

2008

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Recommended Citation

Jose M. Mendoza, *Securities Regulation in Low-Tier Listing Venues: The Rise of the Alternative Investment Market*, 13 Fordham J. Corp. & Fin. L. 257 (2008).

Available at: <https://ir.lawnet.fordham.edu/jcfl/vol13/iss2/3>

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**SECURITIES REGULATION IN LOW-TIER
LISTING VENUES: THE RISE OF THE
ALTERNATIVE INVESTMENT MARKET**

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I. INTRODUCTION

In recent years, participants in the world's capital markets witnessed a shift in the tide of international listings. As the U.S. financial market rapidly loses its standing as the center of the global economy, other countries eagerly rise to challenge its dominance. In the aftermath of the Enron collapse and the "dot com" bubble burst, investors and other market participants are turning away from the regulatory burden imposed by the rigorous U.S. securities framework. While some favor delisting,¹ others seek jurisdictions with less stringent regulation in which the costs of being a public company are comparatively lower.² By reducing the cost of listing and remaining listed, this trend allows systems that feature lighter levels of regulation and specialized market segments to thrive. These events might well be considered symptoms of global regulatory competition among securities regulators and stock exchanges.³

The worldwide growth of competing trading fora and a stirring movement for reform in the U.S. have given new life to an old debate concerning the proper degree of regulatory stringency for financial markets. Ascertaining the level of securities regulation that will prove most effective in increasing overall social welfare is not an easy task. A straightforward cost-benefit examination might be insufficient to solve this problem, since it is difficult to quantify the economic effects of

1. See Craig Doidge, G. Andrew Karolyi & René M. Stulz, *Has New York Become Less Competitive in Global Markets?: Evaluating Foreign Listing Choices Over Time 1* (Fisher Coll. of Bus., Working Paper Series, Paper No. 2007-03-012, 2007), available at <http://ssrn.com/abstract=982193>.

2. See *id.*

3. See Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525 (2005); Merrit B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment* (Univ. of Mich. Law Sch., Working Paper No. 99-008, 1999), available at <http://ssrn.com/abstract=155928> [hereinafter Fox, *Mandatory Disclosure*]; Merrit B. Fox, *The Issuer Choice Debate* (Univ. of Mich. Law Sch., Working Paper No. 01-007, 2001), available at <http://ssrn.com/abstract=285294> [hereinafter Fox, *Issuer Choice*]; Roberta Romano, *The Need for Competition in International Securities Regulation* (Nat'l Bureau of Econ. Research, Yale Int'l Ctr. for Fin., Working Paper No. 00-49, 2001), available at <http://ssrn.com/abstract=278728> [hereinafter Romano, *Competition*]. This literature represents a sampling of the extensive scholarship produced in the field of global regulatory competition in the securities markets, particularly with respect to the "Issuer Choice Debate."

securities regulation.⁴ In any case, an optimal securities framework should strike a balance between investor protection and compliance costs for listed companies.⁵ The tension lies in introducing proper measures to attain such a balance, while still allowing for the development of a deep and liquid capital market. For instance, even if prophylactic regulation boosts investor confidence in the market, thereby enhancing liquidity, such rules can increase the costs of equity issuances beyond reasonable boundaries.⁶ This situation could induce public companies to de-list or to seek alternative listing venues.⁷ Yet, lighter levels of regulation could lead to market failures, eroding investor confidence to a point in which liquidity is constrained and a crash ensues.⁸

Two moments in U.S. capital market history provide further insight. The 2002 Sarbanes-Oxley Act⁹ (“SOX”) is often criticized for increasing listing costs in the U.S.¹⁰ SOX was merely the product of a

4. See John C. Coates, *The Goals and Promise of the Sarbanes-Oxley Act*, 21 J. ECON. PERSP. 91 (2007) (stating that it is hard to weigh the costs and benefits of the Sarbanes-Oxley Act). Nevertheless, the increasing convergence of securities laws and listing rules across jurisdictions point to some underlying compromise as to the minimum regulatory burden that must be imposed on public companies in order to protect the market. See *id.*

5. See Adam C. Pritchard, *Self-regulation and Securities Markets* (Georgetown Univ. Law Ctr., Working Paper No. 318939, 2003), available at <http://ssrn.com/abstract=318939>.

6. See Romano, *Competition*, *supra* note 3. The cost of raising capital is lowered if investor confidence, as a result of stringent disclosure standards, is high. See *id.*; see also John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement* (Columbia Law & Econ., Working Paper No. 304, 2007), available at <http://ssrn.com/abstract=967482> [hereinafter Coffee, *Enforcement*].

7. Cf. Coffee, *Enforcement*, *supra* note 6, at 19 (arguing that “although [offering] ‘lighter’ regulation may not improve [a] cross-listing firm’s cost of capital, it could still attract foreign issuers by offering heightened liquidity and visibility without impeding their controlling shareholders’ enjoyment of private benefits”).

8. See Diana B. Henriques, *Back from the Brink; The Fear That Made the Fed Step In*, N.Y. TIMES, Dec. 6, 1998, § 3, at 13 (discussing opposing views of the Federal Reserve Bank of New York’s arrangement of a rescue fund by Wall Street banks to prevent a hedge fund, Long Term Capital Management, from defaulting). Independent market strategist Henry Kaufman claims that when “regulatory infrastructure is not strong enough or encompassing enough” there is “a better-than-even chance” of “future significant financial problems” in securities markets. *Id.*

9. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

10. Doidge et al., *supra* note 1 (stating that despite greater costs, unique benefits

legislative reaction following a market crash, however, which brings to mind the response to the 1929 collapse that prompted the U.S. Congress to pass the Securities Act of 1933¹¹ and the Securities Exchange Act of 1934.¹² Although the 1930's measures and minor subsequent amendments significantly raised listing costs, they created a framework in which the U.S. market flourished for several decades.¹³ Scholars argue that despite its higher costs, SOX's dissuasive effect on fraudulent behavior will generate net long-term benefits.¹⁴ Moreover, well-known regulatory figures, like former Securities and Exchange Commission ("SEC") chairman Arthur Levitt, call for the implementation of still stronger measures in the United States.¹⁵

Nevertheless, proponents of a lighter approach to securities regulation abound in the U.S. and abroad.¹⁶ As companies flee from the burden of U.S. regulation, policy-makers and scholars argue for an alleviation of local regulatory requirements for listed companies. The Report of the Committee on Capital Market Regulation (informally dubbed the "Paulson Report," after U.S. Treasury Secretary Henry Paulson) set the tone for reform by pointing out the erosive effect of regulatory intensity on U.S. dominance and competitiveness.¹⁷ The

garnered by listing in the U.S. have not been eroded by SOX).

11. 15 U.S.C. §§ 77a *et seq.* (2006).

12. *Id.* §§ 78a *et seq.*

13. See ROY C. SMITH & INGO WALTER, GOVERNING THE MODERN CORPORATION: CAPITAL MARKETS, CORPORATE CONTROL AND ECONOMIC PERFORMANCE 222 (2006).

The cost of this regulation was considerable, and much objected by the participants. One consequence, however, was that in time, public confidence in banking and financial markets was not only restored but enhanced, and public participation in those markets expanded well beyond levels that might have been imagined at the time the regulations were adopted.

Id.

14. Arthur Levitt, Chairman, SEC, Remarks Before the Conference on the Rise and Effectiveness of New Corporate Governance Standards (Dec. 12, 2000), available at <http://www.sec.gov/news/speech/spch449.htm> (stating, in regard to new SEC rules increasing committee disclosure requirements, "A more globally integrated and interconnected marketplace is upon us. The need for vigilant oversight has become nothing less than a new global directive."); see Coates, *supra* note 4, at 107.

15. Neil Weinberg, *Levitt Loves Sarb-Ox*, FORBES.COM, Feb. 8, 2007, http://www.forbes.com/business/2007/02/07/levitt-sec-sarbox-biz-cz_nw_0207levitt.html.

16. See *infra* Part II.B.

17. See COMM. ON CAP. MKT. REG., INTERIM REP. (Nov. 30, 2006), available at <http://www.capmktreg.org/research.html> (recommending amendments to regulatory legislation, changes to litigation procedure, and adjustments regarding the

publication of the Paulson Report was followed by a study conducted by the Commission on the Regulation of U.S. Capital Markets in the 21st Century.¹⁸ The argument of this more recent report hinges on a comprehensive overhaul of the U.S. securities framework, focusing on the federal government's regulatory approach to financial markets and the SEC's powers regarding SOX.¹⁹ A decline in U.S. market hegemony can be seen in developments like the launching of OTCQX, a listing service whose structure closely resembles London's more lightly-regulated Alternative Investment Market ("AIM").²⁰

This Article suggests an alternative model to the one-size-fits-all approach that prevails in U.S. securities regulation. A broad approach might prove inadequate when tested in a global market, encompassing jurisdictions with differing characteristics (e.g., the technical sophistication of investors) or when applied to firms with heterogeneous incentive structures (e.g., family firms, large conglomerates).²¹ Market venues with different levels of regulatory intensity can accommodate the needs of various types of firms and investors, without sacrificing market integrity.²² A segment with stringent rules and enhanced disclosure requirements would be located at one end of the spectrum. The other end would feature a segment with less onerous regulation, providing access to liquidity pools for small-cap companies that require funds for further expansion, or family firms that favor listing but intend to retain

implementation of section 404 of SOX).

18. See CapitalMarketsCommission.com, <http://www.capitalmarketscommission.com/portal/capmarkets/default> (last visited Oct. 6, 2007). The Commission on the Regulation of U.S. Capital Markets in the 21st Century was formed by the U.S. Chamber of Commerce as an independent group of experts. Its mission is to preserve and strengthen U.S. capital markets by evaluating U.S. legal and regulatory framework and suggesting amendments to the current system. *Id.*

19. See COMM'N ON THE REG. OF U.S. CAP. MKTS. IN THE 21ST CENTURY, REP. AND RECOMMENDATIONS (Mar. 2007), available at <http://www.capitalmarketscommission.com/portal/capmarkets/default.htm> (follow link to "Download Full Report").

20. See OTCQX Brochure, <http://www.otcqx.com/otcqx/docs/OTCQXBrochure.pdf> (last visited Sept. 15, 2007). The newly-formed service for over-the-counter trading features reduced regulatory requirements and a counselling party (the Designated Adviser for Disclosure), not unlike AIM's "Nominated Adviser."

21. See *infra* Part II.A.

22i See *infra* Part II. Stock exchanges indeed appear to be introducing specialized segments for different types of firms. Coffee notes that the increased specialization of stock exchanges is a direct consequence of competitive pressures building up among such entities. See Coffee, *Enforcement*, *supra* note 6, at 18.

some of the benefits of private control.²³ A low-tier market segment, not subject to a plethora of costly rules, could be used as a stepping stone for companies that purport to engage in future issuances in primary markets like the London Stock Exchange (“LSE”), the National Association of Securities Dealers Automated Quotations (“NASDAQ”), or the New York Stock Exchange (“NYSE”).²⁴

AIM, conceived by the LSE, embodies this novel approach to securities regulation. While the LSE’s less stringent approach draws the attention of many large companies, AIM attracts the attention of small and mid-cap companies.²⁵ In order to elude mandatory regulation, such as the European Union Directives, that increases transaction costs for listed firms, trading venues such as AIM are classified as exchange-regulated markets.²⁶ AIM’s model relies heavily on lower listing standards and lighter ongoing requirements for listed companies, paired with the so-called “Nominated Adviser,” a private consultant that guides firms through their existence as listed companies.²⁷ This alternative approach propelled AIM’s rise as one of the world’s fastest growing exchanges, as measured by the number of initial public offerings (“IPOs”).²⁸

23. See Chris Gibson-Smith, Chairman, London Stock Exch., Address at the Risk Capital Summit: AIM for Europe (Oct. 4, 2005), available at <http://www.londonstockexchange.com/en-gb/about/Newsroom/Media+Resources/Speeches/aimforeurope.htm>.

This segment might also prove to be an adequate exit venue for venture capital investors. The European Venture Capital Association, for instance, has shown interest in developing a pan-European market with lighter regulation for smaller firms. *Id.*

24. See *infra* Part II.B.

25. See First Columbus Invs., About AIM/AIM Statistics and Facts, http://www.first-columbus.com/aim_stats.shtml#para10 (last visited Feb. 15, 2008).

26. Chris Blackhurst, *Cheap Trick*, CNBC EUR. BUS., Jan. 1, 2006, available at <http://cnbceb.com/2006/01/01/cheaptrick>.

27. See LONDON STOCK EXCH., AIM THE MOST SUCCESSFUL GROWTH MARKET IN THE WORLD 3 (2008), available at http://www.londonstockexchange.com/NR/rdonlyres/3B5EDCF9-1E01-4B7C-A31A-95B7170675B9/0/LSEAIMBROCHURE_WEB.pdf (discussing AIM’s advantages, including “appropriate” regulation for smaller companies, and the Nominated Advisor’s role in taking “responsibility for co-ordinating (sic) the admission process” and carrying out “extensive due diligence to ensure the company is suitable for AIM”).

28. See Press Release, London Stock Exch., AIM Study Identifies Keys to Market’s Success (Nov. 13, 2007), available at <http://www.londonstockexchange.com/NR/exeres/6B9D495B-26D4-42D6-9067-31ACC74C8F3A.htm> (“[S]ince 1995 some 2,300 British and 400 foreign companies have come to AIM, raising a total of £49 billion, of which over 40 per cent has been in the form of further issues [and

AIM's thriving success led to an outbreak of similar trading venues across Europe.²⁹ The Borsa Italiana sponsored the creation of Mercato Expandi in December 2003;³⁰ the Irish Enterprise Exchange was created in April 2005;³¹ Euronext quickly followed suit, launching the Alternext venue.³² Even the Deutsche Börse emulates AIM with its "Entry Standard" segment, launched in October 2005.³³ When the Nordic OMX introduced its First North tier, commentators proclaimed the start of a price war that could lead European securities markets into a regulatory race to the bottom.³⁴ Adding to this wariness, the disastrous European experience with the now extinct "New Markets" still looms in the mind of policymakers and investors alike.³⁵ Despite this ominous forecast, European low-cost market segments continue to flourish, even altering the course of international cross-listings.³⁶

This Article focuses on AIM's regulatory model in order to explain the recent success of low-cost listing venues in international financial markets. Part I explains how AIM covers a funding gap for companies whose specific characteristics preclude them from listing in senior markets such as NASDAQ, the NYSE, or the LSE. In addition, it states that AIM's level of regulation is close to optimal—imposing low costs on firms but ensuring sufficient disclosure and transparency—given the type of companies that seek an AIM listing and the nature of its investor

approximately 60 per cent of the AIM's issuances were IPO's]."); Sridhar Arcot et al., The London Sch. of Econ. & Pol. Sci., *From Local to Global – The Rise of AIM as a Stock Market for Growing Companies*, available at <http://www.londonstockexchange.com/NR/rdonlyres/4B0DF62A-BE1E-44F5-8616-EA2891873F1D/0/AIMshortreport.pdf>; see also First Columbus Invs., *supra* note 25 (providing general AIM statistics).

29. Blackhurst, *supra* note 26.

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.* "Segment" refers to a target group of listing companies, in this case small to mid-size companies, which must weigh the advantages of Deutsche Börse's Entry Standard against the London Stock Exchange's AIM to determine where to list their shares. *See id.*

34. *Id.*

35. See Marc Goergen et al., *The Rise and Fall of the European New Markets: On the Short and Long-run Performance of High-tech Initial Public Offerings* (Eur. Corp. Gov. Inst., Fin. Working Paper No. 27, 2003), available at <http://ssrn.com/abstract=443861> (providing a detailed account of the rise and fall of the European New Markets).

36. See Joseph Piotroski & Suraj Srinivasan, *The Sarbanes-Oxley Act and the Flow of International Listings* (Jan. 2007) (unpublished working paper), available at <http://ssrn.com/abstract=956987>.

base. Part II traces the evolution of a regulatory dynamic that gave rise to the existing cost/benefit structure of stock exchanges. Part III analyzes AIM's regulatory model in an attempt to explain its recent success and its adequacy as a listing venue for certain types of firms. Part IV concludes that AIM's model is a legitimate success, although remaining flaws must be corrected for the platform to continue to be favored by small, high-growth firms.

II. THE EVOLUTION OF SECURITIES REGULATION

Financial markets have come a long way since Adam Smith espoused the free allocation of economic resources in market systems and the all-too-familiar invisible hand more than two centuries ago.³⁷ Without neglecting the principle of *laissez-faire* that allowed sophisticated economies to prosper, regulators and policy-makers in advanced jurisdictions discovered long ago that some intervention was necessary if financial markets were to function properly.³⁸ Although the level of governmental intervention varies across jurisdictions, existing rules and statutes focus primarily on the importance of timely and accurate disclosure of relevant information to the market and corporate governance structures.³⁹

It is a fundamental tenet of capital markets that an adequate flow of high-quality information enhances investor confidence and, thus, contributes to the development of deep and liquid financial markets.⁴⁰ Enhanced transparency might not only allow for timely, extensive information, but can also improve and homogenize the quality of the data disclosed. Standardized information enables investors to compare different business prospects. If investors possess a greater degree of

37. See SMITH & WALTER, *supra* note 13, at 221.

38. See *id.* at 220. Political considerations play a large role concerning governmental intervention in market systems. *Id.* at 222. As Smith and Walter point out, a democratic society is sometimes at odds with a totally free market system, in which some parties sustain heavy losses at the expense of others. *Id.* at 223. Consequently, legislators with political incentives often strive to transfer wealth from "the richer to the poorer members of a democratic society, as a measure of moral justice." *Id.* at 224. This is accomplished by progressive taxing and the introduction of measures that reduce freedom in the market. *Id.* at 223-24.

39. See *id.* at 272.

40. Arthur Levitt, Chairman, SEC, Remarks to the Inter-American Development Bank: The Importance of High Quality Accounting Standards (Sept. 29, 1997), available at <http://www.sec.gov/news/speech/speecharchive/1997/spch176.txt>.

standardized, high-quality information, they may be more inclined to invest in securities markets. Disclosure is frequently coupled with corporate governance mechanisms that attempt to neutralize agency problems in listed firms.⁴¹ A balanced mix of properly enforced disclosure requirements and corporate governance rules is a telltale sign of a jurisdiction with a sophisticated capital market.⁴²

Successive financial collapses have led policymakers to focus on disclosure⁴³ and corporate governance,⁴⁴ by introducing and enforcing rules aimed at providing an adequate level of investor protection. This regulatory dynamic, in which market crashes are followed by legislative and policy responses, still determines the aims and stringency level of securities laws in multiple jurisdictions.⁴⁵ Market complexities, however, make it extremely difficult to introduce such corrective

41. See Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 21, 21-31 (2004). Agency problems can affect the relations that exist between (i) majority and minority shareholders, (ii) shareholders and management, and (iii) the firm and other constituencies. *Id.*

42. See generally Francisco Reyes, *Corporate Governance in Latin America: A Functional Analysis* (2007) (unpublished working paper), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1005208.

43. The debate regarding the importance of mandatory disclosure mainly concerns informational efficiency in the market, such as reducing the information gap that exists between public companies and investors. See Frank Partnoy, *Why Markets Crash and What Can Law Do About It?* (2000) (unpublished working paper), available at <http://ssrn.com/abstract=183473>. According to Partnoy, most authors agree that securities regulation should focus mainly on mandatory disclosure. See *id.* at 21; see also Steven M. Davidoff, *Regulating Listings in a Global Market* (Wayne State Univ. Law Sch., Legal Studies Research Paper No. 07-02, 2007), available at <http://ssrn.com/abstract=964704>; Coffee, *Enforcement*, *supra* note 6; Romano, *Competition*, *supra* note 3; Fox, *Mandatory Disclosure*, *supra* note 3.

44. See William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism* 43 (Eur. Corp. Gov. Inst., Law Working Paper No. 23, 2004), available at <http://ssrn.com/abstract=606481>. In the midst of the Great Depression in the U.S., Associate Justice William O. Douglas identified the insufficiency of disclosure requirements in preventing market failures and advocated corporate governance reform. In Douglas' opinion, preventing a collapse similar to the one that led to the Depression in the 1930s would require regulation concerning the separation of ownership and control. His proposal consisted mainly of a monitoring model in which independent directors would oversee management. Bratton and McCahery explain that "Douglas' article set out the basic terms of the governance agenda that has guided corporate law reform ever since." *Id.*

45. See SMITH & WALTER, *supra* note 13, at 222.

measures *ex ante* to prevent the market from collapsing.⁴⁶ Securities laws could thus largely be considered a regulatory response to market failures. Analyzing this interaction between policymakers and the market is central to understanding the role of securities regulation in ensuring a healthy marketplace.

A. A Regulatory Dynamic

The rules set out in advanced economic systems are often the result of a continuous regulatory dynamic in which market flaws are detected and fixed *ex post*.⁴⁷ Most major interventions in the world's financial systems are the result of a market collapse, often preceded by the burst of speculative bubbles and corporate scandals.⁴⁸ Early examples of this trend include the failure of the Mississippi and South Sea Companies in the eighteenth century, which led to significant investor losses, general public outrage, and ensuing governmental intervention. The stories behind both scandals are well known. After the French and English governments, respectively, granted monopolistic positions to each company, public investors poured funds into these ventures. In each case information was manipulated or concealed from the market and a harmful speculative bubble was quick to inflate and burst, leading to massive losses for the unwary investors of both companies.⁴⁹ The

46. See Partnoy, *supra* note 43, at 3.

47. See Stuart Banner, *What Causes New Securities Regulation: 300 Hundred Years of Evidence*, 75 WASH. U. L.Q. 849 (1997), available at http://law.wustl.edu/WU_LR/75-2/752-5.html; John C. Coffee, Jr., *A Theory of Corporate Scandals: Why the U.S. and Europe Differ* (Columbia Law & Econ., Working Paper No. 274, 2005), available at <http://ssrn.com/abstract=694581> [hereinafter Coffee, *Scandals*].

48. See John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms* 5 (Columbia Law & Econ., Working Paper No. 237, 2003), available at <http://ssrn.com/abstract=447940> [hereinafter Coffee, *Gatekeeper*]. This crash-then-law sequence has repeated itself multiple times over the course of several centuries "with financial regulation following largely as a response to market crashes." See Partnoy, *supra* note 43, at 3.

49. See Joseph McCahery & Erik Vermeulen, *Corporate Governance and Innovation: Venture Capital, Joint Venture and Family Businesses* (Eur. Corp. Gov. Inst., Law Working Paper No. 65, 2006), available at <http://ssrn.com/abstract=894785>. In the case of the South Sea Company, for instance, crucial information regarding the Spanish dominion of key New World territories was concealed from the public. See *id.* at 11. "The South Sea Company was in fact nothing more than an empty shell without any future cash flows and expectations." *Id.* The South Sea Company endured an 80% loss in the value of its shares in the period leading to its collapse. Partnoy, *supra* note

upshot of these debacles was not only swift governmental action, but also a general loss of confidence in the corporate form, which persisted until the Industrial Revolution.⁵⁰

In the United States, the regulatory dynamic in securities regulation has been far more visible than in other jurisdictions. Following the devastation of the First World War in Europe, the U.S. emerged as the leading center for financial services. Unrestrained market activity characterized the 1920s era, in which high returns were often the result of speculation and market manipulation.⁵¹ In 1929, the speculative bubble finally ruptured, throwing the U.S. economy into a period of economic decline, aptly termed the Great Depression. Public discontent eventually led to the election of Franklin D. Roosevelt and the implementation of his New Deal policies, which sought to reactivate the economy and restore public confidence in the market.⁵² The Securities Act of 1933⁵³ and the Securities Exchange Act of 1934⁵⁴ served as cornerstones of his policy agenda and were swiftly approved by Congress.⁵⁵ These measures significantly raised the costs of being a listed company in the U.S.⁵⁶ Despite raising compliance costs, governmental intervention (including the passage of both acts) succeeded in restoring public confidence and allowed financial markets to flourish. Although corporate scandals and minor market crashes occurred during the ensuing decades, the United States enjoyed a period

43, at 8.

50. See David Sanders, *Financial Catastrophes: The Overthrow of Modern Financial Theory* (Oct. 2003) (unpublished working paper), <http://www.actuaries.org.uk/files/pdf/proceedings/giro2003/Sanders.pdf>. Historical records concerning the South Sea bubble crash point to Robert Walpole as leading an investigation, which ultimately resulted in the introduction of several measures to increase public confidence. See *id.* app. 1.

51. See SMITH & WALTER, *supra* note 13, at 58.

52. See *id.* During this period “lost market values, bankruptcies and scandals led to cries for punishment of the ‘guilty’ and improved regulation to prevent future recurrences. The 1929 crash was a watershed event because it was seen at the time as the cause of the ruinous economy that followed a decade of prosperity.” *Id.* at 7.

53. 15 U.S.C. §§ 77a *et seq.* (2006).

54. *Id.* 78a *et seq.*

55. See SMITH & WALTER, *supra* note 13, at 7-8.

56. See ALAN R. PALMITER, *SECURITIES REGULATION: EXAMPLES AND EXPLANATIONS* (3d ed. 2005) (giving a detailed explanation of such measures).

of relative stability that was to last until the end of the twentieth century.⁵⁷

After the vibrant takeover wave of the 1980s, the U.S. economy entered a high-growth period in which market conditions were optimal for the economic expansion of the following decade. As high-tech start-up firms started to dominate the marketplace, investors and gatekeepers alike were caught in a wave of irrational exuberance that would ultimately lead to a market collapse of vast dimensions.⁵⁸ The bull market of the 1990s saw stock indices rise to unprecedented levels, peaking in 2000: the NASDAQ Composite Index reached 5,048, the Dow Jones Industrial Average rose to 11,722, and the S&P 500 peaked at 1,527. Despite the buoyant expansion of this decade, the problems that foreshadowed the passage of SOX soon became evident. As the 1990s economy slowed, the high overvaluation of tech-related stocks, largely fuelled by market euphoria, negatively affected investors in equity markets.⁵⁹ Widespread gatekeeper failure accompanying notorious fraud scandals at some of the largest U.S. companies⁶⁰ and public anxiety following terrorist attacks on New York played a large part in shifting public opinion against regulatory laxity.⁶¹ Federal intervention was swift.⁶² After Enron's stock plummeted amid

57. See SMITH & WALTER, *supra* note 13, at 8 (recording the existence of a bubble burst in 1958, which was followed by minor intervention embodied by the passage of the Williams Act, and another crash in 1987, which only gave rise to reforms by stock exchanges).

58. See *id.* at 10-12.

59. Edwin J. Perkins, Book Review, 6 OXFORD J. ENTER. & SOC'Y 557, 557-58 (2005) (reviewing ROGER LOWENSTEIN, *ORIGINS OF THE CRASH: THE GREAT BUBBLE AND ITS UNDOING* (Penguin 2004)).

60. See Coffee, *Gatekeeper*, *supra* note 48, at 5.

61. See Bratton & McCahery, *supra* note 44, at 46-47 (arguing that the combination of three elements led to the passage of SOX—"a major and ongoing decline in the equity markets . . . headline-grabbing stories of corporate corruption and popular anger towards corporate management"—and pointing out that these same ingredients were also instrumental in the enactment of the Foreign Corrupt Practices Act during the 1970s); see also *supra* notes 11-13 (explaining responses to the 1929 market crash and how the economy flourished thereafter).

62. See SMITH & WALTER, *supra* note 13, at 7-8 (asserting that a general loss of confidence in the U.S. financial market, a loss of market capitalization estimated at over \$8 trillion, and increasing public outrage are some of the factors that may have prompted the federal government to intervene so rapidly).

accounting scandals and paper-shredding rumors, and Worldcom collapsed, the U.S. Congress raced to pass SOX.⁶³

Federal intervention again broke from the historical trend that each state regulates the corporate affairs of its companies.⁶⁴ The newly enacted SOX imposed stiff corporate governance requirements on publicly-held corporations, particularly with regard to the company's auditing processes.⁶⁵ Scholars across the U.S. still argue whether the costs imposed by raising governance hurdles are justified.⁶⁶ Specifically, the SOX debate turns on whether the Act reduced the cost of capital in the U.S. more than it increased the regulatory burden for publicly-held companies.⁶⁷

63. See Bratton & McCahery, *supra* note 44, at 47. In their account of the SOX enactment process, Bratton and McCahery explain that as the Senate held hearings on the bill that would become SOX, Worldcom collapsed, leading to an accelerated approval of the new law. *Id.*

64. See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance* (Yale Int'l Ctr. for Fin., Working Paper 04-37, 2005), available at <http://ssrn.com/abstract=596101> [hereinafter Romano, *Sarbanes-Oxley*]; Bratton & McCahery, *supra* note 44, at 35. The securities acts of the 1930s had also impinged on states' autonomy in corporate affairs. Even though such laws did not directly concern company law matters, they clearly affected the way firms operated. The Securities Act of 1933, although passed almost four years after the stock market crash of 1929, was the result of hasty governmental intervention. See Paul G. Mahoney, *The Political Economy of the Securities Act of 1933* 2 (Univ. of Va. Sch. of Law, Legal Studies Working Paper No. 00-11, 2000), available at <http://ssrn.com/abstract=224729>.

65. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2006). As stated in the preamble to SOX, its purpose is "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws." *Id.* The Act is applicable to public firms incorporated in the U.S., public accounting firms, any person or company involved in audit or reporting under U.S. law, and to foreign firms that undergo public issuances in the U.S. See *id.* Some of the provisions set out in SOX concern (i) the creation of the Public Company Accounting Oversight Board, (ii) a requirement to set into place strong control structures and evaluate them periodically, (iii) certifications by CEOs and CFOs of financial reports, (iv) completely independent audit committees, and (v) a prohibition of personal loans to management. See *id.*

66. See *supra* notes 43-44. A vast array of academic literature addresses the costs and benefits structure of SOX and its impact on the U.S. market.

67. See Posting of Larry Ribstein to Ideoblog, *Should We Care About the Decline in U.S. IPOs?*, http://busmovie.typepad.com/ideoblog/2006/11/should_we_care_.html (Nov. 25, 2006, 7:18 AM) (arguing that this valuation cannot be effectively undertaken without the benefit of hindsight).

While both sides offer compelling arguments for⁶⁸ and against⁶⁹ the Act, recent reports, which single out the 2002 law as one of the main reasons for the loss of competitiveness of the U.S. financial markets, tend to bolster the argument of SOX's opponents.⁷⁰ The Report of the Committee on Capital Market Regulation, released on November 30, 2006, concluded that regulatory intensity set into place by SOX and similar legislative efforts eroded U.S. dominance and competitiveness.⁷¹ After carefully analyzing the current state of affairs in the U.S., the blue-ribbon Paulson Committee recommended amendments to securities regulation and litigation, as well as adjustments regarding the implementation of SOX section 404.⁷² The publication of the Paulson Report preceded a study conducted by the Commission on the Regulation of U.S. Capital Markets in the 21st Century. This report suggests a comprehensive overhaul of U.S. securities regulation, centered on the federal government's approach to financial markets, the SEC's powers regarding SOX, and the U.S. litigation framework.⁷³ A third report sprung from a joint effort between New York City's Mayor Michael Bloomberg and Senator Charles E. Schumer.⁷⁴ After

68. See, e.g., Robert J. Brown, *Criticizing the Critics: Sarbanes-Oxley and Quack Corporate Governance*, 90 MARQ. L. REV. 309 (2006) (providing several counter-arguments for the main critiques of SOX); Coates, *supra* note 4, at 92.

69. See, e.g., HENRY N. BUTLER & LARRY E. RIBSTEIN, ABSTRACT TO THE SARBANES-OXLEY DEBACLE: HOW TO FIX IT AND WHAT WE'VE LEARNED 4 (2006) (arguing that "[b]y imposing the costs of eliminating fraud on all firms in investors' portfolios, the SOX mandates are a terrible deal for the ordinary investors it purports to protect"); Stephen M. Bainbridge, *Sarbanes-Oxley: Legislating in Haste, Repenting in Leisure* 15 (UCLA Sch. of Law, Law-Econ. Research Paper No. 06-14, 2006) (arguing that "by raising the cost of access to the capital markets, SOX likely will slow down the economy in the long-run"); Edward F. Greene, *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, 48 HARV. INT'L L.J. 85, 86 (2007) (arguing that "[t]he current U.S. regulatory scheme makes cross-border investment costly and inefficient"); Romano, *Sarbanes-Oxley*, *supra* note 64, at 2-3.

70. Whether SOX erodes U.S. competitiveness is beyond the scope of this paper. However, it is important to note that the U.S. securities framework, including the SOX provisions, impose high costs on publicly-held firms. Smaller firms bear a disproportionate part of such costs and will thus refrain from going public, seek alternative listing venues, or de-list. See *infra* Part II.C.

71. See COMM. ON CAP. MKT. REG., *supra* note 17.

72. See *id.*

73. See COMM'N ON THE REG. OF U.S. CAP. MKTS. IN THE 21ST CENTURY, *supra* note 19.

74. See MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW

identifying several factors that have eroded New York's leading position, including the migration of IPO activity and strong dynamics driving the growth of non-U.S. markets, the Bloomberg-Schumer report calls for urgent action "at the national, State and City levels to enhance the competitiveness of the U.S. financial markets and defend New York's role as a global financial center."⁷⁵ Lending further credence to the three reports, a recent study displaced New York as the world's top financial services center, awarding London the highest ranking.⁷⁶

As the U.S. markets slowly adapted to SOX's regulatory framework, the European Union became immersed in a series of corporate scandals of their own. Irregularities in high-profile European firms such as Parmalat and Hollinger, however, stemmed from a different source than the North American episodes. Whereas Enron, Worldcom and similar cases concerned manipulation of financial statements by management, Parmalat eventually collapsed after controlling shareholders misappropriated company assets in an amount close to \$17 billion.⁷⁷

Disparities in the corporate governance systems of the United States and Europe account for the methodological differences in both types of fraudulent behavior. The dispersed shareholder model that prevails in the U.S. and its equity-based system of executive compensation created a set of incentives for managers to engage in financial manipulation in order to maximize personal benefits.⁷⁸ The European concentrated

YORK'S AND THE U.S.' GLOBAL FINANCIAL SERVICES LEADERSHIP (2007), available at http://www.schumer.senate.gov/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf. This report is also tough on SOX. Its preamble categorically criticizes SOX for having eroded U.S. competitiveness: "The flawed implementation of [SOX] which produced far heavier costs than expected, has only aggravated the situation." *Id.*

75. See *id.* at 29. An expert group commissioned to modernize securities legislation in Canada recently found that SOX had a detrimental impact on U.S. capital markets, to the extent that it was allegedly introduced without consideration of essential market characteristics (e.g., the influence of gatekeepers, the effectiveness of private enforcement, and the role of market forces). The report hinges on whether to introduce reforms to the Canadian system that would bring it closer to the LSE's and AIM's level of regulation than the one set forth by SOX. See JOHN BOARD ET AL., THE LSE'S AIM MARKET: EFFECT ON RETURNS AND TRADING OF CANADIAN STOCKS (2006).

76. See Alan Beattie, *London Named Top Financial Centre*, FIN. TIMES, June 11, 2007 (showing London at the top position of the world's top fifty financial centers, with New York, Tokyo, and Chicago as runners-up).

77. See Coffee, *Scandals*, *supra* note 47, at 14.

78. See *id.* at 18. Upon receiving stock options as remuneration for their services,

ownership model generated conditions under which controlling parties were able to expropriate other constituencies.⁷⁹ Accordingly, the Parmalat racket largely consisted of controlling shareholders siphoning company assets through related party transactions.⁸⁰ However, financial statement misrepresentations and other instances of fraud involving European public firms had been uncovered even before the Milan Stock Exchange suspended trading in Parmalat shares at the end of 2003.⁸¹ The European Commission responded by introducing a series of amendments, “including an Action Plan for the modernization of company law and plans for the reform of the statutory audit.”⁸²

Ultimately, securities regulation will have net positive effects if it reduces the cost of capital more than it raises regulatory costs for listed companies in a given jurisdiction.⁸³ Regulatory costs, while varying in nature, are often imposed without regard to a firm’s size or specific

managers had an incentive to tamper with a firm’s short-term profits, since better results meant a higher payout derived from such options. *Id.* at 7.

79. *See id.* at 11-13 (explaining that the European model allows controlling parties to expropriate the minority holders’ interests).

80. *See id.* at 14. After bond issuances for \$150 million and \$200 million in 2003, Parmalat’s financial statements were subject to rigorous scrutiny. *See* Guido Alessandro Ferrarini & Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: The Parmalat Case 9* (Eur. Corp. Gov. Inst., Law Working Paper No. 40, 2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=730403. Auditors detected some irregularities concerning funds supposedly deposited in an offshore account held by Bonlat, a Cayman Island subsidiary of Parmalat. *See* Ferrarini & Giudici, *supra*. A governmental inquiry subsequently unveiled the truth—no such account existed. Members of the company’s management had apparently forged a letter from the Bank of America and manipulated financial statements for over a decade. *See* Coffee, *Scandals*, *supra* note 47, at 14.

81. *See* Abe De Jong et al., *Royal Ahold: A Failure of Corporate Governance 13* (Eur. Corp. Gov. Inst., Fin. Working Paper No. 67/2005, 2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=663504. Managers in the Dutch Ahold company had overstated financial statements by consolidating amounts derived from a 50-50 joint venture (which is not permitted under Dutch regulation unless the consolidating company has effective control of the venture) and then tried to cover such irregularities by misrepresenting control of the joint venture in a series of letters. *Id.* Deceptive accounting in an Ahold U.S. subsidiary—U.S. Foodservices—was also uncovered. *See id.* at 12-13.

82. *See* John Armour & Joseph A. McCahery, *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the U.S. 3* (Amsterdam Ctr. for Law & Econ., Working Paper No. 2006-07, 2006), available at <http://ssrn.com/abstract=910205>.

83. *See* Coffee, *Enforcement*, *supra* note 6, at 70-71.

incentive structure.⁸⁴ Accordingly, it is up to each firm to balance the costs of listing against its benefits when deciding whether to go public.⁸⁵ If the introduction of strict auditing and disclosure rules raise listing costs too high, a firm may seek other listing venues, alternative financing mechanisms, or even undergo delisting procedures.⁸⁶

However important this homogeneous cost structure is in ensuring investor protection, it might also become a deterrent for small-cap companies that cannot afford to endure such costs, or family firms that could derive higher benefits from remaining unlisted.⁸⁷ It follows that one-size-fits-all rules can have negative spillover effects vis-à-vis

84. See BUTLER & RIBSTEIN, *supra* note 69 (arguing that SOX has a negative overall impact on investors, since it includes the costs of eliminating fraud on *all* listed firms—with some exceptions for foreign firms). In the authors' opinion, investors will profit from securities regulation only:

if the benefit from reduced fraud is greater than the cost of compliance by the firms they invest in. . . . Moreover, it is well-accepted in the financial economics literature that the costs and benefits of securities regulation should be evaluated from the perspective of shareholders who can avoid some costs of fraud by investing in diversified portfolios of shares.

Id. at 2.

85. See Amin N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141 *passim* (2003) [hereinafter Licht, *Bonding*]. Licht also suggests that the listing decision may be a consequence of opportunistic behavior on behalf of corporate insiders. In this scenario, such insiders would derive a higher direct benefit than the firm. See *id.*

86. See, e.g., Joseph A. McCahery & Erik P.M. Vermeulen, *The Internal Organization of Private Equity and Hedge Fund-oriented Governance*, *Maandblad voor accountancy en Bedrijfseconomie* (forthcoming 2007) (arguing that “these funds not only endeavour to deliver superior returns by diligent research and insightful analysis, but also by actively reshaping a portfolio firm’s business policy and strategy”); William W. Bratton, *Hedge Funds and Governance Targets* (Eur. Corp. Gov. Inst., Law Working Paper No. 80, 2007), available at <http://ssrn.com/abstract=928689> (explaining some of the different strategies used by private equity and hedge funds in order to maximize investment returns). The recent “going private” movement led by private equity and hedge funds worldwide may be seen as a sign that the costs of being a listed company in certain jurisdictions exceed its benefits. Private equity funds can obtain high returns on their investment by lowering regulatory costs associated with disclosure and compliance, implementing customized business policies, and then taking the company public again. See McCahery & Vermeulen, *supra*.

87. See Bratton & McCahery, *supra* note 44, at 50. SOX requirements in the U.S. have been criticized for raising compliance costs more than compliance benefits for certain types of firms. “In particular, the costs bear more heavily on a marginal class of firms that will be discouraged from going public or, if already public, might be forced to go private.” *Id.*

smaller public firms, which are forced to bear a disproportionate part of the regulatory costs of listing.⁸⁸ These firms are thus compelled to operate under low or even negative profit margins, which could eventually cause them to go private.⁸⁹ Accordingly, it might be possible to specifically tailor cost structures to accommodate the needs of different types of firms, while still ensuring an adequate level of disclosure and investor protection.⁹⁰ Specialized rules can be a natural outcome of increasing regulatory competition among stock exchanges.⁹¹ Even though some expect this competition to lead to convergence around uniform rules, the most likely outcome is increased specialization of listing venues.⁹²

88. See Davidoff, *supra* note 43, at 2, 7, 43; see also ROBERT ABBANAT, EASDAQ, S.A., FEASIBILITY STUDY: A PAN-EUROPEAN MARKET FOR TECHNOLOGY GROWTH COMPANIES 6-7 (2004), available at <http://www.europabio.org/documents/MIT-Full.pdf>; Coffee, *Enforcement*, *supra* note 6, at 13-14, 42-43; Bainbridge, *supra* note 69, at 13.

SOX imposes high regulatory costs that place particular burdens on smaller publicly-held companies. As a result, many firms are deciding not to go public, while a substantial number of public firms are going private. SOX thus reduces investor choice, makes many investments less liquid, and in the long run likely will discourage entrepreneurship by denying start-ups access to financing in the capital markets.

Id. One could add to Bainbridge's remark the fact that some of these smaller firms are seeking alternative listing venues such as AIM. See *infra* Part III; see also William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of Going Private* (Emory Law and Econ. Research Paper No. 05-4, Feb. 2005), available at <http://ssrn.com/abstract=672761> (providing interesting empirical data to support the hypothesis that smaller firms are disproportionately affected by one-size-fits-all rules like the ones contained in SOX).

89. See Bainbridge, *supra* note 69, at 12-13.

90. See BUTLER & RIBSTEIN, *supra* note 69, at 4 (arguing that although investors do not like to be defrauded and do want some regulation, they "will find such regulation valuable only if the benefit from reduced fraud is greater than the cost of regulatory compliance").

91. See Coffee, *Enforcement*, *supra* note 6, at 14-15. Competition among exchanges has been escalating in recent times, leading to highly publicized events such as the NYSE's acquisition of Euronext, NASDAQ's failed attempts to acquire the LSE and, of course, the latter's attempt to acquire the Borsa Italiana. See *id.* at 14 n.31; see also Davidoff, *supra* note 43, at 14-15.

92. See John C. Coffee, Jr., *Racing Towards the Top: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance* (Columbia Law Sch. Working Paper No. 205, 2002), available at <http://ssrn.com/abstract=315840> [hereinafter Coffee, *Cross-Listings*]; Coffee, *Enforcement*, *supra* note 6, at 18-19. According to Jackson and Gkantinis, the demutualization and subsequent listing of stock exchanges has changed their inherent incentive structure, such that these entities

An assortment of securities by-products could result, such as stringent requirements that enhance bonding benefits, or cheap access to equity for small firms.⁹³ The introduction of lower market tiers with varying degrees of regulatory stringency could enhance public welfare, while still retaining main market regulatory levels.⁹⁴ Each tier would possess unique advantages and impose a certain level of expenditure in accordance with the cost/benefit structure explained below.

B. The Cost/Benefit Structure of Financial Markets

Financial market access provides public firms with a series of benefits unavailable to private companies. It also imposes significant costs upon a firm's operations. The extent to which a company derives a net benefit from gaining admittance to a stock exchange depends largely on the relevant regulatory model, as well as on the firm's particular traits. For instance, the strict U.S. securities framework creates a niche in which companies benefit from reductions in the cost of capital and a higher valuation premium.⁹⁵ These conditions are optimal for large firms that pursue public equity financing or that cross-list for bonding purposes.⁹⁶ Conversely, jurisdictions that feature lighter regulation can offer smaller firms heightened visibility and liquidity at lower cost.⁹⁷ This divergence in regulatory models leads authors to categorize the levels of regulatory stringency available for companies seeking equity

now cater to the interests of shareholders instead of their members. *See* Howell E. Jackson & Stavros Gkantinis, *Markets as Regulators: A Survey* 11-15 (Harvard Law & Econ. Discussion Paper No. 579, 2007), available at http://papers.ssrn.com/abstract_id=960168. This has increased competitive pressures among exchanges, which now seek to increase profit margins by developing and offering new products. *See id.*

93. *Cf.* Coffee, *Enforcement*, *supra* note 6, at 18-19.

94. *See id.* at 59-60. Coffee posits that it may be perverse to listen to the siren call of those who intend to reduce the levels of regulatory stringency for listed companies in the U.S. In his opinion, this would increase the cost of capital in the U.S. and reduce the benefits arising from the bonding premium available to firms that cross-list into U.S. capital markets. *Id.*

95. *See, e.g.,* Coffee, *Enforcement*, *supra* note 6 (suggesting that higher disclosure standards have a considerable impact in lowering the cost of capital for listed firms); Goergen et al., *supra* note 35, at 1 (same); Romano, *supra* note 3 (same).

96. *See* Piotroski & Srinivasan, *supra* note 36, at 6.

97. *See* Coffee, *Enforcement*, *supra* note 6, at 19. However, firms listing in these markets would not benefit from the lower cost of capital that characterizes jurisdictions with a higher level of enforcement. *See id.*

financing. Although several of these market taxonomies exist, this Article refers to a sequential classification in which jurisdictions abide by low, middle or high regulatory models.⁹⁸

In each model, the pros and cons of listing vary gradually. One must understand the cost/benefit structure of capital markets to measure the impact of the disparities upon various categories of firms.⁹⁹ Firms incur both direct and indirect costs upon going public and maintaining their listing. The direct costs of going public may include initial listing fees, IPO underwriting fees, professional fees like legal and accounting advisers, and other compliance expenses.¹⁰⁰ Indirect costs of going public include the loss of private control suffered by controlling shareholders, like the loss of proprietary information due to disclosure requirements, and IPO underpricing, which can occur in some listing venues.¹⁰¹ Direct costs of remaining listed include recurring expenses, like stock exchange fees, legal and accounting advisory fees, or charges for new issuances of stock. Indirect costs of remaining listed can include diverted managers' attention from maximizing shareholder value, distorted directors' and managers' incentive structures, and management exposure to excessive litigation.¹⁰² Figure 1 shows the cost structure of capital markets.

98. See Davidoff, *supra* note 43, at 44-50. Although this paper classifies these approaches sequentially, it is important to note the approach suggested by Jackson and Gkantinis, whereby regulatory responsibility is divided into a Government-led model (e.g., France and Germany), a Flexibility model (e.g., U.K. and Hong Kong) and a Cooperation model (e.g., U.S. and Canada). See Jackson & Gkantinis, *supra* note 92, at 3.

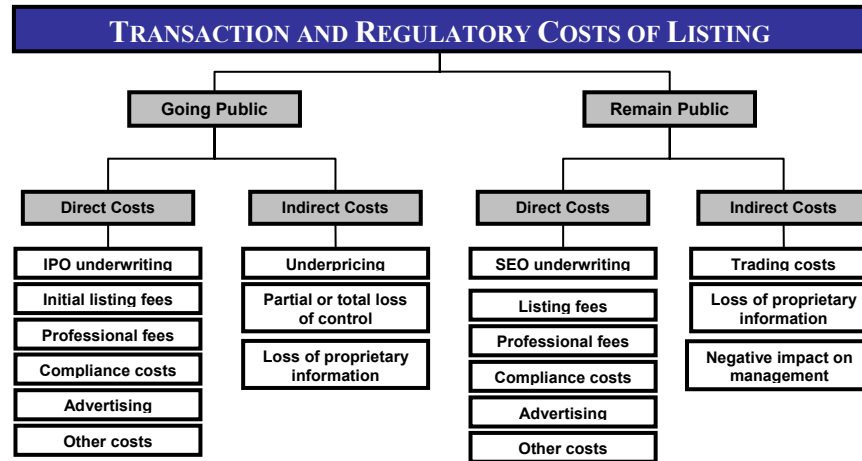
99. See Coates, *supra* note 4, at 92; Amin N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT'L L. 563 (2001) [hereinafter Licht, *Regulation*] (arguing that pricing legal rules is a complex task). Although some of these costs and benefits may be weighed and measured accurately, certain factors, such as gauging indirect costs, make it difficult to calculate the overall effect of securities regulation. Coates, *supra* note 4, at 106.

100. See CHRISTOPH KASERER & DIRK SCHIERECK, DEUTSCHE BÖRSE AG, THE COST OF CAPITAL: GOING PUBLIC AND BEING PUBLIC, AN INTERNATIONAL COMPARATIVE STUDY (2006) (on file with the *Fordham Journal of Corporate & Financial Law*). Such compliance costs may refer to specific corporate governance or other requirements imposed in different regulatory frameworks. *Id.*

101. Cf. Goergen et al., *supra* note 35, at 3 (detailing an analysis of IPO underpricing in junior equity markets).

102. See BUTLER & RIBSTEIN, *supra* note 69, at 2 (arguing that these indirect costs have a significant impact on financial markets and that SOX raised indirect costs to a

FIGURE 1
THE COST STRUCTURE OF CAPITAL MARKET



Source: KASERER & SCHIERECK, *supra* note 100, at 13.

Firms also derive many benefits from gaining admittance to capital markets. For instance, in order to address increasing levels of competition, listing allows companies to raise equity for expansion or maintenance plans.¹⁰³ Firms might also reduce or eliminate higher-interest debt obligations by raising less costly funds in equity markets.¹⁰⁴ Market listing can also provide an exit mechanism for incumbent shareholders,¹⁰⁵ or enhance a company's visibility and reputation.¹⁰⁶

point where the U.S. market has been severely affected).

103. See Felice B. Friedman & Claire Grose, *Promoting Access to Primary Equity Markets: A Legal and Regulatory Approach*, 7-8, 13 (World Bank Pol'y Res., Working Paper No. 3892, 2006).

104. See Alexander Ljungqvist, *IPO Underpricing*, in HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE VOLUME 1 375, 378 (B. Espen Eckbo ed., 2007).

105. See Bernard Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets*, 47 J. FIN. ECON. 243 (1998); Cf. Douglas J. Cumming & Jeffrey G. MacIntosh, *A Cross Country Comparison of Full and Partial Venture Capital Exists*, 27 J. BANKING & FIN. 511, 512 (2003) (discussing that an IPO allows venture capitalists to obtain a significant return on their initial investment and entrepreneurs to regain control of the newly-listed company).

106. See Friedman & Grose, *supra* note 103 (explaining that academic literature regarding the listing decision is profuse); Ivo Welch & Jay Ritter, *A Review of IPO Activity, Pricing and Allocations* 5-6 (Yale Int'l Ctr. for Fin., Working Paper No. 02-01,

Small and medium-sized companies are particularly drawn to equity financing, due to credit constraints and the high cost of capital that debt financing can pose.¹⁰⁷ Credit constraints are largely the result of financial entities' bias toward projects with low risk.¹⁰⁸ The provisions contained in the Basel II Accord might have further tightened credit for small companies,¹⁰⁹ luring them away from debt financing and into capital markets.¹¹⁰

More stringent regulation, however, is a two-way street. Academic literature refers extensively to the "bonding hypothesis," whereby cross-listing firms profit from adopting the higher governance standards of a foreign jurisdiction.¹¹¹ A listed company's management can seek to

2002) (classifying the reasons for going public under the Life-Cycle Model, in which companies that reach a specific size have more to gain from going public, and the Market-Timing Model, in which companies will not go public if they consider that the market will undervalue them).

107. See Don Cruickshank, *Market Failure in the Provision of Equity to SMEs, in* COMPETITION IN UK BANKING: A REPORT TO THE CHANCELLOR OF THE EXCHEQUER 169 (2000) (analyzing the different causes of such credit constraints).

108. See OXFORD ANALYTICA, ASSESSMENT OF THE ECONOMIC BENEFITS AND OPPORTUNITIES FOR A PAN-EUROPEAN GROWTH MARKET 5 (Oct. 2005) (a study prepared for the LSE).

109. See MONDO VISIONE LTD., WORLD EXCHANGES: GLOBAL INDUSTRY OUTLOOK AND INVESTMENT ANALYSIS EXECUTIVE SUMMARY 4 (Mar. 2007), available at <http://www.mondovisione.com/index.cfm?section=order&action=detail&id=2> ("The implementation of more stringent lending rules for E.U. banks under the Basel II Capital Adequacy Directive may provide further encouragement for small European companies to raise funds by going public.").

110. See *id.* Credit constraints have a larger effect on European firms than on their American counterparts, given the former's higher reliance on debt for financing purposes. See G. Andrew Karolyi, *The World of Cross-Listings and Cross-Listings of the World: Challenging Conventional Wisdom* 21 (Dice Ctr., Working Paper No. 2004-14, 2004), available at <http://www.cob.ohio-state.edu/fin/dice/papers/2004/2004/2004-14.pdf>.

111. See, e.g., Coffee, *Cross-Listings*, *supra* note 92, at 78; Coffee, *Enforcement*, *supra* note 6, at 5; Jonathan Witmer, *Why Do Firms Cross-Delist? An Examination of the Determinants and Effects of Cross-Delisting* 5 (Sept. 2006) (unpublished working paper), available at http://www.fma.org/SLC/Papers/Cross_delistings.pdf; Karolyi, *supra* note 110, at 14. *But cf.* Licht, *Bonding*, *supra* note 85, at 148-49 (rebutting bonding as an instrument for merely improving corporate governance standards, and contending that the aim of cross-listing for bonding purposes is twofold and ultimately unrelated to bona fide self-discipline on behalf of managers). Licht refers to corporate governance as a second-order consideration that can even have a negative role in the context of bonding and cross-listing, to the extent that it deters some issuers from listing in markets with more stringent regulation or gives rise to exemptions granted by the

increase firm value by cross-listing in a foreign market, voluntarily subjecting the company to more stringent regulation in the second jurisdiction.¹¹² In so doing, the firm adopts—at least in part—the foreign governance regime and is “bonded” by its more severe provisions.¹¹³ Bonding benefits are usually exploited by larger public companies that have sufficient resources to afford an increase in regulatory compliance costs.¹¹⁴

If regulation is relaxed, the utility of bonding can be significantly stunted, especially in the U.S. market—the venue most often targeted for bonding.¹¹⁵ Regulatory costs in the U.S. and European traditional exchanges, however, could be too high for small and mid-size companies that pursue equity financing.¹¹⁶ Specialized market segments, not subject to a plethora of costly securities regulation, could provide these companies with public equity until they reach a stage in their growth cycles that allows them to list in senior markets.

C. The Public Equity Funding Gap

Clearly, firms must take into account the particular cost/benefit structure of the venue in which they intend to issue and trade their shares before listing or cross-listing in capital markets. Such analysis, if conducted properly, allows firms to maximize the utility obtained from accessing a specific equity market. For instance, a large, private U.S.

local regulator to foreign firms that cross-list (i.e., the “avoiding hypothesis”). *See id.* at 142.

112. *See* Witmer, *supra* note 111, at 5 (arguing that “in this case, management receives a net utility gain as the increase in their utility from firm value outweighs the utility reduction from the loss of some private benefits of control”).

113. *See, e.g., id.* By listing in the U.S., firms have traditionally maximized bonding benefits since, upon listing, the firm is monitored closely by multiple constituencies, including institutional investors that acquire shares in the company, lurking private equity and hedge funds, auditors, and even the Securities and Exchange Commission. *See id.*

114. *See* Bainbridge, *supra* note 69, at 2.

115. *See, e.g., AIM in a U.S. Context: Exploding Some Myths*, WHITE PAPER (First Columbus Invs. & London Stock Exch.), 2006, at 2, http://www.first-columbus.com/fc_publications.php (accept “Disclaimer”; then download “AIM in a U.S. Context: Exploding Some Myths”). In spite of the alleged negative effects of SOX, the U.S. share of global IPOs increased from 8% in 2001 to 15% in 2005, showing that SOX may have more to it than meets the eye. *See id.*

116. *See id.* (comparing the regulatory environments of London and New York for small companies); Bainbridge, *supra* note 69, at 2.

firm might find it optimal to list in the NYSE or NASDAQ, despite the high costs imposed by U.S. regulation, due to the multiple benefits the firm would derive from such a listing.¹¹⁷ Similarly, a listed European firm may opt to undergo a cross-listing in either of these exchanges, whether to profit from the bonding benefits associated with a U.S. listing or to create or expand its U.S. operations.¹¹⁸ A flawed analysis of the cost/benefit structure of listing venues could lead to adverse results.¹¹⁹ Absent special circumstances, a NASDAQ-listed company that seeks to improve its valuation premium by undergoing multiple listings in South American stock exchanges might find its task highly unrewarding.¹²⁰

It follows from the previous discussion that an optimal listing venue for each type of firm exists, depending on specific traits like market capitalization and growth stage, and market conditions at the time of listing.¹²¹ Assuming this hypothesis is accurate, recent events in Europe and the United States might have altered the optimal choice of venue for small-cap firms, excluding them from traditional stock exchanges. First, regulatory costs for listed companies have dramatically increased due to the burden of SOX compliance¹²² and the stringent corporate governance and listing standards mandated by the main stock exchanges.¹²³ These costs disproportionately affect small firms,

117. See, e.g., Coffee, *Enforcement*, *supra* note 6, at 71. A large private firm may, for example, lower its cost of capital, obtain higher visibility, or secure sufficient funds for expansion plans. See *id.*

118. Royal Philips Electronics N.V. exemplifies the typical European corporation with a dual listing. Its shares are traded both in the NYSE (ticker: PHG) and Euronext Amsterdam (ticker: PHI).

119. See Witmer, *supra* note 111, at 30-34.

120. See *generally id.* at 26 (discussing NASDAQ cross-listing generally).

121. Cf. Wolfgang Aussenegg et al., *Sticky Prices: IPO Pricing on NASDAQ and the Neuer Markt* 39 (Apr. 2002) (unpublished working paper), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=302917. Market capitalization in the IPO stage refers to the value obtained after multiplying the offer price times the number of shares outstanding after completion of the offering. See *id.*

122. See Coates, *supra* note 4, at 107 (presenting evidence which suggests that SOX increases auditing costs by a ratio of \$1 million per \$1 billion of revenue). *But see* THOMAS E. HARTMAN, FOLEY & LARDNER LLP, *THE COST OF BEING PUBLIC IN THE ERA OF SARBANES-OXLEY* (2006), available at http://www.foley.com/publications/pub_detail.aspx?pubid=3736 (presenting the results of a survey showing that SOX costs appear to be decreasing as firms streamline compliance with the Act's provisions).

123. See *Self-Regulatory Organizations, Exchange Act Release No. 48745*, 68 Fed. Reg. 64154-01 (Nov. 4, 2003) (approving the NYSE's and NASDAQ's enhanced corporate governance standards for listed companies, which significantly raised the

precluding them from listing in mainstream regulated markets, or even causing them to de-list.¹²⁴ Although European listing costs are lower than in the U.S., they can also prove to be too high for small-cap firms seeking access to such venues.¹²⁵ The reticence of market-makers to underwrite offerings below a certain amount also increases entry barriers for small firms.¹²⁶

Second, the recent enlargement of a public equity funding gap in Europe and the U.S. also inhibits small-cap firms from listing in traditional stock exchanges.¹²⁷ An increase in listing costs and a reversal in market trends after the dot com bubble ruptured exacerbated the funding gap. In the years preceding the downfall of the technology market, small firms with high growth potential—particularly high-tech or internet-focused companies—could easily obtain equity funding by issuing shares in listing venues like NASDAQ or the German Neuer

level of regulatory stringency for such firms in regards to, *inter alia*, conflicts of interest and related party transactions, director independence, and audit committees). Both exchanges have also set forth multiple listing standards establishing market cap thresholds, restrictions on the minimum number of shareholders, track records, and similar requirements. See NASDAQ, Inc., Listing Standards & Fees, available at http://www.nasdaq.com/about/listing_information.stm (last visited Oct. 7, 2007); NYSE Euronext, Listing Standards, available at <http://www.nyse.com/regulation/listed/1022221392369.html> (last visited Oct. 7, 2007).

124. See Bainbridge, *supra* note 69, at 13. Given the high costs that the U.S. regulatory framework imposes on these firms, they may be forced to operate under low or even negative profit margins. See *id.*

125. See ABBANAT, *supra* note 88. Evidence of this assertion may be found in the high number of low-cost stock exchanges currently spawning in Europe. *Id.*

126. See Posting of Dale Oesterle to Business Law Prof Blog, *London's AIM*, http://lawprofessors.typepad.com/business_law/2006/08/londons_aim.html#comments (Aug. 15, 2006) [hereinafter Oesterle, *London's AIM*] (suggesting that underwriters are no longer interested in IPOs in which a firm intends to raise amounts below \$50 million, since their fees would not cover their time expenditure).

127. See Cruickshank, *supra* note 107, at 172-73. However, this private equity gap refers to start-ups seeking to raise amounts between £100,000 and £250,000 and not to the types of companies that would seek an AIM listing. These firms have already reached a later stage in their growth cycle and, thus, should not be confused with the market failure, usually labeled as the “equity gap,” affecting start-ups. See *id.* at 173. Cf. Community Guidelines On State Aid To Promote Risk Capital Investments In Small And Medium-Sized Enterprises, 2006 O.J. (C 194) 2 [hereinafter Community Guidelines]. Firms in an early growth stage are usually equity-constrained, given the existence of sharp information asymmetries between owners and investors, with higher risk exposure for the latter. See *id.*

Markt.¹²⁸ The market collapse at the end of the twentieth century marked a turning point, as the European New Markets disappeared and IPO volumes floundered on both sides of the Atlantic.¹²⁹ Not only did successful IPOs after the year 2000 significantly drop, the average market capitalization for issuing companies increased dramatically. Empirical studies of IPO market trends illustrate this point: during the previous decade, 62% of the companies engaging in IPOs had a market capitalization of less than \$200 million, but during 2004-05, only 30% fell within that range.¹³⁰ Table 1 shows the discussed reduction in IPO volume.

TABLE 1
REDUCTION IN IPO VOLUME

IPO MARKET TRENDS			
Trend (yearly average)	1990s	2001-2003	2004-2005
Number of IPOs	533	87	225
% with deal size Below \$50 Million	59%	24%	23%
% with deal size Below \$200 Million	62%	28%	30%

Source: ThinkEquity Partners¹³¹

128. See Aussenegg et al., *supra* note 121, at 39; see also Goergen et al., *supra* note 35, at 8-9.

129. See Goergen et al., *supra* note 35, at 8-9 (focusing on the dissolution of the European new markets after 2000).

130. See Posting of Michael T. Moe to ThinkBlog, http://www.thinkequity.com/mt-archive/2006/03/aim_for_the_sta.html (Mar. 27, 2006, 10:02 EST). The number of companies with a market cap under \$50 million diminished from 59% to 23% during the same periods.

131. ThinkEquity Partners, ThinkBlog, (Mar. 2006), <http://www.thinkequity.com/mt-archive/2006/03/index.html> (IPO Market Trends table).

Core¹³² and non-core¹³³ listing requirements in venues such as NASDAQ can prevent small companies from listing, or even lead to compulsory delisting for non-compliance,¹³⁴ which adds to the public equity funding gap. The demutualization process of stock exchanges, by which such entities become listed companies subject to public shareholder scrutiny, also negatively impacts small-cap firms' choice of listing venue.¹³⁵ As exchanges in Europe and the U.S. demutualize, their incentive structures adjust toward a revenue-seeking model, excluding some risk-laden small firms seeking to raise low amounts of equity through a public issuance.¹³⁶

The circumstances previously described propelled the emergence of new listing venues, tailored to fit the needs of small firms with high-growth potential.¹³⁷ Entering the marketplace with a fury,¹³⁸ these new alternative market segments differ from their predecessors (e.g., Neuer Markt, NASDAQ during the 1990s).¹³⁹ The next part traces the rise of London's AIM, the most successful of these listing venues, and provides some insight into AIM's regulatory model.

III. THE RISE OF THE ALTERNATIVE INVESTMENT MARKET

As financial markets race toward convergence and private equity and hedge funds rampage across jurisdictions in their quest for absolute returns, the success of a London-based "junior" market draws the collective attention of international market participants.¹⁴⁰ The LSE,

132. Cf. Jeffrey H. Harris et al., *Off But Not Gone: A Study of NASDAQ De-listings* 4 (Dice Ctr., Working Paper No. 2004-22, 2004), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=628203 (referring to the NASDAQ stock market). Core requirements can refer to variables such as the minimum number of shareholders, market capitalization, and the number of market makers. See *id.*

133. Cf. *id.* Non-core variables often refer to minimum market float and bid price in a share issuance. See *id.*

134. Harris et al., *supra* note 132, at 4. It is important to note that both NASDAQ (NASDAQ Capital Market) and the NYSE (NYSE Arca) launched trading platforms with lower core and non-core requirements specifically designed for small-cap firms. See *infra* Part III.

135. Coffee, *Cross-Listings*, *supra* note 92, at 52.

136. *Id.* at 55-56.

137. Oesterle, *London's AIM*, *supra* note 126; Moe, *supra* note 130.

138. Moe, *supra* note 130.

139. *Id.*

140. Moe, *supra* note 130.

which set up AIM as a low-cost segment for small companies, draws praise from investors, firms, and policy-makers alike, due to AIM's impressive results since 2000.¹⁴¹ Although AIM has been in place for over a decade,¹⁴² recent market conditions facilitated its unprecedented growth, surpassing even mature markets such as NASDAQ and the NYSE, according to the number of IPOs since 2004.¹⁴³ Despite a significant slowdown during 2006, AIM still posted 341 IPOs, increased its total listed companies to 1,634 (including 306 foreign firms), and raised \$55 billion.¹⁴⁴ AIM even captured the attention of a number of U.S. firms that may have previously sought a listing with NASDAQ.¹⁴⁵

141. *Id.*

142. See STÉPHANE ROUSSEAU, THE COMPETITIVENESS OF CANADIAN STOCK EXCHANGES: WHAT CAN WE LEARN FROM THE EXPERIENCE OF THE ALTERNATIVE INVESTMENT MARKET 93 (2006) (research study commissioned by the Task Force to Modernize Securities Legislation in Canada). AIM was set up in 1995 after its predecessor, the Unlisted Securities Market, floundered in the midst of a severe financial downturn brought about by rising interest rates and a recession in the U.K. See *id.*; see also Tim Bauer & J. Efrim Boritz, Report on the UK's Alternative Investment Market – AIM 4 (Nov. 18, 2006) (unpublished working paper), available at http://accounting.uwaterloo.ca/research/publications/AIM_Discussion_Paper-rev5.doc (explaining that the reduction of the waiting period for companies seeking an LSE listing also contributed to the collapse of the Unlisted Securities Market); ABBANAT, *supra* note 88, at 14 (“AIM was first announced in a proposal by the London Stock Exchange in April 1994 in response to heavy lobbying from the City Group for Smaller Companies (CISCO), led by Sir Ronald Cohen of Apax Partners and Andrew Beeson of Beeson Gregory.”).

143. See LEONIE BELL ET AL., OXERA CONSULTING LTD., THE COST OF CAPITAL: AN INTERNATIONAL COMPARISON 56 (June 2006), available at <http://www.cityoflondon.gov.uk/economicresearch> (follow “Research Publications” hyperlink; then follow “Archived Reports 2000-2006” hyperlink; then follow “Download the Cost of Capital published report PDF” hyperlink). But see BELL ET AL., *supra*, at 59-60 (showing that market capitalization in both NASDAQ and the NYSE is significantly higher than in AIM); see also Bauer & Boritz, *supra* note 142, at 5. AIM companies also under-perform NASDAQ and NYSE companies by almost every other measurement. *Id.* This might be due to the fact that AIM companies are in an earlier stage in their growth cycles than the firms listed in NASDAQ or the NYSE. *Cf. id.* at 6.

144. LONDON STOCK EXCH., AIM: SUPPORTING THE GROWTH OF SMALL AND MIDCAP COMPANIES 5 (2006), available at http://www.brownrudnick.com/event/pdf/AI_M_USA_FINAL.pdf; O'MELVENY & MYERS, LLP, THE LSE IS BOOMING – BUT WILL THE BUBBLE BURST? 1 (May 2007), available at http://www.omm.com/webdata/content/publications/client_alert_communicate_2007_05_21e.htm [hereinafter O'MELVENY & MYERS, LLP, LSE] (last visited Nov. 12, 2007).

145. See Abulani Lefall, L.A. Firms Lured by Foreign Exchanges; Launching IPOs is Easier but U.S. Markets Still Goal, L.A. BUS. J., Apr. 23, 2007 (reporting that fifty-

AIM's remarkable growth is not exempt from a certain degree of skepticism. The most caustic critics contend that investors in AIM can be easily manipulated and even defrauded, given its sub-optimal disclosure and corporate governance standards.¹⁴⁶ SEC Commissioner Roel Campos recently triggered a media dispute with LSE officials by comparing AIM to a casino in which 30% of listed companies disappeared a year after gaining admission.¹⁴⁷ A majority of detractors adopt the milder view that AIM companies only pose a high risk to investors, given their reduced dimensions¹⁴⁸ and the lack of specific hurdles for listing.¹⁴⁹ Others simply recall the recent collapse of the European New Markets (e.g., the German Neuer Markt) and discard AIM's success as a fleeting phenomenon.¹⁵⁰

While some of these negative reviews could be accurate,¹⁵¹ AIM's approach to regulation gives it an edge in the market for small-cap high-growth companies.¹⁵² As a result of this competitive advantage, stock exchanges worldwide attempt to replicate AIM's model. Europe, for instance, has experienced an outbreak of similar trading venues: the

one U.S. companies had listed on AIM as of Oct. 30, 2006, marking an increase of over 100% more than the previous year); *see also* *AIM in a U.S. Context: Exploding Some Myths*, *supra* note 115, at 1.

146. Iain Dey, *You Have to Go Into AIM with Your Eyes Open*, THE SUNDAY TELEGRAPH (LONDON), June 18, 2006, at 6.

147. *See* *AIM Stock Market 'Like a Casino,'* BBC NEWS, Mar. 9, 2007, available at <http://news.bbc.co.uk/2/hi/business/6433637.stm>. Commissioner Campos' comments may have been somewhat exaggerated. *See* Adam Smith, *A Sharp AIM*, TIME, Mar. 29, 2007, available at <http://www.time.com/time/magazine/article/0,9171,1604485,00.html?iid=chix-sphere>.

148. *See, e.g.*, Herb Greenberg, *Is IPO Slowdown a Bad Thing, As Sarbanes-Oxley Foes Claim?*, WALL ST. J., Nov. 25, 2006, at B4 (arguing that AIM subjects investors to heightened risk exposure, due to the characteristics of its companies). This critique is based on profit warning reports issued by some of AIM's smaller companies during 2006. *Id.*

149. *See* David Blackwell & John Gapper, *NYSE Chief Says AIM Must Raise Standards*, FIN. TIMES (LONDON), Jan. 27, 2007, at 8. NYSE's chief executive officer, John Thain, publicly called for more rigid regulation in AIM to prevent an erosion of public confidence in the City of London as a main financial center. *Id.* Note, however, that such criticism may be a result of competitive pressures, as the NYSE, since its Euronext takeover, must compete with the LSE for international and European listings. *Cf. id.*

150. Dey, *supra* note 146 (discussing the successes and failures of AIM).

151. *Id.* (stating that there have been a high number of crashes on AIM, including Regal Petroleum and Chariot).

152. Davidoff, *supra* note 43, at 45.

Borsa Italiana launched its Mercato Expandi in December 2003; the analogous Irish Enterprise Exchange was created in April 2005; Euronext has been promoting its Alternext segment since 2005; the Deutsche Börse set forth its Entry Standard segment in December 2005, and the Nordic OMX introduced its First North segment last year.¹⁵³ AIM's model has also served as a prototype for the New Zealand Alternative Market, which launched in November 2003, and for the trading platform currently under design by the Singapore Stock Exchange.¹⁵⁴ While these fledgling venues might be able to emulate AIM's achievements, it seems unlikely, since AIM owes its staggering success to a wealth of interlinked elements not present elsewhere.

A. Supply and Demand—The Causes of Aim's Success

AIM has thrived in recent years, due to a series of interrelated events. Following the turn of the twenty-first century, London continues to rise in prominence among the world's most important international financial centers, amassing large pools of liquidity and gathering specialists in multiple fields: investment banks, underwriters, institutional investors, and foreign and domestic companies. London's increasing sophistication as a provider of financial services results from a decades-long reform movement intended to transform the city into a competitive venue.¹⁵⁵ The results of this comprehensive overhaul are manifest; a study released in June 2007 proclaimed that London deposed New York as the leading financial services hub in the world.¹⁵⁶ Several

153. See BOARD ET AL., *supra* note 75, at 185. Other examples in the same region include the Guernsey Stock Exchange, the Nordic Growth Market in Sweden, the Local Business Exchange in Birmingham, and the M: Access in Munich. *Id.*

154. See Ass'n of Small and Medium Enters., *3rd Board Listing: A Viable Alternative for SMEs Looking for Growth?*, ENTREPRENEURS' DIG., available at <http://www.asme.org.sg/subpage.aspx?pageName=digest>. Listing venues specializing in smaller companies have also spawned in Central and South America. However, these new market segments feature more stringent corporate governance and disclosure standards than the corresponding main markets. Brazil's Novo Mercado and Costa Rica's Mercado Alternativo para Acciones appear to be less modeled on AIM than on the now extinct German Neuer Markt. See Davidoff, *supra* note 43, at 50.

155. See *London as a Financial Centre: Capital City*, THE ECONOMIST, Oct. 21, 2006.

156. See Chia-Peck Wong, *London Tops as World Commerce Center, Says Mastercard*, BLOOMBERG NEWS, June 12, 2007, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=af92ReNSibw4>. The index used for this study combined "six

ingredients, including a sophisticated corporate governance system, an efficient regulator embodied in the Financial Services Authority, an aggressive marketing campaign, and the increase of regulatory costs in the U.S., contributed to London's outranking of New York as the leading center for finance.¹⁵⁷

The LSE profits vastly from this upward trend, outstripping even its main competitor, the NYSE, in number of IPOs and money raised through initial offerings in 2006.¹⁵⁸ AIM capitalized on London's success, evidenced by its IPO volume, its number of listed companies, and its share issuances, each of which surged at an almost exponential rate over the past few years.¹⁵⁹ Yet, AIM is not merely a free-rider on London's and the LSE's reputation. Rather, AIM succeeds because it supplies a scarce product to the marketplace: rapid, low-cost access to public equity for small firms with high growth potential.¹⁶⁰ London's status as one of the world's leading financial hubs simply adds to AIM's prominence and success.

Following the enactment of SOX and the burst of the dot com bubble, the regulatory costs of equity financing through U.S. capital markets skyrocketed.¹⁶¹ Small-cap companies were disproportionately

measures of commercial power including flows of finance, volumes of business and the creation and dissemination of knowledge. It was developed by a team of academics specializing in economics, business, urban studies and finance." See Beattie, *supra* note 76.

157. See *International Equity Cross-Listing and Corporate Governance*, CAIR NEWSL. (Manchester Bus. Sch., Manchester, U.K.), Dec. 2006, at 1, available at <http://www.mbs.ac.uk/Research/analysisinvestment/documents/CAIRNewsletter21-11-06.pdf>.

158. O'MELVENY & MYERS, LLP, LSE, *supra* note 144.

159. ROUSSEAU, *supra* note 142, at 92 ("Being based in London, AIM enables resource companies to enter a sophisticated market that provides both a source of capital and a community of knowledgeable professionals."). London brings together different elements that create optimal conditions for a market like AIM to develop—a large pool of liquidity, a sophisticated marketplace, and a flexible and efficient legal system. See *id.*

160. See London Stock Exch., About AIM, http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim_new/About+AIM/ ("To join AIM, companies do not need a particular financial track record or trading history. There is also no minimum requirement in terms of size or number of shareholders. This more flexible approach reflects the fact that AIM was designed specifically for smaller growing companies.").

161. Scott Liebs, *Five Years and Accounting*, CFO.COM, July 1, 2007, http://www.cfo.com/printable/article.cfm/9393501/c_9394789?f=options.

affected by this cost increase in Europe and the U.S.¹⁶² Consequently, small firms seeking to raise capital through financial markets turned away from more traditional listing venues such as NASDAQ and started favoring exchanges which provided expeditious and low-cost access to equity financing.¹⁶³ Despite the existence of several venues that specialize in small-cap firms, AIM was the first-mover in supplying the marketplace with a lower regulatory burden, while enhancing listed companies' reputations and providing access to institutional investors seeking firms with long-term growth potential.

Furthermore, as the primary U.S. stock exchanges demutualized in order to become public companies themselves, their incentive structures recalibrated into a revenue-seeking model that, to some degree, excluded risk-laden small firms trying to raise low amounts of equity through a public issuance.¹⁶⁴ A reversal in IPO market trends also adversely impacted small-cap firms.¹⁶⁵ These factors exacerbated the public equity funding gap, which affects companies with a low market capitalization.¹⁶⁶ While the average market capitalization for an AIM

162. See Posting of Dan Oesterle to Business Law Prof Blog, *Cross-Listing Premiums*, http://lawprofessors.typepad.com/business_law/archives.html (Apr. 27, 2007) [hereinafter Oesterle, *Cross-Listing Premiums*] (explaining that small companies are reluctant to bear such high costs to obtain a mere "seal of approval" regarding their corporate governance and disclosure standards). Oesterle's metaphor clearly portrays the problem:

[The U.S. established] a very high standard of reporting that only very large, well run companies can use as a 'seal of approval.' It makes sense for them to do so; smaller and medium companies with more average business practices no longer find is [sic] sensible to incur the high costs of using the 'seal.'

Id.

163. See London Stock Exch., About AIM, *supra* note 160 ("Since its launch in 1995, over 2,500 companies have joined AIM – raising more than £34 [billion] in the process.").

164. See Oesterle, *London's AIM*, *supra* note 126.

165. *Id.*

166. Cf. Cruickshank, *supra* note 107 (arguing that the "public equity funding gap" arises from a disparity between the demand of low-cap firms that require smaller investments and the market supply of such investments). This phenomenon is somewhat different to the "equity gap" market failure that affects firms in the initial stages of their growth cycles. *Id.* The equity gap is commonly present in start-ups in which "high transactional and monitoring costs associated with early stage ventures make them unattractive for investment." See Jimmy Schwarzkopf & Moren Lévesque, Closing the "Equity Gap" in Startup/Seed Investment for ICT Ventures: The Israeli Experience (unpublished), available at <http://www.mansci.uwaterloo.ca/~levesque/papers/Schwarzkopf%20&%20Levesque.pdf>. However, the equity gap can also affect

company is close to \$70 million, NASDAQ's average is closer to \$1 billion; the NYSE's average exceeds both figures.¹⁶⁷ Thus, AIM currently supplies access to the capital market vis-à-vis an increasing demand for equity funding by companies with low market capitalization.¹⁶⁸ While NASDAQ formerly covered this market segment, particularly during the 1990s with respect to high-tech low-cap firms,¹⁶⁹ it has since matured, shifting its focus to larger firms.¹⁷⁰ Consequently, undersized companies in the U.S. that might have trouble

enterprises in later growth stages. This apparently led the European Commission to issue a set of guidelines concerning state aid to reduce the equity gap for small, high-growth companies. See Community Guidelines, *supra* note 127. Interestingly, an accompanying memorandum even references "alternative stock markets specialized in SMEs including high-growth companies." Memorandum from Eur. Comm'n on Guidelines on State Aid to Promote Risk Capital Investment in SMEs (Memo. No. 06/295) (July 19, 2006), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/295&format=HTML&aged=0&language=EN&guiLanguage=en>.

167. See *AIM in a U.S. Context: Exploding Some Myths*, *supra* note 115, at 3; see also Rick Kennedy, *Law Firms take Aim at IPOs Listing Overseas*, SAN FRANCISCO DAILY J., Dec. 8, 2006, at 1, available at http://www.reedsmith.com/_db/_documents/SF_Daily_Journal_120806.pdf ("The average market capitalization of a company on the NASDAQ is \$1.2 billion, and on the AIM it is \$89 million."). It is also important to note that both NASDAQ and the NYSE set strict track record requirements for initial listing and thresholds for continued listing. Any failure to comply with such requirements will result in either a rejection of initial listing or a forced delisting following a verification process. See NASDAQ, Inc., Listing Standards & Fees, *supra* note 123; NYSE Euronext, Listing Standards, *supra* note 123.

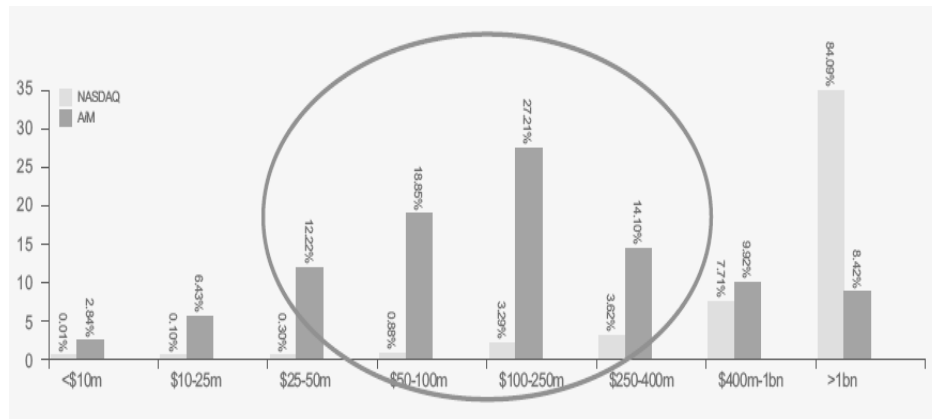
168. See Friedman & Grose, *supra* note 103, at 23; Doidge et al., *supra* note 1, at 42 ("If anything has changed in the aftermath of SOX, it is that the non-listed firms have become smaller and are therefore less likely to list on the U.S. exchanges or the Main Market in London."). The authors further contend that it is firm size, rather than a reduction in the attractiveness of U.S. capital markets, that has led to a shift in cross-listings. *Id.*

169. See Robert E. Grady, *The Sarbox Monster*, WALL ST. J., Apr. 26, 2007, at A19. In 1996, the average market capitalization for a tech-company undergoing a NASDAQ IPO was close to \$130 million. See *id.* Some historical figures shed further light on the evolution of NASDAQ share offerings: Intel's 1970 IPO consisted of \$8 million in issued shares and a market cap of \$53 million, and Cisco Systems raised only \$50 million in 1990 and reached a market cap of \$226 million. See *id.*

170. See OSBORNE CLARK, IS AIM THE NEW NASDAQ? 4 (2006) [hereinafter IS AIM THE NEW NASDAQ?]; see also Susan Arterian Chang, *Tech Start-ups Spurn NASDAQ for London*, IEEE SPECTRUM, Dec. 6, 2007, available at <http://spectrum.ieee.org/dec06/4752> ("The NASDAQ Electronic Market, founded in 1971, for many years offered U.S. entrepreneurs access to public equity. But these days NASDAQ is setting its sights on larger corporations, the likes of Google and Microsoft.").

obtaining a NASDAQ listing may flock to AIM.¹⁷¹ As of June 2007, sixty-three U.S. firms worth \$11 billion had successfully completed an AIM listing.¹⁷² Figure 2 shows the different market capitalization focus between NASDAQ and AIM and what has been called the “AIM sweet spot.”¹⁷³

FIGURE 2
AIM vs NASDAQ—COMPARATIVE MARKET CAP FOCUS



Source: IS AIM THE NEW NASDAQ, *supra* note 170.

The state of affairs in Europe also contributed to a climate in which AIM has been able to prosper. In an effort to imitate NASDAQ’s experience in attracting high growth companies with a relatively low market capitalization, several European stock exchanges launched specialized market segments during the 1990s. Europe’s experiment with market design led to the creation of venues featuring elevated regulatory requirements, including high disclosure and conformance to international accounting standards.¹⁷⁴ The first of these venues aimed at start-up, high-growth enterprises was the pan-European stock market

171. IS AIM THE NEW NASDAQ?, *supra* note 170, at 13.

172. See *infra* Part III.C.

173. See Robert B. Ahdieh, *Dialectical Regulation*, 38 CONN. L. REV. 863, 927 n.59 (2006). This divergence in market cap focus allows AIM to capture trading that would otherwise be done on NASDAQ. See *id.*

174. See Laura Botazzi & Marco Da Rin, *Europe’s New Stock Markets* (Ctr. for Econ. Pol’y Res., Discussion Paper No. 3521, 2002).

EASDAQ, which began trading in November, 1996.¹⁷⁵ Subsequent attempts to emulate NASDAQ's model led to the creation of the Neuer Markt sponsored by the Deutsche Börse, the Paris Stock Exchange's Nouveau Marché, the Italian Nuovo Mercato, the New Market of Amsterdam Exchanges, and the Euro NM Brussels, among others. Although these new markets might have temporarily reduced the public equity funding gap, their ultimate failure paved the way for AIM to capture a substantial portion of the market for small-cap funding.¹⁷⁶ Table 2 shows the dates in which the European New Markets were launched and subsequently closed.

TABLE 2
RISE AND FALL OF THE EUROPEAN NEW MARKETS

EUROPEAN NEW MARKETS			
Market	Country	Opening Date	Closing Date
Alternative Investment Market	UK	June 19, 1995	N/A
Nouveau Marché	France	February 14, 1996	Eurolist as of February 21, 2005
EASDAQ (renamed NASDAQ Europe)	Pan-European	June, 1996	November 28, 2003
Neuer Markt	Germany	March 10, 1997	December 31, 2003
NMAX	Netherlands	March 25, 1997	Eurolist as of April 4, 2005
Euro NM Brussels	Belgium	April 11, 1997	October 2000
Nuovo Mercato	Italy	June 17, 1999	MTAX as of Sept. 19, 1995

Source: BOARD ET AL., *supra* note 75.

175. See Steven Weber & Elliot Posner, *Creating a Pan-European Equity Market: The Origins of EASDAQ*, 7 REV. INT'L POL. ECON. 529, 529 (2000).

176. See Hans-Peter Burghof & Adrian Hunger, *Access to Stock Markets for Small and Medium Sized Growth Firms: The Temporary Success and Ultimate Failure of Germany's Neuer Markt* (Oct. 2003) (unpublished working paper), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=497404; BOARD ET AL., *supra* note 75; Botazzi & Da Rin, *supra* note 174; Goergen et al., *supra* note 35 (offering a detailed analysis concerning the deficiencies of the European New Markets, including IPO underpricing, offerings with negative initial returns, and negative cumulative abnormal returns).

AIM's success can also be attributed to its ability to avoid some of the most significant factors responsible for the collapse of the European New Markets. For instance, the New Markets narrowly focused on high-tech companies, whose massive downturn during the dot com bubble burst helped bring about their demise.¹⁷⁷ AIM companies' broader range of economic activities could be what allowed it to endure the demise of the technology sector worldwide.¹⁷⁸ Whereas the NASDAQ of the 1990s and the European New Markets focused primarily on technology stocks, AIM extended its scope to include firms engaging in all sorts of industrial activities, such as mining, oil and gas, and real estate (see Figure 3 below).¹⁷⁹ To ensure adequate compliance with reporting rules in this highly diversified environment, thereby protecting investor confidence in the market, AIM issues specialized notices for certain sectors that require technical guidance in interpreting disclosure requirements.¹⁸⁰ For instance, after Regal Petroleum's shares plummeted following fruitless oil exploration activities off the Greek coast,¹⁸¹ AIM issued a Guidance Note requiring independent reports for reserves in admission documents and periodical market updates.¹⁸² This

177. See Friedman & Grose, *supra* note 103, at 21. The authors attribute AIM's success largely to a matter of timing. *Id.* However, this interpretation fails to fully recognize the fact that AIM did not depend exclusively on the technology sector to survive.

178. See Mark Landler, *German Technology Stock Market To Be Dissolved*, N.Y. TIMES, Sept. 27, 2002, at W1 (asserting that the burst of the dot com bubble had a negative impact on some European New Markets, such as the German Neuer Markt, and contributed significantly to their decline).

179. Cf. London Stock Exch., techMARK: A Focus on Innovation, <http://www.londonstockexchange.com/techmark> (last visited Sept. 21, 2007). In the midst of the dot com bubble, NASDAQ and other European New Markets impinged on AIM's relevance in the technology sector. In response, the LSE launched a specialized market segment, techMARK, to focus exclusively on tech stocks. TechMARK was launched in November 1999 as a segment of the LSE's Main Market. Despite this new segment's relative success, there appears to be little or no overlap with AIM companies since techMARK targets larger enterprises. *See id.*

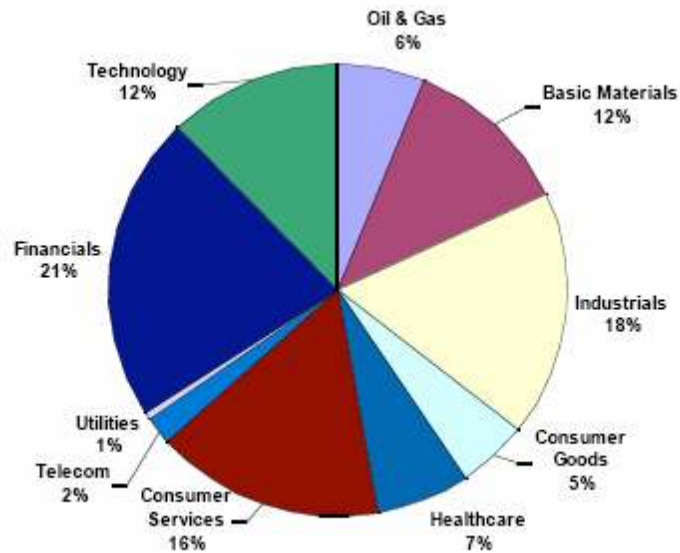
180. See London Stock Exch., AIM Rules for Companies, pt. 1 (2007), available at http://www.spgmedia.com/documents/AIMRULESFORCOMPANIES_2007.pdf [hereinafter AIM Rules for Companies].

181. See Heather Connon, *Don't Panic If Your Fund Manager Slips Up*, GUARDIAN UNLIMITED, Jan. 29, 2006, <http://www.guardian.co.uk/money/2006/jan/29/fundsbondstrusts.investments>.

182. See London Stock Exch., AIM Rules – Guidance Note for Mining, Oil and Gas Companies (2006), available at <http://www.londonstockexchange.com/NR/rdonlyres/01>

close monitoring of market developments allows AIM to promptly adjust some of its rules to better suit its broad base of “customers” (i.e., investors and listed companies).

FIGURE 3
SECTOR DISTRIBUTION OF AIM COMPANIES



Source: ThinkEquity Partners, *supra* note 131.

AIM has thus far eluded another likely cause for the failure of the New Markets, the German Neuer Markt in particular—an apparent lack of sophistication of both investors and regulatory authorities.¹⁸³ AIM’s privileged location in London, the LSE’s reputation as a sophisticated exchange, and the sophistication of the investors driven to AIM¹⁸⁴ all

B3C887-9559-458C-B19B-B41A6E641F9B/0/FinalGuidanceMOG.pdf.

183. See Friedman & Grose, *supra* note 103, at 21.

184. See *Excerpt to INSTITUTIONAL INVESTORS IN AIM 2006*, GROWTH COMPANY INVESTOR (Teather & Greenwood, London, U.K.), available at <http://www.londonstockexchange.com/NR/rdonlyres/E416463D-CB0B-4949-B33E-8F7DAFD3DAAA/0/InstitutionalInvestors4pp2006.pdf> (explaining that given the risks associated with low-cap companies and the relative illiquidity of AIM shares, owners of AIM stock are mostly sophisticated institutional investors that seek long-term positions); Clara Furse, *Taking AIM at Small Caps*, WALL ST. J., Jan. 30, 2007, at 15. Although individual retail investors are also encouraged to participate in AIM (AIM offers incentives in the form of tax benefits), senior investors are the most common market players. See Daniel

permit the exchange to succeed. Although some defects of the New Markets may exist, like IPO underpricing, the fact that AIM outlived and outperformed most of its New Market counterparts suggests its continued success.¹⁸⁵

Recent changes in the European Union's policy agenda have also contributed to the growth of AIM. Traditionally, European firms have relied on banks as the primary source of financing, due to the privileged standing of credit institutions across the different Member States.¹⁸⁶ Small companies expose banks to high-growth potential as well as riskier financing conditions.¹⁸⁷ Accordingly, these companies are charged higher interest rates and must abide by more stringent conditions when applying for debt financing.¹⁸⁸ The International Convergence of Capital Measurement and Capital Standards (the Basel II Accords) aggravated this situation by reducing the availability of financial credit for small and medium-sized enterprises.¹⁸⁹ As the European Union moves away from a bank-based system and toward an equity-oriented system, small and medium-sized firms turn to capital markets—"growth" stock exchanges in particular—to obtain public

Thomas, *AIM Promises the World Property Shares: Property Companies Are Homing In on the 'Junior' Market*, FIN. TIMES, June 2, 2007, at 8.

185. See Goergen et al., *supra* note 35 (discussing how the Member States' inability to harmonize different sets of listing rules, the involvement of multiple national regulators, and inefficient cross-border trading led the Belgian, Dutch and French markets to merge, forming Euronext in 2000 and breaking up several of the New Markets); *NASDAQ Europe to Close*, BBC NEWS, June 26, 2003, <http://news.bbc.co.uk/2/hi/business/3024558.stm> (arguing that EASDAQ's poor performance paved the way for a successful takeover by NASDAQ in 2001, leading to the creation of NASDAQ Europe, and that NASDAQ's subsequent inability to improve NASDAQ Europe's results eventually led to a closing of European operations in 2003); Davidoff, *supra* note 43, at 50 (asserting that high profile scandals and issuer implosions led to the demise of the German Neuer Markt and its 2003 absorption into Germany's primary market). The French Nouveau Marché disappeared after the introduction of the AIM-like Alternext segment by Euronext in 2005. Finally, the Italian Nuovo Mercato was replaced by the STAR segment. Italy also introduced Mercato Expandi, a listing venue similar to AIM. See Goergen et al., *supra* note 35, at 7-8.

186. See Franklin Allen, Laura Bartiloro & Oskar Kowalewski, *The Financial System of the E.U. 25 (2005)* (unpublished working paper), available at <http://ssrn.com/abstract=871454>.

187. See OXFORD ANALYTICA, *supra* note 108, at 4.

188. *Id.*

189. See *id.* at 12.

financing.¹⁹⁰ AIM captured a large number of these companies by supplying expedited, low-cost access to equity,¹⁹¹ made possible through its unique regulatory model.¹⁹²

B. AIM's Regulatory Model

AIM is an exchange-regulated venue featuring an array of principles-based rules for publicly held companies. The genius of AIM's regulatory model lies with the comply-or-explain option provided to each listed company to adapt to the exchange's flexible and reduced set of rules.¹⁹³ Flexibility notwithstanding, rule-tailoring is not a reckless process governed by firms' self-interest. While granting companies regulatory compliance leeway, the exchange also mandates continuous oversight and advice by a private party—the Nominated Adviser (“Nomad”).¹⁹⁴ The Nomads' role is central to AIM's regulatory model, as these entities act as gatekeepers, advisers, and regulators of AIM-listed companies.¹⁹⁵ In advising each firm's rule selection and compliance, Nomads enable firms to abide by tailor-made regulation, reducing regulatory costs in the process.¹⁹⁶ Further, a unique incentive structure constrains Nomads from inattentively performing this role.¹⁹⁷ Specifically, Nomads bear significant damages for tolerating misdemeanors on behalf of their supervised companies, including the loss of “reputational capital.”¹⁹⁸ Accordingly, AIM can be considered a “reputational market,” in which investors rely on the standing of

190. *Cf. id.* at 8-9.

191. *See id.* at 16.

192. *Cf. id.* at 15-16.

193. *Id.* Listed companies have some freedom to interpret the principles-based rules contained in AIM's regulatory documents. AIM companies may conclude, for instance, that certain rules do not apply to them, or even decide the way in which to abide by certain disclosure requirements. This process of interpretation and selection is conducted jointly with the Nominated Advisers, which decreases the likelihood of firms behaving in an opportunistic manner in regards to their obligations as listed companies. *See generally* FINANCIAL REPORTING COUNCIL, THE COMBINED FINANCIAL CODE ON CORPORATE GOVERNANCE 1-2 (2006), available at <http://www.frc.org.uk/documents/pagemanager/frc/Combined%20code%202006%20OCTOBER.pdf>.

194. *See id.* at 15.

195. *Id.*

196. *See id.* at 15-16.

197. *See generally* Coffee, *Gatekeeper*, *supra* note 48 (explaining gatekeepers' incentive structures in financial markets).

198. *See generally id.*

Nomads as a proxy for the quality of listed companies, rather than on the market's regulation.¹⁹⁹

The nature of an exchange-regulated market segment permits AIM's model of self-imposed rules.²⁰⁰ As such, AIM escapes most of the mandatory provisions contained in European Union directives—as implemented in the U.K.—and other rules applicable to companies listed in the LSE.²⁰¹ Self-regulation is pivotal to AIM's low regulatory burden for several reasons: (1) companies seeking an AIM listing are not subject to significant admission requirements;²⁰² (2) after admission is granted, the ongoing obligations with which firms must comply are comparatively lower than those that govern larger exchanges; and (3) corporate governance provisions are not mandatory for AIM companies.²⁰³ Despite this light regime, most AIM firms voluntarily subject themselves to higher corporate governance and disclosure standards, due largely to Nomads' advice and pressure from institutional investors.²⁰⁴ Again, this intentional abidance by higher standards does

199. See Davidoff, *supra* note 43, at 45.

200. See generally Pritchard, *supra* note 5 (arguing that, if left to their own devices, exchanges are likely to find an optimal balance between regulatory costs and investor protection); Ernest Badway & Jonathan M. Busch, *Ending Securities Industry Self-Regulation As We Know It*, 57 RUTGERS L. REV. 1351 (2005) (providing an analysis of self-regulation).

201. See Council Directive 2003/71, 2003 O.J. (L 345) (Prospectus Directive). The Prospectus Directive sets out financial reporting requirements and informs that since 2004, AIM is not considered a “regulated market” for the purposes of European Directives. AIM, in light of its exemption from particular provisions under the Prospectus Directive, grants listed status after submission of a simple admission document, instead of a prospectus. See *id.*; see also AccountingWEB, Combined Code on Corporate Governance—Overview, Oct. 27, 2003, <http://www.accountingweb.co.uk/cgi-bin/item.cgi?id=119232> (stating that the U.K.'s Combined Code on Corporate Governance (2003) is not applicable to AIM-listed companies, although they may voluntarily adopt the provisions contained therein).

202. See OXFORD ANALYTICA, *supra* note 108, at 15.

203. See IS AIM THE NEW NASDAQ?, *supra* note 170, at 8.

204. See OSBORNE CLARK, WHY U.S. (AND NON-EUROPEAN COMPANIES) NEED AIM (2005), available at http://www.casestudyagency.com/clientwork/OC_AIM_05.pdf (explaining that institutional investors expect AIM-listed companies to abide by high standards of disclosure and corporate governance); *Monitoring and Taking Action on Financial Performance, Corporate Governance and Corporate Responsibility*, U.K. RESPONSIBLE INV. POL'Y (Henderson Global Invs.), Apr. 2007, available at http://www.henderson.com/home/uk/governance/responsible_investment/ (follow link to “U.K. Responsible Investment Policy”).

not raise regulatory costs to main market levels, since AIM firms still benefit from customized compliance.²⁰⁵

Another important element of AIM's model is the composition of its investor base. While few are start-ups, a majority of AIM-listed companies have not yet reached the later, less risk-laden stages of their growth cycles.²⁰⁶ This could prove hazardous for unsophisticated investors who lack both the knowledge and resources to conduct proper inquiries into a firm's prospects and activities.²⁰⁷ Consequently, wealthy individuals with experience in securities trading, institutional investors, and entities specializing in AIM investments comprise most of AIM's investor base,²⁰⁸ including financial powerhouses such as JP Morgan, Merrill Lynch, and Goldman Sachs, and investment funds like Fidelity and Artemis Investments.²⁰⁹ AIM has been aptly labeled as a "junior" market for "senior" investors.²¹⁰ The venue's location in London and the large role played by institutional investors there favors this situation.²¹¹ Still, the LSE does attract more retail investors to AIM by offering certain advantages, including tax breaks for individuals that invest in its low-tier market segment.²¹²

205. See OXFORD ANALYTICA, *supra* note 108, at 15-16.

206. See Bauer & Boritz, *supra* note 142, at 12. Though initially launched as a market for low-caps, AIM is maturing, now turning its focus to mid-caps, whose numbers in AIM have quadrupled since 2004. See *id.* at 4.

207. See S. M. Solaiman, *Disclosure Philosophy for Investor Protection in Securities Markets: Does One Size Fit All?*, 28 COMPANY LAW. 139 (May 2007) (stressing the importance of considering the level of sophistication of investors in regards to stock exchanges and securities regulation). "Information and transaction costs tend to be far more serious when it comes to doing business with unsophisticated retail costumers, who may be poorly informed or find it difficult to shop around, making them ripe for picking by unscrupulous operators." *Id.*

208. See NICK ELLIS, COLLINS STEWART PLC, AIM: THE ROLE OF A NOMAD (2007), available at <http://www.ukinvest.gov.uk/Financial-services/4009261/en-GB.html>.

209. See *Excerpt* to INSTITUTIONAL INVESTORS IN AIM 2007, GROWTH COMPANY INVESTOR (Landsbanki, London, U.K.), available at http://www.londonstockexchange.com/NR/rdonlyres/3B4D7EF6-0CFD-4DCE-B2FD-7B116D84E766/0/INSTITUTIONAL_INVESTORS.pdf; see also LONDON STOCK EXCH., AIM MARKET STATISTICS: APR. 2007 (2007), available at <http://www.londonstockexchange.com/en-gb/about/statistics/factsheets/aimmarketstats.htm> (follow link to "April 2007").

210. See Thomas, *supra* note 184, at 1.

211. See Friedman & Grose, *supra* note 103, at 21 (pointing out that while the U.K. has an institutional investor-focused system, in the U.S. retail investors play a larger role in securities markets).

212. See, e.g., AIM in a U.S. Context: Exploding Some Myths, *supra* note 115, at 5

The fact that most AIM companies have not reached a significant stage in their growth cycle impacts the venue's liquidity ratio. A significant number of companies that seek an AIM listing expect to raise capital in amounts sufficient to allow them, at a later date, to list in a larger exchange or undergo takeover proceedings.²¹³ Most of these companies even rely on post-IPO funding rounds in AIM to raise sufficient amounts of equity.²¹⁴ Hence, AIM firms seldom provide investors with short-term profits. As investors expect long-term gains from their participation in AIM companies, they pour considerable resources into analyzing a firm's prospects and would loath liquidating their shares before payoff.²¹⁵ Accordingly, AIM shares are not actively traded.²¹⁶

(discussing how retail investors that acquire AIM shares are offered a tax incentive if they hold their investment for a certain amount of time). This incentive, provided in the capital gains tax toll, decreases to 50% of the total gain after one year and to 25% after two years. *Id.* Private investors generally only acquire AIM shares after an IPO, since securities in initial public offerings are often totally acquired by institutional investors. *See id.* Other fiscal breaks relate to inheritance taxes, enterprise investment schemes, and venture capital trusts. *See* Tom Bulford, *Should You Invest in AIM?*, MONEYWEEK, Apr. 7, 2006, <http://www.moneyweek.com/file/11116/should-you-invest-in-aim.html>.

213. *See* Bauer & Boritz, *supra* note 142, at 4. A majority of delistings in AIM are due to either a listing move to a senior exchange, like the LSE, or company takeover or reverse takeover proceedings. Bauer points out that only a reduced number of firms delist because their shares have lost considerable value. *See id.* at 4. It is relevant to note that AIM's Rules appear to take particular interest in regulating takeovers and significant corporate transactions. *See* AIM Rules for Companies, *supra* note 180, Rules 12-16, at 5-7.

214. *See* *AIM in a U.S. Context: Exploding Some Myths*, *supra* note 115, at 5. This practice, which is customary in AIM, may be compared to the multiple funding rounds in venture capital investments. *See id.* The main difference between both types of funding lies with the absence of typical venture capital restrictions and the reliance on market mechanisms to govern the relationship between AIM companies and their investors. *Id.*

215. *See id.* Investors in AIM have a longer investment time horizon than investors in the U.S. The former often take large positions and hold them until they are certain to obtain a significant return in their investment. *See id.*

216. *See* Davidoff, *supra* note 43, at 44. During 2006, average trading volumes for AIM companies were only two percent of NASDAQ companies. *Id.* This liquidity constraint is certainly a consequence of AIM investors' long-term profit goals, as evidenced by the characteristics of the companies in which they invest. Since these companies are frequently unable to deliver short term returns, investors focus on reaping profits after a period of at least twelve months. *See* *AIM in a U.S. Context: Exploding Some Myths*, *supra* note 115, at 5.

Critics of AIM's regulatory model point to these liquidity constraints as a signal of the venue's imminent collapse.²¹⁷ However, adverse low trading volumes might be, AIM provides its companies with a relatively higher level of liquidity, as compared to other listing venues. Hypothetically, companies that list their shares in AIM would be more thinly traded in exchanges such as NASDAQ or the LSE's Official List.²¹⁸ A study in 2007, comparing firms with a market capitalization below \$450 million, also shows that AIM is at least as liquid as the LSE's Official List.²¹⁹ Recently, AIM has implemented numerous measures that could improve the venue's liquidity ratio, such as the AIM 50, AIM 100, and AIM-All Share indices, AIM index trackers, and specialized trading platforms such as the SETSmm²²⁰ and PLUS.²²¹ As AIM evolves into a more mature market, it must continue to address liquidity constraints.

The oversight roles of its own regulation service, and that of the LSE, also play a part in the success of AIM's model. Both have proven

217. See Friedman & Grose, *supra* note 103, at 6. Liquidity constraints are one of the main factors that deter the development of vibrant capital markets. Higher liquidity levels increase trading opportunities by attracting a higher number of listings, thus increasing market activity. See *id.* Low liquidity is common in systems with lower levels of regulatory stringency. See Frank B. Cross & Robert A. Prentice, *Economies, Capital Markets and Securities Law* 39 (Law and Econ. Research Paper No. 73, 2006); Davidoff, *supra* note 43, at 44.

218. See IS AIM THE NEW NASDAQ?, *supra* note 170, at 7. Since investors in AIM companies are usually institutional investors seeking long term gains, they are less pressed to sell their holdings and, thus, benefit less from enhanced liquidity. See Bauer & Boritz, *supra* note 142, at 12.

219. See *Initial Public Offerings on AIM for U.S. Corporations*, A TAYLOR WESSING GUIDE (Taylor Wessing, London, U.K.), 2007, at 3, available at http://www.taylorwessing.com/website/generator/taylorwessing/content/publications/items/UK/InitialPublicOffersAIMforUSCorporations__TWUK__english.en.property=file.pdf.

220. See *id.* AIM 50, AIM 100 and AIM-All Share are market capitalization weighted indices tracking the largest 50, 100, and all AIM companies, respectively. SETSmm is an order book service provided by the LSE, which guarantees two-way prices for trading parties. See London Stock Exchange, <http://www.londonstockexchange.com/aim/> (last visited Feb. 16, 2008).

221. See Quoted Companies Alliance, Guide to U.K. Markets, http://www.quotedcompaniesalliance.co.uk/market_comparison.asp (last visited Jan. 16, 2008) (comparing AIM and PLUS). PLUS is a self-regulated U.K. market which tailors its regulation to the needs of both investors and growing companies. Although PLUS is not meant to be a tool for improving AIM's liquidity—since to some extent it is the latter's competitor—PLUS does contemplate special proceedings for AIM companies' cross-listings, which may enhance liquidity for AIM traded shares. *Cf. id.*

to be highly responsive regulators, adjusting AIM's rules promptly and according to market need. Constant regulatory fine-tuning has allowed the venue to counter its most mordant critics by expeditiously fixing any detected glitches. The exchange's reaction to adverse media reports in early 2006 concerning cash shells listed on AIM with no real business purpose exemplifies its vigilance. On March 17, 2006, the exchange set a deadline for investing companies that had raised at least £3 million on AIM, but had not yet put those funds to any use.²²² Upon expiration of the deadline, the exchange immediately suspended thirty-eight companies from trading.²²³ Recently, the exchange also introduced a new rulebook for Nomads to ensure a consistent level of good practice.²²⁴ Notices published on the exchange's website tweak AIM's rules and regulations process.²²⁵ Twenty-nine different notices have been published to date (February 2008) and concern all sorts of matters, including clearing and settlement conducted through the CREST system, disciplinary procedures, permissible accounting standards, and amendments to AIM's Rules for Companies.²²⁶ In February 2007, the exchange launched a major regulatory overhaul, including issuing the new rulebook for Nomads,²²⁷ mandating that AIM companies maintain a website for disclosure purposes, and refining its disciplinary proceedings.²²⁸

222. See London Stock Exch., AIM Notice No. 17: AIM Rules – Reminder of Investing Company Rules, (Mar. 17, 2006), available at <http://www.londonstockexchange.com/NR/rdonlyres/E0B87D50-F0A1-4BD7-ADCD-EAF5942421B2/0/AIMNotice17.doc>.

223. See Bauer & Boritz, *supra* note 142, at 10.

224. See *Confirmation of New Aim Rules and Feedback on AIM's Notice 24*, CORPORATE UPDATE (Clifford Chance, London, U.K.), May 2007, available at <http://www.cliffordchance.com/expertise/publications/details.aspx?FilterName=@URL&LangID=UK&contentitemid=12138>.

225. See London Stock Exch., AIM Notices, http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim_new/For+AIM+Advisers/aimnotices.htm (last visited Jan. 16, 2008).

226. See *id.*

227. See London Stock Exch., AIM Notice No. 27: Confirmation of New Rules and Feedback on AIM Notice 27 (Feb. 20, 2007), available at http://www.londonstockexchange.com/NR/rdonlyres/91B19E7D-550C-440A-BCCA-52A32F1913DB/0/AIMRULESFORCOMPANIES_2007.pdf. The new rules enhance the eligibility criteria for Nomads and lay down core responsibilities. See *id.*

228. See *id.*

1. Listing Process

In contrast with the majority of exchanges worldwide, AIM does not impose stringent admission requirements on companies seeking entry to the market. The few objective listing criteria set forth by the exchange can be complied with easily; admittance simply requires firms to appoint a Nomad and submit an admission document.²²⁹ Although these requirements, at first glance, might seem excessively lax, AIM listings are subject to a safeguard that ensures market integrity and contributes to the preservation of AIM's reputation. In the absence of minimum capitalization, share volume thresholds, and trading track record requirements,²³⁰ AIM charges Nomads with the task of certifying firms that request admission.²³¹ Certification can only be issued after firms have passed a suitability test designed by AIM and administered by Nomads.²³² Although Nomads have significant discretion in determining which companies pass the suitability test, AIM's Rules for

229. See London Stock Exch., *AIM: The World's Most Successful Growth Market*, in LONDON STOCK EXCH., JOINING AIM: A PROFESSIONAL HANDBOOK 4-14 (2007), available at <http://www.londonstockexchange.com/NR/rdonlyres/DBA42382-DCD4-4966-9733-F6ACB01FBA10/0/JoiningAIMAprofessionalhandbookFinal.pdf>.

230. See AIM Rules for Companies, *supra* note 180, Rule 7, at 4. The lock-in provision set forth in AIM's Rules for Companies partially offset the lack of these requirements. See *id.* Under this rule, if a business has not been active and earning revenue for at least two years, its related parties and employees are locked in as shareholders. *Id.* This measure is clearly intended to protect investors from fraudulent schemes or the use of worthless cash shells. See *id.*

231. See London Stock Exch., AIM Rules for Nominated Advisers, sched. 2 (2007), available at <http://www.londonstockexchange.com/NR/rdonlyres/8104E31B-946D-49F1-A82B-CC14499B435A/0/AIMNominatedAdviser.pdf> [hereinafter AIM Rules for Nominated Advisers]. AIM's Rules for Nomads contain a certification model, pursuant to which Nomads must attest, *inter alia*, that "the applicant and its securities are appropriate to be admitted to AIM, having made due and careful enquiry and considered all relevant matters set out in the AIM Rules for Companies and the AIM Rules for Nominated Advisers." *Id.*

232. See *id.*, sched. 3, at 16. The test imposes certain responsibilities on Nomads regarding the admission of applicants to AIM. See *id.* Although such duties are principles-based, AIM's Rules suggest a number of actions whose execution is considered appropriate in assessing an applicant's suitability. See *id.* For example, Nomads are compelled to achieve a "sound understanding" of the applicant's business. *Id.* In order to do so, the Rules recommend measures such as undertaking visits to the applicant's site of operations and using external experts to analyze the latter's business. See *id.*

Nomads mandate a rigorous examination of the applicant's affairs.²³³ AIM requires Nomads to soundly understand an applicant's business plans, management structure, and financial and legal status before certifying that a firm is qualified for listing.²³⁴

Consequently, the admission process entails considerable legal and financial due diligence, in addition to a complete review of the relevant entry documents.²³⁵ In performing their functions as AIM's gatekeepers, Nomads ascertain whether a company's admission will provide shareholders with real value and enhance the venue's reputation.²³⁶ At this juncture, Nomads also determine whether a company has reached the appropriate stage of its growth cycle to seek an AIM listing. In cases where listing costs outweigh its benefits and admittance to AIM is not in the best interests of a company, the Nomad is advised to refrain from providing certification.²³⁷ Nomads have significant incentives to ensure that only suitable companies gain access to the market.²³⁸ A thorough review during the entry process generally spans three to six months.²³⁹

Suitable AIM applicants must complete and submit an admission document containing all relevant information about the firm.²⁴⁰ The applicant must supply detailed information, including a description of the company's business, financial information, risk factors, legal structure and material contracts, relevant legal proceedings, and any

233. See ROUSSEAU, *supra* note 142, at 97; Colin Aaronson, *Role of the Nominated Adviser in an AIM Flotation*, in LONDON STOCK EXCH., JOINING AIM: A PROFESSIONAL HANDBOOK 19-28 (2007), available at <http://www.londonstockexchange.com/NR/rdonl yres/DBA42382-DCD4-4966-9733-F6ACB01FBA10/0/JoiningAIMAprofessionalhand bookFinal.pdf>. It appears that a certain degree of consensus in the Nomad industry exists as to the standards for measuring companies undergoing the suitability test. Rousseau refers to some areas usually verified by the Nomads, which include management composition, corporate governance, business viability, market potential, and working capital. See ROUSSEAU, *supra* note 142, at 97. Aaronson describes the way in which Nomads should inquire into each of these areas. See Aaronson, *supra*, at 19-28.

234. See AIM Rules for Nominated Advisers, *supra* note 231, sched. 3, at 16.

235. See *id.* AIM's Rules determine that Nomads must oversee the due diligence process to ensure that it is conducted adequately. See *id.*

236. See Aaronson, *supra* note 233, at 19-20.

237. See *id.* at 20.

238. For instance, Nomads have reputational incentives to perform this task diligently. See *infra* Part III.B.4.

239. See Bauer & Boritz, *supra* note 142, at 7.

240. See AIM Rules for Companies, *supra* note 180, Rule 3, at 3.

other information “which it reasonably considers necessary to enable its investors to form a full understanding of the assets, liabilities, financial position, profits and losses, and prospects of the applicant and its securities for which admission is being sought.”²⁴¹ If the applicant specializes in a particular field, such as mining or technology, the admission document should contain an expert’s report providing investors sufficient information to make sound investment decisions.²⁴² In the case of investment companies, managers must attest to at least three years of performance data experience.²⁴³ The admission document must also contain directors’ statements assuming responsibility for the veracity of all supplied information and certifying the adequacy of the firm’s working capital.²⁴⁴ Importantly, Nomads participate in the drafting process and verify proper completion of the admission documents.²⁴⁵ Nomads’ examination of the entry documents serves the purpose of a regulatory review, not unlike the one conducted by the U.K.’s Financial Services Authority (“FSA”) when admitting a company to the Official List. Applicants must make their admission document publicly available at least one month before admittance to AIM.²⁴⁶ Additionally, the listing process requires the issuance of a pre-admission document at least ten business days prior to admission, in which basic company information is provided.²⁴⁷ The exchange forwards the information to its Regulatory Information Service, which then publishes an announcement on AIM’s website and adds the applicant to the AIM listing.²⁴⁸

If an applicant seeks to make a public share offering concurrently with admission to AIM, it must draft and circulate a prospectus instead of the aforementioned admission document.²⁴⁹ The prospectus must

241. See *id.*, sched. 2(k), at 45; see also Aaronson, *supra* note 233, at 26 (detailing that applicants must also reveal information about key personnel, firm policy on corporate governance, share option and dividend policies, an indication of substantial shareholders, and a summary of tax issues).

242. See ROUSSEAU, *supra* note 142, at 109.

243. See Bauer & Boritz, *supra* note 142, at 9.

244. See AIM Rules for Companies, *supra* note 180, Rule 3, at 3.

245. See ROUSSEAU, *supra* note 142, at 104.

246. See AIM Rules for Companies, *supra* note 180, Rule 3, at 3.

247. See *id.*, Rule 2, at 3.

248. See *id.*

249. See Bauer & Boritz, *supra* note 142, at 6. The public nature of an offering is determined by examining the number of non-qualified investors to which the offer is addressed. Qualified investors are defined as those authorized to execute investment

comply with the more comprehensive FSA Prospectus Rules, including the provisions introduced after the European Prospectus Directive. Unlike the admission document, the prospectus is subject to regulatory review by the FSA, which acts as the U.K.'s listing authority.²⁵⁰ However, AIM share issuances—both concurrent with and subsequent to admission—commonly involve private placements, in which a restricted number of investors are invited to acquire shares in the applicant firm, thus eliminating the need to publish a prospectus.²⁵¹ This comports with AIM's reliance on a large, qualified investor base. As a result, few AIM applications have necessitated the issuance of a prospectus.²⁵²

Private placements gives rise to numerous advantages for AIM firms and investors alike. Issuer companies benefit from a faster, cheaper equity-raising process, as compared to a public offering. Investors in these placements have greater control over their investments and can more readily assess the risks associated with the issuing company.²⁵³ Family firms might also profit from private placements. Controlling insiders could negotiate terms with prospective investors, forfeiting some benefits of private control in exchange for increased capital.²⁵⁴

As the AIM market matures and shifts its focus to larger firms, it is likely that applicants and listed companies alike will gravitate away from private placements and toward public offerings, which involve the

business and include financial institutions, mutual and pension funds, large corporations, and individuals registered with the FSA. *See id.* at 6. If an applicant is expected to have more than 100 non-qualified investors, it must publish a prospectus instead of an admission document. Other exceptions to the publication of a prospectus relate to the size of the issue (roughly less than \$3 million) and the minimum consideration to be paid by any person for offered securities (roughly \$65,000). *See Initial Public Offerings on AIM for U.S. Corporations, supra* note 221, at 8.

250. *See* Financial Services and Markets Act, 2000, c. 8, § 87 (U.K.) (establishing a compulsory review process, in which the FSA verifies that the submitted prospectus contains all required information); *see, e.g.*, Fin. Servs. Auth. Handbook, Prospectus Rules, 2008, S.I. 2008/1, R. 5.3.1 to 5.3.4 (U.K.), *available at* <http://fsahandbook.info/FSA/html/handbook/PR/5/3#D66> (last visited Feb. 12, 2008).

251. *See* ROUSSEAU, *supra* note 142, at 110.

252. *See* Bauer & Boritz, *supra* note 142, at 6.

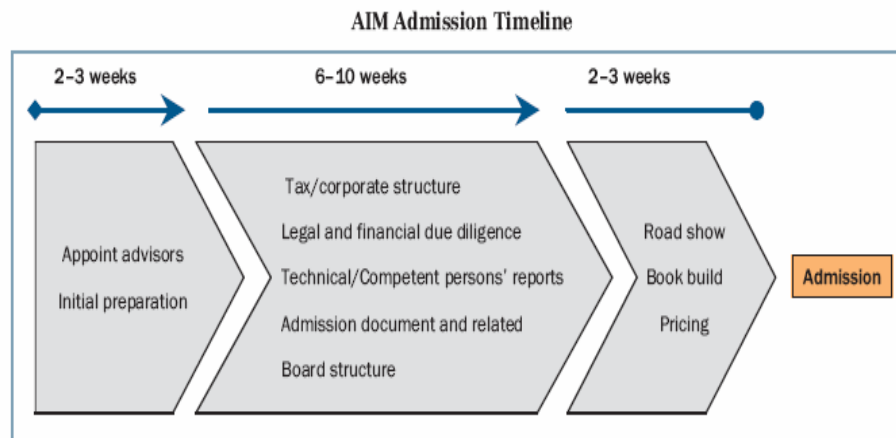
253. *See* Friedman & Grose, *supra* note 103, at 27.

254. *See* BAKER TILLY ET AL., TAKING AIM (2007). A recent survey conducted by Baker Tilly shows that a high percentage of family firms consider AIM to be a fairly attractive option for raising capital. *Id.* However, no studies have been conducted on the specific relation between AIM private placements and family firms going public.

drafting of a prospectus.²⁵⁵ In fact, some U.S. law firms have already struck marketing deals with AIM, emphasizing the prospectus-based IPO process as the ideal gateway to the market.²⁵⁶ Figure 4 contains a portrayal of the admission process for firms undergoing private placements and public offerings.

FIGURE 4
AIM ADMISSION PROCESS

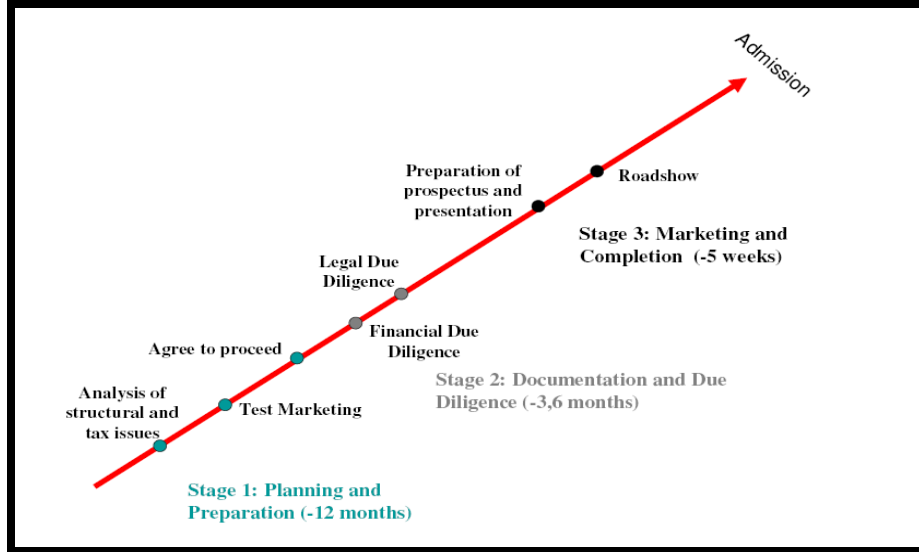
Private Placements



Source: AIM in a U.S. Context: Exploding Some Myths, *supra* note 115, at 4.

255. See Bauer & Boritz, *supra* note 142, at 4. Recent figures show that the AIM market is indeed maturing and granting entry to ever larger firms. *See id.*

256. See HAYNES & BOONE, THE ALTERNATIVE INVESTMENT MARKET (2006) (on file with author); see also *infra* Part III.C (providing more information about these alleged marketing deals).

Public Offerings

Source: HAYNES & BOONE, *supra* note 256.

The AIM listing process also features fast-track admission for so-called “quoted applicants.”²⁵⁷ This streamlined process exempts AIM applicants already listed in certain overseas exchanges from submitting an admission document.²⁵⁸ Quoted applicants are deemed acceptable for an AIM listing due to their track record in one of several recognized listing venues, dubbed AIM Designated Markets. These venues include the NYSE, NASDAQ, Euronext, the Deutsche Börse, and the UKLA Official List, among others.²⁵⁹ Under fast-track admission, quoted applicants must issue a pre-admission document, which is more detailed than the one required under the standard listing process.²⁶⁰ Under this

257. See AIM Rules for Companies, *supra* note 180, at 28. Quoted applicants are defined as issuers that trade their securities in AIM Designated Markets for at least eighteen months prior to an AIM admittance. *Id.*; see LONDON STOCK EXCH., AIM DESIGNATED MARKETS, available at <http://www.londonstockexchange.com/NR/rdonlyres/A1DF2948-5726-4075-B8C5-46E2EECF9353/0/AIMDesignatedMarkets1.pdf> (last visited Feb. 12, 2008) (listing the AIM Designated Markets).

258. See LONDON STOCK EXCH., AIM DESIGNATED MARKETS, *supra* note 257.

259. *Id.*

260. See ROUSSEAU, *supra* note 142, at 105. Rousseau points out that quoted applicants must also comply with certain technical requirements, such as conforming their financial statements to GAAP or, in the alternative, IAS. *Id.*

expedited process, applicants must still retain the services of a Nomad and pass the suitability test administered prior to AIM admittance.²⁶¹

After the applicant submits the required admission documentation, the Nomad certification of suitability, and pays the AIM listing fee, admission is complete, and the exchange will issue a dealing notice granting entry to the market.²⁶² AIM's initial listing fee is fixed, unlike other exchanges such as NASDAQ, which calculates the fee based upon the aggregate number of shares being listed.²⁶³ AIM has set its initial listing fee around £4535 (roughly \$7300), which is significantly lower than a NASDAQ listing (\$100,000 - \$150,000 for a listing in the Global Select segment and \$50,000 - \$70,000 for a listing in the Capital Market segment),²⁶⁴ but higher than the fee charged by the Entry Standard Segment of the Deutsche Börse (roughly \$2000 for private placements and \$1000 with a prospectus).²⁶⁵ Listing fee included, the total cost of an AIM listing appears to be lower than a NASDAQ listing. Table 3 shows a comparison of direct initial listing costs (expressed in U.S. dollars), based on the premise of a company seeking to launch a \$50 million IPO on both AIM and NASDAQ.²⁶⁶

261. See generally Bauer & Boritz, *supra* note 142; ROUSSEAU, *supra* note 142. This process is expected to last anywhere from four to six weeks, a significant reduction from the three to six months for non-quoted applicants under the standard process. See Bauer & Boritz, *supra* note 142; ROUSSEAU, *supra* note 142.

262. See AIM Rules for Companies, *supra* note 180, Rules 5-6, at 4. The dealing notice is made public through the exchange's Regulatory Information Service. *Id.*

263. See NASDAQ, Inc., Listing Standards & Fees, *supra* note 123, at 5.

264. *Id.*

265. See *Entry Standard: Tailormade Capital Market Access for Small-Caps and Mid-Caps* (Deutsche Börse Group, Frankfurt/Main, F.R.G.), Nov. 2007, available at http://deutscheboerse.com/dbag/dispatch/en/binary/gdb_content_pool/imported_files/public_files/10_downloads/33_going_being_public/50_others/entry_standard_broschuere_06.9.pdf.

266. See *IS AIM THE NEW NASDAQ*, *supra* note 170, at 4; Bauer & Boritz, *supra* note 142, at 7. While the cost difference in this chart is significant, other estimates show an AIM IPO posting around \$922,000 in costs, as opposed to \$2.4 million in NASDAQ. See *IS AIM THE NEW NASDAQ*, *supra* note 170, at 4; Bauer & Boritz, *supra* note 142, at 7.

TABLE 3
AIM VS NASDAQ—DIRECT INITIAL LISTING COSTS

DIRECT INITIAL LISTING COSTS			
AIM IPO		NASDAQ IPO	
Item	Cost	Item	Cost
Nomad / Broker Fee	\$2,000,000	Underwriting Fee	\$3,500,000
Corporate Finance Fee	\$500,000	Legal Fees	\$500,000
Company Counsel	\$262,000	Miscellaneous Fees	\$145,000
Nomad Counsel	\$300,000	Printing Fees	\$75,000
Accounting Fees	\$312,000	Accounting Fees	\$65,000
AIM Fee	\$7,300	NASDAQ Listing Fee	\$100,000
Registration Fee	\$45,000	SEC and NASD Registration Fees	\$107,000
Total	\$3,426,300	Total	\$4,472,000

Source: ThinkEquity Partners, *supra* note 131.

A significant cost difference between AIM and NASDAQ also appears to exist regarding ongoing compliance for listed companies. As aforementioned, the exchange-regulated nature of AIM allows it to issue a set of rules, imposing low disclosure and governance hurdles upon its listed firms.²⁶⁷ The AIM rulebook contains a meager forty-five rules, of which roughly twenty-eight concern a company's ongoing obligations after listing.²⁶⁸ Most of these rules seek to ensure timely and adequate disclosure of all relevant information to the marketplace. Other rules oblige companies to retain a Nomad at all times and pay listing fees.²⁶⁹ Table 4 compares direct ongoing costs for AIM and NASDAQ firms based on the premise of an already completed \$50 million IPO.

267. See AIM Rules for Companies, *supra* note 180, Rules 10-38, at 5-11.

268. *Id.*

269. *Id.*

TABLE 4
AIM vs NASDAQ—DIRECT ONGOING LISTING COSTS

DIRECT ONGOING LISTING COSTS			
AIM		NASDAQ	
Item	Cost	Item	Cost
Nomad Fee	\$90,000	SOX Compliance	\$3,500,000
AIM Annual Fee	\$7,300	NASDAQ Annual Fee	\$17,500
Accountants	\$50,000		
Total	\$147,300	Total	\$3,517,500

Source: ThinkEquity Partners, *supra* note 131.

2. Disclosure Requirements Following Admission

AIM's regulatory model presupposes proper communication and continuous disclosure of information flowing from listed companies to the marketplace.²⁷⁰ Since AIM's investor base is predominantly institutional and private placements are commonplace, listed companies feature a small number of investors with whom they maintain tight links.²⁷¹ Even though AIM's ongoing rules for listed companies may appear lax *prima facie*, disclosure levels are close to optimal for a sophisticated investor base that demands adequate information. Nomads play an important role in maintaining AIM's market integrity, as they liaison between companies and investors and essentially advise AIM companies as to the timing, form, and content of any disclosures that must be made to the market.²⁷² With Nomad assistance, AIM firms can reduce compliance costs by setting apart relevant information—which should be disclosed—from immaterial information.²⁷³ Thus, Nomads fulfill their general mandate that disclosed information is not misleading

270. See London Stock Exch., *AIM: The World's Most Successful Growth Market*, *supra* note 229, at 13.

271. IS AIM THE NEW NASDAQ, *supra* note 170, at 5 ("AIM is predominantly an institutional market, which means its investor relationships can be structured more efficiently than those of a market where shares are mainly traded retail.")

272. See Aaronson, *supra* note 233, at 34.

273. See ROUSSEAU, *supra* note 142, at 105 ("Since the Nomad is acting as regulator, this framework can reduce the risk of non-disclosure of important information by issuers for good reasons.")

or deceptive and that a company does not omit “anything likely to affect the import of such information.”²⁷⁴

A company listed in AIM is obliged to disclose price sensitive, non-public information.²⁷⁵ AIM’s definition of price sensitive information—any new developments which, if made public, would be likely to lead to a substantial movement in the price of a company’s AIM securities²⁷⁶—is coupled with a list of defining criteria regarding the area in which such developments may occur: (1) financial condition, (2) sphere of activity, (3) business performance, and (4) expectations as to business performance.²⁷⁷ AIM adopted this definition pursuant to the implementation of the European Directive on Insider Dealing and Market Manipulation (dubbed the “Market Abuse Directive”), applicable in part to AIM, despite its condition as an exchange regulated venue.²⁷⁸ This extensive application also affects AIM’s insider trading regime.²⁷⁹ AIM companies must work closely with their Nomads, charged with ensuring market awareness “of all information that needs to be in the public domain,” to determine which information is price sensitive and merits disclosure.²⁸⁰

274. See AIM Rules for Companies, *supra* note 180, Rule 10, at 5.

275. See *id.*, Rule 11, at 5.

276. See *id.*

277. *Id.*

278. See Transposition Note for Directive (EC) 2003/6, The Market Abuse Directive, available at http://www.hm-treasury.gov.uk/media/7/B/MAD_tn240205.pdf. The issuance of several instruments, including the Financial Services and Markets Act Regulations 2005, completed the adoption of the Market Abuse Directive in the U.K. Upon implementation, the scope of the Market Abuse Directive—which applied only to regulated markets—was extended to cover AIM. *Id.*

279. See *Market Abuse, The EU Directive on Insider Dealing and Market Manipulation*, MONDAQ BUS. BRIEFING (Goliath/Thomson-Gale Info. Serv.), Feb. 3, 2005. Indeed, the main market abuse offences contemplated under the Directive are deemed applicable to AIM-listed companies, but other provisions, such as the issuance of insider lists, are not. See *id.* AIM’s rules specify:

[S]ecurities of an AIM company may not be traded by its directors or applicable employees during a trading close period. In this context, applicable employees are those employees likely to be in possession of unpublished price-sensitive information in relation to the company because of their employment with the company Nomads will insist that an AIM company adopt an insider-trading policy to comply with the above.

ROBERT BRANT ET AL., LEXPERT 500, AIM: GATEWAY TO EUROPEAN MARKETS 6-7 (2005), available at <http://www.lexpert.ca/500/lb.php?id=91>.

280. See Aaronson, *supra* note 233, at 29.

AIM rules also categorize four types of corporate transactions that require disclosure: (1) substantial transactions, (2) related party transactions, (3) reverse takeovers, and (4) disposals resulting in a fundamental change of business.²⁸¹ The exchange designed specific “class tests” for each transaction type,²⁸² addressing factors such as gross assets, profits, or turnover ratios to determine transaction size and relevancy. For instance, the Gross Assets Test computes the gross assets of the acquisition or disposition contemplated by the relevant transaction over those of the AIM company, while the Turnover Test similarly computes the ratio of the turnover attributable to the contemplated transaction to that of the AIM company overall.²⁸³ Substantial transactions, then, are defined as those that exceed a threshold of 10% in any of the class tests. Related party transactions²⁸⁴ and reverse takeovers²⁸⁵ set forth additional criteria. AIM firms engaging in any of these transactions must also provide specific information, supplementing the general duty to disclose.²⁸⁶ The aggregation of transactions executed over a period of twelve months prior to the latest operation completes this set of AIM rules.²⁸⁷

Though less stringent than most stock exchange venues, AIM requires companies to periodically disclose financial information.²⁸⁸ For example, AIM companies must prepare a semi-annual report, containing a balance sheet, income and cash flow statements, and comparative figures for the corresponding period in the previous year.²⁸⁹ Companies must also prepare, publish, and send to shareholders audited annual accounts within six months of the conclusion of the fiscal year.²⁹⁰ Unlike the requirements set forth under SOX, executive officers of AIM

281. See AIM Rules for Companies, *supra* note 180, Rules 12-15, at 5-6.

282. See *id.*, sched. 3, at 20-21.

283. See *id.*

284. See *id.*, Rule 13, at 5-6.

285. See *id.*, Rules 10-11, at 5. If a takeover transaction does not meet class test thresholds, a company must account for fundamental changes in business or board and voting control, or in the case of investing companies, any substantial departures from initial investing strategies. See *id.*

286. See ROUSSEAU, *supra* note 142, at 118 (identifying additional information needed, such as the identities of related parties).

287. See AIM Rules for Companies, *supra* note 180, Rule 16, at 7.

288. See *id.*, Rule 11, at 5.

289. See *id.*, Rule 18, at 7-8.

290. See *id.*, Rule 19, at 8.

companies are not called upon to certify financial reports.²⁹¹ Critics proclaiming AIM's regulatory laxity often reference the absence of quarterly reports or executive certification of financial reports.²⁹² To the extent that institutional investors acquiring AIM securities exert close scrutiny, given their long-term expectations and close relationship with issuers, and the Nomad's involvement counteracting AIM leniency, this negative assessment is unjustified.²⁹³ AIM rounds out its disclosure requirements with such miscellaneous information as: deals undertaken by directors, relevant changes to significant shareholdings,²⁹⁴ changes in board composition, material changes between actual performance and profit forecasts, resignations, dismissals and appointments of Nomads, and admission to trading in any other exchange.²⁹⁵

The exchange's Regulatory Information Service channels the required disclosure information—including any data specifically requested by the exchange.²⁹⁶ Recent amendments to the AIM rules obligate every company to establish and maintain a website containing financial and corporate information²⁹⁷ before August 26, 2007.²⁹⁸ Multiple private parties already offer website services specifically designed for AIM companies.²⁹⁹

291. See *supra* Part II.

292. See, e.g., Blackwell & Gapper, *supra* note 149, at 8.

293. Nomads must ensure that AIM companies comply with ongoing disclosure requirements and employ due care in ensuring that disclosed information is accurate.

294. See London Stock Exch., AIM Notice No. 25: Changes to the Disclosure of Significant Shareholders (Nov. 11, 2006), available at <http://www.londonstockexchange.com/NR/rdonlyres/37156CEB-E10C-4551-A2B0-E6BE3AB38047/0/AIMNotice25.pdf>. This requirement can be seen as a direct consequence of the implementation of the Transparency Directive in the UK. Although most of the Transparency Directive did not affect AIM, disclosure of relevant shareholding was retained. *Id.*; see also London Stock Exch., AIM Notice No. 26: Update on AIM Notice 25 (Disclosure of Significant Shareholders) and Discussion of Other Legislative Changes (Including Electronic Communications) (Jan. 12, 2007), available at http://www.londonstockexchange.com/NR/rdonlyres/A1DF2CCC-8530-4328-9A8B-3EF44DD45566/0/AIMNotice25_FINAL_.pdf.

295. See AIM Rules for Companies, *supra* note 180, Rule 17, at 7.

296. *Id.*, Rules 22-23, at 9. The exchange is entitled to request any kind of information from AIM listed companies and to mandate the publication of such data. See *id.*

297. See *id.*, Rule 26, at 9.

298. See *id.*

299. See, e.g., AIM Compliance, <http://www.aimcompliance.com/> (last visited Feb. 17, 2008).

3. Corporate Governance for AIM Firms

While AIM regulates, to some extent, disclosure requirements, the exchange leaves unaddressed corporate governance. AIM firms are not legally bound to comply with the provisions of the U.K.'s Combined Code on Corporate Governance,³⁰⁰ nor does the exchange require that its companies create audit committees or appoint independent directors.³⁰¹ Nevertheless, market pressures offset the lack of prescriptive regulation and drive firms to voluntarily adopt corporate governance provisions.

AIM's investor base is mainly composed of sophisticated institutions that delve profoundly into the business of a firm before investing in its shares.³⁰² Institutional investors would not take interest in a company lacking the necessary mechanisms to ensure adequate corporate governance.³⁰³ To allure prospective investors, AIM companies often integrate various corporate governance mechanisms and disclose these policies in their admission documents and websites.³⁰⁴ Nomads also commonly persuade their clients to adopt high corporate governance standards.³⁰⁵

300. See David Robbins, *Corporate Governance and AIM*, in *AIM: A CLOSER LOOK* (Media Planet/London Stock Exch., London, Eng.), Apr. 20, 2007, at 12, available at <http://www.londonstockexchange.com/NR/rdonlyres/FAD7D047-6B52-4A00-9AE6-9F0526F881DC/0/AIMAcloserlook.pdf>. The Combined Code incorporates recommendations from a number of authorities, including the Cadbury report, the Greenbury report, the Smith report, the Turnbull report, and the Higgs report. See FINANCIAL REPORTING COUNCIL, *THE COMBINED CODE ON CORPORATE GOVERNANCE* (2003), available at http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf.

301. See AIM Rules for Companies, *supra* note 180, Rules 14-15, at 6. However, some transactions require shareholder approval, such as in a "reverse takeover" or a disposal of corporate assets exceeding 75% percent in any of the class tests. *Id.*

302. See *supra* notes 270-74.

303. *Monitoring and Taking Action on Financial Performance, Corporate Governance and Corporate Responsibility*, *supra* note 204. In demanding the introduction of corporate governance provisions for AIM firms, a major institutional investor stressed that "the main principles of good corporate governance embodied in the (Combined Code) are applicable to listed companies of all sizes and stages of development." *Id.*

304. See, e.g., Supporta, Investor Relations, <http://www.supportapl.com/investor-relations/corporate-governance/> (last visited Feb. 17, 2008); Zenergy Power, Investor Relations, http://www.zenergypower.com/investors/corporate_governance (last visited Feb. 17, 2008).

305. See Aaronson, *supra* note 233, at 35.

Since no compulsory rules exist, AIM companies have a certain degree of flexibility regarding the mechanics of their internal governance structures. Nevertheless, investors' and Nomads' vision of best practice largely constrains firm autonomy. Any sub-optimal corporate governance regime will undoubtedly negatively impact a firm's ability to raise equity or maintain continuity as an AIM-listed company.³⁰⁶ AIM firms are thus expected to comply with the Combined Code or, if some provisions are considered detrimental or overly costly, justify non-compliance. However, the rules promulgated by the Combined Code are generally intended to govern the affairs of larger corporations (i.e., those listed in the U.K.'s Official List) and might not be fit for the smaller companies listed on AIM. Combined Code adherence may lead to an unnecessary increase in compliance costs for firms that can ill afford to waste resources abiding by stiff governance processes.

The *Corporate Governance Guidelines for AIM Companies*, published by the Quoted Company Alliance ("QCA"), exemplify recent efforts to address the drawbacks of Combined Code application to AIM firms.³⁰⁷ The QCA guidelines are tailored to small firms and represent the consensus view on best practices by the AIM advisory and investor community.³⁰⁸ Overall, the guidelines do not stray far from the principles set out in the Combined Code, but they do adjust the specific governance mechanisms to the needs of small-caps. For instance, the guidelines underscore the importance of having two independent directors, and further suggest that different individuals should act as Chairman of the Board and CEO.³⁰⁹ The guidelines also advocate

306. See *infra* Part III.B.4. It must be stressed that Nomads, charged with assessing the continuous suitability of firms listed in AIM, could single out any company which does not abide by high standards of governance and disclosure. Such a company would surely be excluded or suspended from AIM.

307. See The Quoted Companies Alliance, Publications, http://www.quotedcompaniesalliance.co.uk/guidance_booklets.asp (last visited Feb. 17, 2008) (offering guidance booklets, including the *Corporate Governance Guidelines for AIM Companies*). This not-for-profit organization claims to protect the interests of the smaller quoted company sector. *Id.*

308. See *Joining AIM: A Field Guide for Potential Applicants to the AIM Market of the London Stock Exchange*, NEWS & INSIGHTS (DLA Piper UK LLP, London, U.K.), Nov. 29, 2007, at 8, <http://www.dlapiper.com/global/publications/detail.aspx?pub=2867>

309. See *What Additional Responsibilities and Obligations Arise for Directors of AIM Companies?*, BRIEFING NOTES (Manches, LLP, London, U.K.), Aug. 2006, http://www.manches.com/downloads/briefings/AIM_Director_Responsibilities.pdf

proportionally-sized remuneration, auditing, and nomination committees composed of non-executive directors.³¹⁰ Moreover, the QCA guidelines recommend that the board of directors ensure satisfactory shareholder dialogue and conduct an annual review of the firm's internal governance controls.³¹¹

Following QCA's initiative, the U.K.'s National Association of Pension Funds ("NAPF") published its own set of guidelines in March 2007. The *NAPF's Policy and Voting Guidelines for AIM Companies* is consistent with QCA's previous efforts to create a customized governance code, and even complement the latter's guidelines.³¹² However, some overlapping provisions exist—particularly in regard to director independence and board committees—which could create confusion for companies following both sets of principles.³¹³ Since the NAPF guidelines do not cover every aspect of internal governance, some recommend initial application of the Combined Code “in a way in which is appropriate to [an AIM firm's] circumstances and its size.”³¹⁴ The guidelines also focus on increased disclosure standards, remuneration arrangements, pre-emption, and senior independent directors.³¹⁵

AIM's unique system of corporate governance, which relies on market pressures and incentive structures, has hitherto produced positive results.³¹⁶ To date, a majority of AIM companies comply with the

[hereinafter Manches, LLP].

310. See The Practical Law Company – Corporate, Remuneration committee terms of reference: AIM, <http://corporate.practicallaw.com/7-202-2501> (last visited Jan. 14, 2008) (stating that remuneration committees should contain “at least two members but companies with larger boards may want to increase this”); *Public Companies Update* (Charles Russell LLP, London, U.K.), Sept. 2005, at 5, http://www.cr-law.co.uk/resources/pdf/Public_Companies_Update_0905.pdf.

311. See Manches, LLP, *supra* note 309.

312. See *Corporate Governance Policy: Policy and Voting Guidelines for AIM Companies* (NAPF, London, U.K.), Mar. 2007, at 3, <http://www.napf.co.uk/documentarchive.asp> (follow “Policy” hyperlink; then follow “Corporate Governance” hyperlink). In order to issue its own principles, NAPF consulted the QCA to assist consistency between both sets of guidelines. *Id.*

313. See *id.*

314. *NAPF Corporate Governance Policy for AIM-Listed Companies*, CORPORATE BRIEFING (Travers Smith, London, U.K.), May 2007, <http://www.traverssmith.com/?pid=24&level=2>.

315. See *id.*

316. See BAKER TILLY ET AL., *supra* note 254, at 15. According to a 2006 survey, AIM investors see improvement in the level of corporate governance within the market.

provisions of the Combined Code or QCA's Guidelines.³¹⁷ Most of these companies implement governance regimes customized to their particular characteristics.³¹⁸ The tailoring procedure decreases compliance costs while simultaneously signals to the market implementation of best practice corporate governance standards. Again, the Nomad's advisory role is central during this fine-tuning process.³¹⁹ A Nomad's knowledge of market trends and its relationship with institutional investors helps to prescribe the optimal level of corporate governance for AIM firms.³²⁰

4. The Nominated Adviser

Without doubt, the comprehensive role of the Nominated Adviser is the strongest pillar of AIM's regulatory model. Assigned the two-fold task of assessing a firm's AIM suitability and advising disclosure and corporate governance compliance, Nomads preserve the integrity and reputation of the market.³²¹ As a liaison between listed companies and the exchange's authorities,³²² Nomads simultaneously play the part of gatekeeper, adviser, and ultimately, regulator, of AIM. Not surprisingly, applicants for Nomad status must clear a rigorous screening process. The exchange sets a high financial and legal standard for Nomad admission.³²³ In addition to the prescriptive criteria, the exchange also

See id. However, 14% of AIM investors have clear doubts about whether AIM's system of corporate governance is in accordance with normal market standards. *Id.*

317. *See* David Robbins, *Corporate Governance and AIM*, AIM: A CLOSER LOOK (Baker Tilly, London, U.K.), Apr. 2007, <http://www.bakertilly.co.uk/default.aspx?page=2670>; Emilio Cattaneo, *Equity Capital Markets Alternative Routes to Raising Capital* (CFS Partners, London, U.K.), Feb. 2007, http://www.cavedatos.org.ve/download/cdt_442.pdf; *A Review of Corporate Governance Adoption with Aim Companies in the South West* (Grant Thornton, London, U.K.), Dec. 2005, <http://www.grant-thornton.co.uk/portals/grantthornton/documents/3-aim-corporate-governance-.pdf>.

318. *See* WHY U.S. (AND NON-EUROPEAN) COMPANIES NEED AIM, *supra* note 204, at 8.

319. *Id.* Nomads allow corporate governance to be adjusted "to ensure the most critical risks were contained, while ensuring that management time was not wasted on over-rigid control of the wrong parts of a business." *Id.*

320. *See* Aaronson, *supra* note 233, at 35.

321. *See id.* at 22.

322. *See* AIM Rules for Nominated Advisers, *supra* note 231, Rule 19, at 9.

323. *Id.*, Rule 2, at 3. Nomad applicants must (i) have practiced corporate finance for a period of at least two years, (ii) have acted in at least three relevant transactions (as defined by AIM rules), and (iii) employ at least four executives that meet AIM

considers the applicant's reputation and its commercial and regulatory performance.³²⁴

AIM created the Nomad figure to advise small firms that lacked the experience to properly function as listed companies.³²⁵ In addition to this consulting role, the exchange decided to outsource the responsibility for firm compliance of market rules to these entities.³²⁶ By devolving part of its regulatory authority to Nomads, AIM succeeded in ensuring that their advice—albeit non-compulsory—would be closely followed by public companies.³²⁷ The exchange also afforded these entities full discretionary powers to determine whether a company was unsuitable to maintain its AIM listing. Nomads can easily single out and remove rogue firms that refuse to abide by proper standards of governance and disclosure.³²⁸ As the best positioned agent to detect substandard behavior, Nomads are justifiably charged with preserving the integrity and reputation of AIM by overseeing the firms that they advise.³²⁹

The adequacy of Nomads as AIM's regulators and gatekeepers could be challenged on the grounds that these entities have a vested interest in the firms they counsel.³³⁰ A unique incentive structure,

standards for adequacy. *Id.*

324. *See id.*, Rule 3, at 3-4.

325. *See* Aaronson, *supra* note 233, at 18.

326. *See id.*

327. *See id.* at 8. Each Nomad must charge at least two qualified members of its staff to oversee each company. *See id.*

328. *See* AIM Rules for Companies, *supra* note 180, Rule 40, at 12. In practice, however, Nomads retain no real power to impose sanctions upon listed firms. If any company does not abide by acceptable corporate governance principles without justification, the Nomad notifies the AIM Regulation Department, which may in turn remove the firm's listed status or impose any other applicable sanction. AIM may adduce any number of reasons, including the need to protect the market's reputation or to safeguard investors. *See id.* (discussing AIM's need to protect the market's reputation); Aaronson, *supra* note 233, at 8 (discussing AIM's need to safeguard investors).

329. *See* Aaronson, *supra* note 233, at 19-20. Nomads preserve AIM's reputation by ensuring not only that a company is suitable for admittance, but also that its subsequent behavior does not have a negative impact on the market. *See id.*

330. *See* Bauer & Boritz, *supra* note 142, at 8. Some are wary about the Nomads' relationship with the firms they advise. The LSE is supposed to have a team of analysts constantly monitoring these advisers. Bauer and Boritz argue that one could consider that this vested interest causes "sub-optimal information quality and investors to be misled." The authors then give several reasons for the unlikelihood of this scenario. *See id.*

however, steers Nomads' performance. Nomads are liable for improper reporting by their supervised companies³³¹ and subject to investor lawsuits if investors are misled.³³² A Nomad's considerable reputational capital complements this set of negative incentives. Like traditional gatekeepers, Nomads build their reputational capital by servicing clients over prolonged periods of time, and ultimately vouch for the suitability of AIM companies and the accuracy of their market disclosures.³³³ Nomads bear a disproportionate loss from permitting or negligently overlooking any transgressions on behalf of their supervised companies. Currently active Nomads, including highly reputed firms like Morgan Stanley, Citigroup, and PriceWaterhouseCoopers, would suffer considerably for sub-optimal performance.

Commentators still criticize that some Nomads are "as small and speculative as the companies they float."³³⁴ Consequently, the exchange must still constantly supervise to ensure its "self-regulation system" functions properly. Accordingly, AIM continuously reviews Nomad activities to verify due diligence.³³⁵ AIM rules also contain a number of measures to prevent conflicts of interest between a Nomad and listed companies, as well as to guarantee the former's independence.³³⁶ Advisers that fail to abide by market standards and practices may be subject to disciplinary proceedings and sanctions, including removal of Qualified Executive status, fines, censure motions, and expulsion from AIM.³³⁷ Although few entities have been levied the most severe

331. See ROBERT BRANT ET AL., *supra* note 279. For instance, misstatements or omissions in an admission document can lead to civil or criminal liability for both the AIM applicant and its Nomad under the Financial Services and Markets Act. *See id.*

332. See Bauer & Boritz, *supra* note 142, at 9 ("The Nomad bears the risk of improper reporting and lawsuits for failing to uphold a proper duty of care to all investors. Investors have legal recourse to pursue damages from the Nomads, the regulator of the shares, if they have been misled into making a poor investment.").

333. See Coffee, *Gatekeeper*, *supra* note 48, at 11 (explaining the reputational incentives of gatekeepers).

334. See *Business: AIM Changes*, BRIEFINGS (Mischon de Reya, London, U.K.), Dec. 2006, http://www.mishcon.com/news/briefings/docs/briefing_176.aspx.

335. See AIM Rules for Nominated Advisors, *supra* note 231, pt. 3, at 11-12.

336. See *id.*, Rule 21, at 9. According to Rule 21, these entities must be able to show sufficient independence from their clients "such that there is no reasonable basis for impugning the nominated adviser's independence." *Id.*

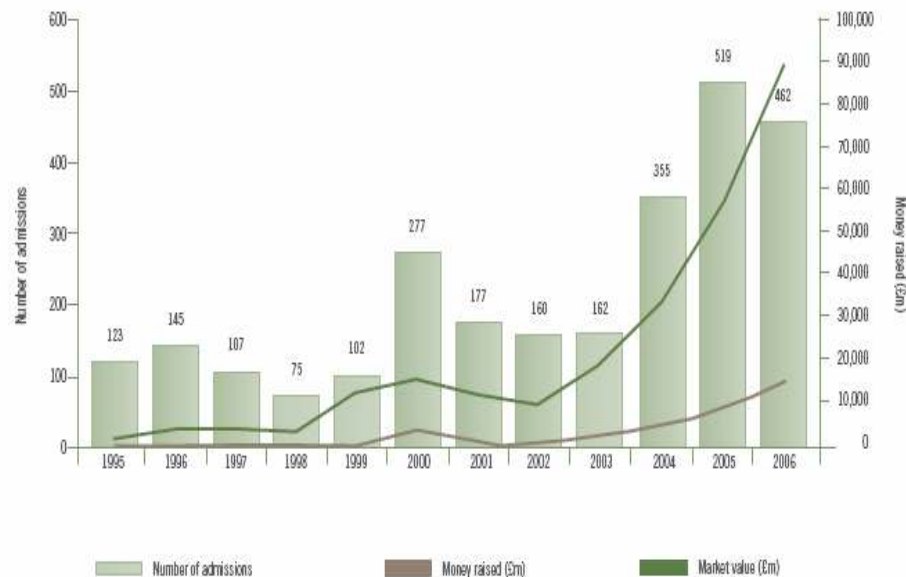
337. See *id.*, Rules 27, 29, at 11.

penalties, the exchange has demonstrated willingness to sanction misbehaving Nomads when appropriate.³³⁸

C. AIM—Going Forward

Thus far, AIM has adapted to the shifting conditions of modern economic systems, allowing it to become a dominant player in the market for small firms with a high growth potential, as the performance statistics in Figure 5 corroborate.

FIGURE 5
AIM ADMISSIONS, MONEY RAISED AND MARKET VALUE (1995-2006)



Source: BAKER TILLY ET AL., *supra* note 254.

Still, as it faces increasing competition from both sides of the Atlantic, AIM will have to be more responsive to preserve its privileged position. Within the European Union, fledging alternative markets such as Alternext, Mercato Expandi, Entry Segment and First North, while

338. See Recent Disciplinary Action on AIM, London Stock Exchange, <http://www.londonstockexchange.com/en-gb/about/cooverview/corpad/recentdisciplinaryactiononaim12.htm> (last visited Feb. 12, 2008).

still at an embryonic stage and not a current threat,³³⁹ could pose a challenge to AIM in the future. AIM must also compete with the lower-tier segments of well-established U.S. exchanges, such as NASDAQ's Capital Market Segment and NYSE Arca, which offer special conditions for small-caps and benefit from such venues' higher liquidity.³⁴⁰ AIM might also face competition within the U.K., specifically from the PLUS and OFEX trading platforms.³⁴¹ Table 5 compares AIM's admission requirements with those established by some of these other exchanges.

In order to compete successfully with these venues, AIM must focus on several areas. For instance, AIM must constantly adjust its rules to fit investor needs and counter negative market trends. Recent polls show that most AIM market participants consider its system of self-regulation to be effective.³⁴² Most firms even point out that listing on AIM adds to their credibility as publicly-held companies. Table 6 provides details of a survey of 150 AIM-listed firms ascribing advantages of an AIM listing.

339. See BAKER TILLY ET AL., *supra* note 254, at 3.

340. See Alistair MacDonald, *Rivals are Chasing AIM*, WALL ST. J., Mar. 23, 2007, at C5 (reporting that a third American competitor may soon enter the race). The American Stock Exchange has requested SEC permission to set up a low-tier market named The American Platform. This segment is designed for companies with a market capitalization of less than \$50 million. *Id.*

341. The OFEX market operates at the lowest level of market capitalization and is not considered to be a direct competitor of AIM. See Incademy Investor Education, <http://www.incademy.com/courses/How-the-stock-market-works/Why-do-companies-list-on-the-Stock-Exchange/5/1014/10002> (last visited Feb. 12, 2008). However, it is undeniable that certain overlap exists between AIM and OFEX, which could lead to future competition. See, e.g., *London & Pacific Healthcare, Inc. Announces Initial Acquisition; Established Corporate Finance Firm to Create Additional Value and Expand Global Reach*, MARKET WIRE, Mar. 8, 2007 (providing an example of a company, PSG Solutions Plc, which moved from OFEX to AIM).

342. See BAKER TILLY ET AL., *supra* note 254, at 15. The survey, conducted among AIM companies and investors, shows that most described AIM's model as "very" or "fairly" effective. Although some investors would like to raise AIM's regulatory stringency, they are also of the opinion that this would reduce the number of companies listing in the market. This, again, may be seen as a response to the slowdown in overall performance during 2006. *Cf. id.*

TABLE 5
ADMISSION REQUIREMENTS FOR SMALL-CAP EXCHANGES

COMPARATIVE ADMISSION REQUIREMENTS						
	European Alternative Markets				U.S. Markets	
	AIM	Alternext	Entry Segment	Mercato Expandi	NASDAQ	NASDAQ CM
Minimum public float	No minimum requirement	At least US\$ 3.2 million (unless private placement)	No minimum requirement	At least 10% of equity	400 shareholders; minimum market value between US \$8-20 million	At least 300 shareholders
Initial equity required	No minimum requirement	No minimum requirement	No minimum requirement	No minimum requirement	US \$0-30 million (depending on listing route)	US \$5 million
Market capitalization	No minimum requirement	No minimum requirement	No minimum requirement	At least US \$1.3 million	At least US \$75 million	At least US \$50 million
Trading history	No minimum requirement	At least 2 years	At least 1 year	At least 2 years	0-2 years (depending on listing route)	1 year
Profitability	No minimum requirement	Profitable is strongly recommended	No minimum requirement	Last net earning and turnover thresholds	No minimum requirement	No minimum requirement
Accounting standards	UK GAAP/IFRS/US GAAP	National accounting standards of Member State/IFRS	National GAAP/IFRS		US GAAP	US GAAP

Source: Grant Thornton New Markets Guide 2006³⁴³

343. GRANT NORTON, NEW MARKETS GUIDE (2006).

TABLE 6
ADVANTAGES OF AN AIM LISTING

A SURVEY OF 150 AIM FIRMS	
Advantage	% of firms claiming a benefit
Added to the company's credibility	85%
Provided long-term growth potential	82%
Provided access to institutions	81%
Provided the company London profile	79%
Provided access to informed shareholders	71%
Facilitated acquisitions	57%
Provided company control over its future	54%
Provided access to venture capital fund	44%

Source: BOARD ET AL., *supra* note 75.

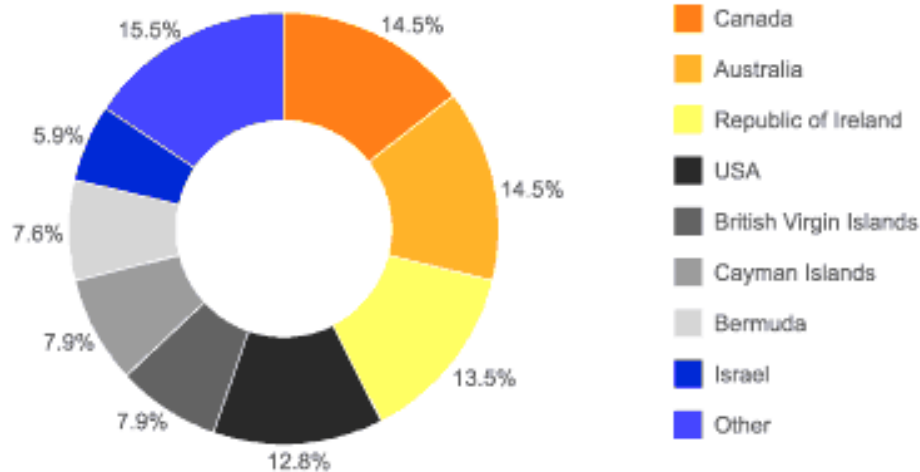
A majority of AIM firms, however, posit that standards and regulation should tighten as the market matures in order to improve investor confidence.³⁴⁴ Going forward, AIM must also continue its unremitting oversight of Nomads and listed firms, improve its liquidity constraints, and increase its international issuer base. Improvements in these areas are fundamental if AIM expects to mature into a deeper market, where larger companies can raise equity and benefit from enhanced liquidity.

AIM is already in the process of increasing the number of international companies admitted to trading. An aggressive marketing campaign conducted simultaneously in different continents has not only been highly rewarding, but underscores AIM's impressive results over the past few years. AIM marketing also benefits from alliances struck

344. *See id.*

with law firms and investment companies.³⁴⁵ Figure 6 shows the composition of AIM's international company base.

FIGURE 6
INTERNATIONAL COMPANIES IN AIM



Source: London Stock Exchange³⁴⁶

Two main areas of focus appear to be the U.S., where listing costs are deemed too high for small companies, and Asia, where firms are allured by the promise of cost-efficient access to capital and London's prestige. In the U.S., fast-growing companies based in Silicon Valley are starting to spurn domestic markets for an AIM listing.³⁴⁷ Table 7 details some of the reasons voiced by U.S. firms listed on AIM.

345. See Press Release, Haynes & Boone LLP, Taking AIM on the London Stock Exchange (Mar. 16, 2005), <http://haynesboone.com/about/pressDetail.asp?pressid=362>. U.S. law firm Haynes & Boone appears to have struck such a deal and is currently marketing AIM as a viable alternative to U.S. capital markets. The firm's web page contains extensive positive information about AIM, and furthermore states that "Haynes and Boone representatives are available to those journalists interested in exploring the AIM and its potential." See *id.*

346. London Stock Exch., Institutional Advisors on AIM, http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim_new/Trade+and+Investin g/institutionalinvestorsonaim.htm (last visited Feb. 12, 2008).

347. See Nicholas A. Vardy, London's Alternative Investment Market: The New NASDAQ?, *The Global Guru*, <http://www.theglobalguru.com/article.php?id=63&offer=GURU001> (last visited Jan 15, 2008).

TABLE 7
MOTIVATIONS OF AIM-LISTED U.S. FIRMS

MAIN REASONS OF U.S. COMPANIES FOR LISTING IN AIM	
Company	Reason for listing
Cyberscan	Access to development capital
Legacy Distribution	Avoid costly US regulation
Prometheus	Achieve greater liquidity
Elcom International	Access capital unavailable in the US
Intermap Technologies	Gain an international shareholder base
Gatekeeper Systems	Facilitate expansion into Europe
OCZ	Remove inefficient financing
Numerous	Provide exit to venture capital investors

Source: AIM in a U.S. Context: Exploding Some Myths, supra note 115, at 3.

Although AIM does offer these firms multiple advantages, certain restrictions still apply to U.S. companies. For instance, in accordance with Rule 903 of Regulation S, these firms may only escape U.S. regulation if they abstain from direct selling efforts in U.S. territory.³⁴⁸ Such regulation also becomes applicable to AIM-listed firms if their investor base exceeds 300 U.S. shareholders or 500 shareholders

348. See *Initial Public Offerings on AIM for U.S. Corporations, supra note 219, at 7* (detailing the so-called “Issuer Safe Harbor” provision).

[A]n offer or sale of securities by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing, shall be deemed to occur outside the United States within the meaning of Rule 901 if: (i) The offer or sale is made in an offshore transaction; (ii) No directed selling efforts are made in the United States by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing; and (iii) The conditions of paragraph (b) of this section, as applicable, are satisfied.

Id.

altogether.³⁴⁹ In Asia, Chinese companies have shown great interest in joining AIM. Of the twenty-five Chinese firms reportedly listed on AIM, a majority spurned local and U.S. exchanges, though on different grounds.³⁵⁰ Other Asian companies have also successfully listed on AIM.³⁵¹

The increasing number of international companies raises some concern as to the possibility of offshore vehicles listing on AIM for no good business purpose.³⁵² Despite the multiple safeguards laid down by the exchange to prevent abuses (such as Nomad oversight, lock-ins, and compulsory use of raised funds), scandals and anomalies already comprise parts of AIM's recent past.³⁵³ Although AIM proved to be a highly responsive regulator, it remains to be seen whether its particular system of self-regulation can take the strain of an increasing number of non-U.K. based companies. Thus far the results appear to be mixed. A survey conducted of AIM investors shows that the venue's performance could have been negatively affected by the poorer quality of companies coming to the market during 2006.³⁵⁴ Analysts argue, however, that the 2006 slowdown was due to market euphoria, which created unduly high expectations and gave way to an onslaught of new listings, some of which may have been mispriced.³⁵⁵ In any case, some preventive

349. *See id.*

350. *See Smart Young Firms Find a Home on AIM*, SOUTH CHINA MORNING POST, June 10, 2006, available at <http://www.chi-med.com/eng/media/pdf/news060610.pdf>. NASDAQ was considered too costly, Singapore's exchange was deemed to be focused only on manufacturing companies, Hong Kong was excluded since investors apparently mostly deal in the securities of large companies, and local venues were considered to be overregulated. *Id.*

351. *See* Sundeep Tucker, *Listing on London's Aim Bears Fruit For Asian Citrus*, FIN. TIMES, May 30, 2007, at 3, available at <http://search.ft.com/ftArticle?queryText=asian+citrus&y=0&aje=true&x=0&id=070530000424&ct=0>. Asian Citrus, for instance, raised nearly £12 million (about \$20 million). Its issuance has been proclaimed as a success for the company, whose CEO described AIM as well organized and teeming with sophisticated institutional investors. *Id.*

352. *See* James Moore, *Brokers Sound Alarm over U.S. Threat to AIM*, THE INDEPENDENT (LONDON), Nov. 14, 2006, available at http://findarticles.com/p/articles/mi_qn4158/is_20061114/ai_n16845272. Market players are particularly wary of newly-listed Russian and Chinese companies. *See id.*

353. *See Business: AIM Changes*, *supra* note 334, at 1. At one point, AIM had to suspend trading of securities issued by a number of cash shells which had raised public equity and subsequently refrained from undergoing any business activities. *See id.*

354. *See* BAKER TILLY ET AL., *supra* note 254, at 7.

355. *See id.*

measures were taken in response, including the new Nomad rulebook, which elevated the hurdles for admittance to AIM.³⁵⁶

The aforementioned liquidity constraints also impede AIM's ambitions. Although liquidity ratios appear to exponentially increase on a yearly basis, AIM still lacks sufficient trading volume to fully support larger companies or a fully-fledged venture capital market.³⁵⁷ Companies that reach the later stages of their growth cycles will surely require enhanced levels of trading liquidity if they are to remain listed with AIM. For these firms, liquidity is vital in determining the price shock that can be absorbed by a particular security during trading.³⁵⁸ Conversely, start-ups value liquidity, particularly at the IPO stage, as the venture capitalists that back them often wish to exit their investment positions, yet still wish to ensure sufficient liquidity to promote further growth.³⁵⁹ The European Venture Capital Association believes that venture-backed firms require a truly pan-European market. LSE's purported acquisition of the Borsa Italiana³⁶⁰ and the removal of barriers to cross-border capital flows in the European Union can be seen as initial steps towards AIM becoming such a trading platform.

356. See *supra* Part III.B.1.

357. See BAKER TILLY ET AL., *supra* note 254, at 3. However, AIM is rapidly maturing beyond its initial status as "nursery" to the Main Market, such that some of AIM's largest companies have not even considered listing in the U.K.'s Official List. *Id.*

358. See *Fulfilling the Promise of Venture-backed High Potential Companies* (European Private Equity and Venture Capital Association, Brussels, Belgium), Oct. 2005, at 3. This notion of price shock refers to the impact on share price of events that alter the demand or supply of a given stock, such as investors selling shares or the exercise of management options. A highly liquid stock with a daily trading volume of \$1 billion will be able to absorb a \$100 million shock with "little or no market impact." *Id.* A company with less liquid stock can see its share price negatively affected by a comparatively lower market shock. *See id.*

359. *See id.* Other reasons include "[generating] sufficient trading commissions to support high quality sellside research coverage, . . . the orderly sale of venture capital positions to efficiently replace them with capital from institutional and retail investors." *Id.*

360. See *LSE Borsa Deal 'Will be Approved,'* BBC NEWS, June 25, 2007, available at <http://news.bbc.co.uk/2/hi/business/6236284.stm>. Both exchanges have recently agreed to a \$2 billion merger in which Borsa Italiana shareholders would receive LSE shares. Although the transaction must still be approved by shareholders, the LSE's directors are confident that it will be completed successfully. *Id.*

IV. CONCLUDING REMARKS

Concurring events after the turn of the twenty-first century have allowed AIM to sway in its favor the market for small high-growth firms. Its unique model, based on customized compliance and self-regulation, has made it possible for this segment of the London Stock Exchange to thrive where others have failed. AIM's timing was impeccable; when regulatory costs were being raised on both sides of the Atlantic after notorious corporate scandals and the bursting of the technology bubble, AIM stood by its low-cost, high-standards philosophy. In so doing, it supplied cost-efficient access to large pools of liquidity in order to meet an increasing demand from companies which could no longer list in the booming small-cap markets of the 1990s.

AIM's regulatory model balances investor protection and compliance costs. Its companies benefit from comply-or-explain rules which set low hurdles for listing and few ongoing obligations, as compared to other stock exchanges. AIM regulation can be fine-tuned to better fit a firm's distinct traits. On the flipside, listed companies are severely constrained from embracing poor standards of disclosure and corporate governance. AIM's investor base is largely composed of sophisticated institutional investors that maintain close ties with the companies in which they invest. Correspondingly, they would be reticent to pour resources into an enterprise that failed to meet certain benchmarks.

More importantly, the exchange has partially delegated its regulatory authority to the so-called Nominated Advisers; namely, private firms that supervise and provide counsel to AIM firms. Not unlike thespians, Nomads play multiple roles as gatekeepers, advisers, and regulators of AIM. Nomad performance is driven by a unique incentive structure in which their reputational capital is pledged as a proxy for a firm's suitability to AIM, its accuracy of ongoing disclosure, and its quality of internal governance structures.

Despite this trade-off between light regulation and investor protection, AIM's model is not without flaws. Some of its smaller companies fail to meet profit forecasts. Cash shells under the guise of investment companies have abused the market. Liquidity appears to be constrained. A few public companies have been fined or censured for grave misconduct, while others have imploded under shady circumstances. Nevertheless, AIM has shown to be a highly responsive

regulator. It has addressed gatekeeper failure by issuing a new set of guidelines for Nomads, which enhance disclosure by requiring all listed firms to establish websites with relevant company information. It has also barred valueless cash shells from the market. Still, AIM needs to improve considerably in a number of areas. If it intends to mature into a deeper market and appeal to larger, international firms, it must fix its liquidity problems. As it attracts more retail investors and non-U.K. based firms, it will surely have to tighten its rules. While AIM's continued ability to adjust to the ever-changing financial environment remains to be seen, the balance appears to be favorable for the venue's innovative model.