pay for the issuers' securities.[114] In contrast, to the extent that issuer nationality attempts to impose regulations that issuers do not value, issuers would not assist enforcement, resulting in higher enforcement costs.

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111 Fox, *supra* note 37.

112 *Id.*

113 *Id.*

114 *See supra* Part I.G.

Not only does issuer nationality encompass enforcement problems greater than those presented by the issuer choice proposal; but it also combines them with the problems inherent in the territorial approach to securities regulation. First, Fox's proposal suffers from all the pitfalls that face any mandatory securities regime: regulatory mistake and public choice-related problems. Individual country regulators may make regulatory mistakes as easily under issuer nationality as under territorial regulation. Absent any active effort at coordination, issuer nationality also may fail to provide standardization in securities regulation. Because issuer nationality depends on the assumption that investors are able to price regulatory protections, the proposal is vulnerable as well to the presence of unsophisticated investors in markets around the globe. For example, investors with cognitive biases might systematically lose under the issuer nationality proposal.[115]

Second, issuer nationality is subject to drawbacks specific to territorial regulation. Issuer nationality in essence simply redraws the boundaries for individual country regulation from national territories to all the various world locations in which an issuer's securities may trade. Rather than simple territorial divisions, the regulatory scopes of individual countries will resemble a checkerboard across the world. To the extent that different countries have jurisdiction over different segments of the checkerboard, issuer nationality will result in individual country regulators ignoring the impact of their regulations on other jurisdictions.

Significantly, companies that enjoy a presence in the international securities markets are typically also companies with a large business presence outside their home countries. For example, companies often raise capital abroad to gain a foothold in the product markets of foreign countries. Externalities from the capital market for such a company, therefore, will have impacts in countries outside the company's home country. For a company such as Daimler-Chrysler—located prominently in both Germany and the United States—it is in fact difficult to know exactly which country is the home country. To the extent that Germany is designated the national regulator, for example, the interests of parties in the United States may go ignored.

115 Segmenting the market according to investor sophistication, as with the issuer choice proposal, nevertheless, may alleviate the problem with unsophisticated investors. *See* Choi, *Promoting Issuer Choice, supra* note 45 (presenting a proposal to partition the market according to investor sophistication).

CONCLUSION

As the world becomes more international, regulators will increasingly face the question of how to allocate securities regulatory authority. In an imperfect world, seeking a perfect regulatory response will not work. Rather, different possible regulatory responses must be assessed against one another to determine the best approach.

The present territorial approach to securities regulation suffers from numerous flaws. As in the case of other forms of mandatory regulation, territorial regulators may make errors and are subject to pressure from special interest groups in the securities industry. Regulators might also seek to maximize their own prestige and power through overly complicated regulations. In addition, territorial regulation brings with it several unique flaws. Individual countries may ignore the interests of investors and capital markets located outside their individual territories. Managers seeking to engage in opportunistic behavior might engage in such behavior outside their home country. Finally, individual countries may fail to standardize investor protections across multiple regimes.

Issuer choice also is flawed. Nevertheless, the market-based nature of issuer choice will allow private actors to adjust to reduce these flaws, something not facilitated under a territorial regulation regime. For example, a legal regime of issuer choice would provide securities market intermediaries with a strong incentive to supply investor protections tailored to specific classes of investors. Such intermediaries also will help internalize any external effects resulting from various adopted investor protection devices and will generate standardized forms of investor protection across the world. Investors, in turn, may shift funds to more sophisticated intermediaries, placing even stronger incentives on issuers to take into account the interests of all possible investors in the issuer's securities.[116]

116 Transition issues also exist with moving toward an issuer choice regime. I discuss such issues in *id.*