

Law and the Rise of Foreign Issuer IPOs

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ABSTRACT: This is a Response Essay to William Moon’s article, “Delaware’s Global Competitiveness,” in which I add to the debate about why issuers headquartered in jurisdictions such as China choose not to incorporate in Delaware when they go public in the United States. Using hand-collected data on foreign issuer IPOs, I show that the market for these transactions is highly dependent on specialists working at a small number of American law firms. These firms form an intriguing new section of the transactional bar. Understanding the role played by these specialized attorneys is essential for seeing the fuller picture of foreign issuer IPOs. These lawyers familiarize their foreign clients with American laws and regulations, partner with local law firms in the issuer’s home country, help issuers incorporate in a suitable jurisdiction, and affect the company’s corporate governance at the time of the IPO by choosing which American stock exchange rules they adopt. The lack of a global convergence toward a standard model of corporate law is surely linked to the business model and local institutions faced by companies. However, it is also the product of deliberate choices made by lawyers working to reduce transaction costs for their clients.

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I. INTRODUCTION

In 2019, the *Wall Street Journal* ran a profile of Z. Julie Gao, a corporate law partner in the Hong Kong office of Skadden, Arps, Slate, Meagher & Flom LLP. The article explained how Chinese CEOs sought her advice on the complicated process of listing their company on American stock exchanges. The CEOs could depend on her to explain why particular contract terms had been crafted the way they were a decade ago. Gao's expertise was valued so much that one client wrote her name into its engagement contract, stating it would hire her next employer if she left Skadden.¹ Unstated in the article was the fact that Gao has personally been involved in one-third of all Chinese initial public offerings ("IPOs") on American stock exchanges since 2009.² This Response argues that the market for foreign issuer IPOs is highly dependent on specialists working at a select number of American law firms. These firms form an intriguing new section of the transactional bar. Understanding the role played by these attorneys is essential to seeing the fuller picture of foreign issuer IPOs. A closer study of the novel transnational role played by transactional lawyers also yields insights into the structure of the American legal profession.

In his important Article, Professor William Moon develops a theory of "territorial market segmentation" to explain why issuers headquartered in jurisdictions such as China choose not to incorporate in Delaware when they go public in the United States.³ According to this thesis, local market conditions in these firms' place of business, such as the prevalence of self-dealing transactions and lack of truly independent directors, make compliance with Delaware corporate law too cumbersome.⁴ Moon finds a steady increase over time in the share of U.S.-listed Chinese firms that incorporate in "tax havens" such as the Cayman Islands and British Virgin Islands, rather than popular American states of incorporation such as Delaware and Nevada.⁵ He contends that the relatively lax and pro-managerial corporate law of these tax haven jurisdictions is a better fit for the business model of Chinese issuers.⁶ Territorial market segmentation should therefore lead us to question earlier scholarly predictions about a grand

1. See Julie Steinberg, *When Tech's Hottest Names Go Public, This Is Who They Call*, WALL ST. J. (Apr. 4, 2019, 6:57 PM), <https://www.wsj.com/articles/when-techs-hottest-names-go-public-this-is-who-they-call-11554386404> [<https://perma.cc/5G5M-ZQ47>].

2. See Dhruv Chand Aggarwal, *Foreign Issuer IPOs and The New Transnational Bar* 36, (forthcoming 2022) (unpublished manuscript) (on file with author).

3. See William J. Moon, *Delaware's Global Competitiveness*, 106 IOWA L. REV. 1683, 1690 (2021).

4. See *id.*

5. See *id.* at 1689.

6. See *id.* at 1700-08.

convergence in corporate law standards to a global standard model very similar to Delaware's shareholder-centric system.⁷

I argue that the choices involved in territorial market segmentation, including but not limited to the choice of where to incorporate, are often driven by lawyers rather than business executives at foreign issuers. The lack of a global convergence toward a standard model of corporate law is surely linked to the business model and local institutions faced by companies. However, it is also the product of deliberate choices made by lawyers working to reduce transaction costs for their clients. In Part II, I document the rising share of foreign companies among newly listed stocks on the two leading American stock exchanges. I demonstrate that the rise of foreign issuer IPOs implicates more corporate governance issues than the site of incorporation, which is the focus of Professor Moon's piece.⁸ Foreign issuers can also be exempt from several important American stock exchange rules, which can be harmful to shareholders. Furthermore, a string of recent corporate governance scandals at Chinese issuers listed in the United States have raised concerns about misrepresentation and fraud at such companies.

In Part III, I draw on theory from economics, sociology, and the law to explain the role transactional lawyers play in shepherding their clients through the IPO process. I emphasize how lawyers arguably play an even more important role when their clients are foreign companies, drawing on their regulatory knowledge and reputational capital to help their foreign clients access American capital markets. I explore the potential lessons further analysis of the transnational bar can hold for research in corporate governance. I focus on what this topic could tell us about the role of home country legal origins in financial development, the role of lawyers in corporate governance, and the growth of diversity in the American legal profession. Part V concludes this Response.

II. WHY CARE ABOUT CHINESE ISSUERS?

One of the most important changes in American capital markets in recent years is the explosion in the number of foreign companies listing on U.S. stock exchanges. Foreign issuers went from comprising a meager two percent of U.S. IPOs in the 1980s to almost a quarter of total IPOs in the 2010s.⁹ Chinese companies, in particular, accounted for 0.3 percent of IPOs in the 1990s, but 18.4 percent in the 2010s.¹⁰ Chinese firms continue to list on American stock exchanges amidst a dip in the two countries' diplomatic relations. Even amidst trade wars and bitter bilateral feuds over issues such as Hong Kong and COVID-19, the number of Chinese IPOs continues to rise.

7. The canonical expression of this thesis is Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001).

8. See generally Moon, *supra* note 3 (focusing on Delaware's "global competitiveness").

9. These numbers are based on author's calculations using JAY R. RITTER, INITIAL PUBLIC OFFERINGS: FOREIGN COMPANIES GOING PUBLIC IN THE U.S., 1980-2021, at 3 tbl.14 (2022), <https://site.warrington.ufl.edu/ritter/files/IPOs-Foreign.pdf> [<https://perma.cc/7A3E-E6JB>].

10. *Id.*

As one partner at a leading accounting firm put it, “[i]f somehow the listing rules are changed and the doors are closed on Friday, you’ll probably see a Chinese IPO on Thursday.”¹¹

Beyond these firms’ choice of domicile, there are important corporate law and governance reasons for studying and potentially regulating Chinese issuer IPOs. First, foreign issuers can exempt themselves from important corporate governance rules instituted by American stock exchanges. Prominent American stock exchanges such as NASDAQ and the New York Stock Exchange (NYSE) impose a variety of requirements on their member companies.¹² These corporate governance rules deal with a variety of topics, such as ensuring a sufficient number of directors are independent from management, mandating that all members of the audit committee are financially literate, and requiring that the company have a code of business ethics.¹³ However, many of these requirements are not binding on foreign issuers.¹⁴ Instead, NASDAQ and NYSE allow these companies to follow their home countries’ practices.¹⁵ For instance, foreign issuers are not required to have a majority of the board consist of independent directors, have independent directors set executive compensation, or create a code of business ethics.¹⁶ Research by financial economists indicates that foreign firms that choose more corporate governance opt-outs suffer from lower firm valuations, and are less responsive to market signals of investment opportunities.¹⁷ Therefore, foreign issuers can weaken shareholder protections despite listing on prominent U.S. stock exchanges, potentially hurting American investors.

A second governance concern that is more specific to Chinese issuers is the possibility of misrepresentation and fraud at these companies. A string of recent scandals at Chinese firms listed in the United States have raised concerns that their performance numbers are false or misleading. For example, NASDAQ-listed Luckin Coffee positioned itself as a Chinese competitor to Starbucks and was widely seen as a dazzling success story. However, it later emerged that \$310 million of sales had been faked: Luckin had given away millions of coffee cups to companies affiliated with its

11. Jing Yang, *The Gold Standard: Why Chinese Startups Still Flock to the U.S. For IPOs*, WALL ST. J. (Aug. 13, 2020, 4:25 PM), <https://www.wsj.com/articles/the-gold-standard-why-chinese-startups-still-flock-to-the-u-s-for-ipos-11597313278> [<https://perma.cc/G4A5-KKE3>].

12. See WEIL, GOTSHAL & MANGES LLP, REQUIREMENTS FOR PUBLIC COMPANY BOARDS: INCLUDING IPO TRANSITION RULES 3–5, 8, 24 (2022), <https://governance.weil.com/wp-content/uploads/2022/01/Requirements-for-Public-Company-Boards-Including-IPO-Transition-Rules.pdf> [<https://perma.cc/825C-95JC>].

13. See *id.*

14. See generally *id.* (noting certain exemptions for foreign issuers).

15. See *id.* at 27.

16. See generally *id.* at 19–26.

17. See generally C. Fritz Foley, Paul Goldsmith-Pinkham, Jonathan Greenstein & Eric Zwick, *Opting Out of Good Governance*, 46 J. EMPIRICAL FIN. 93 (2018) (discussing costs and benefits of corporate governance choices).

chairman and controlling shareholder.¹⁸ \$140 million in supplier payments were processed by an employee who did not exist.¹⁹ A key cause for such lack of transparency at Chinese issuers is the dubious quality and business ethics of Chinese accounting firms, and China's refusal to allow teams from the U.S. government accounting regulatory agency from conducting investigations or accessing audit work papers on its territory.²⁰ Chinese companies often disclose one set of financial results in their U.S. filing and an altogether different set in Chinese filings for the exact same time period.²¹

Despite forming an increasingly important segment of new U.S. IPOs, foreign issuers present several important corporate governance challenges. Some, such as foreign issuers exempting themselves from NASDAQ or NYSE rules, can be traced to regulatory decisions made in the United States by regulators such as stock exchanges. Others, however, are inextricably linked to the business prospects and socio-economic "institutional" conditions faced by foreign issuers in their home countries. These problems include not just tax haven incorporation, but also accounting deficiencies, as well as blatant misrepresentation and fraud. These institutional problems are far more intractable: While it is easy to imagine NASDAQ limiting the exemptions available to foreign issuers, it is less likely that the Chinese government will allow Public Company Accounting Oversight Board ("PCAOB") teams to investigate in its territory. As of early 2022, Chinese authorities have reluctantly discussed potentially giving PCAOB teams limited access to accounting information, despite U.S. regulators saying full access to audit documents "was 'not negotiable.'"²²

Since the appeal of foreign issuer stocks to American investors, as well as the corporate law concerns associated with them, show no signs of abating, it is useful to understand which agents and institutions determine these firms' internal governance. In the rest of this Response, I argue that transactional lawyers play a crucial role in shepherding their foreign clients through the regulatory hurdles involved in listing in the United States and have an impact on corporate governance at these firms at the time of the IPO. While corporate attorneys minimize transaction costs in a variety of contexts, they

18. See Jing Yang, *Behind the Fall of China's Luckin Coffee: A Network of Fake Buyers and a Fictitious Employee*, WALL ST. J. (May 28, 2020, 12:12 PM), <https://www.wsj.com/articles/behind-the-fall-of-chinas-luckin-coffee-a-network-of-fake-buyers-and-a-fictitious-employee-11590682336> [<https://perma.cc/QY37-GN26>].

19. See *id.*

20. See Jay Clayton, Wes Bricker, & William D. Duhnke III, *Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-Listed Companies with Significant Operations in China*, U.S. SEC. & EXCH. COMM'N (Dec. 7, 2018), <https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other> [<https://perma.cc/gL33-ZEM8>].

21. See Colleen Honigsberg, *The Case for Individual Audit Partner Accountability*, 72 VAND. L. REV. 1871, 1905 n.137 (2019).

22. See Eleanor Olcott & Michael O'Dwyer, *US Says Hopes of Resolution of Audit Impasse with China 'Premature'*, FIN. TIMES (Mar. 24, 2022), <https://www.ft.com/content/f0225140-a424-4ae0-bf27-a90170b1d215> [<https://perma.cc/8TV9-FMDK>].

do so with special force when involved with an IPO. Transaction cost minimization is more essential for foreign issuers because of special regulatory requirements as well as management's unfamiliarity with American regulatory and business norms. Transactional lawyers add value to foreign issuer IPOs by: (1) specializing in IPOs by firms based in specific countries; (2) drawing on their personal "extralegal" ties to the issuer's home country; and (3) forming interfirm alliances with home country lawyers.

III. THE NEW TRANSNATIONAL BAR

A. TRANSACTIONAL LAWYERS AND THE (FOREIGN ISSUER) IPO

Law and economics scholars have long conceptualized transactional lawyers as "transaction cost engineers," who keep track of complex rules and regulations, negotiate with counterparties and secure the best terms for their clients. Transactional attorneys take the complexities of the real world and try to bring it as close as possible to the idealized transaction-cost-free world of asset pricing models.²³ The IPO process brings substantial transaction costs because the firm is facing a public company's heightened disclosure requirements for the first time. In its comment process, the Securities Exchange Commission ("SEC") reviews registration statements to ensure companies are adequately disclosing to the investing public the material risks associated with their business operations.²⁴ The Commission has had a "Plain English Rule" since 1998, which mandates that issuers explain risk factors (such as regulatory issues, competing companies, and changing demand for its products) in simple language that a layperson can understand.²⁵ Issuers are strictly liable for material misstatements or omissions in their IPO registration statements, per Section 11 of the Securities Act of 1933.²⁶ Issuers therefore depend on law firms, which are repeat players in the IPO market, to limit their securities litigation risk by crafting disclosure documents appropriately. Beyond reducing securities liability, transactional lawyers at large law firms also aid clients by using their access to the entire universe of "deal terms," i.e., contractual provisions that increase the value of the transaction.²⁷ For instance, three law firms advising IPOs—Cooley, Goodwin Procter, and Wilson Sonsini—pioneered the inclusion of "federal forum provisions" ("FFPs"), which limit Securities Act claims to federal court.²⁸ These provisions were novel and controversial when introduced, but

23. See Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 242–44 (1984).

24. Jeremy McClane, *Boilerplate and the Impact of Disclosure in Securities Dealmaking*, 72 VAND. L. REV. 191, 206–07 (2019); see 17 C.F.R. § 230.421 (2018).

25. *Id.*

26. See Marc I. Steinberg & Brent A. Kirby, *The Assault on Section 11 of the Securities Act: A Study in Judicial Activism*, 63 RUTGERS L. REV. 1, 10 (2010).

27. See Elisabeth de Fontenay, *Law Firm Selection and the Value of Transactional Lawyering*, 41 J. CORP. L. 393, 406–08 (2015).

28. See Dhruv Aggarwal, Albert H. Choi, & Ofer Eldar, *Federal Forum Provisions and the Internal Affairs Doctrine*, 10 HARV. BUS. L. REV. 383, 392–94, 401 (2020).

increased shareholder value by reducing the risk of securities litigation in state courts.²⁹ By reducing litigation risk and including beneficial contractual terms, transactional lawyers add value to their clients' IPOs.

The disclosure requirements and potential liability associated with an IPO are daunting enough for American companies. For foreign businesses unfamiliar with American laws and business practices, "fears of the IPO process in the U.S. . . . fill companies, directors and management with dread thinking about the onerous obligations of the Sarbanes-Oxley Act, the rigorous SEC review process and complex rules requiring difficult disclosure."³⁰ In addition to being unfamiliar with U.S. regulations, foreign issuers often are unknown to American investors, or even have a bad reputation. For example, after recent scandals such as at Luckin Coffee, American investors became warier of Chinese issuers, and many Chinese companies canceled or delayed their U.S. IPOs.³¹

Finally, foreign issuers sometimes face unique regulatory burdens when listing in the United States. Since the Chinese government does not allow firms to directly list on a foreign market, companies use a complex network of contractual relations called Variable Interest Entities ("VIEs").³² The typical VIE involves a Chinese firm opening a subsidiary that is domiciled abroad, such as in the Cayman Islands. This foreign subsidiary is linked to a series of operating entities within China through an elaborate system of contracts. This subsidiary—not the operating entities in China—lists on American markets and issues shares to American investors.³³

Foreign issuer IPOs have higher transaction costs than their domestic counterparts because they are relatively unfamiliar with U.S. laws and face reputational deficits as well as additional regulatory hurdles. This means that American law firms, with their status as repeat players in the U.S. capital markets, have the regulatory expertise and reputational capital to help clients understand U.S. laws and reduce the penalty for issuer foreignness. The presence of an elite American law firm may signal higher quality to investors, improving the performance of the IPO.³⁴ In the next Section, I analyze three specific ways in which corporate lawyers reduce transaction costs in foreign issuer IPOs: (1) by specializing in the regulatory hurdles facing issuers from

29. See *id.* at 401.

30. Filipe B. Areno et al., *Key Considerations for Non-US Companies Listing in the US*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (June 17, 2020), <https://www.skadden.com/insights/publications/2020/06/key-considerations-for-non-us-companies> [<https://perma.cc/VAS4-YJZT>].

31. See Steven Russolillo & Corrie Driebusch, *Chinese IPOs in the U.S. Are Saddling Investors With Big Losses*, WALL ST. J. (Dec. 17, 2017, 7:00 AM), <https://www.wsj.com/articles/year-of-the-turkey-for-chinese-ipos-in-the-us-1513512000> [<http://perma.cc/FC8X-UDMK>].

32. See Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control* 1, 3–4 (Eur. Corp. Governance Inst., Working Paper No. 533, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3644019 [<https://perma.cc/XYK6-FQR6>].

33. See *id.*

34. See Larry E. Ribstein, *Ethical Rules, Agency Costs, and Law Firm Structure*, 84 VA. L. REV. 1707, 1739 (1998) ("Clients can use large law firms as reputational intermediaries or signals of good behavior by choosing firms that have a reputation for honesty and fair dealing.").

particular countries; (2) by drawing on their personal “extralegal” ties to the issuer’s home country; and (3) by forming interfirm alliances with home country lawyers.

B. *TRANSACTIONAL LAWYERS AS TRANSNATIONAL LEGAL ACTORS*

1. Specialization and Regulatory Knowledge

In separate empirical work, I show that a small number of transactional lawyers dominate the legal market for foreign issuer IPOs.³⁵ Seventy percent of Brazilian IPOs in the period 2009-19 were handled by some combination of three individual lawyers in Davis Polk’s New York office.³⁶ By specializing in IPOs for companies from certain countries and legal systems, individual lawyers become better at spotting common drafting errors, inserting value-adding provisions, and navigating regulatory issues such as VIEs. Professor Moon’s piece gives one example of such regulatory specialization: Law firms such as Davis Polk have the expertise to help Chinese companies reincorporate from Delaware to tax havens such as the Cayman Islands.³⁷ Another example comes from the decision to exempt the foreign issuer from American stock exchange rules.

Financial economics research on corporate governance opt-outs assumes that it is foreign issuers and their management who choose which rules to exempt themselves from.³⁸ However, this should strike legal observers as unlikely. Stock exchange rules are esoteric legal requirements. Only someone highly familiar with these regulations would know to recommend opting out of such requirements. For example, NASDAQ Listing Rule 5620(c) requires a company to “provide for a quorum as specified in its by-laws for any meeting of the holders of common stock; provided, however, that in no case shall such quorum be less than $33 \frac{1}{3}$ % of the outstanding shares of the Company’s common voting stock.”³⁹ Several foreign companies opt out of this quorum requirement. However, it is implausible that CEOs, bankers, accountants or anyone except the issuer’s lawyers are even aware of such a quorum requirement or have the foresight to opt out of it. In my empirical analysis, I found that the level of corporate governance exemptions a foreign issuer selects is highly dependent on the identity of the foreign issuer’s law firm.⁴⁰ Therefore, transactional lawyers use their regulatory expertise to assist their clients in important activities such as establishing VIEs, reincorporating the company, and deciding which stock exchange rules to opt out of.

35. See Aggarwal, *supra* note 2.

36. See *id.* at 36.

37. See Moon, *supra* note 4, at 1688 n.21.

38. See generally Foley et al., *supra* note 17 (discussing firm decisions to opt out and the factors driving that decision).

39. NASDAQ, § 5600 *Corporate Governance Requirements*, RULEBOOK—THE NASDAQ STOCK MARKET (2021), https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series#nasdaq-rule_5620 [<https://perma.cc/8JRK-6XPW>].

40. See Aggarwal, *supra* note 2, at 3-4.

2. Attorney-Client Affinity

Attorney-client affinity plays an important role in many legal contexts. For example, criminal law scholars have written extensively about how race and identity affect the professional relationship between criminal defendants and their lawyers. Black American defendants share a common identity with Black lawyers, and are able to communicate more easily with them on average than with white lawyers.⁴¹ A survey of lawyers at the New York City Legal Aid Society found that a majority of white women and minority lawyers (but, interestingly, not a majority of white male lawyers working there) thought that defendants felt more at ease and had more trust in the attorney-client relationship if their lawyer shared the same race.⁴²

Attorney-client affinity—the positive effect of extralegal commonalities the lawyer and their client may share, especially common demographics and life experiences—can play an important role in the legal services industry. Arguably, such similarities enable Professor Charles Fried’s famous paradigm of “lawyer as friend”: a lawyer placing the interests of her client above those of others, even those of society’s collective interest, just as she would safeguard the interests of her friends and kinsmen.⁴³ Beyond the criminal justice setting, parties in high-value commercial settings may also be more likely to trust each other and work well together if they share a common background. For example, a recent empirical study found that U.S.-based venture capital (“VC”) firms were more likely to invest in Indian startups if the VC firms themselves were led by immigrants who were born in India.⁴⁴ Furthermore, such ethnic ties between the venture capitalist and the entrepreneur predicted a higher likelihood of success for the business partnership.⁴⁵ Likewise, attorney-client affinity plays an important role in foreign issuer IPOs.

Many U.S. firms maintain offices abroad, in cities as diverse as Beijing, Frankfurt, Hong Kong, London and São Paulo. In the last ten years, the top 200 American law firms have seen an eight percent increase in the number of offices outside the United States, and a thirty-five percent increase in the number of attorneys at these foreign offices.⁴⁶ Foreign clients prefer lawyers

41. See Shani M. King, *Race, Identity, and Professional Responsibility: Why Legal Services Organizations Need African American Staff Attorneys*, 18 CORNELL J. L. & PUB. POL’Y 1, 4–6 (2008).

42. See Kenneth P. Troccoli, “I Want a Black Lawyer to Represent Me”: *Addressing a Black Defendant’s Concerns with Being Assigned a White Court-Appointed Lawyer*, 20 L. & INEQ. 1, 22–24 (2002).

43. See Charles Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relation*, 85 YALE L.J. 1060, 1065–67 (1976).

44. See Sarath Balachandran & Exequiel Hernandez, *Mi Casa Es Tu Casa: Immigrant Entrepreneurs as Pathways to Foreign Venture Capital Investments* 1, 2–5 (Nov. 2, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3331264 [<https://perma.cc/PFW5-M2AK>].

45. *Id.*

46. Ben Seal, *Grand Openings: Where U.S. Law Firms Are Setting Up Abroad*, LAW.COM (Sept. 24, 2019, 5:30 AM), <https://www.law.com/americanlawyer/2019/09/24/grand-openings-where-us-law-firms-are-setting-up-abroad-405-43918> [<https://perma.cc/4NVN-DCCM>].

who are in the same city, country, or time zone, so that they have greater access to their counsel. Furthermore, all else equal, a lawyer employed by an American firm but working out of the Beijing office is more likely to be familiar with his Chinese client's legal and cultural environment than his coworkers in the firm's New York office.

More strikingly, an increasing number of transactional lawyers in charge of foreign issuer IPOs have personal ties to their foreign client's home countries.⁴⁷ An attorney who works at a U.S. law firm but was born and brought up in a foreign country is likely to have a deep understanding of the business and cultural practices of firms from that nation. Her personal experiences and prior work experience in that part of the world equip her to become a more effective advisor to her clients, and to more quickly grasp the client's perspectives and limitations. In my empirical work, I find that more than seventy percent of IPOs for companies based in Mainland China and Hong Kong involve foreign-trained attorneys, far higher than the figure for issuers from other countries.⁴⁸

Attorney-client affinity in foreign issuer IPOs reduces transaction costs by customizing the legal services arrangement to account for the unique challenges associated with the client's foreignness. The foreign issuer continues to enjoy the reputational boost from having an elite American law firm as counsel, as well as gaining from the firm's experience navigating the SEC comment process and negotiations with underwriters. Additionally, the issuer benefits from having individual lawyers who, either because of their location in the same country or ethnic origins, are better trusted by senior management and can provide advice suited to local norms.

3. Global Law Firm Alliances

American federal and state securities laws and regulations are not the only legal issues that foreign issuer IPOs implicate. The issuer must also ensure its going public transaction complies with its home country's legal system. There is usually a division of labor involved between lawyers in foreign issuer IPOs. An American law firm handles all U.S. laws and regulations, while a local law firm deals with home country legal matters. For example, when the Chinese company Lizhi, Inc., went public in 2020, Davis Polk & Wardwell LLP's Hong Kong office handled all matters of U.S. federal and New York state law.⁴⁹ However, a Chinese firm called King & Wood Mallesons was

47. Aggarwal, *supra* note 2, at 32.

48. *Id.*

49. See Lizhi, Inc., Registration Statement (Amendment No. 3 to Form F-1) 224 (Jan. 13, 2020), https://www.sec.gov/Archives/edgar/data/1783407/000119312520006154/d762894df1a.htm#from762894_29 [<https://perma.cc/25GZ-WFNU>] (“We are being represented by Davis Polk & Wardwell LLP with respect to certain legal matters of U.S. federal securities and New York state law Legal matters as to PRC law will be passed upon for us by King & Wood Mallesons Davis Polk & Wardwell LLP may rely upon . . . King & Wood Mallesons with respect to matters governed by PRC law.”).

responsible for all matters of Chinese law.⁵⁰ This arrangement is highly effective because local firm lawyers on the ground presumably know best about home country rules and regulations.

U.S. law firms maintain close relationships with local attorneys with whom they repeatedly partner on different foreign issuer IPOs. One leading American law firm involved in foreign issuer IPOs, for example, advertises itself as “hav[ing] long-term, close working relationships with Brazil’s leading law firms, which allow us to coordinate Brazilian law matters with well-qualified local counsel.”⁵¹

Multiple law firms in the issuer’s home country compete to be the “local law firm” when the issuer goes public in the United States. Top legal trade magazines track the performance of these local law firms, and regularly evaluate their participation in foreign issuer IPOs.⁵² An alternative to forming global law firm alliances is for U.S. law firms to handle home country issues in-house, typically at their own foreign offices. For example, when the British company Freeline Therapeutics listed on the NASDAQ in August 2020, Davis Polk & Wardwell’s New York office handled the American legal issues, while Davis Polk’s London office oversaw the shares’ validity under English law.⁵³ The decision to keep home country legal matters within the same firm involves a fundamental trade-off. On the one hand, it allows for quality control, since a U.S. firm can monitor its own foreign office better than a separate law firm located abroad can. On the other, if the expertise of local attorneys is much greater than that of lawyers at the U.S. law firm, it makes sense to delegate home country issues to these external law firms.⁵⁴ Whether American law firms in foreign issuer IPOs ally with another law firm or keep all work in-house, they need to ensure that home country legal issues are appropriately resolved.

IV. FOREIGN ISSUER IPOs AND CORPORATE GOVERNANCE

A. LAW AND FINANCE DEBATE

The “Law and Finance Hypothesis” is a theory in financial economics arguing that countries with stronger legal protections for shareholders benefit

50. *Id.*

51. See *Brazil*, WHITE & CASE LLP, *Brazil*, <https://www.whitecase.com/law/latin-america/brazil> [<https://perma.cc/QD5Y-UP9E>].

52. See *Capital Markets: PRC Firms*, LEGAL 500, <https://www.legal500.com/c/china/capital-markets-prc-firms> [<https://perma.cc/7AUJ-A5W8>]; Amy Guthrie, *Banner Year for Brazil IPOs Bodes Well for Law Firms*, LAW.COM INT’L (Nov. 10, 2020, 7:13 PM), <https://www.law.com/international-edition/2020/11/10/banner-year-for-brazil-ipos-bodes-well-for-law-firms> [<https://perma.cc/663X-TKM2>].

53. See Freeline Therapeutics Holdings plc, Registration Statement (Amendment No. 1 to Form F-1) 277 (Aug. 3, 2020), https://www.sec.gov/Archives/edgar/data/1810031/000119312520207194/d857852df1a.htm#rom857852_24 [<https://perma.cc/BL7Q-H4RG>].

54. Cf. Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 691–93 (1986) (exploring when it is appropriate to perform tasks within the same firm, and when one should write a contract with an external party to execute them).

from less concentrated share ownership and larger stock markets.⁵⁵ “Common law” countries such as Britain, the United States, Israel, and India (whose system is based on judge-made law) have stronger investor protections than “civil law” nations such as France, Germany, China, and Italy (where law is found in comprehensive legal codes).⁵⁶ These differences between common and civil law countries persisted even after controlling for per capita income.⁵⁷ The Law and Finance Hypothesis fundamentally tells us that *law matters*: Higher levels of economic growth, property rights, financial markets, and democratic government can be linked to a country’s legal origins as a common law jurisdiction.⁵⁸ This theory has spurred over a hundred empirical papers in finance literature, and various academic debates over constructing alternative measures of shareholder rights.⁵⁹

Adjudicating the validity of the “Law and Finance Debate” or its critics is beyond the scope of this Response. However, it is interesting to note how the legal origins of the home country affect the structure of the attorney-client relationship in foreign issuer IPOs. IPOs for issuers from countries with common law origins and institutions more similar to the United States, such as the United Kingdom, presumably have lower transaction costs than transactions for issuers from non-common law jurisdictions such as China. Since there are larger differences between the legal systems and business practices of non-common law countries and those of the United States, transactional lawyers have more work to do to ensure their clients successfully list on a U.S. stock exchange. Therefore, we can expect more of the adaptive mechanisms discussed in Part III—specialized attorneys dedicated to issuers from particular countries, lawyers who grew up in the issuer’s home country, and global law firm alliances—when the issuer is from civil law countries like China, rather than common law jurisdictions such as the United Kingdom. Whatever the merits of the law and finance hypothesis, cross-border differences in legal institutions plausibly affect the complexity of transactional lawyering.

55. Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113, 1113–17 (1998).

56. *Id.*

57. See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1132 (1997); La Porta et al., *supra* note 55, at 1132. The Law and Finance Hypothesis has been called “one of the most controversial theories in financial economics.” Graeme G. Acheson, Gareth Campbell & John D. Turner, *Private Contracting, Law and Finance*, 32 REV. FIN. STUD. 4156, 4156 (2019).

58. See Daniel M. Klerman, Paul G. Mahoney, Holger Spamann & Mark I. Weinstein, *Legal Origin or Colonial History?*, 3 J. LEGAL ANALYSIS 379, 382–83 (2011).

59. See generally Holger Spamann, *The “Antidirector Rights Index” Revisited*, 23 REV. FIN. STUD. 467 (2010) (challenging the Law and Finance Hypothesis’s claims about shareholder rights and corporate governance in common and civil law countries).

B. LAWYERS AND CORPORATE GOVERNANCE

Corporate lawyers add value for their clients in many proactive ways, such as negotiating for better terms in merger agreements⁶⁰ or pioneering new corporate bylaws that increase firm value.⁶¹ However, not all of lawyers' contributions are made keeping the specific details of the particular transaction in mind. An alternative view held by some law and economics scholars is that contractual provisions in high-value transactions simply reflect the default language of law firm templates. In other words, whether a law firm decides to include a certain clause in one contract depends on whether it included that provision in previous deals. This path-dependent approach to contracting is called "stickiness," i.e., terms are sticky or persistent between a firm's successive transactions.⁶² Sticky contracting is documented in various scenarios in transactional law, from takeover defenses⁶³ to mergers and acquisitions⁶⁴ to forum selection clauses.⁶⁵

Stickiness in contracting is not always bad for clients. If a provision is value-increasing in every transaction, it makes sense for a law firm to include it in every deal.⁶⁶ However, stickiness can also be pernicious: Law firms can insert a sticky provision even if it reduces the value of the transaction to the client,⁶⁷ or with the purpose of increasing their billable hours rather than furthering the client's objectives.⁶⁸ Contractual stickiness then becomes a form of *agency costs* between attorneys and their clients: the interests of the agent (the lawyer) diverge from those of her principal (the client).⁶⁹

Foreign issuer IPOs present an interesting context in which to study transactional lawyers' active contributions toward corporate governance at their client firms, as well as the impact of contractual stickiness. In my empirical work, I find that the number of exemptions a foreign issuer takes

60. See generally Adam B. Badawi & Elisabeth de Fontenay, *Is There A First-Drafter Advantage in M&A?*, 107 CALIF. L. REV. 1119 (2019) (showing how the side whose lawyers prepare the first draft of a merger agreement benefits from more favorable non-price terms, such as material adverse change ("MAC") clauses).

61. See generally Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, 14 J. EMPIRICAL LEGAL STUD. 31 (2017) (showing how law firms innovated to include novel forum selection provisions that benefitted their corporate clients).

62. See Julian Nyarko, *Stickiness and Incomplete Contracts*, 88 U. CHI. L. REV. 1, 23-29 (2021).

63. See John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CALIF. L. REV. 1301, 1317-21 (2001).

64. See Robert Anderson & Jeffrey Manns, *The Inefficient Evolution of Merger Agreements*, 85 GEO. WASH. L. REV. 57, 64-65 (2017).

65. See Romano & Sanga, *supra* note 61, at 41-43.

66. See *id.* at 50 n.56 (documenting the near-universal adoption of forum selection clauses, which can be said to improve firm value by reducing expected litigation costs).

67. See generally Coates, *supra* note 63 (explaining how stickiness can lead to IPO lawyers including takeover defenses that reduce firm value).

68. See generally Anderson & Manns, *supra* note 64 (demonstrating that labor-intensive edits to acquisition agreements in mergers are more likely to be explained by law firms wanting to increase their billable hours than lawyers furthering their clients' interests).

69. See Coates, *supra* note 63, at 1317-22.

from U.S. stock exchange rules is heavily dependent on the identity of its law firm.⁷⁰ This could be because of any combination of the following factors: (1) different law firms have different value judgments about the optimal level of compliance with U.S. corporate governance norms; (2) clients with different levels of corporate governance quality self-select into engaging certain law firms; or (3) different law firms have pre-selected a particular level of corporate governance exemptions in their default templates. Irrespective of the exact combination of these factors at work, it is clear that the choice of law firm is highly correlated with the quality of corporate governance at the time of the IPO. The choice of law firm may affect corporate governance in the long-term as well, since research indicates that foreign issuers' level of compliance with U.S. stock exchange rules is relatively persistent over time.⁷¹ Transnational IPOs therefore offer a striking example of lawyers influencing corporate governance at their client companies.

C. DIVERSITY IN THE LEGAL PROFESSION

The new transnational bar that has come to dominate foreign issuer IPOs also serves to increase the gender and racial diversity of law firms. As discussed in Part III, law firms find it advantageous to hire foreign-born attorneys to handle these transactions, whether at U.S. or foreign offices.⁷² Immigrant lawyers are far more likely to be diverse than their native-born counterparts. One empirical study found that while foreign-born lawyers constituted just seven percent of the American legal profession, they accounted for a disproportionate number of women and minority attorneys.⁷³ Most of the foreign issuers in my sample are from Asia and the Middle East, rather than Europe or Oceania, and a majority of the foreign-born lawyers are nonwhite. While most of the attorneys in my sample are male, women are strongly represented, with the most prolific attorneys for IPOs from China, Hong Kong, Netherlands and the United Kingdom all being women. Although law firms hire diverse attorneys for their intimate knowledge of local customs and institutions, which adds value for the client, these lawyers also diversify the ranks of the firm.

V. CONCLUSION

Foreign issuer IPOs are an increasingly important component of American capital markets and implicate a unique set of legal and regulatory questions. Professor Moon's work helps us understand the divergence of foreign issuers from the American norm in an important decision: choice of incorporation.⁷⁴ In this Response, I have argued that foreign issuer IPOs

70. See Aggarwal, *supra* note 2, at 41–47.

71. See Foley et al., *supra* note 17, at 109.

72. See *supra* Section II.B.2.

73. See Ethan Michelson, *Immigrant Lawyers and the Changing Face of the U.S. Legal Profession*, 22 *IND. J. GLOB. LEGAL STUD.* 105, 108–11 (2015).

74. See generally Moon, *supra* note 3 (discussing Delaware as the leading choice of incorporation).

present a host of other corporate governance problems, such as misrepresentation in their registration statements and exemptions from important U.S. stock exchange rules. It is important to understand the central role of lawyers and law firms in structuring foreign issuer IPOs in ways that reduce transaction costs for their clients but may also reduce the quality of corporate governance at these firms and harm American investors.

The new cadre of transactional lawyers who dominate these IPOs should intrigue those studying the legal profession for their specialization in cross-border transactions, personal ties to their clients' home countries, and ability to form global law firm alliances. Careful empirical study of the role of transactional lawyers in foreign issuer IPOs can help us understand the role of home country legal origins in cross-border transactions, the impact of external counsel on corporate governance at the time of the IPO, and the growth of gender and racial diversity in the American legal profession. Territorial market segmentation in corporate law⁷⁵ may also therefore be driven by the transformation of parts of the transactional bar.

75. *See id.* at 1730-34.