THE SEC AND INTERNATIONAL CORPORATIONS: A PATH TO OPTIMAL PUBLIC ENFORCEMENT AFTER *MORRISON V. NATIONAL AUSTRALIA BANK*

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This Article examines SEC enforcement against international corporations and seeks to identify the optimum approach to cross-border enforcement after Morrison v. National Australia Bank. *In* Morrison, *the Supreme Court sought to limit the extraterritorial reach of the antifraud provisions of the U.S. securities laws and to scale down the exposure of foreign issuers to securities liability risk. The decision has effectively restricted the ability of private plaintiffs to bring actions against international companies. This Article examines the doctrinal and market consequences of* Morrison *and identifies a number of red flags potentially indicative of an increased risk of fraud. The Article also presents an empirical analysis of all enforcement actions against foreign issuers five years before and five years after* Morrison*. The analysis suggests that the SEC pursues a lenient approach in foreign issuer enforcement. This traditional policy may attract low-quality firms in the post-*Morrison *environment and has become suboptimal. The Article explores policy options and concludes that the SEC should not engage in more enforcement actions at this point. Instead, the warning signs identified in this paper and* Morrison *as such call for preventive monitoring. To this end, the SEC should pursue a policy of soft enforcement, put its new data analysis programs to work, and rely more on private enforcement and market "gatekeepers." By relying on the low-cost actions suggested in this Article, the SEC may reach a more optimal level of deterrence without ramping up enforcement and increasing the costs of international corporations.*

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I. INTRODUCTION

As capital markets grow progressively international, private firms face increasingly complex decisions regarding their capital raising strategies in various jurisdictions. In this new world, the invisible hand of the market, the

efficient market hypothesis[1] or the spontaneous order[2] resulting from decisions of investors and corporations operate as loose proxies for cross-border listings. Issuing securities and raising capital in a jurisdiction outside a state of domicile is no longer solely a business decision, it has become primarily a legal decision. When doing a probabilistic risk assessment, international corporations must consider regulatory risks, projected compliance costs, the risk of enforcement, and the corresponding changes in enforcement policies in light of the evolution of jurisprudence and statutory reforms. In the United States, foreign firms' decisions largely depend on the interplay between the Securities and Exchange Commission (SEC or Commission), the American watchdog of securities markets, and United States courts.

The Supreme Court, unquestionably one of the leading global policy setters, has already acknowledged the new economic realities of international markets, as Justice Breyer emphasized in "The Court and the World."[3] It appears that the SEC, on its part, has also been responsive to globalization. In the past fifteen years, the Commission engaged in a series of regulatory reforms and introduced extensive international cooperation programs with foreign regulators.[4] The Commission also serves as an international standard-setter, a voting member of the Steering Committee of the Financial Stability Board, and a longstanding member of the International Organization of Securities Commissions.[5]

More important from the perspective of American markets and investors is the reality that at home the SEC is overseeing the largest financial market in the world. A significant part of this market are about a thousand foreign corporations which are registered with the SEC and have access to U.S. investors.[6] The Commission sets the rules for their corporate reporting and enforces those rules to protect investors and ensure market efficiency and integrity.[7] The ascendant enforcement philosophy and the nuances of prosecutorial actions in response to statutory and case law developments thus become the variables at the forefront of international listings.

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[1] *See generally* Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014).

2 FRIEDRICH A. HAYEK, STUDIES IN PHILOSOPHY, POLITICS AND ECONOMICS 97 (1969).

[3] STEPHEN BREYER, THE COURT AND THE WORLD: AMERICAN LAW AND THE NEW GLOBAL REALITIES 119-24 (2015).

[4] *Infra* Part IV.

[5] *See* Financial Stability Board, Members of the Steering Committee, May 24, 2017, http://www.fsb.org/about/organisation-and-governance/members-of-the-steering-committee/; International Organization of Securities Commissions, https://www.iosco.org/.

[6] Securities and Exchange Commission, International Registered and Reporting Companies, https://www.sec.gov/divisions/corpfin/internatl/companies.shtml.

[7] 15 U.S.C. § 78c(f) (2015).

The breathtaking pace of international markets after the financial crisis of 2007-2008 demands that the Commission continuously recalibrate its regulations and enforcement. In the words of former Chair White, "[t]he SEC needs to find its precisely right place in that global market."[8] This Article examines what that right place should be in the enforcement of securities law against foreign corporations and how the Commission should respond to *Morrison v. National Australia Bank,* a crucial Supreme Court decision which has reduced the exposure of international corporations to the risk of investor class-action litigation in the U.S.[9]

This topic is increasingly well-timed and touches upon the ongoing political "battles," spanning what one can tentatively dub "regulation and enforcement versus deregulation and laissez faire." To give a few examples, in March 2017, a federal district court explicated a previously murky provision of the Dodd-Frank Act regarding the ability of the SEC to rely on a broad, essentially pre-*Morrison,* interpretation of the extraterritorial reach of securities law in enforcement actions against foreign defendants.[10] The decision was in favor of the Commission.

On the 5th of June, 2017, Justice Sotomayor delivered a unanimous opinion of the Court in *Kokesh v. SEC.*[11] The Court overruled the formerly ingrained position that disgorgement - a typical remedy sought by the SEC in district courts and in administrative proceedings - was an equitable remedy. The Supreme Court held that SEC disgorgement was a penalty and, hence, was subject to the five-year statute of limitations.[12] *Kokesh* may have wide-ranging ramifications for complex investigations, including enforcement actions involving cooperation with foreign regulators and international enforcement requests.[13] If the SEC shuns foreign investigations that appear too time-consuming to its staff, the exposure of international corporations to the liability risk in the U.S. may drop.

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[8] The Center for Strategic and International Studies, *The Future of the Securities and Exchange Commission in a Changing World* 19 (2015) (hereinafter "*The Future of the Securities and Exchange Commission*").

[9] Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869 (2010).

[10] SEC v. Traffic Monsoon, LLC, 2017 WL 1166333, at 11 (D. Utah, Mar. 28, 2017) ("The fact that the Supreme Court issued *Morrison* on the last day that the conference committee met to negotiate a reconciliation between the House and Senate bills, and five days before the final version of the bill was published, does not convincingly demonstrate that Congress had changed its mind about codifying the conduct and effects test.").

[11] Kokesh v. SEC, 2017 WL 2407471, at *9 (U.S. June 5, 2017).

[12] *Id.* at *8-10.

[13] For the consequences of *Kokesh, see, e.g.,* King&Spadling, *Reflections on* Kokesh v. SEC: *Potential Ramifications of SEC Disgorgement Being a Penalty*, Client Alert, June 14, 2017.

Finally, consider that the Commissioners approve SEC enforcement actions and that the Administration has nominated new Commissioners whose conservative bona fides are beyond question.[14] At the same time, on June 27, 2017, Chairman Clayton in his testimony to Congress requested a staggering $1.602 billion for the Commission's 2018 budget and highlighted that the SEC's priorities are, *inter alia*, enforcement and technological support of enforcement.[15] In the same month, on June 8, 2017, the House passed the Financial CHOICE Act,[16] which sought to undermine the mainstay of Dodd-Frank, that post-crisis epitome of capital market regulations.[17] This fight is hardly over.

These conflicting policy signals and case law developments may be confusing to foreign corporations seeking to tap American capital markets. Will the SEC become more conservative in its enforcement policies? Shall we expect a departure from the "Broken Windows" philosophy, an enforcement approach championed by Chair White to signal that the SEC should target all violations, large and small?[18] In his July 2017 speech, Chairman Clayton summarized several major SEC enforcement priorities.[19] This address and similar speeches largely omitted, however, the international enforcement perspective.[20] The question of finding an optimum approach to foreign issuer enforcement remains open.

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[14] *See, e.g.,* Dave Michaels, *White House to Nominate Hester Peirce as Republican SEC Commissioner*, THE WALL STREET JOURNAL, Jul. 18, 2017, https://www.wsj.com/articles/white-house-to-nominate-hester-peirce-as-republican-sec-commissioner-1500417225.

[15] Jay Clayton, *Testimony on the Fiscal Year 2018 Budget Request*, Jun. 27, 2017, https://www.sec.gov/news/testimony/testimony-fiscal-year-2018-budget-request.

[16] Jeff Cox, *House Passes Choice Act That Would Gut Dodd-Frank Banking Reforms*, CNBC, Jun 8, 2017, http://www.cnbc.com/2017/06/08/house-has-votes-to-pass-choice-act-that-would-gut-dodd-frank-banking-reforms.html.

[17] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 929P, 124 Stat. 1376, 1864 (codified in sections of 7 U.S.C., 12 U.S.C. and 15 U.S.C. (2015)).

[18] "[T]he Broken Windows policy presumes that aggressive action against infractions of all sizes… sends a broad message that deters others from violation the law." CENTER FOR CAPITAL MARKETS COMPETITIVENESS, EXAMINING THE U.S. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT: RECOMMENDATIONS ON CURRENT PROCESSES AND PRACTICES 5 (2015).

See also Mary Jo White, *Remarks at the Securities Enforcement Forum*, Oct. 9, 2013, https://www.sec.gov/news/speech/spch100913mjw (discussing the Broken Windows approach and observing that "[the] theory can be applied to our securities markets – minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines.").

[19] SEC Chairman Jay Clayton, Remarks at the Economic Club of New York, July 12, 2017, https://www.sec.gov/news/speech/remarks-economic-club-new-york.

[20] *See, e.g.,* Stephanie Avakian, Co-Director, Division of Enforcement, *The SEC Enforcement Division's Initiatives Regarding Retail Investor Protection and Cybersecurity*, Oct. 26, 2017, https://www.sec.gov/news/speech/speech-avakian-2017-10-26

This Article seeks to shed light on these policy questions by focusing on the following theoretical inquiries. The first inquiry is whether the SEC needs to take into account the recent changes in the judicial interpretation of the extraterritorial provisions of U.S. law *and* the developments in the class-action regime. In other words, how should the SEC respond to *Morrison* and its implications? If the Supreme Court in *Morrison* has created a risky enforcement lacuna on the side of private class actions against foreign corporations, should the SEC's response be necessary and inevitable? This first-order question dovetails with and explains the second inquiry regarding an optimum policy approach to enforcement of the U.S. securities laws against international issuers.

By seeking to answer these questions, the Article contributes to the salient longstanding debate about the relative merits of public and private enforcement of securities law. Numerous researchers weighed in on whether public enforcement and class-action litigation are complementarities or substitutes;[21] whether the U.S. "multienforcer" system is redundant;[22] which prong, public or private, is associated with a healthy capital market;[23] and how a liability regime may deter foreign companies from listing on American exchanges.[24] This Article presents relevant doctrinal, socioeconomic, institutional, and empirical arguments. To my knowledge, this paper presents the first empirical overview of the recent changes in enforcement against international companies.[25] The

[21] For new empirical data, see Stephen Choi & Adam C. Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison*, 13 JOURNAL OF EMPIRICAL LEGAL STUDIES 27 (2016) (hereinafter "SEC Investigations"). *See also* James Park, Cal L. Rev (2012).

[22] *See generally* Zachary D. Clopton, *Redundant Public-Private Enforcement,* 69 VAND. L. REV. 285 (2016); Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173 (2010); Howard M. Erichson, *Coattail Class Actions: Reflections on Microsoft, Tobacco, and the Mixing of Public and Private Lawyering in Mass Litigation*, 34 U.C. DAVIS L. REV. 1 (2000); Margaret H. Lemos & Max Minzner, *For-Profit Public Enforcement,* 127 HARV. L. REV 853 (2014); David Freeman Engstrom, *The Lost Origins of American Fair Employment Law: Regulatory Choice and the Making of Modern Civil Rights*, 1943-1972, 63 STAN. L. REV. 1071, 1073-74, 1081-82 (2011)

[23] The leading papers in the debate on public and private enforcement are Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-based Evidence*, 93 J. FIN. ECON. 207 (2009) & Rafael La Porta et al., *What Works in Securities Laws?,* 61 J. FINANCE 1 (2006). For further discussion, see *infra* Part II.

[24] *See generally* John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA L. REV. 229, 303–04 (2007); Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J. L. & PUB. POL'Y 1187, 1204–05 (2013) (emphasizing that "[s]ecurities class actions are… a serious problem for the attractiveness of the U.S. public capital markets.").

[25] The research covers only foreign private issuers. The term is defined in Rule 405 of the Securities Act (17 C.F.R. § 230.405 (2015)) and Exchange Act Rule 3b-4 (17 C.F.R. § 240.3b-

research will identify the dominant strategy for the SEC and suggest several policy adjustments necessitated by the recent doctrinal and economic developments.

The paper proceeds in seven parts. Part II summarizes theoretical arguments on enforcement and the role of the SEC. Part III examines the Commission's approach to enforcement against international corporations. Section (C) of Part III tracks enforcement actions against international firms five years before and five years after *Morrison,* between 2005 and 2016. The results suggest that enforcement has remained stable over the years.

Part IV explains this low-key enforcement approach and suggests that it is rational and inevitable. Overall, it is the *dominant* strategy for the Commission. Part V demonstrates, however, that the traditional enforcement philosophy may attract low-quality firms to American markets and raises a number of post-*Morrison* red flags associated with foreign listings. The remaining sections seek to reconcile the rationality of low-key enforcement with the realities and risks of post-*Morrison* cross-listings.

Part VI reviews the doctrinal implications of *Morrison* and concludes that, if necessary, the SEC has the capacity to act aggressively against foreign issuers. At the same time, the doctrinal ambiguity of *Morrison* should dampen the Commission's incentives to act. Part VII suggests solutions to these dilemmas. It argues that although the SEC needs to act in response to the red flags identified in this paper and that low-key enforcement and path dependence are no longer tolerable, the Commission should not strengthen prosecution *qua* prosecution. Instead, the post-*Morrison* trends call upon the Commission to design better tools for *preventive* monitoring. By focusing on *low-cost preventive* monitoring, the SEC should be able to maintain a certain level of fraud deterrence without actually ramping up enforcement and increasing the costs of both the SEC and the international companies considering listing in the United States. Part VIII concludes the paper.

II. THEORIES OF EFFICIENT ENFORCEMENT: CLASS ACTIONS AND PUBLIC ENFORCEMENT AGAINST INTERNATIONAL CORPORATIONS

In the context of international listings, the first-order line of analysis should focus on a bird's eye view on the social value, realities, and implications of having multiple enforcers such as the SEC and the plaintiffs' bar. The following discussion touches upon the following literatures: the potential

4(b) (2015)). The Article refers to foreign private issuers as "international companies," "international corporations," "foreign corporations" or "foreign issuers."

redundancy of this system and its possible efficiencies, such as filling the gaps in enforcement where private plaintiffs are unlikely to pursue certain types of cases. What is the place of *Morrison* in this debate?

A. Morrison *and Its Implications*

The Supreme Court in *Morrison* sought to limit the extraterritorial reach of the antifraud provisions of securities law and to rein in global class actions against international corporations. The decision has restricted the ability of private plaintiffs to bring actions against foreign companies under the key antifraud provisions of the U.S. securities laws, including section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder, as well as sections 11 and 12(a)(2) of the Securities Act.[26] After *Morrison,* a foreign issuer no longer faces the same uncertainty and risk of investor class-action litigation in connection with its decision to enter U.S. capital markets.[27]

In the name of a faithful reading of the statute and of certainty, the majority in *Morrison* rejected the long-established "conduct test" and the "effects test" of a half a century of Second Circuit jurisprudence.[28] The Second Circuit's tests were laid out primarily by the legendary Judge Henry Friendly.[29] The old jurisdictional approach was painted with broad strokes. It guided courts to inquire if the culpable conduct took place in the United States and caused harm to investors, *viz., all* investors, including in some cases foreign plaintiffs. This test was dubbed the "conduct" test. Under the second test, the detrimental "effects" of a foreign defendant's activity upon U.S. investors or upon American markets and exchanges allowed federal courts to exercise jurisdiction over the actions.[30]

This "judicial oak [of section 10(b)] which has grown from little more than a legislative acorn"[31] was mercilessly pruned by the late Justice Scalia. The Court observed, *inter alia*, that:

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[26] 15 U.S.C. § 78j(b) (2010); 17 C.F.R. § 240.10b-5 (2010); 15 U.S.C. § 77k (1995); 15 U.S.C. § 77*l*(a)(2) (1995).

[27] *See, e.g.,* Yuliya Guseva, *Extraterritoriality of Securities law Redux: Litigation Five Years after Morrison v. National Australia Bank*, 2017 COL. BUS. L. REV. 101, 150-51.

[28] *Morrison*, 561 U.S. at 253.

[29] *See generally* Merritt B. Fox, *Securities Class Actions against Foreign Issuers*, 64 STAN. L. REV. 1173, 1233-63 (2012) (comparing the old tests with the new test).

[30] *See* SECURITIES AND EXCHANGE COMMISSION, STUDY ON THE CROSS-BORDER SCOPE OF THE PRIVATE RIGHT OF ACTION UNDER SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934 ii (2012), https://www.sec.gov/news/studies/2012/929y-study-cross-border-private-rights.pdf (hereinafter "2012 SEC Study").

[31] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).

> The concurrence seemingly believes that the Courts of Appeals have carefully trimmed and sculpted this "judicial oak" into a cohesive canopy, under the watchful eye of Judge Henry Friendly, the "master arborist." Even if one thinks that the "conduct" and "effects" tests are numbered among Judge Friendly's many fine contributions to the law, his successors, though perhaps under the impression that they nurture the same mighty oak, are in reality tending each its own botanically distinct tree.[32]

The Court cogitated about its new approach along the lines of the leading academics' conclusions regarding the considerable uncertainty of the old tests and their inconsistent application.[33] The *Morrison* Court shifted the emphasis of an inquiry from the conduct of foreign defendants or the effects of their actions to purchases and sales of securities.[34] For this reason, the new approach circumscribes the reach of section 10(b) of the Exchange Act within the realm of "domestic" transactions and listed securities.[35]

An appurtenant motivation behind the decision was the global ramifications of unrestrained cross-border litigation implicating international capital markets and deterring foreign companies from listing on U.S. exchanges. Echoing academic commentators,[36] Justice Scalia quipped that:

> While there is no reason to believe that the United States has become the Barbary Coast for those perpetrating frauds on foreign securities markets, some fear that it has become the Shangri-La of class-

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[32] *Morrison*, 561 U.S. at 260, n. 4 (2010) (citations omitted).

[33] Fox (2012), *supra* note___, at 1184 (observing that "[c]ompared to restoring the conduct/effects test, using the Morrison test would reduce confusion and likely lead to more consistent court decision-making," but generally proposing an alternative test); BREYER, THE COURT AND THE WORLD, *supra* note___, at 123-24 (emphasizing that a need for a "more definite" territorial scope of the statute was recognized by the Court); Coffee, *Law and the Market, supra* note___, at 303-04; Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM J. TRANSNAT'L L. 14, 67 (2007); Stephen J. Choi & Linda J. Silberman, *Transnational Litigation and Global Securities Class Action Lawsuits*, 2009 WIS. L. REV. 465, 467, 489-90, 506; Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Regulation*, 17 NW. J. INT'L L. & BUS. 207, 228-29 (1996).

[34] *Morrison*, 561 U.S. at 266 ("Section 10(b) does not punish deceptive conduct, but only deceptive conduct 'in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered.'" (citations omitted)).

[35] *Id.* at 267 ("And it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies").

[36] Buxbaum, *Multinational Class Actions*, *supra* note___, at 16-18, 29-34, 62; Coffee, *Law and the Market, supra* note___, at 303–04.

> action litigation for lawyers representing those allegedly cheated in foreign securities markets.[37]

In summary, courts have deliberately narrowed down the application of the securities laws to only those transactions which involve securities listed on U.S. exchanges and "domestic" transactions, in which either the title to the securities at issue passes in the U.S. or parties incur "irrevocable liability" to execute a securities transaction within the U.S.[38] Courts have also extended the application of *Morrison* from actions brought under section 10(b) and Rule 10b-5 to sections 11 and 12(a)(2) of the Securities Act.[39] As a result, there is a new status quo in private litigation against international companies. This begs the question whether the SEC should recalibrate its policies taking *Morrison* into account.

B. Public and Private Enforcers

The first normative question is whether SEC enforcement would serve capital markets better than the extensive class-action litigation of the pre-*Morrison* kind. Researchers typically disagree on which enforcement prong – private or public - is more efficient[40] and which one fosters a healthy securities

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[37] *Morrison*, 561 U.S. at 264-65.

[38] *See, e.g.,* United States v. Vilar, 729 F.3d 62, 76-77 (2d Cir. 2013); United States v. Mandell, 752 F.3d 544, 548 (2d Cir. 2014); Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310 (11th Cir. 2011); United States v. Georgiou, 777 F.3d 125, 135–37 (3d Cir. 2015); Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 69 (2d Cir.2012); SEC v. Levine, 462 Fed.Appx. 717, 719 (9th Cir.2011); United States v. Isaacson, 752 F.3d 1291, 1300 (11th Cir.2014).

[39] *Morrison,* 561 U.S. at 268 ("The same focus on domestic transactions is evident in the Securities Act"); In re Smart Techs., Inc. S'holder Litig., 295 F.R.D. 50, 56 (S.D.N.Y. 2013).

[40] On the theories of efficient enforcement, *see generally* Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance and Compensation of Enforcers*, 3 J. LEGAL STUD. 1 (1974); Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 JOURNAL OF POLITICAL ECONOMY 169 (1968); William M. Landes & Richard A. Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1 (1975); A. Mitchell Polinsky, *Private versus Public Enforcement of Fines*, 9 J. LEGAL STUD. 105, 120-21 (1980). On the public enforcement benefits, *see, e.g.,* David Freeman Engstrom, *Agencies as Litigation Gatekeepers,* 123 YALE L. J. 616, 626-30 & 632 (2013) (discussing information processing, economies of scale and other advantages of public enforcement and observing that "[i]n theory, at least, public enforcement is a more efficient means of achieving optimal deterrence of undesirable conduct," citing Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 200 (1968)). *See also* Richard B. Stewart & Cass R. Sunstein, *Public Programs and Private Rights*, 95 HARV. L. REV. 1193, 1298 (1982). On the relative merits of private enforcement, *see, e.g.,* John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 226-27 (1983); (suggesting that "private enforcement may be able to mobilize and reallocate its resources more quickly than the public enforcer . . . " and

market. A series of famous papers, written mainly between 1998 and 2008 and often referred to as the "LLSV," "Law and Finance," and "Legal Origins Theory," identified the common law legal system, robust investor protection rules, and private enforcement as crucial factors spurring the growth of capital markets.[41] In an influential 2009 rebuttal, Jackson and Roe refuted at least one conclusion by suggesting that disclosure rules and public enforcement are more impactful variables.[42] That titanic debate inspired a host of research papers on the topic.[43]

Some papers, for instance, suggest that the inherent value of public enforcement is that it "level[s] the playing field for small firms who struggle for adequate access to equity capital."[44] If public enforcement is robust, smaller firms more easily gain access to capital markets.[45] Private enforcement does not produce the same equalizing effect.[46] Researchers also argue that regulatory oversight is associated with better compliance and fewer restatements of financial reports.[47]

Empirical studies aside, the comparative benefits of public enforcement are often explored by unearthing the imperfections in private actions. For instance, enforcement agencies may have an institutional ability to fill the "gaps" left by private enforcers.[48] They also may administer penalties without distorting the original legislative intent and without producing precedents conflicting with the panoramic regulatory philosophy. Private plaintiffs, by contrast, lack a

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that private plaintiff "performs an important failsafe function by ensuring that legal norms are not wholly dependent on the current attitudes of public enforcers"); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 342 (2013); Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 GA. L. REV. 63, 99 (2008) (arguing that private actions "guard against" SEC inaction and counterbalance "lackluster governmental incentives").

[41] *See generally* La Porta et al. (2006), *supra* note___.

[42] Jackson & Roe (2009), *supra* note___.

[43] *See, e.g.,* Coffee, *Law and the Market, supra* note___, at 245-55.; John Echeverri-Gent & Benjamin Bloom, *Do Competitive Politics Produce Competitive Markets? Politics of Financial Market Development,* APSA Annual Meeting (2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1644631. For a review of the literature, *see* Howell E. Jackson & Jeffery Y. Zhang, *Private and Public Enforcement of Securities Regulation, in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (2015).

[44] Douglas Cumming et al., *Firm Size and the Impact of Securities Regulation*, 43(2) J. COMP. ECON. 417 (2015).

[45] Cumming et al., *Firm Size, supra* note___.

[46] *Id.*

[47] *See, e.g.,* Tim Lohse et al., *Public Enforcement of Securities Market Rules: Resource-based Evidence from the Securities Exchange Commission,* 106 J. ECON. BEHAV. & ORG. 197 (2014); Terrence Blackburne, *Regulatory Oversight and Reporting Incentives: Evidence from SEC Budget Allocations* (2014) (manuscript).

[48] This is but one aspect of redundancy as systemic reliability. Clopton, *Redundant Enforcement, supra* note ___, at 307-308, n. 144.

synoptic perspective and fidelity to the underlying regulatory objectives.[49] A related argument is the expertise of the agencies vis-à-vis the private plaintiffs' bar and generalist courts.[50]

There is also considerable scholarship on the disparate incentives of public and private enforcers. For one, private parties are more prone to bring non-meritorious suits, i.e., cases that have little social value and fail to enhance social welfare.[51] Another argument lies in the preoccupation of the plaintiffs' bar with maximizing their profits[52] and building up cases which are more likely than not to survive a motion to dismiss. A successful dismissal motion counts as a procedural victory associated with settlements.[53] This "cherry-picking" of actions with a high projected success rate may lead to a suboptimal level of enforcement.

The "cherry-picking" stratagems are grounded in the current statutory system and procedural rules.[54] Since plaintiffs' law firms bear the costs of a

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[49] *See, e.g.,* Engstrom, *Agencies*, *supra* note___, at 639, n. 74 (discussing the lack of judicial expertise arguments that may lead to systematically imperfect decisions); Richard A. Nagareda, *Class Actions in the Administrative State: Kalven and Rosenfield Revisited*, 75 U. CHI. L. REV. 603, 606 (2008) (discussing nonenfocement and policy priorities); David Freeman Engstrom, *Private Enforcement's Pathways: Lessons from Qui Tam Litigation*, 114 COL. L. REV. 1913 (2014); Pamela H. Bucy, *Private Justice*, 76 S. CAL. L. REV. 1, 66 (2002) (examining environmental law and observing that "incompetent, overworked, or inexperienced private counsel, whose interests may diverge from the public interest, may be generating case precedent that restricts government regulators."); Cass R. Sunstein & Adrian Vermeule, *Interpretation and Institutions*, 101 MICH. L. REV. 885, 928 (2003) (observing that "agencies are likely to be in a better position to decide whether departures from the text actually make sense" or "unsettle the statutory scheme"). *Compare* Coffee, *Rescuing, supra* note___, at 227.

[50] *See generally* Engstrom, *Agencies, supra* note ___, at 639 & 664.

[51] Warren F. Schwartz & C. Frederick Beckner III, *Toward a Theory of the "Meritorious Case": Legal Uncertainty as a Social Choice Problem*, 6 GEO. MASON L. REV. 801, 803 (1998) (discussing this view of "merits"). *See also infra* note ___ and accompanying text; Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlement in Securities Class Actions*, 43 STAN. L. REV. 497 (1991). For a critique of the litigation system and a historical account of the private right of action, *see, e.g.*, Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5,* 108 COLUM. L. REV. 1301, 1307-15 (2008); Rose, *Securities Fraud Deterrence, supra* note___, at 2200-01.

[52] On the different incentive structures of public and private enforcers, *see, e.g.,* William B. Rubenstein, *On What a "Private Attorney General" Is—And Why It Matters,* 57 VAND. L. REV. 2129, 2151 (2004); Lemos & Minzner, *For-Profit Public Enforcement*, *supra* note___.

[53] A.C. Pritchard and Hillary Sale, *What Counts as Fraud? An Empirical Study of Motions to Dismiss Under the Private Securities Litigation Reform Act*, 2 J. OF EMPIRICAL LEG. STUD. 125, 128 (2005).

[54] *Id.*; James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 743-44 (2003) (underscoring that "numerous regulatory provisions of the securities laws create problems that prevent the meaningful pursuit of violations by private plaintiffs" and

lawsuit,[55] attorneys are naturally incentivized to invest in only potentially successful cases.[56] In the first place, plaintiffs' lawyers must ensure that their complaints pass muster with the court under the Private Securities Litigation Reform Act, which stays discovery pending a ruling on a motion to dismiss.[57]

In complaints, plaintiffs must plead certain elements of the cause of action under Section 10(b) and Rule 10b-5, including untrue statements of a material fact, scienter, loss causation, reliance, and others.[58] Some elements, such as scienter, have to be pleaded with particularity;[59] others, such as loss causation, require compliance with ordinary pleading rules.[60] As the Supreme Court in *Dura Pharmaceuticals* emphasized, however, even under the ordinary pleading rules "a plaintiff who has suffered an economic loss [need] to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind."[61]

Plaintiffs also need to show reliance, which is another element of the cause of action under section 10(b).[62] Three years ago, the Supreme Court reaffirmed its long-standing holding in *Basic v. Levinson.* As the Court stated in *Halliburton,* if a securities market is efficient, an "investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price" and only needs to show, *inter alia*, that "misrepresentations were publicly known" and material, and the plaintiff traded the stock.[63]

These procedural hurdles limit the profitable range of class actions. For example, it should be incomparably easier for plaintiffs' attorneys to show reliance "on the integrity" of the market price where securities are traded on

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that "the loss… may not rise to a sufficient level to attract the interest of the entrepreneurial plaintiffs' attorney").

[55] *See, e.g.,* James Bohn & Stephen Choi, *Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions*, 144 U. PA. L. REV. 903, 925–26 (1996) (commenting that "plaintiffs' attorneys must invest substantial amounts of effort in examining the merits of a case before drafting a complaint. Such a process requires substantial care due to the large up-front costs plaintiffs' attorneys incur in pursuing a securities case on a contingent-fee basis.").

[56] In this sense, "the attorney acts less as an agent and more as a principal," which is the essence of "entrepreneurial litigation." John C. Coffee, Jr., *The Globalization of Entrepreneurial Litigation: Law, Culture, and Incentives*, 165 UNIV. PENN. L. REV. 1895, 1897 (2017).

[57] *Id.;* Pritchard & Sale, *supra* note___.

[58] 15 U.S.C. § 78u–4(b) (2010).

[59] *See, e.g.,* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 318-25 (2007).

[60] Not all circuits are in agreement regarding the standards. *See, e.g.,* Lormand v. U.S. Unwired Inc., 565 F.3d 228 (2009). *Cf.* Teachers' Retirement System of Louisiana v. Hunter, 477 F.3d 162 (4th Cir. 2007).

[61] Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 347 (2005).

[62] Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2409–11, 2413-14 (2014).

[63] *Id.* (citing Basic Inc. v. Levinson, 485 U.S. 224(1988)).

efficient national exchanges as opposed to over-the-counter platforms. Attorneys can more easily find listed issuers' misleading reports, which are filed with the SEC, effortlessly track share prices on the New York Stock Exchange (NYSE) or Nasdaq, and have experts run event studies to identify a corresponding market reaction and a statistically significant abnormal return around a public announcement by the defendant. Other cases may be rationally ignored absent a "smoking gun" or a compelling justification to bring an action.

Class actions against domestic and foreign issuers share these procedural and case-selection characteristics. In foreign issuer litigation, "U.S. plaintiffs' bar performs its expected role in the presence of actionable events to hold foreign firms accountable."[64] Accounting restatements, missing forecasts, and share price drops are the typical triggers searched for by attorneys.[65] Corporate reports containing untrue statements of material facts or material omissions actuate most antifraud lawsuits[66] and predetermine attorneys' behavior.

C. Private Litigation against International Issuers

There are three additional factors that may dampen attorneys' incentives to bring class actions against foreign firms. One difference between domestic and foreign enforcement realities stems from the additional tools that foreign companies may resort to in order to minimize their litigation risk. Namely, when a firm is less "visible" or has a smaller presence in U.S. markets, its law-related risks may be systematically lower. The factors associated with an increased risk of litigation include, *inter alia,* the size of a firm; the likelihood of higher damage awards; poor stock performance; high share turnover and volatility, explained by the rule that damages are "an increasing function of the number of shares that

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[64] Beiting Cheng et al., *Securities Litigation Risk for Foreign Companies Listed in the U.S*. 30 (Harvard Business School, Working Paper Jun. 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2163864.

[65] *Id*.

[66] *See, e.g.,* Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions,* 67 STAN. L. REV. 331, 393-94 (2015) (observing that "the most lucrative and successful class actions are those associated with restatements and accounting irregularities" and that "private securities litigation targets only one type of securities violation – accounting fraud"); SECURITIES AND EXCHANGE COMMISSION, INFORMAL AND OTHER PROCEDURES § 202.5 (2017) (listing investigation triggers considered by the staff). *See also* Cheng et al., *supra* note___; Pritchard & Sale, *supra* note___. *See also* Stephen J. Choi*, Do the Merits Matter Less After the Private Securities Litigation Reform Act?,* 23 J.L. ECON. & ORG. 598, 598 (2006).

trade at misleading prices;"[67] having more assets located in the U.S.;[68] and listing on U.S. exchanges.[69] In sum, these factors are mostly related to exchange-trading *and* asset location. The first helps attorneys identify and adequately plead a violation, while the second is related to the enforcement of judgments.

An international corporation may more easily maneuver around these risks than a domestic company. For example, a foreign firm may keep its listing on a foreign exchange, delist from a U.S. exchange, deregister its securities with the SEC, terminate its reporting obligations, and move trading of U.S. securities to an over-the-counter (OTC) platform.[70] Recall that that indicia of fraud are teased out from a combination of corporate reports filed with the SEC, accounting restatements, and sharp share price drops following trading on efficient national exchanges. Accordingly, private plaintiffs could purposely avoid less "visible" defendants and focus on large international corporations with securities listed on efficient national exchanges.[71]

These case-selection strategies dovetail with unique *transaction costs*. This is the *second* difference between class-action litigation against domestic and foreign issuers. Consider that the likelihood of fraud and the firms' "propensity… to follow the rules with regard to accounting data is a function of their home environment"[72] and that not all countries equally ensure transparency and

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[67] Amar Gande & Darius P. Miller, *Why Do U.S. Securities Laws Matter to Non-U.S. Firms? Evidence from Private Class-Action Lawsuits* 13 (Apr. 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1939059).

[68] Gande & Miller, *supra* note___, at 11, 13, 16-17, 30. The authors also find that inadequate legal protection of minority shareholders in the country of domicile increases the likelihood of litigation. *Cf*. Cheng et al. *supra* note___; Siegel (2005), *infra* note___; W. A. J. Reese & M. S. Weisbach, *Protection Of Minority Shareholder Interests, Cross-Listings in the United States, and Subsequent Equity Offerings*, 66 J. FIN. ECON. 65 (2002); Craig Doidge, et al., *Why Are Foreign Firms Listed in the U.S. Worth More?*, 71 J. FIN. ECON. 205, 210 & 215 (2004).

[69] Guseva (2017), *supra* note___.

[70] On the mechanics of desilting and switching to OTC trading, *see, e.g.,* DEUTSCHE BANK, FOREIGN PRIVATE ISSUER DELISTING AND DEREGISTRATION 8-10 (Aug. 2014), https://www.adr.db.com/drweb/public/en/docs/Whitepaper-Foreign_Private_Issuer_Delisting_and_Deregistration.pdf. *See also* C.F.R. 240.12h-6 (2011).

[71] Thus, a foreign company deliberately opting for non-exchange-traded securities will face less exposure to liability under sections 11 and 12(a)(2) of the Securities Act and to fraud-on-the-market class actions under section 10(b) of the Exchange Act. Guseva (2017), *supra* note___.

[72] Audra L. Boone et al., *The Information Environment of Cross-Listed Firms: Evidence from the Supply and Demand of SEC Filings* 2 (2015), https://www.business.uq.edu.au/sites/default/files/events/files/cross-listing-disclosures-may-2015.pdf. *See also* Rose, *Securities Fraud Deterrence, supra* note___, at 2182 (observing that the likelihood of fraud depends, inter alia, on "the mores of a nation's business and financial community…, as well as the size and structure of a nation's securities markets").

investor protection.[73] Even though issuers from countries with inadequate investor protection, reporting rules, and judicial systems, as well as investors in their securities, would benefit from more rigorous monitoring and prosecution in the U.S., profit-chasing plaintiffs' attorneys may strategically avoid those cases.[74]

For one, working with foreign courts, for instance, seeking assistance with discovery or enforcement of judgments, may be unfeasible and costly. Secondly, an attorney may not have the expertise to parse financial statements and corporate reports filed by an issuer with foreign authorities and to identify misleading statements of material facts or omissions. Hence, a private enforcer anticipates that she may not amass sufficient evidence to bring a successful action without additional investment and, for example, retaining local experts.

Thirdly, the attorney should account for the probability that after spending considerable resources on building up a case, discovery, and litigation, she might be unable to enforce a judgment rendered by a U.S. court. Some, albeit not many, foreign jurisdictions are hostile to the U.S. opt-out-class-action regime, while in others recognition proceedings entail unique transaction costs either because of local judicial inefficiencies and the absence of equivalent local procedures, or on procedural grounds.[75] In short, there are additional reasons to expect that the plaintiffs' costs of litigation against international corporations may exceed comparable litigation costs in domestic cases. The higher expected transaction costs and uncertainties should reduce the incentives of attorneys to proceed against international corporations.[76]

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[73] *See, e.g.,* La Porta et al. (2006), *supra* note___.

[74] On the conflicting findings on the likelihood of litigation and local law, *see supra* note 63. *See also* Cheng et al., *supra* note___, at 30 (suggesting "that factors that increase the costs to pursue litigation against firms in foreign countries lower the rate of lawsuits against foreign companies listed in the U.S.").

[75] *See, e.g.,* Zachary D. Clopton, *Transnational Class Actions in the Shadow of Preclusion*, 90 IND. L.J. 1387 (2015); Kevin M. Clermont, *Solving the Puzzle of Transnational Class Actions,* 90 Ind. L. J. 69 (2015); Richard Fentiman, *Recognition, Enforcement and Collective Judgments*, in CROSS-BORDER CLASS ACTIONS: THE EUROPEAN WAY 85 (Arnaud Nuyts & Nikitas E. Hatzimihail eds., 2014); Antonio Gidi, *The Recognition of U.S. Class Action Judgments Abroad: The Case of Latin America,* 37 BROOK. J. INT'L L. 893 (2012); Mark Stiggelbout, *The Recognition in England and Wales of United States Judgments in Class Actions,* 52 HAR. J. INT'L L. 433 (2011); Samuel P. Baumgartner, *Understanding the Obstacles to the Recognition and Enforcement of U.S. Judgments Abroad,* 44 N.Y.U. J. INT'L L. & Pol. (2013).

[76] Cheng et al., *supra* note___, at 32 (suggesting that "[f]irms in countries that are farther from the U.S., those that have weaker judicial efficiency in the home country or from countries with a weaker track record of prior U.S. acquisitions are less likely to be targeted by plaintiff investors and attorneys. This suggests that factors that increase the costs to pursue litigation against firms in foreign countries lower the rate of lawsuits against foreign companies listed in the U.S.")

The *third* difference is that *Morrison* has reduced the "return" on private attorneys' efforts. My previous research suggests that the mean and median post-*Morrison* settlements have shrunk. So has a typical plaintiff class.[77] Admittedly, as Professor Coffee observed in his recent article, entrepreneurial American law firms are seeking ways to bring suits in foreign jurisdictions. Often, they do that after a parallel action in the U.S. and "obtaining discovery in the U.S. under the more liberal U.S. rules and utilizing it in the later … action."[78] Uncertainties abound, however, since shareholder class actions and claim aggregation are still in their infancy in most countries around the globe.[79] In any case, *Morrison* should change the profitability of domestic litigation and, consequently, modify the behavior of domestic law firms in U.S. courts. A plaintiffs' attorney must take into account that her payout is *a priori* lower after *Morrison* because a projected settlement, which is often the only plausible finale of a class action complaint that survives a motion to dismiss, has declined. Obviously, there is not a commensurate decrease in the average costs of bringing a successful suit. Furthermore, international litigation raises additional transaction costs associated with the issuer "visibility," the initial complaint filing, discovery, and enforcement of judgments.

Cross-border class actions essentially represent a modification to Landes and Posner's "overenforcement theorem." The overenforcement theorem postulates that "all laws would be enforced that yielded a positive expected net return" on private enforcers' investment in litigation.[80] It appears that in class actions against foreign issuers, the overenforcement theorem should hold in the case of larger and more visible companies from jurisdictions where discovery and enforcement are more cost-efficient.

A systematic "fissure" in enforcement may thus be created as more "visible" listed issuers would suffer from excessive plaintiff monitoring and "strike" suits, while others would routinely slip through the cracks in the civil liability machinery and the victims of their fraud could be undercompensated on average.[81] In this scenario, public enforcement *may* compensate "defrauded investors in cases where private litigation is not serving its compensatory

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[77] Guseva (2017), *supra* note___.

[78] Coffee, *The Globalization of Entrepreneurial Litigation, supra* note___, at 1914. *See also id.* at 1904-06, 1910 & 1922.

[79] *See, e.g., id.* at 1918, 1922-23 (discussing some relevant policy arguments).

[80] Landes & Posner, *Private Enforcement*, *supra* note___, at 38.

[81] For instance, the principal benefits of antifraud liability, such as victim compensation, would become crucial in the case of smaller firms where the price impact of fraud may be less observable. Jeff Schwartz, *The Law and Economics of Scaled Equity Market Regulation*, 39 J. CORP. L. 347, 377 (2014).

function."[82] Enforcement agencies *may* also improve compliance by an average foreign corporation and control opportunism and expropriation.[83] When a regulator operates as a "gap-filler," it transcends a purely Blackstonian distinction between public wrongs and private civil injuries.[84] It performs both functions.[85]

Serving as a "gap-filler" is not limited to providing compensation to defrauded investors. The SEC has a second priority - market efficiency. The SEC's mandate is to stand sentinel protecting investors and, at the same time, to guard "fair, orderly, and efficient markets, and facilitate capital formation."[86] In the following Parts, I proceed to explore how the SEC performs on that score, whether it operates as a meaningful "gap-filler," and if *Morrison* has affected its approach to cross-border enforcement.

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[82] *See* Velikonja (2015), *supra* note___, at 394.

[83] Jackson & Roe (2009), *supra* note___; Roger Silvers, *The Valuation Impact of SEC Enforcement Actions on Nontarget Foreign Firms*, 54 JOURNAL OF ACCOUNTING RESEARCH 187 (2016) (suggesting that SEC enforcement constrains expropriation in foreign firms). The common presumption in securities law is that "the efficacy of legal enforcement in promoting non-opportunistic behavior hinges on public authorities that investigate breaches and mete out punishment and a civil liability system that awards damages." Amir N. Licht et al., *What Makes the Bonding Stick? A Natural Experiment Involving the U.S. Supreme Court and Cross-Listed Firms* 3, Harvard Business School Strategy Unit Working Paper No. 11-072 (2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1744905.

[84] WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND, Book IV, Chapter 1 (1765-69) ("The distinction of public wrongs from private, of crimes and misdemeanours from civil injuries, seems principally to consist in this: that private, or civil injuries, are an infringement or privation of the civil rights which belong to individuals, considered merely as individuals; wrongs, or crime and misdemeanours, are a breach and violation of the public rights and duties, due to the whole community, considered as community, in its social aggregate capacity.").

[85] *See, e.g.,* Clopton, *Redundant Enforcement, supra* note___, at 291; Prentiss Cox, *Public Enforcement Compensation and Private Rights,* 100 MINN L. REV. 2313, 2380 (2016); Amanda M. Rose, *Designing an Efficient Securities-Fraud Deterrence Regime* in PROSPERITY UNLEASHED: SMARTER FINANCIAL REGULATION 256 (2017) ("[C]ivil penalties can be thought of as those meant to "price" behavior, whereas criminal penalties can be thought of as those meant to "sanction" behavior"); Lemos & Minzner, *For-Profit Public Enforcement*, *supra* note___.

A germane example of these prosecutorial and compensatory functions of the SEC is the Fair Funds provisions of Sarbanes-Oxley and Dodd-Frank. 15 U.S.C. § 7246(a) (2010). The statutes have allowed distribution of disgorged profits and civil penalties collected by the SEC to private investors. *See, e.g.,* Cox, *Public Enforcement Compensation, supra* note___, at 2320-21 (discussing the "Fair Funds"). Through the Fair Funds programs, recoveries may be distributed to private parties even in cases of ongoing private class actions. Clopton, *Redundant Enforcement, supra* note___, at 297 & 303; Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors,* 60 FLA. L. REV. 1103, 1103–44 (2008).

[86] SECURITIES AND EXCHANGE COMMISSION, STRATEGIC PLAN, FISCAL YEARS 2014-2018 3 (2013), https://www.sec.gov/about/sec-strategic-plan-2014-2018.pdf.

III. REALITIES OF ENFORCEMENT AGAINST FOREIGN ISSUERS: AN EMPIRICAL INQUIRY

A. The Traditional Enforcement Approach

Previous research suggests that the SEC *may* serve as a "gap-filler" by targeting defendants that private enforcers ignore, such as firms with lower market capitalization, firms in financial distress, and minor infractions.[87] At the same time, the Commission has traditionally focused on domestic rather than international companies and thus must have relied heavily on the efforts of the plaintiffs' bar to ferret out international fraudsters.

The two major comprehensive studies on enforcement against international issuers, by Shnitser and Siegel, suggested that the SEC had commenced fewer meaningful actions against foreign issuers than against domestic firms.[88] An interesting recent case study by Erica Gorga also documented how the private plaintiffs' bar promptly acted in the case of speculative trading by large Brazilian corporations, while the SEC, in contrast to the Brazilian regulator, failed to take action.[89]

This policy preference is self-explanatory in many contexts inasmuch as "American law relies upon private litigants to enforce substantive provisions of law that in other legal systems are left largely to the discretion of public enforcement agencies."[90] Unfortunately, in the international regulatory context, this reliance on private plaintiffs coincides with the discussed in Part II systematic "fissures" in private enforcement.

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[87] *See, e.g.,* Natalya Shnitser, *A Free Pass for Foreign Firms? An Assessment of SEC and Private Enforcement Against Foreign Issuers*, 119 YALE L. J. 1638, 1660–84, 1693 (2010); James D. Cox, *Securities Class Actions as Public Law*, 160 U. PA. L. REV. PENNUMBRA 73, 80-81 (2011); Cox et al., *SEC Enforcement Heuristics, supra* note___, at 764; James D. Cox & Randall S. Thomas, *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?,* 80 NOTRE DAME L. REV. 893, 901-02 (2005). *Cf.* Choi & Pritchard, *SEC Investigations*, *supra* note___, at 36.

[88] Shnitser, *A Free Pass for Foreign Firms, supra* note___, at 1675-84; Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?*, 75 J. FIN. ECON. 319, 342, 349 (2005) (observing that "the SEC had taken few enforcement actions against cross-listed foreign firms during 1934–2002" and "that the SEC has not been able and/or willing to be the world's governance enforcement agency").

[89] Erica Gorga, *Is U.S. Law Enforcement Stronger than That of a Developing Country? The Case of Securities Fraud by Brazilian Corporations and Lessons for the Private and Public Enforcement Debate*, 54 COLUM. J. TRANSNAT'L L. 603 (2016).

[90] John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 669 (1986).

Admittedly, SEC enforcement has dramatically increased,[91] and the market takes notice of the most notorious actions against international corporations.[92] However, despite the well-documented "aggressiveness" of the SEC vis-à-vis its foreign homologues,[93] foreign issuers listing in the United States do not face the prosecutorial wrath comparable to that faced by domestic issuers. In addition, foreign firms also enjoy lower costs of reporting and compliance due to a more permissive regulatory approach taken by the SEC in the past fifteen years.[94]

B. Reporting Flaws

This Article is the first attempt to analyze recent changes in SEC enforcement around the *Morrison* decision.[95] Recall that *Morrison* effectively targeted private actions against foreign defendants and reduced their risk of civil liability.

Changing enforcement tack may be subtle and difficult to identify compared to an interplay between statutory actions and their corresponding implementation through regulations.[96] As required by the Administrative Procedure Act, for instance, the agency rulemaking is transparent.[97] It begins with

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[91] Silvers (2016), *The Valuation Impact*, *supra* note___.

[92] *See, e.g.,* Karolyi (2006), *supra* note___, at 17 (citing studies suggesting "that, though the numbers of actions are few, some of the cases have been important and noticed… and that the numbers are biased downward by the many cases settled out of court.").

[93] *See, e.g.,* Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253, 283 (2007); Coffee, *Law and the Market, supra* note___, at 272; John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 729 (2009).

[94] To give a few examples, the reforms introduced simplified disclosure forms for foreign firms, exempted them from Regulation FD, allowed filing of financial statements prepared in accordance with International Financial Reporting Standards as opposed to U.S. GAAP, amended Rule 12h-6, allowed suspension of reporting obligations immediately upon filing of Form 15F, and introduced some exemptions from Regulation G and Sarbanes-Oxley. For a overview of the regulations, *see* Guseva (2017), *supra* note___, at 207-13. *See also* Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1077 (noting that "there are two very distinct tiers of investor protection in the United States: a more rigorous standard for domestic companies and a less rigorous one for foreign companies").

[95] Shnitser and Siegel do not examine cases filed after 2008. *Supra* note___.

[96] For example, the SEC meticulously documents Dodd-Frank rules and adopting releases. *See* Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act — Pending Action, https://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml.

[97] *See* 5 U.S.C. § 553 (2015); Steven P. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 98 COLUM. L. REV. 1, 106-09 (1998); Lisa Schultz Bressman, *Beyond*

either a concept release seeking public input on the most complex issues or a rule proposal published for notice and public comment in the Federal Register and on the SEC's webpage and completes with the rule adoption.[98] The legislature's actions and the resultant reactions of the regulators are thus easily identifiable to a researcher while market participants are fully informed of the reform and have sufficient time to adjust to its implications.

When it comes to changes in enforcement trends, however, it takes time to determine explicit patterns and well-calibrated reactions.[99] Moreover, the Commission's stance on prosecution is not always clear and may be misleading to the court of public opinion. Consider as examples a spike in enforcement actions and the increased budget of the SEC and its Division of Enforcement in recent years.[100] In its November 2016 Agency Financial Report, the SEC announced that it "continued to build an impressive record of cases that spanned

Accountability: Arbitrariness and Legitimacy in the Administrative State, 78 N.Y.U. L. REV. 461, 541-44 (2003).

[98] In adopting releases, the Commission typically conducts a cost-benefit analysis, addresses public comments and either modifies the proposed rule accordingly or attempts to provide cogent explanations why the rule should be enacted as originally proposed. *See, e.g.,* Securities and Exchange Commission, Rulemaking Process, Audit No. 347, Jul. 12, 2002, https://www.sec.gov/oig/reportspubs/aboutoigaudit347finhtm.html#P45_7906; Office of the Federal Register, A Guide to the Rulemaking Process, (2011), https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf; 76 F.R. 3821 (2011) ("Our regulatory system must protect public… welfare… while promoting economic growth, innovation, competitiveness, and job creation… It must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends. It must take into account benefits and costs, both quantitative and qualitative."); 58 F.R. 51735 (1993); 43 F.R. 12661 (1978).

[99] This is not to say that the SEC does not react promptly to judicial decisions. For instance, "[i]n response to a charge from Chairman Schapiro after a federal circuit court called the SEC's economic analysis arbitrary and capricious, the Division of Economic Research and Analysis (DERA) created a framework for converting large databases into meaningful, sensible, common sense economic analysis in order to inform its rule-making. That effort was described in the Commission's Guidance to Economic Analysis." *The Future of the Securities and Exchange Commission, supra* note___, at 36. The changes followed Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011). *See also* Joshua T. White, *The Evolving Role of Economic Analysis in SEC Rulemaking,* 50 GA. L. REV. 293 (2015) (discussing the changes). In contrast to rulemaking, enforcement is changing slowly, which may be explained by multiple factors. The staff "has too many investigations" and "there seems to be less and less opportunity to have a meaningful dialogue with the staff, especially in the regional offices." *The Future of the Securities and Exchange Commission, supra* note___, at 15.

[100] SECURITIES AND EXCHANGE COMMISSION, FY 2016 BUDGET REQUEST BY PROGRAM 60 (2015), https://www.sec.gov/about/reports/sec-fy2016-budget-request-by-program.pdf (showing annual increases in the costs of the Enforcement Division); SEC Announces Enforcement Results for FY 2016, Press Release, Oct. 11, 2016, https://www.sec.gov/news/pressrelease/2016-212.html (providing a table summarizing the increases in enforcement results over the past three years).

the spectrum of the securities industry. The SEC ended the fiscal year with a record 548 stand-alone enforcement actions, plus 195 follow-on proceedings and 125 delinquent filing proceedings, for a total of 868 enforcement actions."[101] The numbers represent a continuous and steady increase in enforcement actions over the years.

These reported trends are no longer a prosecutorial response to the recent financial crisis since "many financial crisis cases are done for the most part."[102] There is a more practical, or even cynical, explanation for tougher prosecution. The SEC, as opposed to some other agencies, is not self-funding.[103] Congress decides on its budget each year. In making its decisions, Congress relies on "objective metrics,"[104] such as the number of actions and the amount of penalties,[105] reported by the Commission in congressional hearings.[106] As the SEC routinely cites its enhanced enforcement activity to justify annual budget requests,[107] pure self-interest may lead it to redouble enforcement efforts or *numbers*.[108] Instead of actually prosecuting more cases, as Velikonja's 2016 study

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[101] *See* U.S. SEC. & EXCH. COMM'N, AGENCY FINANCIAL REPORT: FISCAL YEAR 2016 16 (2016), https://www.sec.gov/about/secpar/secafr2016.pdf.

[102] *The Future of the Securities and Exchange Commission, supra* note___, at 15.

[103] *The Future of the Securities and Exchange Commission, supra* note___, at 23 (citing Chair White expressing a preference for a self-funding Commission and mentioning "the crying resource needs at the SEC"). On the related institutional design and agency independence issues, *see, e.g.,* Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 611 (2010); Michael M. Ting, *The "Power of the Purse" and Its Implications for Bureaucratic Policy-Making*, 106 PUB. CHOICE 243, 244-47 (2001).

[104] John C. Coffee, Jr., *SEC Enforcement: What Has Gone Wrong?*, CLS BLUE SKY BLOG (Jan. 2, 2013), http://clsbluesky.law.columbia.edu/2013/01/02/secenforcement-what-has-gone-wrong/ ("[T]he SEC needs to be able to use objective metrics to justify its request for budget increases. By bringing many actions and settling them cheaply, it can point to an increase in the aggregate penalties collected, even if the median penalty is at the same time decreasing. This may impress Congress….").

[105] *Id.;* Jonathan R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 HARV. J.L. & PUB. POL'Y 639 (2010).

[106] *See, e.g.,* Examining the SEC's Agenda, Operations, and FY Budget Request: Hearing Before the H. Comm. on Fin. Servs., 114th Cong. (2015) (statement of Mary Jo White, Chair, Securities and Exchange Commission), http://financialservices.house.gov/uploadedfiles/114-10.pdf.

[107] *See* Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 906-19 (2016).

[108] For a review of pertinent regulatory inefficiencies and biases, *see, e.g.,* Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC,* 56 STAN. L. REV. 1, 20–36 (2003); Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909, 922–23 (1994); Jonathan R. Macey & David D. Haddock, *Shirking at the SEC: The Failure of the National Market System*, 1985 U. ILL. L. REV. 315; A.C. Pritchard, *The Sec at 70: Time for Retirement?*, 80 NOTRE DAME L. REV. 1073, 1077–92 (2005).

of annual enforcement reports suggests, the Commission may be inflating the numbers by double-counting some actions.[109]

C. Enforcement Actions between 2005 and 2016

Since the SEC summary statistics may be opaque, the first task of this research project was to develop a comprehensive database. To identify legal decisions against foreign private issuers, my assistants and I searched Westlaw, LexisNexis, and Bloomberg Law databases.[110] We also reviewed the decisions of Administrative Law Judges,[111] the SEC enforcement data,[112] including litigation releases, notices and settlements, Commission opinions, and adjudicatory orders.

We manually identified actions against foreign private issuers (FPIs) registered with the SEC and FPIs whose securities are traded on the OTC markets. The list of registered and reporting FPIs was obtained from the SEC's webpage and included companies registered between 2005 and 2016.[113] It was supplemented by the list of foreign companies trading American Depository Receipts (ADRs) on various U.S. OTC platforms between 2005 and 2016. This list was obtained from the database of ADRs provided by BNY Mellon.[114] We cross-checked the two lists to eliminate duplicates. During the timeframe of the research, some companies moved trading from an OTC platform to an exchange or from an exchange to an OTC market. In the below summaries, these companies are classified based on their status at the time of the respective litigation releases.

Consulting firms, such as Cornerstone Research or NERA Consulting, track mainly class actions. The new Securities Enforcement Empirical Database (SEED) of the NYU Pollack Center for Law and Business and Cornerstone Research provides data only on enforcement actions against listed companies and includes only actions initiated after 2009. I used the data shared with me by the NYU SEED to crosscheck our results.

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[109] Velikonja (2016), *supra* note___, at 932-67. Depending on one's opinions on the administrative state, the SEC's measuring metrics may be viewed either as imprecise due to the complexity of the data the staff handles or as somewhat self-serving. From a practical perspective, they also permit the Commission to apply for higher appropriations, allocate its scarce enforcement resources toward certain priorities, and maintain its reputation for zealous enforcement without draconian prosecutions.

[110] To identify the decisions, I used the following terms: "foreign issuer," "foreign private issuer," "ADR," "ADS," "depositary receipt," "depositary share," and "Morrison."

[111] The database is available at https://www.sec.gov/litigation/aljdec.shtml.

[112] The database is available at https://www.sec.gov/litigation.shtml.

[113] The list of International Registered and Reporting Companies is available at https://www.sec.gov/divisions/corpfin/internatl/companies.shtml.

[114] The data were collected from the descriptions of the parties in the complaints and confirmed through BNY Mellon, Depositary Receipts, https://www.adrbnymellon.com/.

This Article reviews SEC actions based on the logistics of enforcement.[115] First, the staff conducts a thorough preliminary investigation of a "matter under inquiry."[116] After a comprehensive investigation, the staff submits a recommendation for enforcement to the Commission. Many targets simultaneously submit settlement offers. The offers are presented to the Commission together with the recommendations of the staff, "an action memorandum," and often before the commencement of an administrative proceeding or a court action. The Commission issues either the Order Instituting Proceedings if it decides to adjudicate the matter "in-house" or proceeds with filing a suit in the federal district court. Available judicial relief ranges from injunctions to civil monetary penalties, disgorgement, and others, while administrative relief includes, *inter alia,* cease-and-desist orders and civil monetary penalties, disgorgement, orders to comply with reporting obligations, trading suspensions, and revocation of the registration of a security.[117]

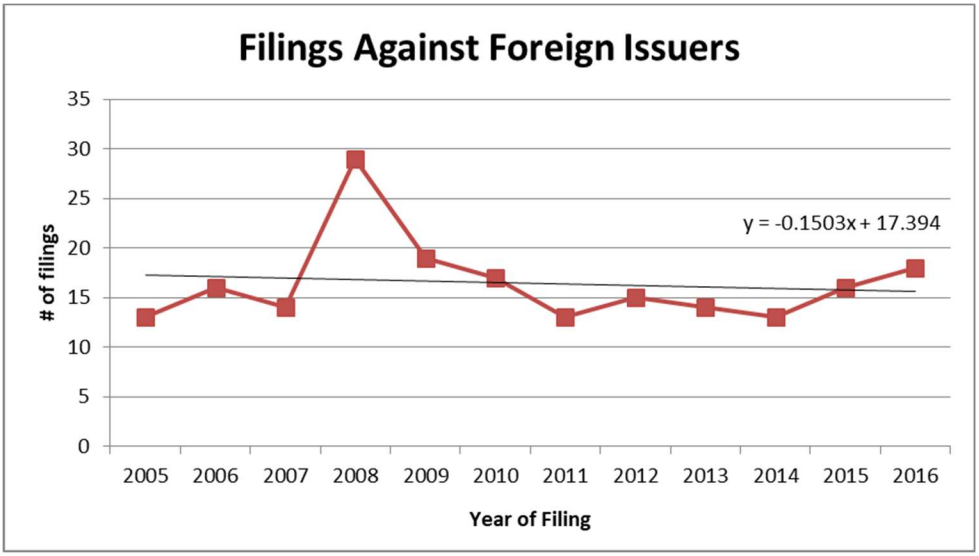
The following overview covers all enforcement actions brought by the SEC either in administrative proceedings or in federal courts between January 2005 and December 2016, about five years before and five years after the *Morrison* decision. If *Morrison* has entailed an under-enforcement problem due to inadequate private litigation or has deprived American investors of a meaningful remedy, the SEC may have responded accordingly. The working hypothesis was that there would be more enforcement actions against international companies after *Morrison*. The below results suggest that this has not happened. Instead, the caseload remained stable.

Graph I: Court Filings and Administrative Proceedings

[115] *See generally* SECURITIES LITIGATION AND ENFORCEMENT 668-772 (Donna M. Nagy, Richard W. Painter & Margaret V. Sachs eds., 2012).

[116] This often produces voluntary cooperation of potential targets and involves testimony and document production. The second stage is recommending an enforcement action. At that point, the target is typically invited to file a Wells Submission, in which it often attempts to explain why enforcement proceedings should not be instituted. An order of investigation is then issued by senior officials in the Enforcement Division. 17 C.F.R. 201.100 et seq. (2016); 17 C.F.R. 202.1 et seq. (2016); 17 C.F.R. 203.1 et seq. (2016); SECURITIES AND EXCHANGE COMMISSION, ENFORCEMENT MANUAL (Oct 28, 2016), https://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

[117] *See, e.g.,* 15 U.S.C.§§ 78u(d); 78u-3; 78o(c); 78l(j) (2015).



The final sample includes 197 cases against foreign firms. The SEC brought actions under the antifraud provisions of the securities laws, including Rule 10b-5 and section 17 violations, as well as the Foreign Corrupt Practices Act (FCPA) violations in about 30% of cases. Issuer reporting and delinquent filings actions[118] consistently represented about 60% of the enforcement actions against corporate issuers.[119] The reporting violations resulted in a trading suspension or the revocation of the registration of securities of international companies[120] that were delinquent in filings for five years on average.[121]

A plausible explanation of this tardiness is that, as a policy matter, the Commission does not interdict trading between willing buyers and sellers absent a threat of substantial public harm.[122] Another explanation is that the SEC relies

[118] 15 U.S.C. § 78m (2015).

[119] This finding is consistent with the previous research by Shnitser, who covered enforcement actions between 2000 and 2008. Her research used a slightly different sample selecting technique and included FPIs, their employees, and subsidiaries. Shnitser, *supra* note___, at 1666 & 1671. The exposure to liability for materially misleading reports is indeed substantial. *See, e.g.,* SECURITIES AND EXCHANGE COMMISSION, AGENCY FINANCIAL REPORT 15-17, 45-51, 155-159 (2016).

[120] 15 U.S.C. § 78l(j) (2015).

[121] Shnitser reported that many issuers were delinquent in periodic filings for "more than seven years." Shnitser, *supra* note___, at 1673. For examples of actions, *see* SECURITIES AND EXCHANGE COMMISSION, SECURITIES EXCHANGE ACT OF 1934 RELEASE No. 76,252 (Oct. 23, 2015); SECURITIES EXCHANGE ACT OF 1934 RELEASE No. 78,439 (Jul. 29, 2016); SECURITIES EXCHANGE ACT OF 1934 RELEASE No. 57,168 (Jan. 18, 2008).

[122] *See* Defunct Company, Stock Continues to Trade, https://www.sec.gov/fast-answers/answersdfnctcohtm.html.

on market gatekeepers such as broker-dealers. Broker-dealers cannot publish a quotation before reviewing certain information about a company and forming "a reasonable basis under the circumstances for believing that… [the] information is accurate in all material respects."[123] Finally, this consistent tardiness may be either related to the need to economize on enforcement resources or the unwillingness of the agency to spend resources on routine "housekeeping" of low value in terms of publicity.[124]

A byproduct of this failure to do routine "housekeeping" and revoke the registration of securities more promptly may expose investors to foreign securities with no current information for several years. Admittedly, the actual harm may be contained within small groups of investors since the securities of issuers delinquent in their filings for a considerable period of time may be illiquid and are traded OTC. However, as discussed in the following sections, there is no need to put small groups of investors in harm's way and give a certain stratum of foreign issuers a free pass. As years pass, foreign firms may avoid antifraud liability either because of the statute of repose[125] or due to the discussed in Part II unwillingness of the plaintiffs' bar to bring cases against smaller foreign companies.

Within the sample, more than 80% of the actions were channeled through administrative law judges (ALJs) and about 20% were filed in district courts. Most court cases involved FCPA violations. The Commission invariably won in those cases. After 2010, there is a slight increase in in-house administrative proceedings. The result is not surprising inasmuch as Dodd-Frank, a statutory reform almost coincidental with *Morrison,* has granted the SEC the right to seek civil penalties in administrative proceedings.[126] I reserve judgment on the constitutionality, merits and demerits of administrative proceedings - the

[123] 17 CFR § 240.15c2-11 (2015).

[124] *See infra* Section IV(B).

[125] Section 10(b) claims are governed by the five-year statute of repose. 28 U.S.C. § 1658 (2002).

[126] 15 U.S.C. § 77h-1 (2012).

scholarship on this subject is voluminous.[127] It is only natural that administrative proceedings are more expedient and cheaper from the perspective of the SEC.[128]

I separately reviewed settled cases. In about 70% of the cases, FPIs preferred to settle promptly, at filing. The cases resulted in a consent judgment, in which defendants waived their right to appeal. The numbers are consistent both before and after *Morrison.* The results are not surprising since pro-settlement arguments are multitude. For instance, to a private company, the expected probability of losing in court appears considerable - "if the Commission chooses to take action against a company…, the odds are high that the SEC views its position as strong."[129] The SEC also awards corporations for cooperation during investigations, which, again, should promote settlements.[130] Statutory law and courts have also afforded the SEC broad discretion and investigatory powers.[131] The current judicial interpretation of the law creates an information asymmetry between investigation targets and the Commission, potentially putting the former at a serious disadvantage and incentivizing the targets to settle.[132]

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[127] For an empirical analysis, *see* Stephen J. Choi & Adam C. Pritchard, *The SEC's Shift to Administrative Proceedings: An Empirical Assessment,* NYU Law & Economics Research Paper Series No. 16-10 (Feb. 2016). *See also* Engstrom, *supra* note___, at 667-68, n. 162 (providing an excellent synopsis of the literature); RICHARD A. POSNER, THE FEDERAL COURTS: CHALLENGE AND REFORM 254-57 (1996); Joshua D. Wright & Angela M. Diveley, *Do Expert Agencies Outperform Generalist Judges? Some Preliminary Evidence from the Federal Trade Commission*, 1 J. ANTITRUST ENFORCEMENT 82, 91-94 (2013). For a review of recent case law developments, *see, e.g.,* Gregory Morvillo, *The ALJ Circuit Split: Fair Reading or Subjective Evaluation*, Feb 9 2017, https://wp.nyu.edu/compliance_enforcement/2017/02/09/the-alj-circuit-split-fair-reading-or-subjective-evaluation/.

[128] *See*, *e.g.,* SECURITIES LITIGATION AND ENFORCEMENT, *supra* note___, at 761-62 (reviewing the proceedings).

[129] *Report of the Task Force on SEC Settlements Prepared by the Subcommittee on Civil Litigation and SEC Enforcement Matters of the Federal Regulation of Securities Committee of the ABA's Section on Business Law*, 47 BUS. LAW. 1083, 1092-94 (1992) (hereinafter "Report of the Task Force on SEC Settlements").

[130] *See, e.g.,* Policy Statement of the Securities and Exchange Commission Concerning Cooperation by Individuals in Its Investigations and Related Enforcement Actions, Exchange Act Release No. 61340 (Jan. 13, 2010), 17 CFR § 202; ENFORCEMENT MANUAL, *supra* note___ § 6.2 (listing cooperation tools); SECURITIES LITIGATION AND ENFORCEMENT, *supra* note___, at 738-39.

[131] *See e.g.,* 15 U.S.C. § 78u (2015); SEC V. Brigadoon Scotch Distributing Co., 480 F.2d 1047, 1052-53 (2d Cir. 1973).

[132] For instance, in *SEC v. Jerry T. O'Brien*, the Supreme Court reviewed the question "whether the Commission must notify the 'target' of… an investigation when it issues a subpoena to a third party" and left it entirely to the discretion of the SEC. SEC v. Jerry T. O'Brien, Inc., 467 U.S. 735 (1984). *See also* SECURITIES LITIGATION AND ENFORCEMENT, *supra* note___, at 668-69.

Another argument was pointed out by Justice Rehnquist in his dissent in *Parklane Hoiseiry.*[133] In his opinion, if "the law of collateral estoppel forecloses the petitioners from litigation [in a following class action] the factual issues determined against them in the SEC action," that policy adds "a powerful club to the administrative agencies' arsenals,"[134] coercing future respondents to settle.

Foreign firms, theoretically, may be less incentivized to cooperate with the SEC and simply leave the U.S. market.[135] They also represent weaker, "judgment-proof" targets if, for instance, they do not have assets in the U.S.[136] For instance, I also identified a significant number of default judgments of about 6% of the sample. Nevertheless, the significant number of settlements confirms that not only in domestic, but also in foreign cases "[t]he divergence in the parties' marginal propensity towards settlement creates uneven bargaining power, with the Commission holding the upper hand."[137]

The judgments and settlements in the pre- and post-*Morrison* subsamples decreased by more than 50%. This complements a considerable decrease in settlements and judgments against foreign issuers in class-action litigation.[138] A typical judgment in an SEC enforcement action, self-evidently, differs in nature and includes a civil penalty, disgorgement of profits, and other relief.[139]

With the average settlements not exceeding $40 million, there were several outliers, which constituted about 10% of the sample. Those cases were related not to the timing of *Morrison* but instead to the nature and seriousness of the violations. One illustrative case of considerable notoriety was *SEC v. BP p.l.c.* resulting in a settlement of $525,000,000 in 2012.[140] BP p.l.c., as a foreign private issuer, furnished misleading information on Form 6-K concerning the Deepwater Horizon oil rig explosion in April 2010. Another example is *SEC v. Nortel Networks Corporation*, *et al*., a pre-*Morrison* case involving a fraudulent accounting scheme and resulting in not only an SEC action but also a criminal

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[133] Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979).

[134] 439 U.S. at 355-56.

[135] The ratio of settling and cooperating domestic issuers is higher. *See* CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY: PUBLIC COMPANIES AND SUBSIDIARIES, MIDYEAR FY 2017 UPDATE 1, 6 (2017).

[136] The scenario is similar to the factors affecting the likelihood of class actions. *See* Gande & Miller, *supra* note___.

[137] Report of the Task Force on SEC Settlements, *supra* note___. *See also* Anne C. Flannery, *Time for Change: A Re-Examination of the Settlement Policies of the Securities and Exchange Commission*, 51 WASH & LEE L. Rev, 1015, 1018 (1994) (observing that respondents face a Hobbesian choice to settle or to litigate).

[138] Guseva (2017), *supra* note___, at 255-69.

[139] *See supra* note___ and accompanying text.

[140] SEC v. BP p.l.c., No. 2:12-cv-02774 (E.D. La. Nov. 15, 2012), Litigation Release No. 22531, Nov. 15, 2012, https://www.sec.gov/litigation/litreleases/2012/lr22531.htm.

investigation in Canada. The defendant consented to the entry of a final judgment and a civil penalty in the amount of $35,000,000.[141]

Most importantly, the data in the sample suggest that there could be certain complementarity of private class actions and public enforcement. For instance, in more than 90% of private class action complaints filed between 2005 and 2015 under Exchange Act section 10(b) and Rule 10b-5 and sections 11 and 12(a)(2) of the Securities Act, plaintiffs overwhelmingly focused on exchange-traded securities.[142] In contrast, between 2005 and 2016, the SEC targeted more companies trading American Depositary Receipts (ADRs) and shares of stock on the OTC market. Those actions constituted about 50% of the sample. Most actions against OTC issues resulted in the revocation of the registration of their securities. By contrast, most actions against exchange-traded issuers produced a serious monetary penalty.

Taxonomizing securities as "OTC" and "listed" avoids the discrepancy identified in the two seminal papers on SEC enforcement, by Cox and Thomas and by Choi and Pritchard, suggesting, respectively, that the SEC targets companies with lower market capitalization and that it investigates firms with higher capitalization compared to private class actions.[143] More research is needed to establish whether the Commission has been continuously filling some gaps in enforcement against weaker international issuers and corporations with lower "visibility" to the plaintiffs' bar.

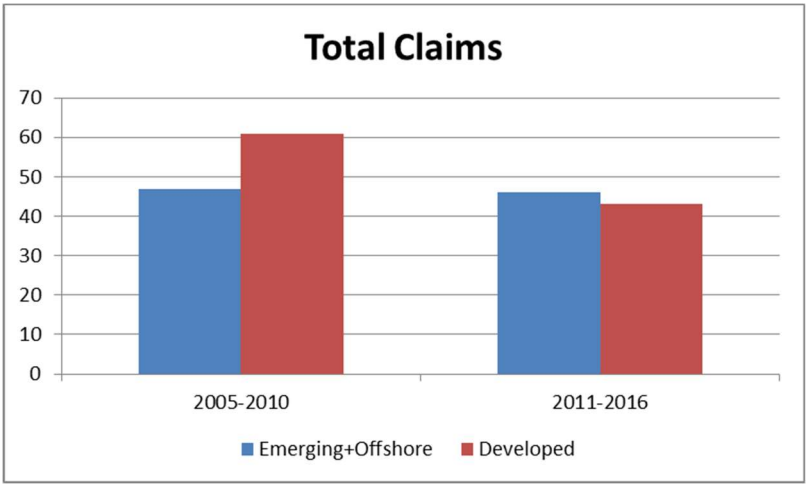
I was able to identify only one post-*Morrison* change, which was a hike in actions against firms from developing markets and offshore markets.

Chart I: Claims and Distribution of Domiciles

[141] SEC v. Nortel Networks Corporation, et al., No. 07-CV-8851-LAP (S.D.N.Y. Oct. 15, 2007); Litigation Release No. 20333, Oct. 15, 2007, https://www.sec.gov/litigation/litreleases/2007/lr20333.htm.

[142] Guseva (2017), *supra* note___, at 269-74.

[143] *See supra* note___.



More pre-2011 actions involved companies from developed economies, such as Canada, the U.K., and Japan, compared with more recent actions. However, these adjustments coincide with the changes in the composition of domiciles of reporting issuers. For instance, there has long been a considerable number of registered companies from Canada, which constitute the largest cohort of foreign reporting issuers.[144] It is thus not surprising that there should be more actions against Canadian companies.[145] Compare also the number of registrants from the U.K. in 2006 and 2015. There were as many as 63 registered and reporting companies from the U.K. in 2006 but only 39 in 2015.[146] The aforesaid trends in enforcement also seem to mimic a recent increase in class action filings against Chinese firms[147] and the growing number of reporting firms from offshore jurisdictions.

Chart II: International Registered and Reporting Companies, 2005-2016[148]

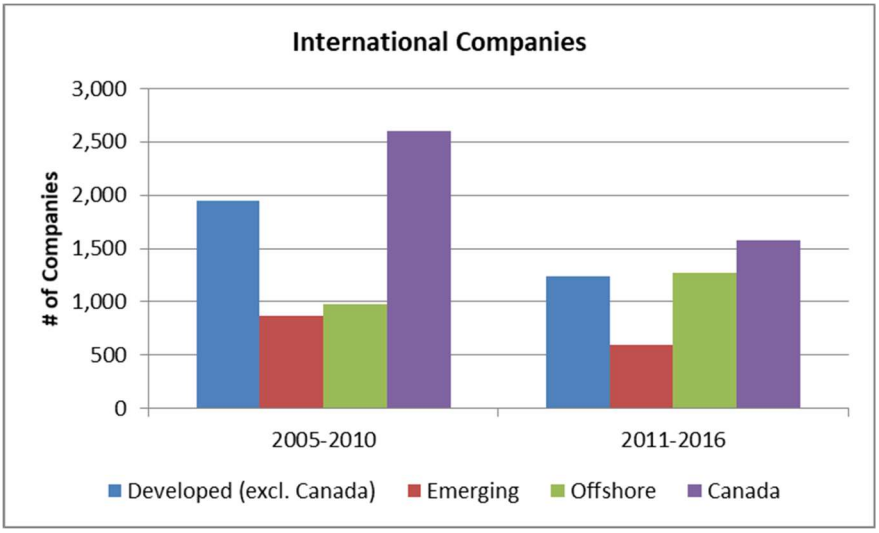
[144] *See* Ryan T. Ball et al., *Equity Cross-Listings in the U.S. and the Price of Debt*, ECGI—Finance Working Paper No. 274/2010 (2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1426586.

[145] Buckberg & Gulker, *supra* note ___, at 14; Gande & Miller, *supra* note ___, at 10. *See also* CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2015 YEAR IN REVIEW 17 (2016).

[146] *Compare* International Registered and Reporting Companies 2006 & International Registered and Reporting Companies 2015, *infra* note___.

[147] Guseva (2017), *supra* note___.

[148] Source: SEC, International Registered and Reporting Companies, https://www.sec.gov/divisions/corpfin/internatl/companies.shtml.



To conclude, it does not appear that the SEC has adapted to *Morrison.* Although it currently targets more companies from less transparent jurisdictions with weaker judiciary and investor protection – the qualities that emerging and offshore markets often share - the results may be explained by multiple other causes and a general increase in the number of registrants from developing economies. The results suggest that the overall numbers of enforcement actions against FPIs are stable and that the SEC routinely waits for several years before revoking the registration of FPI securities. It is possible that, as consistent with prior research, the SEC prefers a low-key strategy in enforcement against international issuers.

IV. LOW-KEY ENFORCEMENT AS A DOMINANT STRATEGY

Several explanations of the enforcement "slack" are in order. The first normative lens of analysis takes the SEC as a benevolent agency concerned about the overdeterrence associated with enforcement against international issuers. The second and third home in on the institutional and international aspects of enforcement. All three arguments ultimately suggest that the low-key approach is, using the vernacular of game theorists, the *dominant* and optimal strategy of the Commission.[149]

[149] In simple terms, "[a] player is said to have a dominant strategy if that same strategy is better for him than all of his other available strategies no matter what… strategy combination the other… players choose." Avinash K. Dixit & Barry J. Nalebuff, THE ART OF STRATEGY (2008).

A. A Benevolent Enforcer

A benevolent Commission should be aware that the critiques of private enforcement of the securities laws are legion. As Part II briefly addresses, private attorneys are more prone to bring cases whose value is lower than the social cost of litigating and "strike" suits. They may target parties which, regardless of their culpability, capitulate and concede to settlement demands for fear of the financial and reputational costs of litigation and massive discovery.[150] These typical critiques are exacerbated by the nature of class-action litigation against foreign firms, where the plaintiffs' bar could, at least before *Morrison,* woo foreign plaintiffs to create a "global" class and augment an eventual recovery to the class.[151]

The SEC is equally aware that overzealous private attorneys may piggyback on its enforcement efforts and bring follow-on cases, which may have little value-added from an efficiency perspective.[152] Any payments to the plaintiff class ultimately would come from the pockets of the existing shareholders, which is sometimes referred to as the "circularity" problem.[153] Bringing coattail actions is comparatively cheaper because plaintiffs' attorneys can economize on information search and discovery by relying, at least in part, on the evidence and conclusions of the SEC Enforcement Division.[154] Moreover, if factual issues have

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[150] *See supra* Section II(A); Engstrom, *supra* note___, at 630-31; Pritchard & Sale, *What Counts as Fraud?, supra* note___; Shavell, *Fundamental Divergence, supra* note___; Alexander, *Do the Merits Matter?, supra* note___; Lucian Arye Bebchuk, *Suing Solely to Extract a Settlement Offer*, 17 J. LEGAL STUD. 437 (1988); Becker & Stigler, *Law Enforcement*, *supra* note___; Landes & Posner, *Private Enforcement*, *supra* note___; Coffee, *Understanding the Plaintiff's Attorney*, *supra* note___ at 669; Coffee, *Rescuing, supra* note___.

[151] Guseva (2017), *supra* note___, at 255-64.

[152] *See, e.g.*, Rose, *Securities Fraud Deterrence*, *supra* note___; Engstrom, *supra* note ___, at 634 ("profit-chasing private enforcers will yield wasteful duplication of effort and socially costly overdeterrence by "piggybacking" on public enforcement efforts and also on each other"); Howard M. Erichson, *Coattail Class Actions: Reflections on Microsoft, Tobacco, and the Mixing of Public and Private Lawyering in Mass Litigation*, 34 U.C. DAVIS L. REV. 1, 2 (2000). *But see* Clopton, *Redundant Public-Private Enforcement*, *supra* note___, at 288-89; Coffee, *Rescuing*, *supra* note ___, at 225-28 (observing that "although some have characterized such 'tag along' private enforcement actions as 'parasitic,' it may be more accurate to describe the relationship between public and private enforcer as symbiotic," *id.* at 225); Maria Correia & Michael Klausner, *Are Securities Class Actions "Supplemental" to SEC Enforcement? An Empirical Analysis* (2012) (showing public-private action complementarity).

[153] For a thorough discussion of the issue, *see, e.g.,* Merritt B. Fox, *Why Civil Liability for Disclosure Violations When Issuers Do Not Trade?*, 2009 WISC. L. REV. 297; Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation,* 2009 WISC. L. REV. 333.

[154] SECURITIES LITIGATION AND ENFORCEMENT, *supra* note___, at 678, 694 & 708 (discussing pertinent scenarios). Some jurisdictions, such as China, even require that "any private action be preceded by a criminal action or civil public enforcement action." Coffee, *The Globalization*

already been litigated between the SEC and a foreign defendant and those facts were resolved adversely to the defendant, the defendant may be collaterally estopped from relitigating the same issues in a private action.[155] Research suggests that defendants may be more likely to promptly settle tagalong private actions.[156] This urge to settle emanates, in part, from the expected market penalties of dual proceedings and an increase in the cost of capital of enforcement targets, "a [market] premium to do business with firms that are [presumed] less trustworthy."[157]

Aware of these negative externalities and instances of socially wasteful private litigation,[158] a benevolent SEC may curb is own actions to achieve a more optimal level of deterrence.[159] Alternative courses of action may be foreclosed because the SEC is powerless against excesses in private litigation. The Commission cannot, as numerous prominent commentators have proposed, monitor private litigation efforts or screen out low-social-value cases to ensure optimal enforcement.[160] To avoid failing its dual mission of protecting investors

of Entrepreneurial Litigation, supra note___, at 1916. In fact, whether in public or private disputes, "there may be a synergy in parallel class actions," indicating serving as "at least some evidence that the case is meritorious." *Id.* at 1914.

155 *See supra* note__ and accompanying text.

156 *See, e.g.,* Cox et al., *SEC Enforcement Heuristics, supra* note___, at 777.

157 Jonathan M. Karpoff, *Does Regulation Work to Regulate Corporate Misconduct, in* THE OXFORD HANDBOOK OF CORPORATE REPUTATION 371 (2012). *See also* Choi & Pritchard, *SEC Investigations, supra* note___ (also suggesting that "[s]tock prices may be responding to… problems revealed with the firm's underlying business as much as to the loss of credibility," *id*. at 29); Karpoff & Lott 1993, *supra* note___; Jonathan M. Karpoff et al., *The Cost to Firms of Cooking the Books,* 43 JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS 581 (2008).

158 For a synoptic review of theory, *see, e.g.,* Clopton, *Redundant Enforcement, supra* note___, at 306. *See also* George J. Stigler, *The Optimum Enforcement of Laws*, 78 J. POL. ECON. 526 (1970); Rose, *Securities Fraud Deterrence*, *supra* note___, at 2189.

159 "[I]deally, liability should be imposed only in cases where, at the margin, the improvement in economic welfare from deterring issuer misstatements is at least as great as the social costs arising from prosecuting the action." Edward G. Fox et. al., *Economic Crisis and the Integration of Law and Finance: The Impact of Volatility Spikes*, 116 COLUM. L. REV. 325, 371 (2016). *See also* Becker, *Crime and Punishment*, *supra* note___, at 200 (discussing optimal costs of enforcement and internalization of social costs of misconduct by offenders); Rose, *Securities Fraud Deterrence, supra* note___, at 2194-95 (suggesting, *inter alia,* that an enforcer may exercise "laudable self-restraint" in cases where significant uncertainty exists).

160 For a sample of this rich literature, *see, e.g.,* Jill E. Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff*, 60 LAW & CONTEMP. PROBS. 167 (1997); Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 925, 941 (2001); Rose, *Reforming Securities Litigation Reform*, *supra* note___; JENNIFER ARLEN, PUBLIC VERSUS PRIVATE ENFORCEMENT OF SECURITIES FRAUD 46 (2007); Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961 (1994); James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Laws*, 100 CALIF L. REV. 115, 174-75 (2012); Tamar Frankel, *Let the Securities*

and safeguarding market efficiency,[161] a benevolent enforcer may take a less zealous and more measured enforcement approach.

In addition, by curbing its own enforcement to allow for the inefficiencies in private litigation, a benevolent agency will be protecting the competitiveness of national capital markets and exchanges. The agency is aware that an association with the American market, and thereby U.S. regulators, is not mandatory for a company domiciled in another jurisdiction. Global corporations may access international markets through London or other prestigious trading venues serving as convenient alternatives to the NYSE and Nasdaq.[162] If the expected regulatory and enforcement costs of listing exceed the expected benefits, a firm may give up its American listing program.[163] The blame for deterring international companies should rest with the domestic capital market regulator whose regulatory policies brought about overdeterrence and reduced the competitiveness of the national markets.[164]

The second concern that a rational benevolent enforcer understands is that there will be an inevitable information loss between a regulatory agency and a foreign issuer. An enforcement agency sets its policies in light of the estimates of the average costs of reporting and enforcement. A foreign issuer, however, must also take into consideration the costs that a regulator cannot directly observe. First, international companies hail to the U.S. from jurisdictions with

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and Exchange Commission Outsource Enforcement by Litigation: A Proposal, 11 J. BUS. & SEC. L. 111, 119-20 (2010); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 115 (1991); Matthew C. Stephenson, *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 VA. L. REV. 93 (2005); Engstrom, *supra* note___.

[161] 15 U.S.C. § 78c(f) (2015).

[162] A database of cross-listed securities is available at BNY Mellon, Depositary Receipts https://www.adrbnymellon.com/directory/dr-directory. *See also* Craig Doidge et al., *Has New York Become Less Competitive than London in Global Markets? Evaluating Foreign Listing Choices over Time*, 91 J. FIN. ECON. 253 (2009); Sergei Sarkissian & Michael J. Schill, *The Nature of the Foreign Listing Premium: A Cross-country Examination*, 36 J. BANKING & FIN. 2494 (2012); Marcelo Bianconi & Liang Tan, *Cross-listing Premium in the US and the UK Destination*, 19 INT'L REV. ECON. & FIN. 244 (2010); Kevin Campbell & Isaac T. Tabner, *Bonding and the Agency Risk premium: An Analysis of Migrations between the AIM and the Official List of the London Stock Exchange*, 30 J. INT'L FIN. MKTS. INSTITUTIONS & MONEY 1 (2014).

[163] On regulatory costs of foreign issuers, *see, e.g.,* Kate Litvak, *The Effect of the Sarbanes-Oxley Act on Non-U.S. Companies Cross-listed In The U.S.,* 13 J. CORP. FIN. 195 (2007); Kate Litvak, *Sarbanes-Oxley and the Cross-Listing Premium,* 105 MICH. L. REV. 1857 (2007); Xi Li, *The Sarbanes–Oxley Act and Cross-listed Foreign Private Issuers,* 58 JOURNAL OF ACCOUNTING AND ECONOMICS 21 (2014).

[164] *See, e.g.,* ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION 45 (2002).

different baseline reporting rules, which implies that some would incur higher costs in the course of cross-listing and restructuring their reporting and internal control procedures than others. Second, corporations cross-listed on U.S. exchanges may pay higher insurance premiums compared to those of similar firms listed only on home-country exchanges.[165] A suggested explanation is an increased exposure to liability.[166] The SEC cannot include those outlays in its calculations.

A foreign issuer is also more likely than the SEC to calculate the indirect costs of enforcement actions and class actions. Those indirect costs culminate in reputational penalties, which are levied by the capital market with a vengeance and may eclipse direct enforcement costs.[167] Recently, Choi and Pritchard have expanded previous studies by identifying that the market penalizes issuers heavily, particularly if there is both a class action and a Commission enforcement action against the same firm.[168] Effectively, the SEC metes out severe punishment not only through the civil penalties and injunctive relief requested in its complaints or through cease-and-desist orders,[169] but also through the market and tagalong class actions. While the Commission may underestimate the indirect costs of its actions, an individual firm may overestimate its risk of liability and projected costs of defense in litigation.[170]

This information asymmetry is compounded by the heterogeneity of business objectives of international companies pursuing listing in the U.S. To name a few examples, one foreign firm may need to use equity consideration in a stock-for-stock merger with a Delaware corporation; another international company explores growth opportunities and seeks to tap external sources of capital, a move that often follows cross-listing; a third one wants to increase international investor exposure; the management of a fourth firm would like to improve liquidity and trading volume; a fifth company is induced to list by better international visibility and analyst coverage, which are associated with more accurate forecasts and higher valuations; while the executives of a sixth

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[165] Stuart L. Gillan & Christine A. Panasian, *On Litigation Risk and Disclosure Complexity: Evidence from Canadian Firms Cross-Listed in the US*, 49 INT'L J. ACCT. 426 (2014).

[166] *Id. See, e.g.,* Peter Iliev et al., *Uninvited U.S. Investors? Economic Consequences of Involuntary Cross-Listing*, 52 J. ACCT. RES. 473 (2014). *But see* Eugene Soltes, *Incorporating Field Data into Archival Research*, 52 JOURNAL OF ACCOUNTING RESEARCH 2 (2014).

[167] *See supra* note___; Choi & Pritchard, *SEC Investigations, supra* note___, at 29-30 (discussing pertinent literature).

[168] Choi & Pritchard, *SEC Investigations, supra* note___, at 40-45.

[169] For an excellent summary, *see, e.g.,* SECURITIES LITIGATION AND ENFORCEMENT, *supra* note___, at 711-16.

[170] *See generally* Guseva (2017), *supra* note___ (discussing risk aversion, information asymmetry, and other relevant arguments).

corporation have specific trade and export objectives in mind.[171] A regulator cannot make allowances for these objectives and equally accommodate all firms in its regulations and enforcement actions. An information loss, which is inexorable and permanent, is thus created.

Finally, there is another variable that creates an information gap and complicates optimal policy setting. At this juncture, the discussion must pay homage to the rich and venerable literatures that argue that the U.S. securities laws per se and listing on American exchanges generate a "bonding" value and trading premiums for foreign firms.[172] The overarching idea is that firms may objectively benefit from better institutions, adequate disclosure, investor protection rules, and robust law enforcement in a host jurisdiction such as the United States.[173] Listing decisions are thus driven by numerous economic variables, which incorporate not only individual firms' business objectives, but also the robustness of the institutional framework of U.S. capital markets, the prestige of American exchanges, and reporting and enforcement ensuring better corporate transparency and accountability.[174] Executives and other market actors

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[171] Guseva (2017), *supra* note___, at 213-34 (summarizing the extensive literature and sources examining the benefits that foreign firms derive from cross-listing).

[172] Guseva (2017), *supra* note___, at 213-34 (reviewing the literature); Doidge et al., *Why Are Foreign Firms Listed in the U.S. Worth More?*, *supra* note___, at 218-29, 208-09; Kate Litvak, *The Relationship Among U.S. Securities Laws, Cross-Listing Premia, and Trading Volumes* 4-5 & 11, CELS 2009 4th Annual Conference on Empirical Legal Studies Paper (2009); Licht et al. (2013), *supra* note ___, at 29 ("U.S.-traded FPI equities command a premium of about 0.9 percent on average over similar equities traded on the home market."); Doidge et al., *Has New York Become Less Competitive Than London?, supra* note___; Michael R. King & Dan Segal, *The Long-term Effects of Cross-listing, Investor Recognition, and Ownership Structure on Valuation,* 22 REV FIN. STUD. 2393 (2009); Boone et al.*, The Information Environment, supra* note___; . Andrew Karolyi, *The World of Cross-Listings and Cross-Listings of the World: Challenging Conventional Wisdom*, 10 REV FIN. 99 (2006); Ball et al., *Equity Cross-Listings in the U.S. and the Price of Debt*, *supra* note___; Luzi Hail & Christian Leuz, *Cost of Capital and Cash Flow Effects of U.S. Cross Listings,* 3-4, 7, 13-15, 40, (2005), http://www.law.yale.edu/documents/pdf/cbl/HL_ECGI_Fin461.pdf.

[173] *See generally* René M. Stulz, *Securities Laws, Disclosure, and National Capital Markets in the Age of Financial Globalization*, 47 J. ACCT. RES. 349, 367 (2009); John Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U. L. REV. 641 (1999); John Coffee, Jr., *Racing Towards the Top? The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002); Licht et al. (2013), *supra* note ___, at 3; Guseva (2017), *supra* note___, at 222-34 (discussing legal bonding).

[174] Guseva (2017), *supra* note___, at 222-34. *See also* Licht et al. (2013), *supra* note ___, at 2 (observing that "[p]otential endogeneity of cross-listing and unobserved firm heterogeneity poses a challenge to identifying the impact of legal bonding").

acknowledge that U.S. securities law and enforcement simultaneously represent a cost and offer benefits.[175]

A benevolent public enforcer, thus, should bear in mind (a) the inefficiencies of private class actions, (b) the information losses resulting from the heterogeneity of foreign firms' business objectives and reputational market penalties of enforcement actions, and (c) the integral value of better laws and institutions. These factors should shepherd the SEC to low-key prosecutorial policies.

A benevolent Commission, however, would not neglect its investor protection objective. After all, as Easterbrook and Fischel famously quipped, "[a] world with fraud…is a world with too little investment."[176] Hence, the SEC would search for substitutes for local enforcement. An example of a functional substitute is cooperation with regulators in the countries of domicile of international issuers. Decades of SEC's initiatives lend support to this argument. The Commission has been increasingly relying on cooperation with foreign regulators through not only technical assistance but also enforcement and supervisory coordination. It has forged bilateral dialogues with regulators around the globe,[177] assists foreign regulators in their investigations,[178] is engaged in information sharing with foreign authorities, and has signed bilateral and multilateral memoranda of understanding, including memoranda with the International Organization of

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[175] Howell E. Jackson, *Summary of Research Findings on Extra-Territorial Application of Federal Securities Law*, 1743 PLI/CORP 1243, 1255 (2009). *See also* Fan He & Chinmoy Ghosh, *The Diminishing Benefits of U.S. Cross-Listing: Economic Consequences of SEC Rule 12h-6*, J. FIN. & QUANTITATIVE ANALYSIS, *forthcoming,* 2017, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2753397; Louis Gagnon & G. Andrew Karolyi, *The Economic Consequences of the U.S. Supreme Court's Morrison v. National Australian Bank Decision for Foreign Stocks Cross-Listed in U.S. Markets*, Johnson School Res. Paper Series No. 50-2011 (2012).

[176] Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VIR. L. REV. 669, 673 (1984).

[177] *See, e.g.,* SECURITIES AND EXCHANGE COMMISSION, PRESS RELEASE NO. 2006-130, SEC AND CESR LAUNCH WORK PLAN FOCUSED ON FINANCIAL REPORTING: DEVELOPING CROSS ATLANTIC FINANCIAL MARKETS, Aug. 2, 2006, https://www.sec.gov/news/press/2006/2006-130.htm; PRESS RELEASE NO. 2006-63, SEC AND CSRC ANNOUNCE TERMS OF REFERENCE FOR ENHANCED DIALOGUE, May 2, 2006, https://www.sec.gov/news/press/2006/2006-63.htm

[178] *See* SECURITIES AND EXCHANGE COMMISSION, SEC FRAMEWORK FOR INTERNATIONAL COOPERATION AND ASSISTANCE, Oct. 16, 2014, https://www.sec.gov/about/offices/oia/oia_crossborder.shtml ("Section 21(a)(2) of the Securities Exchange Act of 1934, authorizes the SEC to conduct investigations on behalf of foreign securities authorities…. In fiscal year 2011, the SEC made 772 requests to foreign authorities for enforcement assistance and responded to 492 requests from foreign authorities.").

Securities Commissions, which currently has as many as 112 signatories,[179] and with individual national regulators.[180]

B. A Rational Bureaucratic Enforcer

Against this optimistic view of the SEC as a benevolent agency lies a *second* perspective, a picture of an SEC acting as a rational utility maximizer instigated to limit its enforcement against foreign corporations by political and institutional benefits, as well as the utility functions of the SEC staff.[181] Consider first the career prospects of the staff. To an attorney, walking through the "revolving door" and capitalizing on her agency experience through the bounties of private practice are important motivations.[182]

I am not insinuating that government attorneys shirk their responsibilities currying favor with enforcement targets. In fact, being tough on fraudsters may improve an attorney's appeal to private firms in the future. Lawyers are "anxious to show their ability to promote their job prospects."[183] This argument is more nuanced. The staff is in a position to steer enforcement decisions in a direction that would correspond to their career objectives. They may, for instance, focus on certain strata of violations and firms which could be useful for their resumes or become employers or clients in the future.[184] Foreign firms are less likely to fall

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[179] IOSCO, MULTILATERAL MEMORANDUM OF UNDERSTANDING CONCERNING CONSULTATION AND COOPERATION AND THE EXCHANGE OF INFORMATION (2002), https://www.iosco.org/about/?subsection=mmou; Appendix A, Jan 16, 2017, https://www.iosco.org/about/?subSection=mmou&subSection1=signatories.

[180] *See, e.g.,* SECURITIES AND EXCHANGE COMMISSION, THE AUTORITE DES MARCHES FINANCIERS, & THE ONTARIO SECURITIES COMMISSION, MEMORANDUM OF UNDERSTANDING CONCERNING CONSULTATION, COOPERATION AND THE EXCHANGE OF INFORMATION RELATED TO THE SUPERVISION OF CROSS-BORDER REGULATED ENTITIES, Jun. 10, 2010, https://www.sec.gov/about/offices/oia/oia_bilateral/canada_regcoop.pdf. Many other authorities have joined the Memorandum since 2010. *Id.*

[181] *See, e.g.,* Engstrom, *supra* note___, at 621 (observing that "[a]gencies may simply lack the capacity to accurately gauge case merits, or they may privilege pursuit of political rewards over welfare-maximizing regulation of private enforcement efforts."); Rose, *Securities Fraud Deterrence, supra* note___, at 2216-17 (discussing personal considerations of future employment).

[182] Jonathan R. Macey & Geoffrey P. Miller, *Reflections on Professional Responsibility in a Regulatory State*, 63 GEO. WASH. L. REV. 1105, 1115-16 (1995); Lemos & Minzner, *For-Profit Public Enforcement*, *supra* note___.

[183] Stephen J. Choi & Adam C. Pritchard, *SEC Enforcement Attorneys: Should I Stay or Should I Go?*, NYU LAW & ECONOMICS RESEARCH PAPER SERIES WORKING PAPER NO. 17-07 (Jan. 2017), at 4. *See also* Donald C. Langevoort, *The SEC as a Lawmaker: Choices About Investor Protection in the Face of Uncertainty*, 84 WASH. U. L. REV. 1591, 1621 (2006).

[184] DANIEL P. CARPENTER, THE FORGING OF BUREAUCRATIC AUTONOMY: REPUTATIONS, NETWORKS, AND POLICY INNOVATION IN EXECUTIVE AGENCIES

within these categories, unless, for the sake of the argument, a staff member is planning to immigrate or an international firm has large operations within the U.S.

This argument skips right off the bat the ascendant "regulatory capture" arguments. Regardless of the underlying probability of capture as an institutional phenomenon,[185] the capture by dispersed foreign corporations hailing from multiple jurisdictions seems unlikely. Even though foreign firms may systematically benefit from lower enforcement costs, the collective action problem would prevent coordinated lobbying on behalf of dispersed foreign corporations. They simply do not represent a coherent organized group.[186] On balance, the personal benefits of career advancement and utility functions of the SEC staff may be a more useful lens of analysis.

This discussion also does not imply that the SEC purposely avoids meritorious cases. As Roberta Karmel emphasized, "[i]t is psychologically and politically difficult to decline to institute a case involving bad facts or to accept a questionable settlement."[187] However, before "bad facts" become known, a target must be chosen and thoroughly investigated. These junctions often depend on the staff.

21-22 (2001) (discussing the influence of low-level managers); Rose, *Securities Fraud Deterrence, supra* note___, at 2213-19 (surveying competing views on regulatory agencies and employment considerations).

[185] *See, e.g.,* Daniel Carpenter, *Detecting and Measuring Capture*, in PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT (Daniel Carpenter & David A. Moss eds., 2013). *But see* Engstrom, *supra* note ___, at 674-78; Steven P. Croley, *Public Interested Regulation*, 28 FLA. ST. U. L. REV. 7, 7-8 (2000); Mark Kelman, *On Democracy-Bashing: A Skeptical Look at the Theoretical and "Empirical" Practice of the Public Choice Movement*, 74 VA. L. REV. 199, 236-68 (1988). On the possible capture of the SEC, *see* Adam C. Pritchard, *The SEC at 70: Time for Retirement?*, 80 NOTRE DAME L. REV. 1073, 1099-1101 (2005); Jonathan R. Macey, *Positive Political Theory and Federal Usurpation of the Regulation of Corporate Governance: The Coming Preemption of the Martin Act*, 80 NOTRE DAME L. REV. 951, 958 (2005); Stewart L. Brown, *Mutual Funds and the Regulatory Capture of the SEC* (November 20, 2016), https://ssrn.com/abstract=2854312. *See also* empirical studies on disproportionate SEC enforcement against smaller industry players. Stavros Gadinis, *The SEC and the Financial Industry: Evidence from Enforcement against Broker-Dealers*, 67 THE BUS. LAWYER 679 (2012); Simi Kedia et al., *The SEC's Enforcement Record against Auditors* (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2947469. *But see* Langevoort, *The SEC as a Lawmaker, supra* note___, at 1599 (suggesting that one "could expect a reasonably vigorous antifraud program from the SEC even with general industry capture.").

[186] That is not to say that an individual firm would not benefit from lobbying. Indeed, there is evidence that corporate lobbying is correlated with lower fraud detection by regulators. *See, e.g.,* Frank Yu & Xiaoyun Yu, *Corporate Lobbying and Fraud Detection*, 46 THE JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS 1865 (2011).

[187] Roberta S. Karmel, *Creating Law at the Securities and Exchange Commission: The Lawyer as Prosecutor*, 61 LAW & CONTEMP. PROBS. 33, 41 (1998).

Most importantly, the personal utility arguments are entwined with institutional benefits. To an agency constantly forced to advertise its enforcement successes, the argument raised in Section II(B),[188] domestic cases provide more bang for the buck. First, they generate better press and publicity compared to cases against foreign defendants.[189] Second, regulators sometimes exhibit caution, a tendency suggested in the literature on the regulatory state[190] and confirmed by a 2013 study of the SEC by the Government Accountability Office.[191] The SEC and its staff may purposely avoid complicated international cases where the costs of investigations are high and the resultant success on the merits is questionable.[192] Incidentally, it is possible that the resource-constrained SEC is not "filling the gaps" in private enforcement against international corporations, as discussed above, but pounces on smaller respondents[193] to avoid failure and public embarrassment.

To summarize, the low-key enforcement against foreign firms is Janus-faced. The SEC may be acting as a benevolent, social-welfare-maximizing enforcer or as an institution whose policies are premised on self-advertising, staff's personal utility functions, budget-related issues, and case selection biases,

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[188] *Supra* Section II(B). *See also* Choi & Pritchard (2016), *SEC Investigations*, *supra* note ___, at 28 (mentioning that "the SEC works to maximize the number of cases brought, penalties, and media attention").

[189] *See, e.g.,* Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience*, *in* INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID AND BEYOND 485, 487 & 499 (2006) (discussing the cost arguments explaining why the SEC should rationally prefer to prosecute domestic issuers).

[190] *See, e.g.,* Engstrom, *supra* note ___, at 682; Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM. L. REV. 1260, 1296-1300 (2006).

[191] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, SECURITIES AND EXCHANGE COMMISSION, IMPROVING PERSONNEL MANAGEMENT IS CRITICAL FOR AGENCY'S EFFECTIVENESS 10, 16, 75 (Jul. 2013), https://www.gao.gov/products/GAO-13-621.

[192] Frankel, *Let the Securities and Exchange Commission Outsource Enforcement, supra* note___, at 113 ("[I]f success for the Enforcement division is measured by the number of cases, convictions, or settlements, incentives would lead [it] to avoid the large costly complicated cases and focus on the small ones."); Rose, *Securities Fraud Deterrence, supra* note___, at 2218 (cataloguing various behavioral biases affecting SEC enforcement polices); Macey, *The Distorting Incentives, supra* note___, at 646 ("The focus is on the number of cases brought by the Division, and, to a lesser extent, on the size of the fines collected by the SEC. . . . In light of this metric of success, it is not surprising that the SEC focuses on low-hanging fruit."). These arguments are also entwined with the penchant for "self-aggrandizement… with an eye to collecting political and personal rewards and ensuring the continued flow of resources to the agency." Engstrom, *supra* note___, at 680.

[193] Cox et al., *SEC Enforcement Heuristics, supra* note___, at 778 (discussing this tendency); Engstrom, *Agencies, supra* note___, at 681; John C. Coffee, Jr., *Is the SEC's Bark Worse than Its Bite?,* NAT'L L.J., July 9, 2012 (noting the tendency of the SEC to pursue many relatively small actions, rather than focusing on a few big ones, in order to avoid the embarrassment of having any defendants "escape scot-free").

all explaining lackluster enforcement against foreign firms. The choice is not binary and both explanations have merit.

C. Specifics of International Enforcement

Regardless of the underlying motivations of the SEC, it has opted for the best strategy of low-key enforcement. Each cross-listed company faces a two-by-two enforcement matrix including at least two national enforcement agencies and at least two sets of national courts. Consider an example of a Canadian company listed on the Toronto Stock Exchange and on Nasdaq and having about 50% of its assets on either side of the U.S.-Canadian border. Just as the U.S. has an efficient private enforcement system, so too does Canada have class-action litigation. Both jurisdictions obviously have public enforcers. This is an example of a two-by-two matrix with at least two venues for private enforcement and at least two public enforcers. Within this matrix, each national policymaker is unable to design procedural rules that would minimize the *total* net social costs of fraud *and* of enforcement.[194] No single country can singlehandedly achieve an optimal level of enforcement against an international firm, unless the other jurisdiction openly imposes restrictions on its own enforcement policy.

Yet no national regulator would openly commit to a hands-off approach, which is akin to freeriding and shirking its responsibilities to protect investors and oversee all issuers registered with the agency. The regulator would easily foresee a likely public backlash following an official announcement of a low-enforcement strategy. Possible consequences include adverse budgetary consequences and acrimonious congressional hearings aggravated by national pride and a common understanding of nonenforcement as an invitation for "lemons" and a threat to the stability of national markets.

The second argument that makes this scenario improbable is grounded in political economy arguments. Recall that according to the bonding theory, cross-listings are associated, *inter alia,* with trading premiums, better reporting and access to capital, and corporate governance improvements.[195] Those benefits would not be concentrated in the U.S. alone. To the extent that the benefits are associated with SEC enforcement actions, the Commission, as a national regulator, would be spending its limited budget on subsidizing foreign markets

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[194] The cross-border aspect of this challenge compounds the common problem that "[i]n choosing the procedural rules that will govern securities fraud cases… lawmakers face yet another difficult challenge. Though the goal is clear enough—to set rules that minimize net social costs— figuring out just what that requires presents murky empirical questions." Rose, *Securities Fraud Deterrence, supra* note___ at 2193.

[195] *Supra* Part II.

and regulators. SEC's regulatory actions would generate a *global* positive externality.

Hence, the SEC is likely to refer some matters to its counterparts abroad instead of actually prosecuting foreign issuers.[196] It is those foreign regulators, not the SEC, that operate as primary regulators of foreign corporations, have better access to evidence about wrongdoings, and naturally should assume the costs of enforcement and prosecute securities fraud in their respective jurisdictions in reliance on domestic law and regulatory policies. Figuratively speaking, this is a "center of gravity" argument in extraterritorial enforcement[197] and an acknowledgement that the SEC cannot act as a global policeman, but must navigate a complex field populated by international corporations and foreign regulators.[198]

Absent specific policy reasons, such as, for instance, the importance of a cross-listed company to a national economy or ownership of substantial assets in one country, i.e., circumstances in which the issuer inches closer to the "domestic" company status,[199] a rational enforcer would not want to absorb the costs of cross-border investigation and enforcement.

This philosophy is also indirectly embedded in the Commission's Enforcement Manual, which guides the Enforcement Division toward "matters having potential programmatic significance, which are deemed 'National Priority Matters.'"[200] Among the criteria that carry weight with the Enforcement Division are a strong message of deterrence and substantial numbers of injured investors.[201] Foreign companies and the magnitude of related investor losses may

196 *See, e.g.,* Howell E. Jackson, *The Impact of Enforcement: A Reflection*, 156 U. PA. L. REV. PENNUMBRA 400, 408 (2008) ("With the globalization of financial markets, regulatory officials routinely refer matters to their counterparts in other jurisdictions. Often, a problem like insider trading or market manipulation will be detected in one market but will be referred to a second or third jurisdiction, where the investor making the trades or the firm in whose stock the trade is affected is located. ").

197 *See, e.g.,* Fox (2012), *supra* note___, at 1179, 1208-10 (discussing "economic center of gravity" arguments and a corresponding approach to litigation).

198 *See, e.g.*, Chris Brummer, MUNILATERALISM: HOW TRADE ALLIANCES, SOFT LAW, AND FINANCIAL ENGINEERING ARE REDEFINING ECONOMIC STATECRAFT 88-97 (2014) (presenting a compelling story of global developments and the policy-setting ecology).

199 *See* 17 C.F.R. § 230.405 (2015) (defining "foreign private issuer"), 17 C.F.R. § 240.3b-4(b) (2015) (same).

200 ENFORCEMENT MANUAL, *supra* note___, § 2.1.1.

201 *Id.*

easily fall outside of these "matters of national significance" and be relegated to the targets of marginal importance.[202]

The third supporting argument is premised on the discussed in Section B public choice explanations. As a national regulator, the Commission would not capture the full benefits from enforcement. Its actions, associated with better deterrence or more competitive and transparent markets, would be a pure "unrequited" subsidy to public agencies and markets in other jurisdictions. Those *global* subsidies would never be assigned to the personnel of the SEC.[203] In all probability, enforcement actions may galvanize the critics of the Commission if, for instance, there is an outflow of foreign firms to exchanges outside the U.S. The SEC bears the risks of deterring foreign issuers from listing and being blamed for the outflow of international companies. Over-deterrence, in turn, not only leads to an exodus of international companies from the U.S. market, but also impedes capital formation and reduces allocative efficiency.

The fourth set of explanations are rooted in the *accretionary* nature of cross-border enforcement,[204] where the U.S., or any other country for that matter, is merely an additional regulatory *layer* for an international company. In this layered system, enforcement cooperation and coordination are advisable. Coordination, however, is often difficult and varies among enforcement agencies.[205] For instance, the Ontario Securities Commission may take the lead in a specific case and the SEC would provide support in that joint investigation. In case there are parallel class actions in Canada and the U.S., courts may split the plaintiff class for the purposes of a settlement.[206] The international two-by-two enforcement matrix between the two neighbors, the U.S. and Canada, would work well in that individual case. However, with some other countries, even if there is a broader umbrella agreement, the SEC's coordination costs could be prohibitive.

Even though several agencies may agree on the broad cooperation terms, they also have to credibly commit to an adequate pre-agreed-upon level of

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[202] An accompanying efficiency consideration is that "[t]o be justified, a deterrence-focused securities fraud liability regime must save more in social costs from fraud than it creates in enforcement costs." Rose, *Securities Fraud Deterrence, supra* note___, at 2178.

[203] *See, e.g.,* Langevoort, *The SEC as a Lawmaker, supra* note___, at 1611 (suggesting this line of reasoning).

[204] The benefits of enforcement may be cumulative. Research suggests, for instance, that international firms subject to enhanced regulatory scrutiny in several jurisdictions of listing file more accurate financial statements. Nelly Samarasekera et al., *IFRS and Accounting Quality: The Impact of Enforcement* (2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2183061.

[205] I would like to thank the participants of the Fifth Corporate and Securities Litigation Workshop and former SEC practitioners for confirming this point.

[206] *See* Guseva (2017), *supra* note___, at 266-67 (discussing such settlements).

performance.[207] To date, however, cross-national enforcement variations endure despite harmonized substantive laws.[208] Moreover, each time the Division of Enforcement calls on foreign regulators for assistance in its investigations, the SEC, as an institution, cashes in on its political capital for the purposes of a specific investigation and related discovery. Just as political capital is limited, so too is international cooperation in enforcement.

International requests for assistance may take time. Recall the new Supreme Court position on the application of the five-year statute of limitation to disgorgement in SEC cases.[209] The new approach should further dampen the Commission's incentives to engage in a cross-border dialogue with foreign bureaucracies whenever time is of essence.[210] Finally, at the time of this writing, the Supreme Court granted certiorari in *U.S. v. Microsoft Corporation,* a case presenting an important question whether domestic U.S. companies must comply with warrants related to customer data stored abroad.[211] The answer to this

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[207] The success of substantive securities law provisions depends on their implementation across markets. *See ,e.g.,* Samarasekera et al., *IFRS and Accounting Quality*, *supra* note___; Christensen et al., *Capital-Market Effects of Securities Regulation, supra* note___. In the words of Bohn and Choi, [t]he benefits of fraud liability depend on securities-fraud actions actually playing an enforcement role." Bohn & Choi, *Fraud in the New-Issues Market, supra* note___, at 924. Investors prefer securities of international and cross-listed companies if their jurisdictions of listing and domicile have good disclosure rules and support the reporting rules by robust public enforcement. *See, e.g.,* Reena Aggarwal et al., *Portfolio Preferences of Foreign Institutional Investors*, WORLD BANK POLICY RESEARCH WORKING PAPER No. 3101 (2003). Empirical research also suggests that efficient home country regulations should not be merely law on the books, but law in action. *See, e.g.,* Irene Karamanou & George Nishiotis, *An Examination of the Comparative Valuation Effects of Enhanced Disclosure and Cross-Listing in the US*, (July 15, 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=968230; Stefan Eichler, *Equity Home Bias and Corporate Disclosure*, 31 J. INT'L. MONEY & FIN. 1008 (2012); Gilberto R. Loureiro & Alvaro G. Taboada, *The Impact of IFRS Adoption on Stock Price Informativeness* (Apr. 2012), http://www.efmaefm.org/0EFMAMEETINGS/EFMA%20ANNUAL%20MEETINGS/2012-Barcelona/papers/IFRS-Adoption_and_Stock_Price_Informativeness-5-7-2012.pdf.

[208] Variability in enforcement intensity persists and is correlated with different capital-market effects. *See, e.g.,* Hans B. Christensen et al., *Capital-Market Effects of Securities Regulation: Prior Conditions, Implementation, and Enforcement*, 29 REV. FIN. STUDIES 2885 (2016) (analyzing the implementation of EU directives by member countries within the EU).

[209] Kokesh v. SEC, WL 2407471 (U.S. June 5, 2017).

[210] The Kokesh decision is also entwined with one novel twist. *See* Honeycutt v. United States, 2017 WL 2407468 (U.S. June 5, 2017). Justice Sotomayor delivered the Kokesh opinion on the same day with *Honeycutt,* another unanimous Court decision. *Honeycutt* addressed the criminal forfeiture statute. After *Honeycutt,* a defendant will not be held jointly and severally liable for the assets received by her co-conspirators. The Court, thus, seems to have taken a general position against excessive government penalties.

[211] For a pertinent overview, *see, e.g.,* Sullivan & Cromwell, LLP, United States Supreme Court Grants Certiorari in United States v. Microsoft Corporation, October 17, 2017.

question depends on the interpretation of *Morrison* and may further affect the ability of enforcement agencies to obtain data stored in foreign jurisdictions.[212]

To summarize, the foregoing issues are bound to produce only one dominant strategy for the SEC - a predictably low enforcement and high discretionary nonenforcement. The cross-border enforcement ecology itself logically pushes the SEC to rely on regulators abroad and on private enforcers within the U.S. Private litigation, thus, is converted from "a necessary supplement to SEC enforcement"[213] to an institutionally preferable and optimum option. The SEC should rationally underinvest in enforcement against international firms. Since the Commission cannot publicly admit its philosophy, this dominant strategy remains unacknowledged.

V. IS LOW-KEY ENFORCEMENT SUSTAINABLE?

A. Class Actions

This Part examines whether this policy needs to be adjusted in the post-*Morrison* world.[214] The below analysis provides a synoptic review of the changes in class-action litigation, firms' incentives, and market trends. In terms of litigation, the SEC may rest assured that *Morrison,* despite concerns of some commentators,[215] has not dealt a deathblow to class actions against international

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[212] *See, e.g.,* Matter of Warrant to Search a Certain E-Mail Account Controlled & Maintained by Microsoft Corp., 829 F.3d 197, 210 (2d Cir. 2016) (citing Morrison v. National Australia Bank Ltd., 561 U.S. 247, 255 (2010)).

[213] Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 652 (1996). In one of his testimonies, Chairman Levitt emphasized that "[t]he Commission has long maintained that private actions provide valuable and necessary additional deterrence against securities fraud, thereby supplementing the Commission's own enforcement activities." Concerning the Impact of the Private Securities Litigation Reform Act of 1995: Before the Subcomm. on Banking, Housing & Urban Affairs, 105th Cong. (1997) (testimony of Arthur Levitt Jr., Chairman, SEC).

[214] Paraphrasing Amanda Rose, is SEC's "prosecutorial discretion [against foreign issuers] palatable [and can] the enforcer… be trusted to promote optimal deterrence" by staying on a course of predictably low enforcement? Rose, *Securities Fraud Deterrence, supra* note___, at 2197.

[215] *See, e.g.,* Luis A. Aguilar, Statement by Commissioner, Defrauded Investors Deserve Their Day in Court, Apr. 11, 2012, https://www.sec.gov/news/public-statement/2012-spch041112laahtm ("It is clear that Morrison has deprived investors of their private rights of action under the Exchange Act with respect to a wide range of potentially fraudulent conduct that the United States has a compelling interest to regulate."); 2012 SEC STUDY, *supra* note ___, at 18-19, 39, 42-53; Licht et al. (2013), *supra* note ___, at 4 (citing comments submitted by 26 pension funds to the SEC).

companies.[216] The decision has clearly strengthened the defendants' hand in many respects. By way of example, most claims are usually settled after a motion to dismiss. More rarely, defendants settle after class certification. *Morrison* may have upended that trend. In its July 7, 2017, *Petrobras* decision, the Second Circuit Court of Appeals, citing *Morrison,* vacated in part a class certification order on the grounds that the lower court did not determine whether the question of the domestic nature of the OTC transactions at issue would predominate over the issues of law and fact common to the whole class.[217]

The *Morrison* decision also seems to have opened some unexpected avenues for potential under-enforcement. For instance, Joseph Grundfest recently pointed out that the Court has missed that in addition to secondary market liability under section 10(b) and Rule 10b-5, *Morrison, ex hypothesi,* reduces section 11 liability in initial public offerings "in which listing on a U.S. exchange follows an initial distribution that includes even a small number of shares sold in transactions that are non-domestic under *Morrison*."[218] In the now global world of securities, foreign institutional investors almost invariably participate in the initial distribution of new securities. Those purchasers do not acquire securities in "domestic transactions" required under *Morrison.* They may not have a private right of action under section 10(b) and lack standing to bring actions under section 11.[219]

More importantly, there is a chance that if they later on sell their securities on an American exchange, the sales will contaminate the whole pool of securities, including those originally purchased in *domestic* transactions. All shares will be commingled and may become "tainted." This will prevent U.S. aftermarket purchasers from satisfying the tracing requirement, *i.e.,* the requirement that "aftermarket purchasers seeking standing must demonstrate the ability to 'trace'

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[216] While theoretically plausible, this scenario is not supported by research and data on current filings and on investment strategies. *See* Robert P. Bartlett III, *Do Institutional Investors Value the Rule 10b-5 Private Right of Action? Evidence from Investors' Trading Behavior following Morrison v. National Australia Bank Ltd.,* 44 J. LEGAL STUD. 183 (2015); http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2171006; Licht et al. (2013), *supra* note___; Guseva (2017), *supra* note___.

[217] In re Petrobras Securities, 862 F.3d 250, 273 (C.A.2 (N.Y.), 2017) ("The need for Morrison inquiries nominally presents a common question because the need to show a "domestic transaction" applies equally to each putative class member."). See also id. at 257 ("However, we next hold that the district court committed legal error by finding that Rule 23(b)(3)'s predominance requirement was satisfied without considering the need for individual Morrison inquiries regarding domestic transactions. We therefore vacate this portion of Certification Order.").

[218] Joseph A. Grundfest, *Morrison, the Restricted Scope of Securities Act Section 11 Liability, and Prospects for Regulatory Reform,* 41 J. CORP.L. 1 (2015).

[219] *Id.*

their shares to the faulty registration"[220] statement. Consequently, *Morrison* represents an approach to extraterritoriality that may shake the foundations of the nearly century-old liability regime under both the Exchange Act and the Securities Act.

There also were some post-*Morrison* changes which may point toward a reduced risk and costs of class-action litigation in general. Even though class action filings against international companies have been rising for a few years,[221] after 2010, foreign issuers face a smaller plaintiff class since federal district courts dismissed *all* actions brought by foreign and U.S. residents with respect to securities purchased abroad.[222] Post-*Morrison* mean and median class action settlement amounts became lower by almost 60%. After *Morrison,* more class action settlements were in the range between $1,000,000 and $5,000,000, and a higher percentage of post-*Morrison* claims settled.[223] More post-*Morrison* defendants prefer to settle quickly, before a court ruling on a motion to dismiss or without ever moving to dismiss, which is their primary and cheapest weapon in securities class-action litigation.[224]

It is, of course, possible that international corporate defendants were motivated to settle because of a need to avoid litigation costs and distraction of class actions, because of agency costs or D&O insurance, or simply due to risk aversion.[225] Post-*Morrison* defendants may perceive the risk of going to trial more daunting compared to a cheaper and prompt settlement. Unfortunately, an alternative explanation could be an increase in fraud[226] and higher net benefits from fraud resulting from suboptimal post-*Morrison* deterrence. Both explanations of economizing on litigation costs and fraud as such would fit with

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[220] Krim v. pcOrder.co, Inc., 402 F3d. 489 (5th Cir. 2005).

[221] *See, e.g.,* Svetlana Starykh & Stefan Boettrich, NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2015 Full-Year Review* (2016).

[222] Guseva (2017), *supra* note___, at 255-64.

[223] *Id*. at 266-68. *See also* Elaine Buckberg & Max Glucker, *Cross-Border Shareholder Class Actions Before and after Morrison* (Dec. 16, 2011), http://dx.doi.org/10.2139/ssrn.1973770.

[224] Guseva (2017), *supra* note___, at 255-64. On the impact of procedural laws, *see generally* Adam C. Pritchard et al*., The Screening Effect of the Private Securities Litigation Reform Act*, 6 JOURNAL OF EMPIRICAL LEGAL STUDIES 35, 35-68 (2009); Pritchard & Sale, *supra* note___, at 128 ("The PSLRA makes the motion to dismiss the main event for securities litigation…. Moreover, the absence of discovery means that the expense of litigation will be manageable for the defendants.").

[225] For instance, the role of D&O insurance and cultural norms may be dispositive in litigation behavior. *See* Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487 (2007); Ji Li, *I Came, I Saw, I… Adapted – An Empirical Study of Chinese Companies Investing in the U.S. and Their Legal and Policy Implications*, 35 NORTHWESTERN J. OF INT'L L & BUS. 143 (2016).

[226] Pritchard & Sale, *supra* note___, at 128 (2005).

the decrease in average settlement values, a higher percentage of settlements, and a growing number of filings. In other words, while it is false to presume that more post-*Morrison* settling defendants are lemons, the reverse cannot be ruled out without additional research.

B. Post-Morrison *Investors*

Another concern is that through listing on exchanges, foreign companies improve their international visibility, proceed to issue more securities, and arouse broad investor interest.[227] When an American investor learns about an international company being listed on the NYSE with all the attendant fanfare, she may be more interested in acquiring its securities, proceed with placing a purchase order with her broker, and notice only too late that the broker executed the order on a foreign exchange in the country of domicile of the cross-listed issuer. In that case, if the international issuer published materially misleading statements, that investor would be unable to bring an action for fraud under the federal securities laws in a U.S. court.

Admittedly, these consequences of *Morrison* may be limited to individuals. In contrast, institutional investors are more sophisticated and well-diversified. Yet they are not immune from being blindsided by fraudsters and bamboozled by the prestige of listing in the U.S. In fact, institutions investing in foreign companies prefer securities of cross-listed issuers.[228] Those securities may be purchased either in the U.S. and thus fall under the *Morrison* test or abroad and thereby possibly fall outside the extraterritorial reach of securities law. Research indicates, however, that many institutional investors did not change their investment and trading policies in the wake of *Morrison.*[229] Institutions either have ignored the "about-face" or, instead of looking to possible litigation, rely in their trading decisions on various economic factors, improvements in

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[227] *See, e.g.,* H.K. Baker et al., *International Cross-Listing and Visibility*, 37 J. OF FIN. & QUANTITATIVE ANALYSIS 495 (2002), 495-521; Litvak, *The Relationship Among U.S. Securities Laws, Cross-Listing Premia, and Trading Volumes, supra* note___; King & Segal, *The Long-term Effects of Cross-listing, Investor Recognition*, *supra* note___; Boone et al., *The Information Environment of Cross-Listed Firms*, *supra* note___; Aggarwal et al., *Portfolio Preferences of Foreign Institutional Investors*, *supra* note___; Karolyi, *The World of Cross-Listings, supra* note___, at 15-16 & 18-19; Reese & Weisbach, *Protection Of Minority Shareholder Interests, supra* note___; Ball et al., *Equity Cross-Listings in the U.S. and the Price of Debt*, *supra* note___.

[228] *See* Aggarwal et al., *Portfolio Preferences of Foreign Institutional Investors*, *supra* note___.

[229] Bartlett, *Do Institutional Investors Value the Rule 10b-5 Private Right of Action?, supra* note___.

disclosure policies, and the informativeness of share prices, which are characteristic consequences of cross-listings.[230]

Yet recent research warns that *Morrison* may have produced a negative impact not only on investor litigation, but also on corporate reporting and transparency.[231] Moreover, even though improvements in corporate governance and reporting ensue after cross-listings,[232] these effects may not be uniform across markets. There are significant country-level effects associated with the strength of local investor protection rules and their enforcement.[233] Depending on the extent of the reduction in post-*Morrison* disclosure and private enforcement, even institutional investors may need help from the Commission.

C. Good and Bad Firms

A 2010 study suggested that private enforcement alone, although not useless for fraud prevention, was responsible for only 3% of the detected cases of fraud while the SEC accounted for 7%.[234] Post-*Morrison,* i.e*.,* after 2010, foreign

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[230] Guseva (2017), *supra* note___; Nicola Cetorelli & Stavros Peristiani, *Firm Value and Cross Listings: The Impact of Stock Market Prestige*, 8 J. RISK FIN. MGMT. 150, 177 (2015); Laurent Frésard & Carolina Salva, *The Value of Excess Cash and Corporate Governance: Evidence from U.S. Cross-listings,* 98 J. FIN. ECON. 359, 359–84 (2010); Licht et al. (2013), *supra* note___, at 11; Venkat Eleswarapu & Kumar Venkataraman, *The Impact of Legal and Political Institutions on Equity Trading Costs: A Cross-Country Analysis*, 19 REV. FIN. STUD. 1081 (2006); Huimin Chung, *Investor Protection and the Liquidity of Cross-listed Securities: Evidence from the ADR Market,* 30 JOURNAL OF BANKING & FINANCE 1485, 1503 (2006); Litvak, *The Relationship Among U.S. Securities Laws, Cross-Listing Premia, and Trading Volumes, supra* note___, at 4-5.

[231] *See* James P. Naughton et al., *Private Litigation Costs and Voluntary Disclosure: Evidence from the Morrison Ruling* (2017), http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2432371.http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2432371. *See also* Gagnon & Karolyi, *The Economic Consequences, supra* note___. Recall that "disclosure has a tempering effect on fraud because transparency makes discovery of ill-behavior more likely." Schwartz (2014), *supra* note___, at 377.

[232] *See, e.g.,* Reena Aggarwal et al., *Does Governance Travel around the World? Evidence from Institutional Investors,* 100 J. FIN. ECON. 154, 154–81 (2011); Reena Aggarwal et al., *Differences in Governance Practices between U.S. and Foreign Firms: Measurement, Causes, and Consequences*, 22 REV. FIN. STUD. 3131, 3131–69 (2009).

[233] *See, e.g.,* Boone et al., *The Information Environment of Cross-Listed Firms, supra* note___, at 8-9; Ana C. Silva et al., *Earnings Management, Country Governance, and Cross-listing: Evidence from Latin America*, 7(1) GLOBAL J. EMERGING MKT. ECONS. JOURNAL OF EMERGING MARKET ECONOMIES 4 (2015)**;** Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets,* 48 UCLA L. REV. 781, 820 (2001); Eleswarapu & Venkataraman, *The Impact of Legal and Political Institutions on Equity Trading Costs, supra* note___*;* Chung, *Investor Protection and the Liquidity of Cross-listed Securities, supra* note___, at 1503.

[234] Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?,* THE J. OF FIN., Vol. LXV, No. 6, pp. 2213-2253, at 2214, 2230 (2010).

companies may come to believe that against a stable level of SEC enforcement, fraud detection through class-action litigation has become even lower. A litigation risk reduction inures to the benefit of honest international firms. Unfortunately, it simultaneously benefits companies which are more likely to under-comply and commit fraud.[235]

Fraud primarily improves the payoffs of culpable corporate insiders.[236] Those insiders may safely reside in foreign countries, which raises personal jurisdiction, investigatory and enforcement obstacles, and enjoy private benefits, which typically should be negatively associated with the greater transparency accompanying cross-listings.[237]

Firms managed by unscrupulous executives should welcome lower enforcement costs.[238] In particular, if a firm has already raised the necessary capital after cross-listing in the U.S., which is generally associated with an uptick in securities offerings,[239] and has nothing further to gain from having its shares traded in the U.S., its cost-benefit analysis may be analogous to the final period problem. In the final period, control persons face termination of employment, takeover or impending bankruptcy and may take on more risk and engage in fraudulent practices.[240] The same reasoning applies to foreign firms poised to leave the U.S. market. A manager's expected return on fraud, materially misleading statements or simply dishonest puffery is inversely related to the

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[235] On the discussion of fraud as a form of risk seeking and undercompliance, *see, e.g.,* Rose, *Securities Fraud Deterrence, supra* note___, at 2190-91.

[236] *See, e.g.,* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1534–35 (2006); Sean J. Griffith, *Afterward and Comment: Towards an Ethical Duty to Market Investors*, 35 CONN. L. REV. 1223, 1241-42 (2003); Baker & Griffith, *Predicting Corporate Governance Risk, supra* note___, at 544.

[237] Research on cross-listings provides ample evidence on the incentives of foreign firms' insiders and a reduction in their individual private benefits in conjunction with cross-listings in the U.S. *See, e.g.,* Doidge et al. (2009), *supra* note ___; Doidge (2004), *supra* note ___; Allen Ferrell, *The Case for Mandatory Disclosure in Securities Regulation Around the World,* 2 BROOK. J. CORP. FIN. & COM. L. 81, 86-91 (2007). The value of control premia is negatively associated with "better general investor protection, higher quality of law enforcement, and stricter takeover laws" and explain as much as "68% of the cross-country variation in the value of control-block votes." Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-country Analysis*, 68 JOURNAL OF FINANCIAL ECONOMICS 325, 344, 348 (2003).

[238] "Unscrupulous" does not necessarily mean that insiders have fraudulent intent. An executive's statement may be mere puffery or express undue optimism. *See, e.g.,* Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms),* 146 U. PA. L. REV. 101, 108, 167 (1997).

[239] *See supra* note___.

[240] *See generally* Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. ILL. L. REV. 691, 702-03 (1992).

expected costs of law and enforcement. Put differently, fraud becomes a positive net value project in the final period.[241]

If this under-deterrence scenario is severe and left unaddressed for a long time, a lemons market may ensue.[242] In that market, rational investors would increasingly and continuously discount the value of publicly traded securities of all foreign issuers regardless of whether an individual issuer is an honest international corporation or a lemon. The honest international issuers would not receive a premium for their truthful corporate reporting, could be penalized with a lower market price, and more strike suits if they candidly disclosed news, particularly bad news, to shareholders. Ultimately, they should be forced to exit American markets.[243] This outcome would defeat the objectives of national securities regulation, including improved share-price accuracy, corporate transparency, and, ultimately, allocative efficiency.[244]

D. Troublesome Market Examples

Even though there is no proof of an urgent lemons problem plaguing the U.S. market, a few trends are worthy of note. Around 2015, the major American exchanges - the NYSE and Nasdaq – overtook London, which has traditionally been their major competitor in attracting cross-listings through depositary receipts.[245] Another statistic comes from the database of reporting FPIs registered with the SEC. Their numbers were slowly dropping for several decades but recently have stabilized.[246] This means that the outflow of international firms has slowed down, even if it has not been entirely reversed.

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[241] *Id*.

[242] *See generally* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 THE QUARTERLY JOURNAL OF ECONOMICS 488 (1970).

[243] *Id*. at 495.

[244] Fox et. al., *Economic Crisis and the Integration of Law and Finance, supra* note___, at 370–71. Making fraud cheaper and opening loopholes in enforcement may be associated with "the possibility of an uncompensated wealth transfer [,] caus[ing] certain socially detrimental investments and result[ing] in other reductions in societal wealth." Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 630 (1992).

[245] *See* Guseva (2017), *supra* note___, at 203 n. 23.

[246] *Compare* Securities and Exchange Commission, International Registered and Reporting Companies, Market Summary 2015 (Dec. 31, 2015), https://www.sec.gov/divisions/corpfin/internatl/foreignmarketsumm2015.pdf; with Summary Information 2014 (Dec. 31, 2014), https://www.sec.gov/divisions/corpfin/internatl/foreignsummary2014.pdf; Summary Information 2011 (Dec. 31. 2011), https://www.sec.gov/divisions/corpfin/internatl/foreignsummary2011.pdf; Summary Information 2000 (Dec. 31, 2000), https://www.sec.gov/divisions/corpfin/internatl/companysum2000.htm; Foreign Companies

Is this because the United States finally has struck the right balance in terms of the costs and benefits of listing, the attendant exposure to its liability regime, and compliance costs? I agree with the answer posited by Leuz and Wysocki:

> [T]he largest and, arguably, most successful capital markets exhibit strong disclosure and securities regulation. Do these markets thrive because of regulation or in spite of it? [Economists] have little evidence that we could bring to bear on this question….[247]

More immediate concerns are whether many of the currently cross-listed issuers are lemons. As mentioned above, more companies may under-disclose information to the market in the wake of *Morrison,* which is associated with reduced voluntary disclosure.[248] Because of an erosion of class actions, theoretically, fewer firms may be pre-committed to good corporate practices.[249]

Consider also the distribution of domiciles of the international companies currently registered with the SEC. It is broad and spans strong and successful markets, as well as jurisdictions with weaker capital markets and securities law. Yet, the following offshore jurisdictions top the lists as of December 31, 2015, and December 31, 2011, but not as of December 31, 2006:

- British Virgin Islands (BVI) had 37 and 53 registered and reporting companies in 2015 and 2011, respectively, but as few as 21 in 2006;
- Cayman Islands companies increased their presence as well, with 119 and 134 companies in 2015 and 2011, respectively, and only 43 in 2006;
- Marshal Islands stand at 45 and 32 issuers in 2015 and 2011, respectively, and only 15 in 2006.[250]

Registered and Reporting with the U.S. Securities and Exchange Commission (Dec. 31, 1998), https://www.sec.gov/divisions/corpfin/internatl/foreignissuers1998.pdf.

[247] Christian Leuz & Peter Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research*, 54 JOURNAL OF ACCOUNTING RESEARCH 525 (2016).

[248] *See, e.g.,* Naughton et al., *Private Litigation Costs and Voluntary Disclosure, supra* note___.

[249] Fox (2012), *supra* note___1206-10 (observing that class actions may be viewed as a corporate governance device).

[250] Securities and Exchange Commission, December 31, 2015 - Market Summary, https://www.sec.gov/divisions/corpfin/internatl/foreignmarketsumm2015.pdf; December 31, 2011 - Market Summary, https://www.sec.gov/divisions/corpfin/internatl/foreignmarketsumm2011.pdf; December 31, 2006 - Market Summary, https://www.sec.gov/divisions/corpfin/internatl/foreignmarketsumm2006.pdf.

About a third of BVI-domiciled companies' securities trade on the OTC market. Other issuers within the foregoing group are almost equally split between the two most reputable listing venues – the NYSE and Nasdaq. Apparently, American investors and exchanges are not deterred by the fact that foreign issuers are registered offshore.

An apt illustration is Alibaba, which is listed in New York.[251] Alibaba's complicated ownership and governance structures were not welcome in Hong Kong. The unsuccessful overtures to the Hong Kong Stock Exchange were among the reasons which led to Alibaba's listing on a United States exchange.[252] Some companies may attempt to avoid the stringency of their domestic regulations or exchange requirements, escape to the United States,[253] and enjoy the historical prestige and liquidity of U.S. exchanges.[254]

Another troubling fact was an uptick in notorious "reverse mergers," a merger practice where surviving companies were ostensibly domestic, but de facto became foreign-controlled issuers. The wave of reverse mergers ultimately prompted the SEC to promulgate a new rule requiring, *inter alia*, that U.S. exchanges monitor reverse-merger companies more closely.[255]

Litigation against offshore and reverse-merger companies poses unique challenges, and scores of aggrieved investors are left with practically no recourse. In the course of my previous research on class actions, I was able to find a number of default judgments against companies which were listed on American exchanges through reverse mergers and ultimately went bankrupt and against

[251] *See, e.g.,* Bradley Hope, *Alibaba to List on New York Stock Exchange*, WSJ, Jun. 26, 2014, https://www.wsj.com/articles/alibaba-to-list-on-new-york-stock-exchange-1403802203.

[252] *Shareholder Democracy is Ailing*, THE ECONOMIST, Feb 9, 2017, http://www.economist.com/news/business/21716654-snaps-refusal-hand-out-any-voting-shares-part-wider-trend-towards-corporate.

[253] *See, e.g.,* Amir Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?,* 4 CHI. J. INT'L L. 141 (2003).

[254] On the effect of the prestige of listing venues, *see, e.g.,* Litvak, *The Relationship Among U.S. Securities Laws, Cross-Listing Premia, and Trading Volumes, supra* note___, at 4-5 & 11; Cetorelli & Peristiani, *Firm Value and Cross Listings, supra* note___, at 177.

[255] *See, e.g.,* SECURITIES AND EXCHANGE COMMISSION, SEC APPROVES NEW RULES TO TOUGHEN LISTING STANDARDS FOR REVERSE MERGER COMPANIES, PRESS RELEASE 2011-235, Nov. 9, 2011, https://www.sec.gov/news/press/2011/2011-235.htm.

many offshore companies.[256] Instead of showing up in court, those companies preferred to walk away.[257]

Table IV: Default Judgments against Offshore and Reverse Merger Companies (2005-2015)

	Total Default Judgments	Reverse Mergers
Post-Morrison	12	8
Pre-Morrison	1	
Grand Total	**13**	**8**

E. Conclusion

It is not an objective of this Article to suggest or to demonstrate that nomadic offshore and foreign hordes are "hell-bent" on ripping off unsuspecting American investors and target U.S. markets because of a lower risk of class action litigation post-*Morrison*. Instead, my purpose is to show that within the global market with a new status quo in private enforcement, American investors may more easily fall prey to fraud by some foreign companies. Whenever a firm's pre-commitment to good behavior is low and whenever deterrence provided by a liability regime, including both public and private enforcement, is inadequate, more low-quality firms may use that opportunity to their benefit.

Taking into account the predicates delineated in Part IV, it is also logical to imagine how in extreme circumstances the international enforcement milieu may be eroded by "the tragedy of the commons."[258] When a company cross-lists in the U.S., the market reacts positively, in part, because, cross-listings ordinarily signal firms' reputation and their commitment to better legal institutions.[259] Foreign regulators may view cross-listings as a quality signal signifying future compliance and reporting by the firm.[260] Foreign agencies also are aware that the Commission is deemed the most active and efficient enforcement agency in the

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[256] *See., e.g.,* ORDER STAYING CASE AS TO DEFENDANT JIANGBO PHARMACEUTICALS, INC. UPON SUGGESTION OF BANKRUPTCY, May 29, 2013, In re Jiangbo Pharmaceuticals, Inc., Securities Litigation, No. 1:11CV22556; Dena Aubin & Tracy Rucinski, *ChinaCast Files for Bankruptcy to Pursue Embezzlement Claims*, REUTERS, 10 Nov. 2016, http://www.cnbc.com/2016/11/10/reuters-america-chinacast-files-for-bankruptcy-to-pursue-embezzlement-claims.html.

[257] *See infra* Appendix I.

[258] For a theory on these dynamics, *see* William W. Buzbee, *Recognizing the Regulatory Commons: A Theory of Regulatory Gaps,* 89 IOWA L. REV. 1 (2003).

[259] *Supra* note___ and accompanying text.

[260] For instance, firms subject to joint oversight file more accurate reports. Samarasekera et al., *IFRS and Accounting Quality, supra* note___.

world in terms of its financial inputs and enforcement outputs.[261] This combination of quality signaling by firms and the SEC reputation could tempt SEC's counterparts to lighten their own oversight and, possibly, freeride on the *expected* Commission enforcement, which, as Part IV indicates, may not be forthcoming.

If the enforcement underinvestment became mutual, investors in international issuers would represent a proverbial common pasture where corporate fraudsters could roam free and no single regulator, particularly, not the SEC, would have sufficient incentives to provide oversight. If, simultaneously, private class-action litigation was hamstrung by procedural rules, the relative costs of fraud would decrease and a lemons market in a specific jurisdiction might ensue.

Presumably, this danger is particularly palpable in a jurisdiction like the United States - its exchanges stand out among global trading venues, including London, which may be affected by the lingering aftermath of Brexit and whose listings generally are not associated with comparable premiums for foreign firms;[262] American economy is growing; and its Congress and the executive branch are mulling over deregulatory reforms. More international firms, including both "oranges" and "lemons," may be enticed to list. What should the SEC do to keep potential international fraudsters in check and, at the same time, to control the costs of cross-listings to avoid deterring honest firms?

VI. A DOCTRINAL INQUIRY: CAN THE SEC ACT?

This Part embarks on this inquiry by reviewing first the relevant doctrinal issues and determining whether the post-*Morrison* SEC has the necessary tools and incentives to proceed more aggressively. In other words, has *Morrison* restricted the SEC's *ability* and *willingness* to prosecute foreign companies, just as it has limited the extraterritorial reach of the antifraud provisions of securities law in class actions?

To date, there remains an ambiguity as to the restraints on the Commission's ability to prosecute foreign firms because *Morrison* intended the restriction on the extraterritorial application of section 10(b) to apply broadly and did not carve out an explicit exception for public enforcement purposes. Following Newton's third law, the Supreme Court's action caused an instantaneous reaction from Congress. A congressional committee approved

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[261] Jackson, *Variation in the Intensity of Financial Regulation, supra* note___, at 283; Coffee, *Law and the Market*, *supra* note__, at 262-72.

[262] For cross-listing companies, listing in London does not result in the same premium. *See* Doidge et al., *Has New York Become Less Competitive than London?, supra* note___.

Dodd-Frank almost immediately after *Morrison.* The statutory language provides that in actions brought by the Department of Justice and the SEC district courts have jurisdiction over:

> 1) Conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
> 2) Conduct occurring outside the United States that has a foreseeable substantial effect within the United States.[263]

Despite this strong language, the statute does not comport with *Morrison.* While the Supreme Court has suggested that "to ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question,"[264] Congress has used the jurisdictional phraseology.[265]

There is a spectrum of lower court decisions running the gamut from strict pro-*Morrison* interpretations on the one side, to uncertain doctrinal construction in the middle, and all the way to pro-SEC conclusions. Within the first group, case law underscores "the presumption that United States law governs domestically but does not rule the world."[266] In the middle are those who share awareness that there is no consensus on whether Dodd-Frank has overruled *Morrison* for purposes of public enforcement. Those courts have been very circumspect in addressing this issue and declined to resolve the matter.[267]

For instance, in *Battoo,* the Northern District of Illinois Court dodged a bullet, observing that it was "not necessary to decide whether Section 929P(b) does indeed overrule *Morrison* for actions brought by the SEC, because the Court concludes that Section 929P(b) does *not* apply retroactively to any pre-Dodd-Frank enactment conduct, which makes up the bulk of the alleged conduct

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[263] 15 U.S.C. § 78aa(b) (2010).

[264] *Morrison*, 561 U.S. at 254.

[265] *See, e.g.,* George T. Conway III, *Morrison at Four: A Survey of Its Impact on Securities Litigation, U.S. Chamber Institute for Legal Reform* (2014), http://xbma.org/forum/wp-content/uploads/2014/11/Morrison-at-Four-A-Survey-of-Its-Impact-on-Securities-Litigation.pdf.

[266] *Vilar*, 729 F.3d at 72 (citing *Kiobel*, 133 S.Ct. at 1664). The court also extended *Morrison* to criminal cases. *Id*. at 70.

[267] United States Sec. & Exch. Comm'n v. Battoo, No. 1:12-CV-07125, 2016 WL 302169, at *9 (N.D. Ill. Jan. 25, 2016); Sec. & Exch. Comm'n v. Sabrdaran, No. 14-CV-04825-JSC, 2015 WL 901352, at *14 (N.D. Cal. Mar. 2, 2015); United States Sec. & Exch. Comm'n v. Brown, No. 14 C 6130, 2015 WL 1010510, at *5 (N.D. Ill. Mar. 4, 2015); S.E.C. v. Funinaga, No. 213-CV-1658 JCM CWH, 2014 WL 4977334, at *7 (D. Nev. Oct. 3, 2014).

committed by [defendant]."[268] In another case, the same district court, cognizant of the complexity, "conclude[d] that it [was] unnecessary to resolve at this time the difficult question of the Dodd–Frank Act's impact on *Morrison*."[269] The Northern District of California Court decided to follow a similarly safe route, looked to the *Morrison* test, and concluded that "[i]n light of the Court's decision that the allegations in the complaint sufficiently meet the transactional test, it need not resolve the debate over whether the Dodd–Frank Act overruled *Morrison,* as the SEC contends."[270]

Even when courts alluded to the substantive, i.e., not merely jurisdictional, nature of the Dodd-Frank amendments, they refrained from definitively resolving the issue. In *Chicago Convention Ctr.,* the court, for example, pointed at "a tension created by Section 929P(b), namely that the plain language of Section 929P(b) seems purely jurisdictional—particularly in light of its placement in the jurisdictional section of the Exchange Act—yet the Congressional intent behind that provision supports a conclusion that the provision is substantive." [271] At the same time, the court acknowledged that its analysis could be incomplete and that "it is possible that this interpretation would create superfluity or contradict the legislative intent."[272] In the end, the court equivocated again and was spared further inquiry because the SEC's complaint could also safely survive under the new *Morrison* test.[273]

At the other end of this case-law spectrum are courts such as the Southern District of New York Court which are markedly less cautious, occasionally have stretched the holding in *Morrison* to cover foreign transactions,[274] and seem to have acknowledged that Dodd-Frank has reversed *Morrison* in public enforcement. For instance, in *Gruss,* the court observed that "[e]ntitled 'Strengthening Enforcement by the Commission,' Section 929P(b) amends the Securities Act, the Exchange Act, and the [Investment Advisers Act (IAA)] to allow the SEC or the U.S. Justice Department to commence civil and criminal

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[268] United States Sec. & Exch. Comm'n v. Battoo, No. 1:12-CV-07125, 2016 WL 302169, at *9 (N.D. Ill. Jan. 25, 2016)

[269] United States Sec. & Exch. Comm'n v. Brown, No. 14 C 6130, 2015 WL 1010510, at *5 (N.D. Ill. Mar. 4, 2015).

[270] Sec. & Exch. Comm'n v. Sabrdaran, No. 14-CV-04825-JSC, 2015 WL 901352, at *14 (N.D. Cal. Mar. 2, 2015).

[271] U.S. S.E.C. v. Chicago Convention Ctr., LLC, 961 F. Supp. 2d 905, 910, 917 (N.D. Ill. 2013).

[272] *Id*. at 916-17.

[273] *Id*.

[274] In *Cañas Maillard*, for instance, the U.S. District Court for the Southern District of New York observed that although the defendant did not trade in listed securities, the chain of transactions involved purchases of contracts-for-difference in Luxembourg. In turn, this caused a brokerage firm to acquire securities which were listed on the New York Stock Exchange. SEC v. Malliard, No. 13-CV-5299, 2014 WL 1660024, at *1 (S.D.N.Y. Apr. 23, 2014).

enforcement actions extraterritorially in certain cases. Therefore, Section 929P(b) restores the SEC's extraterritorial authority over the IAA and its passage suggests that Congress intended for the extraterritorial application of the IAA…."[275] Finally, as recently as March 28, 2017, the District Court for the District of Utah unambiguously stated that Congress intended that the antifraud provisions of the securities law apply extraterritorially under the broader conduct and effects tests.[276] The court granted the SEC's motion for preliminary injunction.

It remains to be seen whether the Utah District Court's decision in *Traffic Monsoon, LLC,* will be adopted by other courts and whether the ability of the SEC to prosecute securities fraud under the more expansive conduct and effects tests will be explicitly and uniformly extended. As it stands now, the case law pendulum mainly swings between a doctrinal ambiguity and a pro-Commission position. The practical outcomes of enforcement actions against foreign companies and their executives, therefore, may be mixed and the inquiry necessarily will be fact-specific.

Through this disparity, the legislature and the Supreme Court have complicated SEC's assessments of its success rate in enforcement actions.[277] When interdigitated with the arguments expounded in Part IV, this doctrinal

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[275] S.E.C. v. Gruss, 859 F. Supp. 2d 653, 664 (S.D.N.Y. 2012). *See also* S.E.C. v. Gruss, No. 11 CIV. 2420, 2012 WL 3306166, at *3 (S.D.N.Y. Aug. 13, 2012) ("Section 929P(b) of the Dodd–Frank Act allows the SEC to commence civil actions extraterritorially in certain cases."); S.E.C. v. Tourre, No. 10 CIV. 3229 KBF, 2013 WL 2407172, at *1, n. 4 (S.D.N.Y. June 4, 2013) (observing that "[b]ecause the Dodd–Frank Act effectively reversed Morrison in the context of SEC enforcement actions, the primary holdings of this opinion affect only pre-Dodd Frank conduct."); Cornwell v. Credit Suisse Grp., 729 F. Supp. 2d 620, 627 n. 3 (S.D.N.Y. 2010) ("Congress explicitly granted federal courts extraterritorial jurisdiction under the conduct or effect test for proceedings brought by the SEC...."); Asadi v. G.E. Energy (USA), LLC, No. CIV.A. 4:12-345, 2012 WL 2522599, at *4 (S.D. Tex. June 28, 2012) (observing that "[t]his conclusion against extraterritorial application is reinforced by Section 929P(b) of Dodd–Frank, which explicitly addresses extraterritorial scope of the statute in a limited context."); In re Optimal U.S. Litig., 865 F. Supp. 2d 451, n. 28 (S.D.N.Y. 2012) (mentioning in dicta that "Congress has attempted to remedy that problem by restoring the conducts and effects test for SEC enforcement actions.").

[276] Sec. & Exch. Comm'n v. Traffic Monsoon, LLC, No. 2:16–cv–00832–JNP, 2017 WL 1166333, at *13 (D. Utah, Mar. 28, 2017) ("[T]he text of Section 929P(b), the legal context in which this amendment was drafted, legislative history, and the expressed purpose of the amendment all point to a congressional intent that, in actions brought by the SEC,10 Sections 10(b) and 17(a) should be applied to extraterritorial transactions to the extent that the conduct and effects test can be satisfied.").

[277] Incidentally, while Justice Scalia's intent to lay out a bright-line rule in international securities litigation has inadvertently been undermined, the misgivings of the concurrence regarding "the clarity and simplicity of the Court's test [that] may have some salutary consequences, [but] like all bright-line rules it also has drawbacks," have been alleviated. *Morrison*, 561 U.S. at 285.

uncertainty implies that if the SEC has become less confident of scoring easy victories against foreign companies, the Commission and its personnel may be even less willing to invest their resources in initiating enforcement actions.[278] As long as the ambiguity remains unsolved, *Morrison* should dampen the incentives of the SEC to engage in closer foreign issuer oversight, except, perhaps, publicized instances of serious fraud implicating large numbers of American investors.

Combining the conclusions of Parts V and VI, we are presented with a dilemma. On the one hand, the SEC may be expected to follow the same safe route of low-key enforcement against international corporations. On the other hand, it is imprudent to ignore the recent "red flags" in foreign listings and changes in class action litigation, which in the future may cause harm to American markets.

VII. POLICY PROPOSALS: PREVENTIVE MONITORING AND A SOFT ENFORCEMENT APPROACH

A. Low-Cost Low-Key Prevention

This Part sketches a few policy options that the SEC could consider to fine-tune its policies in order to simultaneously avoid the lemons problem and the overdeterrence effect. Two factors bear on the proposals. First, the SEC's enforcement approach is its dominant strategy within the existing ecology of enforcers. Its stance is also institutionally optimal, deeply entrenched, and based on the existing political and economic incentives to underinvest in enforcement against foreign issuers. Second, there is a need to reconsider the current policy to tackle the red flags identified in this Article. Bearing these two considerations in mind, the Commission needs to devise low-cost measures that would allow it to internalize the costs and benefits of its policies, simultaneously navigate the cross-border enforcement realities[279] and the interdependencies within the ecosystem of private and public mechanisms, and minimize redundancy in enforcement.[280]

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[278] In these circumstances, foreign issuers could rationally discount the probability of enforcement, while the SEC should overestimate the risk of failure in a district court, particularly in broader international schemes where fraudulent conduct or substantial harm to investors occurs in foreign countries.

[279] Engstrom, *supra* note___, at 656 (discussing the contextual nature of an "optimal gatekeeper").

[280] On the pros and cons of multi-enforcer systems, *see generally* Engstrom, *supra* note___, at 629 (underscoring a need for coordination and interdependencies); Clopton, *Redundant Public-Private Enforcement, supra* note___, at 290 & 306-308 (suggesting that "redundant

To begin with, there is no need for the Commission to ramp up enforcement qua enforcement. It is not clear if international markets, as a global *sui generis* policy assessment mechanism, have penalized international issuers for the Supreme Court decision. Neither firm values nor institutional investors' portfolios were affected by *Morrison*'s pruning of class actions.[281] The red flags identified in Part V point toward future problems that *may* affect the market if the SEC stays on the same course of low-key enforcement. If the resultant efficiency gains are uncertain, stronger public enforcement should not automatically follow weakened class actions.[282] The red flags, instead, warrant allocating more resources not toward enforcement actions per se but toward low-cost preventive measures and better "housekeeping."

Recall, for instance, that the Commission has been tardy in doing "housekeeping" and revoking registration of securities. With its current data analysis programs, however, the Commission should be able to generate better information and revoke registrations promptly. Already in his 2015 testimony before the House Committee on Financial Services, Andrew Ceresney, Director of the Enforcement Division, stated that such enforcement priorities as reporting and disclosure violations were supported by large-scale data analysis programs.[283] These programs may be put to use to assist the Commission in routine "housekeeping" in foreign issuer reporting.[284]

When it comes to potentially more serious violations, the SEC equally has the capacity to ensure better monitoring based on data analytics. The Division of Enforcement collaborates with the new Division of Economic and Risk Analysis (DERA) in developing methods "to detect anomalous financial results disclosed in public company filing data."[285] The Commission established DERA in 2009.

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litigation may cure existing under-enforcement and deter future under-enforcement by allowing a second agent to fill the remedial gap" and reviewing design arguments). *But see* Grundfest, *Disimplying Private Rights of Action, supra* note___.

[281] *Compare* Bartlett, *Do Institutional Investors Value the Rule 10b-5 Private Right of Action?, supra* note___*;* Licht et al. (2013), *supra* note___, at 11, *with* Gagnon & Karolyi, *The Economic Consequences, supra* note___.

[282] For theories of optimal enforcement, *see, e.g.,* Stigler, *supra* note___; Fox et al. (2016), *supra* note___; Rose (2017), *supra* note___, at 255-57; Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*," 72 NYU L. REV. 687 (1997).

283 Andrew Ceresney, Testimony on "Oversight of the SEC's Division of Enforcement," Mar. 19, 2015, https://www.sec.gov/news/testimony/031915-test.html.

[284] Although revoking the registration of a security requires notice and a hearing (15 U.S.C.§§ 78l(j) (2015)), this is a lower-cost procedure compared to investigations.

[285] Ceresney (2015), *supra* note___. The Enforcement Division also created the Financial Reporting and Audit Task Force to this purpose. *Id. See also* THE FUTURE OF THE SECURITIES AND EXCHANGE COMMISSION, *supra* note___, at 13; Securities and Exchange Commission,

Among its functions are assisting in enforcement and identifying market trends and risks.[286]

The idea of using DERA more extensively in foreign issuer regulation comports with the overarching policies of the SEC. Michael Piwowar, for instance, urged in one of his speeches that "early DERA participation can help determine materiality, harm to investors (if any)… whether the benefits of pursuing a particular enforcement action outweigh the costs, and whether it would be prudent to pursue alternative enforcement actions."[287] As discussed in Part IV, institutional constraints and public choice arguments suggest that the SEC may overestimate the costs of enforcement against international issuers and underestimate the benefits. Using DERA's resources as a primary screening mechanism would minimize those biases.

In addition to DERA, the SEC has established within its Enforcement Division the Financial Reporting and Fraud Group with the purpose of not only identifying violations but also exploring areas "susceptible to fraudulent financial reporting."[288] The SEC should put this large-scale data analysis tools to use to identify potentially fraudulent trends in foreign issuer reporting.

The key proposal, however, is that the SEC staff does not need to either proceed with an investigation or recommend that the SEC take an enforcement action. Instead, the Commission may consider developing a new mechanism for preventive foreign issuer monitoring. By way of example, DERA may run data analysis and alert the Enforcement Division that a single firm or several foreign companies with certain characteristics exhibit reporting discrepancies and anomalies.[289] After that, the Enforcement Division may informally communicate to the potential targets that they need to address the concerns raised by DERA.

The SEC does have a somewhat similar practice of sending "cautionary letters" to the subjects in cases that do not merit a full-scale investigation. In contrast to the mechanism I am suggesting here, the Commission does not issue the letters often and sometimes uses them in lieu of fines. Under this proposal,

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DERA – Office of Corporate Finance https://ww gov/page/dera ocf page (explaining the mission of the Office).

[286] *See* DERA - Office of Corporate Finance, https://www.sec.gov/page/dera_ocf_page.

[287] Piwowar (2015), *supra* note___.

[288] Financial Reporting and Audit (FRAud) Group, https://www.sec.gov/spotlight/financial-reporting-and-audit-task-force.shtml.

[289] The need for more economic analysis and using DERA in SEC rulemaking and enforcement has already been explored in the literature. *See, e.g.,* White, *The Evolving Role of Economic Analysis, supra* note___, at 297; Jerry Ellig & Hester Peirce, *SEC Regulatory Analysis: "A Long Way to Go and a Short Time to Get There,"* 8 BROOK. J. CORP. FIN & COM. L. 361 (2014;) J.W. Verret, *Economic Analysis in Securities Enforcement: The Next Frontier at the SEC,* 82 U. CIN. L. REV. 491 (2013). In this paper, I would like to go further and sketch a few possibilities tailored to the specifics of foreign issuer enforcement.

however, DERA-generated letters should be routine and not related to a formal or informal investigation.

First, consider the costs. Once the practice of informal requests becomes standardized and routine, economies of scale should reduce the SEC's costs per issuer. Second, these actions would not reach the level of a "matter under investigation." Instead, the SEC would be reacting to anomalies in the data. The primary objective of this light-touch approach is eliciting cooperation and improvements in issuers' corporate governance and/or internal controls. A collateral benefit, self-evidently, would be the additional information about the registrants, which could be used in the future to identify serious violations and bring enforcement actions.

Here is how it may work. A firm would have the right to choose to either respond to the informal request from the Commission or modify its reporting and corporate policies without responding to the SEC letter. In the latter case, the firm would have an option to file either a current report by furnishing Form 6-K;[290] its next annual report if it was due within less than, for instance, six months from the date of the request; or a domestic report with a foreign regulator or exchange. In the alternative, it could publish a notice about relevant corporate governance or reporting improvements on its webpage in English. The management's incentives to comply would be strengthened by the nonpublic nature of the SEC's actions. The firm would publicize its initiatives and signal corporate improvements as if they were "sua sponte" actions. Even though the role of DERA would remain nonpublic, the resultant improvements in governance or transparency should accrue to the benefit of the investors.

As a way to promote compliance, the SEC letters could explicitly stipulate two courses of action. *First*, the Commission may threaten retaliation. Unless a firm explained its reporting choices or changed its policies as described above, the Enforcement Division would either commence an investigation or refer the matter to the firm's primary regulator abroad. In essence, under this mechanism, the Commission would be blowing the whistle either to prompt the firms to run internal investigations and ensure proper reporting and internal controls[291] or to refer the anomaly to foreign enforcers. The latter option would also remove these items from the SEC enforcement agenda and balance sheet.

The Commission may also seamlessly combine the new low-cost measures with the tried-and-tested techniques such as reports under section 21(a)

[290] Form 6-K (2017), https://www.sec.gov/files/form6-k.pdf.

[291] The process is also similar to the no-action letters, which currently are becoming less appropriate in the official enforcement process. *See, e.g.,* THE FUTURE OF THE SECURITIES AND EXCHANGE COMMISSION, *supra* note___, at

of the Exchange Act.[292] Should it be necessary to give publicity to the DERA requests and ensuing investigation, the SEC could publish the report and, if necessary, permit the foreign firm to file a statement in writing explaining its version of the events.[293]

Second, the SEC should also spell out that it reserved an option not to retaliate without providing explanations to the target. In other words, it may openly exercise discretionary nonenforcement. As the firm would not know upfront which action the SEC might choose, its management would be incentivized to cooperate and undertake measures to effect compliance or, in the alternative, to prepare for an action.

To be effective, this approach requires the following commitment from the SEC - a firm which tries to cooperate and improve should not be prosecuted unless the Commission determined that the violations were egregious and that public policy and investor protection objectives militated against discretionary nonprosecution.[294] Cooperation is already a prominent mechanism welcomed by the Commission and embedded in its 2010 Policy Statement, the new Enforcement Cooperation Program, and its 2016 Enforcement Manual.[295] Moreover, there is room for significant enforcement flexibility. The Manual itself acknowledges that "[s]ince every enforcement matter is unique, the appropriate use of a cooperation tool invariably depends upon a careful analysis of the facts and circumstances of each case."[296] In the informal system that I propose here, the cooperation takes place earlier, before an investigation and at a lower cost.

The justification of this light-touch approach lies not only in the pure costs of enforcement, but also general economic arguments. It is commonly understood that the primary objective of enforcement actions is deterrence.[297] As discussed

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[292] 15 U.S.C. § 78u(a) (2015). The reports have traditionally served as a publicity device allowing the SEC to discuss an investigation without taking an action and "to articulate novel legal theories or standards of conduct." SECURITIES LITIGATION AND ENFORCEMENT, *supra* note___, at 703. Reports may be published in conjunction with cease-and-desist proceedings. 15 U.S.C. § 78u–3 (2015).

[293] 15 U.S.C. § 78u(a) (2015).

[294] Presumably, "an enforcer can help reduce this risk of overdeterrence by signaling to firms that they will escape liability for their agents' frauds if they can demonstrate that they took efficient precautions." Rose, *Securities Fraud Deterrence, supra* note___, at 2202.

[295] SECURITIES AND EXCHANGE COMMISSION, Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions, Release No. 34-61340, Jan. 19, 2010, https://www.sec.gov/rules/policy/2010/34-61340.pdf; Enforcement Cooperation Program, https://www.sec.gov/spotlight/enforcement-cooperation-initiative.shtml; Enforcement Manual § 6.2, *supra* note___.

[296] Enforcement Manual § 6.2, *supra* note___.

[297] *See, e.g.,* SEC v. Rind, 991 F 2d 1486, 1490 (9th Cir. 1993) (underscoring the differences between SEC actions and claims of individual investors and emphasizing that "[t]he theory behind the remedy is deterrence and not compensation."); ABA SECTION ON BUSINESS

earlier in this Article, the adjacent goals are market efficiency entwined with controlling the risk of overdeterrence. In international issuer regulation, this is not merely a theoretical concept but a measurable phenomenon that may entail an unnecessary outflow of issuers from the U.S.[298] The suggested above mechanism is a cost-efficient way of fostering cooperation while keeping the overdeterrence concerns in check.

The nature of cross-listings and the bonding theory outlined in Part IV also suggest that companies that will choose to heed the warnings will be self-identifying as "oranges," while firms ignoring the SEC will default to the "lemons" category. There will be a clear separating equilibrium, which will help the SEC identify and, if necessary, proceed against certain issuers. If a firm remains interested in listing on U.S. exchanges, it will reaffirm its "bond" to American law and market institutions and cooperate with the SEC early on, particularly if the publicity, costs, and risks of doing so are low. Put differently, informing foreign issuers early about *possible* investigations would help the SEC identify international companies that value their cross-listings programs and allow those companies take corrective measures preempting enforcement.

B. Killing Two Birds with "Low-Cost Stones"

My second proposed policy adjustment is firmly rooted in the reality that the SEC relies on private enforcers, that both have been ineluctable litigation companions, and that the market reacts strongly to a combination of private and public actions.[299] If in the post-*Morrison* world the SEC would like to continue to rely on private enforcers, it must take notice of the ongoing procedural developments. One specific initiative would be helping both the market and the plaintiffs' bar identify potentially meritorious violations by publishing some results of DERA economic analysis on market trends and providing it to the public at large.

DERA itself does not have the authority to frame SEC enforcement priorities.[300] Publishing its data analysis and reporting on market trends may represent another soft method for increasing deterrence without actual public

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LAW, REPORT OF THE TASK FORCE ON SEC SETTLEMENTS, 47 BUS. LAW. 1083, 1092 (1992) (mentioning that "the agency's position reflects a strong public interest dimension").

[298] *Supra* note___.

[299] *See* Choi & Pritchard, *SEC Investigations*, *supra* note___.

[300] *See, e.g.,* Verret, *supra* note___, at 495 ("The SEC Enforcement Division currently uses DERA to effectively provide litigation support after a case has been brought, or utilizes DERA to provide expert guidance during an investigation, but DERA has no authority to participate in the decision to bring an investigation or action nor to set the ground rules for how the SEC Enforcement Division prioritizes its caseload or determines penalties and settlements.").

enforcement. DERA has a separate Office of Corporate Finance, which examines reporting issuers' filings, public offerings, and unregistered offerings.[301] The Commission would kill two birds with one stone by adding a new project line to the already existing review of filings and selectively publishing results.[302]

This informational input would alert the market that something is amiss and galvanize such "gatekeepers" as market analysts and institutional investors. Research suggests that the extent of analyst coverage, for instance, is correlated not only with cross-listing in a foreign jurisdiction,[303] *but also* with the enforcement capacity of regulatory agencies.[304] As an enforcement agency charged with the dual task of protecting investors and promoting market efficiency, through these measures the SEC will equip institutional "gatekeepers" with additional informational tools.

A subsequent downward price adjustment may, as it typically does, draw attention of another group of gatekeepers - the plaintiffs' bar - and prompt a review of filings in search of actionable violations.[305] Enabling the plaintiffs to better monitor foreign issuers would benefit the Commission by promoting the equilibrium where the plaintiffs' bar and the SEC each takes the lead in different enforcement segments.[306] *Morrison* will allay the germane concerns about frivolous litigation and over-enforcement, serve as a sentry, watching for the excesses in the extraterritorial application of the antifraud provisions of the securities laws, and subdue attorneys' animal spirits actuating strike suits.[307] By the same token, the suggested approach should alleviate the inefficiencies associated with copycat cases, where private attorneys freeride off SEC efforts and turn class actions into inefficient bounty-hunter enforcement.[308] Instead, private attorneys would lead off and invest resources in investigating potential violations, while the SEC would merely provide "data pointers."

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[301] *See* DERA - Office of Corporate Finance, https://www.sec.gov/page/dera_ocf_page.

[302] The Commission, obviously, does not need to disclosure its enforcement techniques.

[303] Lang et al., 2003, *supra* note___; Baker et al., *International Cross-Listing and Visibility*, *supra* note___; Lang et al., 2004, *supra* note___.

[304] Alexander Kerl & Martin Ohlert, *Star-Analysts' Forecast Accuracy and the Role of Corporate Governance* (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2195909.

[305] *Supra* Part II.

[306] These complementarities have long existed in different enforcement areas. *See, e.g.,* Tamar Frankel, Implied Rights of Action, 67 VA. L. REV. 553, 580 (1981) ("the SEC has largely left the field to private enforcers . . . in enforcement of proxy rules").

[307] *See supra* Part V.

[308] *See, e.g.,* Rose, *Reforming Securities Litigation Reform, supra* note___, at 1345, 1362 (noting that "'copycat' class actions often are not amenable to dismissal at the pleadings stage-even if it appears that the damages claimed will, at the end of the day, be fully offset by a Fair Funds distribution.").

To conclude, a soft approach is rational and feasible. The SEC has intimated that its enforcement guides are efficiency and net benefits from enforcement, evaluated against the costs to the market, the SEC, corporations, and investors.[309] If so, the Commission should openly acknowledge its traditional low-key enforcement against foreign corporations and set forth the metes and bounds of an efficacious preventive approach.

As this analysis demonstrates, the SEC cannot produce a national system of optimal enforcement which would minimize the social costs of fraud without cooperation from the plaintiffs' bar, the market, and the regulators in various jurisdictions. Through traditional enforcement, the SEC would be pursuing an insurmountable task of designing a proper "Pigouvian tax"[310] on fraud by international corporations. Through non-enforcement, it could miss the lemons problem. Would it not be more logical to start with sending an explicit signal to the market that the Commission is using the best data tools at its disposal and more efficient low-key-low-cost options?

VIII. CONCLUSION

To conclude, this Article is not a call to arms. Instead, the Commission should send a clear signal to the market regarding its renewed willingness to closely monitor foreign issuers after *Morrison.* The Commission needs to react to the changes in private litigation, a possible lemons problem, and the potential risk of under-enforcement.

Despite the presence of several important red flags, the SEC has not meaningfully altered its enforcement in recent years. International corporations continue to face a comparatively low risk of enforcement actions. This generally stable level of enforcement could be welfare maximizing if the pre-*Morrison*

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[309] In 2006, the Commission issued a statement concerning financial penalties and prioritized the universal tenet that it was "important to provide the maximum possible degree of clarity, consistency, and predictability in explaining the way that its corporate penalty authority will be exercised." SECURITIES AND EXCHANGE COMMISSION, STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION CONCERNING FINANCIAL PENALTIES, RELEASE NO. 2006-4, Jan. 4, 2006, https://www.sec.gov/news/press/2006-4.htm. Unfortunately, it is possible that the staff recommends actions without assessing such 2006 factors as "a direct benefit to the corporation" and compensation of "harm to the injured shareholders." Piwowar (2015), *supra* note___. *See also* Rose, *Securities Fraud Deterrence, supra* note___, at 2184-85; Rose (2017), *supra* note___, at 255 (observing that "[t]he goal of a securities-fraud deterrence regime should be to minimize the sum of the costs that securities fraud produces and the costs that the deterrence regime itself produces").

[310] *See, e.g.,* Jonathan S. Masur & Eric A. Posner, *Toward a Pigouvian State*, 164 U. Pa. L. Rev. 93, 94-95 (2015) ("A Pigouvian tax is a tax equal to the harm that the firm imposes on third parties."); A. Mitchell Polinsky & Steven Shavell, *The Optimal Tradeoff Between the Probability and Magnitude of Fines*, 69 AM. ECON. REV. 880, 880 (1979) (viewing an optimal fine as a tax).

public and private enforcement generated excessive deterrence and wasteful litigation and drove international issuers from American markets. An alternative outcome, however, is under-enforcement resulting in an influx of low quality firms in the future.

The Commission should develop *preventive* monitoring policies and utilize its recently improved capacity to analyze "big data" and identify anomalies in reporting by international issuers. The proposed low-cost procedures should help the SEC engage market gatekeepers and private attorneys, achieve a more optimal level of deterrence without bringing enforcement actions, and simultaneously send a strong signal to international "lemons."

Appendix I: Post-Morrison Filings (2010-2015), Certificates of Default and Default Judgments (excluding cases pending as of Nov. 26, 2016)

1. Fayun Luo v. Qiao Xing Universal Resources et al, No. 1:12-cv-00045 (D. Virgin Islands, Jun. 6, 2017)
2. In Re Puda Coal Securities Inc., et al. Litigation, No. 1:11-cv-02598 (S.D.N.Y., May 10, 2017)
3. Dan Katz, et al. v. China Century Dragon Media., Inc., et al., No. LA CV11-2769 (JAK)(SSx) (C.D.
4. In Re Chinacast Education Corporation Securities Litigation, No. 2:12-cv-04621 (C.D. Cal., Nov. 8,
5. Dartell, et al. v. Tibet Pharmaceuticals, Inc., et al., 2:14-cv-03620 (Dist. of New Jersey, Jul. 28, 2016)
6. In re Jiangbo Pharmaceuticals, Inc., Securities Litigation, No. 11-cv-22556 (S.D. Florida, Apr. 13, 2012); In re Jiangbo Pharmaceuticals, Inc., Securities Litigation, No. 11-cv-22556 (S.D. Florida, Sept 29,
7. Tak Hiromoto et al v. Subaye Inc et al, No. 2:11-cv-07168 (C.D. Cal., Dec. 15, 2014)
8. In Re: China Intelligent Lighting and Electronics, Inc., No. 2:11-cv-02768 (C.D. Cal., Sept. 18, 2014)
9. McIntire v. China MediaExpress Holdings, Inc., No. 1:11-cv-00804, (S.D.N.Y., Jan. 17, 2014)
10. In re Longwei Petroleum Investment Holding Limited Securities Litigation, No. 1:13-cv-00214 (S.D.N.Y.,
11. In re Longtop Financial Technologies Limited Securities Litigation, No. 1:11-cv-03658 (S.D.N.Y., Nov.
12. Morad Ghodooshim, et al. v. Rui Lin Wu, et al., No. 1:12-cv-09264 (S.D.N.Y., May 23, 2013)