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A Coffee Break for Bitcoin

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For many, the appeal of bitcoin is in its detachment from government regulation. However, the Coffee bonding theory, which initially arose in the context of foreign stocks, suggests certain benefits of regulation for bitcoin, including increased legitimacy. By invoking the Coffee bonding theory, this Article offers another perspective on the regulation of bitcoin.

INTRODUCTION

As bitcoin has become more mainstream, it has drawn the attention of regulators. Transactions in bitcoin have received scrutiny from the United States Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), the Financial Crimes Enforcement Network (FinCEN), the Internal Revenue Service (IRS), and the federal courts.[1] These agencies have differed in their treatments of virtual currency, and confusion continues over whether the law considers bitcoin to be securities, commodities, currency, or property.[2]

Thus far, comprehensive regulation has been unsuccessful. Not only have many bitcoin users resisted regulation, but regulation has also stalled because it is unclear how to regulate virtual currency.[3] The challenges to regulation include bitcoin's rapid growth and the anonymity surrounding bitcoin.[4]

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1. Christopher Burks, *Bitcoin: Breaking Bad or Breaking Barriers?*, 18 N.C. J.L. & TECH. ONLINE 244 (2017). Most recently, the IRS issued warning letters to over 10,000 cryptocurrency holders regarding possible back taxes. *See, e.g.*, Laura Saunders & Britton O'Daly, *IRS Sending Warning Letters to More Than 10,000 Cryptocurrency Holders*, WALL STREET J. (July 26, 2019, 6:39 PM), https://www.wsj.com/articles/irs-sending-warning-letters-to-more-than-10-000-cryptocurrency-holders-11564159523 [https://perma.cc/VS4H-MU5V].

2. Burks, *supra* note 1.

3. "Nakamoto's writings acknowledge the attractiveness of Bitcoin to libertarians, but they do not specifically support any view of his own politics." Shawn Bayern, *Of Bitcoins, Independently Wealthy Software, and the Zero-Member LLC*, 108 NW. U. L. REV. ONLINE 257, 260 n.13 (2014) (citing Posting of Satoshi Nakamoto to cryptography@metzdowd.com (Nov. 14, 2008), http://www.mail-archive.com/cryptography@metzdowd.com/msg10001.html [https://perma.cc/R73A-SBDH]).

4. *See, e.g.*, Kevin V. Tu & Michael W. Meredith, *Rethinking Virtual Currency Regulation in the Bitcoin Age*, 90 WASH. L. REV. 271 (2015); Misha Tsukerman, *The Block Is Hot: A Survey of the State of Bitcoin Regulation and Suggestions for the Future*, 30 BERKELEY TECH. L.J. 1127 (2015).

The Coffee bonding theory, which arose in the context of foreign stocks, suggests several benefits of regulation for bitcoin, including increased legitimacy. By invoking the Coffee bonding theory, this Article offers another perspective on the regulation of bitcoin.

I. FOREIGN STOCKS & BONDING THEORY

Public companies located outside the United States may have lighter regulatory standards compared to those located in the United States.[5] In contrast, high regulatory standards and oversight for companies in the United States have made it a secure place to invest.[6] However, foreign companies may cross-list their shares on a U.S. exchange if they subject themselves to American regulatory standards,[7] including disclosure and legal requirements.[8]

There are many reasons for foreign companies to cross-list their shares in the United States.[9] Benefits include exposure to an international capital market, which can create changes in corporate governance and improve investors' perception of the quality of governance.[10] A U.S. listing can also reduce the extent to which controlling shareholders can engage in expropriation and thereby increase the firm's ability to take advantage of growth opportunities.[11] Among the principle considerations that drive a company's decision to cross-list its shares are: financial gains, increased

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5. The lack of regulation may make high rewards possible. Ashoka Mody, *What Is An Emerging Market?*, 35 GEO. J. INT'L L. 641, 642 (2004).

6. For background on securities law in the United States, see Paul G. Mahoney, *The Development of Securities Law in the United States*, 47 J. ACCOUNTING RES. 325 (2009).

7. Kyle W. Pine, *Lowering the Cost of Rent: How IFRS and the Convergence of Corporate Governance Standards Can Help Foreign Issuers Raise Capital in the United States and Abroad*, 30 NW. J. INT'L L. & BUS. 483, 483 n.1 (2010).

8. Stephen P. Ferris, Kenneth A. Kim & Gregory Noronha, *The Effect of Crosslisting on Corporate Governance: A Review of the International Evidence*, 17 CORP. GOVERNANCE: AN INT'L REV. 338, 343-45 (2009); *see also* James A. Fanto & Roberta S. Karmel, *A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing*, 3 STAN. J.L. BUS. & FIN. 51, 53-58 (1997) (providing an overview of U.S. laws and regulations affecting foreign companies that wish to reach U.S. capital markets investors).

9. For example, one reason to cross-list might be to facilitate acquisitions. *See*, *e.g.*, Pasi Tolmunen & Sami Torstila, *Cross-Listings and M&A Activity: Transatlantic Evidence*, 34 FIN. MGMT. 123 (2005) (revealing evidence from a sample of 547 European companies that cross-listed firms are significantly more active in acquiring U.S. companies than their domestically listed peers); *see also* Fanto & Karmel, *supra* note 8 (citing disclosure requirements, business purposes, benefits of U.S. capital markets, and industry specific incentives as considerations in the decision of whether to cross-list in the United States).

10. Ferris, Kim & Noronha, *supra* note 8, at 338.

11. Craig Doidge, G. Andrew Karolyi & René M. Stulz, *Why Are Foreign Firms Listed in the U.S. Worth More?*, 71 J. FIN. ECON. 205 (2004).

liquidity, shares marketability, and growth motivations.[12] Companies must weigh these benefits against the compliance and other costs of cross-listing.[13]

Empirical research confirms the benefits of cross-listing. One team of authors examined what happens to the global value of trading, turnover, and prices of 128 non-U.S. stocks over the twelve-month period surrounding their listing on the New York Stock Exchange (NYSE).[14] The results suggest that listing on the NYSE benefits the home market and the U.S. market, as well as the companies being listed: "stock prices in the six months after listing are 8% higher than prices in the six months immediately prior."[15]

Another study reveals that foreign firms that cross-list shares on U.S. exchanges "earn cumulative abnormal returns of 19% during the year before listing, and an additional 1.20% during the listing week, but incur a loss of 14% during the year following listing."[16] Such "unusual share price changes are robust to changing market risk exposures and are related to an expansion of the shareholder base and to the amount of capital raised at the time of listing."[17] Yet another scholar noted that growth opportunities are more highly valued for companies that cross-list on American stock exchanges, especially those from countries with weaker investor rights.[18]

Finally, another paper examines whether cross-listing in the United States reduces foreign firms' cost of capital.[19] The authors find strong evidence that it does,

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12. Ahmed Ibrahim & Mohamed Youssef, *Cross-Listing and Implications on Corporate Governance*, *ta'ameen Qatar* (Nov. 2013), http://www.taameenqatar.com/index.php?go=s&s=cross-listing-and-implications-on-corporate-governance [https://perma.cc/9R6L-26GH].

13. Shahrokh M. Saudagaran, *An Empirical Study of Selected Factors Influencing the Decision to List on Foreign Stock Exchanges*, 19 J. INT'L BUS. STUDIES 101 (Spring 1988) (noting that the growing internationalization of capital markets suggests that an increasing number of firms perceive the benefits of listing their stocks on foreign exchanges as outweighing the related cost). However, the SEC recently lessened the regulatory burden for cross-listing companies, such as by changing the registration and reporting forms to the standardized requirements of the International Organization of Securities Commissions (IOSCO). Yuliya Guseva, *Cross-Listings and the New World of International Capital: Another Look at the Efficiency and Extraterritoriality of Securities Law*, 44 GEO. J. INT'L L. 411, 451-56 (2013).

14. Katherine Smith & George Sofianos, *The Impact of an NYSE Listing on the Global Trading of Non-U.S. Stocks* (NYSE Working Paper 97-02, 1997). On average, the authors find that "the combined (home plus U.S.) value of trading in the sample stocks changed from $240 million per stock per day prior to the NYSE listing to $340 million after, a 42% increase, and that the home-market value of trading increased 24% from $210 to $260 million, while annual turnover increased from 65 to 90%." *Id.*

15. *Id*.

16. Stephen R. Foerster & G. Andrew Karolyi, *The Effects of Market Segmentation and Investor Recognition on Asset Prices: Evidence from Foreign Stocks Listing in the United States*, 54 J. OF FIN. 981 (1999).

17. *Id*.

18. Doidge, Karolyi & Stulz, *supra* note 11.

19. Luzi Hail & Christian Leuz, *Cost of Capital Effects and Changes in Growth Expectations Around U.S. Cross-Listings* (European Corporate Governance Institute Working

especially for firms from countries with weaker institutional structures. Furthermore, the authors explain that cross-listing creates positive valuation effects stemming from changes in growth expectations.[20]

Although cross-listing has traditionally been credited with these various benefits,[21] the globalization of financial markets and instantaneous electronic communications may make such explanations dated.[22] Another prominent explanation put forth in the 1990s by Professor Coffee is "bonding." According to this theory, "issuers migrate to U.S. exchanges because by voluntarily subjecting themselves to the United States' higher disclosure standards and greater threat of enforcement (both by public and private enforcers), they partially compensate for weak protection of minority investors under their own jurisdictions' laws and thereby achieve a higher market valuation."[23] In other words, firms are choosing to "rent" the securities laws of other countries.[24]

In sum, commentators have offered several explanations for the significant cross-listing of foreign company shares on exchanges in the United States, including the prominent Coffee bonding theory, which argues that there are legitimacy gains to renting American securities laws through cross-listing. This theory on regulation has direct implications in the bitcoin context.

II. Implications for Bitcoin

Satoshi Nakamoto, a pseudonym for an unknown person, designed bitcoin and introduced it in a 2008 white paper titled "Bitcoin: A Peer-to-Peer Electronic Cash System."[25] Bitcoin is a cryptocurrency, which is a digital currency issued electronically by a computer program. Bitcoin has a predetermined cap of 21

Paper, 2006).

20. *Id.*

21. *See also* H. Kent Baker, John R. Nofisnger & Daniel G. Weaver, *International Cross-Listing and Visibility*, 37 J. FIN. & QUANT. ANALYSIS 495 (2002) (offering a study showing that international firms listing their shares on the New York or London Stock Exchange experience a significant increase in visibility, as proxied by analyst coverage and print media attention, and a decrease in the cost of equity capital after the listing event).

22. John C. 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).

23. *Id. See also* René M. Stulz, *Globalization, Corporate Finance, and the Cost of Capital*, 12 J. OF APPLIED CORP. FINANCE 8 (Fall 1999); William A. Reese Jr. & Michael S. Weisbach, *Protection of Minority Shareholder Interests, Cross-Listings in the United States, and Subsequent Equity Offerings*, 66 J. FIN. ECON. 65 (2002) (concluding that the desire to protect minority shareholder rights is an important reason causing some non-US firms cross-list in the United States). *But see* Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141, 142 (2003) (questioning the bonding role of cross-listing and suggesting an alternative theory: "the avoiding hypothesis").

24. Pine, *supra* note 7.

25. Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, 1 (2008), https://bitcoin.org/bitcoin.pdf [https://perma.cc/BJ2G-BWQR].

million.[26] To implement bitcoin, Nakamoto devised the first blockchain to solve the double-spending problem for digital currency (preventing people from spending the same money twice).[27] There are two main ways to get bitcoin—to buy it on an exchange such as Coinbase, or to earn it by processing bitcoin transactions, called "mining."[28] Owners store their bitcoin in a "digital wallet," which exists either in the cloud or on a user's computer.[29]

In the decade that Bitcoin has existed, it has amassed a plethora of issues that continue to plague the virtual currency. Mainstream users have found it difficult to trust bitcoin as a currency without a central bank underlying it.[30] The volatility of Bitcoin's price has discouraged many investors.[31] Bitcoin is neither intrinsically valuable, like gold, nor is it rooted in a commodity expressing a certain purchasing power.[32] There might be some value resulting from its scarcity, but it is an artificial scarcity.[33] Generally, bitcoin as a currency is not regulated like stocks and futures, and this lighter regulation allows price manipulation.[34] Bad actors can manipulate the price of cryptocurrencies and then cash out before other investors realize. There are also concerns about initial coin offerings of bitcoin, with the main reason for

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26. David Groshoff, *Kickstarter My Heart: Extraordinary Popular Delusions and the Madness of Crowdfunding Constraints and Bitcoin Bubbles*, 5 WM. & MARY BUS. L. REV. 489, 512 (2014).

27. Scott J. Shackelford & Steve Myers, *Block-By-Block: Leveraging the Power of Blockchain Technology to Build Trust and Promote Cyber Peace*, 19 YALE J.L. & TECH. 334, 342 (2017).

28. Benjamin W. Akins, Jennifer L. Chapman & Jason M. Gordon, *A Whole New World: Income Tax Considerations of the Bitcoin Economy*, 12 PITT. TAX REV. 25, 32 (2014).

29. Catherine Martin Christopher, *Whack-A-Mole: Why Prosecuting Digital Currency Exchanges Won't Stop Online Money Laundering*, 18 LEWIS & CLARK L. REV. 1, 14 (2014); *How to Store Your Bitcoin*, COINDESK, (Jan. 20, 2018), https://www.coindesk.com/information/how-to-store-your-bitcoins/ [https://perma.cc/24WV-X8BE].

30. *See, e.g.,* Jeff Kearns, *Greenspan Says Bitcoin a Bubble Without Intrinsic Currency Value*, BLOOMBERG (Dec. 4, 2013, 5:37 PM), www.bloomberg.com/news/2013-12-04/greenspan-says-bitcoin-a-bubble-without-intrinsic-currency-value.html [https://perma.cc/59EE-SRPE]. *But see* Catherine Martin Christopher, *The Bridging Model: Exploring the Roles of Trust and Enforcement in Banking, Bitcoin, and the Blockchain*, 17 NEV. L.J. 139, 139 (2016) ("Bitcoin has long been touted as a currency and a payment system that relies on cryptography and mathematics rather than trust.").

31. *See, e.g.*, Christopher, *supra* note 30.

32. Nicholas A. Plassaras, Comment, *Regulating Digital Currencies: Bringing Bitcoin Within the Reach of the IMF*, 14 CHI. J. INT'L L. 377, 390-91 (2013).

33. Only 21 million bitcoins will be issued. Mark Edwin Burge, *Apple Pay, Bitcoin, and Consumers: The ABCs of Future Public Payments Law*, 67 HASTINGS L.J. 1493, 1531 (2016).

34. *See, e.g.*, Jerry W. Markham, *Manipulation of Commodity Futures Prices—The Unprosecutable Crime*, 8 YALE J. ON REG. 281 (1991).

going public being for insiders to cash out. Additional concerns arise regarding a bitcoin bubble.[35] This all contributes to bitcoin's price volatility.[36]

In the same way as foreign stocks, regulation may legitimize bitcoin to a certain extent, which is particularly important given its start as an anonymous cryptocurrency for illegal purposes.[37] Historically, the legitimizing effect of regulation has brought some value.[38]

It is true that there are drawbacks to regulation. For example, criticism has targeted the enforcement of regulation, such as the possibility of bias in enforcement of the laws.[39] Furthermore, there are separate critiques regarding the over-regulation of the business environment.[40] These concerns with regulation no doubt hold true in the bitcoin context, but must be considered alongside the benefits of regulation, including those articulated by the Coffee bonding theory.

CONCLUSION

While bitcoin is a new product, it is experiencing issues similar to those of foreign stocks. The Coffee bonding theory arose two decades ago to explain the significant

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35. "Others, however, argue that this is all hype or technological alchemy and that the current interest in virtual currencies is overblown and resembles wishful thinking, a fever, even a mania. They have declared the 2017 heightened valuation of Bitcoin to be a bubble similar to the famous 'Tulip Bubble' of the seventeenth century." *Written Testimony of Chairman J. Christopher Giancarlo Before the U.S. Senate Agriculture, Nutrition, and Forestry Committee*, Washington, D.C. (Feb. 15, 2018), https://www.agriculture.senate.gov/hearings/state-of-the-cftc-examining-pending-rules-cryptocurrency-regulation-and-cross-border-agreements [https://perma.cc/A8VE-CZTV].

36. "In 2013, the market price of a bitcoin fluctuated between $13 and $1200 USD." Matthew Kien-Meng Ly, Note*, Coining Bitcoin's "Legal-Bits": Examining the Regulatory Framework for Bitcoin and Virtual Currencies*, 27 HARV. J.L. & TECH. 587, 590 (2014).

37. Sean Foley, Jonathan R. Karlsen & Tālis J. Putniņš, *Sex, Drugs, and Bitcoin: How Much Illegal Activity is Financed Through Cryptocurrencies?* 32 REV. FIN. STUD. 1798 (2018) (estimating that "approximately one-quarter of bitcoin users and one-half of bitcoin transactions are associated with illegal activity" and "[a]round $72 billion of illegal activity per year involves bitcoin, which is close to the scale of the US and European markets for illegal drugs.").

38. Coffee, *supra* note 22 (suggesting that issuers migrate to U.S. exchanges because by voluntarily subjecting themselves to the United States' higher disclosure standards and greater threat of enforcement, both by public and private enforcers, they partially compensate for weak protection of minority investors under their own jurisdictions' laws and thereby achieve a higher market valuation).

39. Joan MacLeod Heminway, *Save Martha Stewart? Observations About Equal Justice in U.S. Insider Trading Regulation*, 12 TEX. J. WOMEN & L. 247, 263 (2003).

40. *See, e.g.*, Karen E. Woody, *Conflict Minerals Legislation: The SEC's New Role as Diplomatic and Humanitarian Watchdog*, 81 FORDHAM L. REV. 1315 (2012) (noting that Dodd-Frank even extends to regulating conflict minerals for ethical reasons). For the argument that tax incentives might be better solutions to certain corporate issues than regulation, see Margaret Ryznar & Karen E. Woody, *A Framework on Mandating Versus Incentivizing Corporate Social Responsibility*, 98 MARQ. L. REV. 1667 (2015).

cross-listing of foreign company shares on the American exchanges. According to the theory, companies wanted the benefits of American securities law. Those foreign companies that cross-listed their shares experienced measurable benefits from doing so.

Bitcoin has similarly suffered legitimacy concerns and may need to benefit from the legitimacy gained from regulation. Like foreign companies that cross-list their shares on U.S. exchanges, bitcoin users may find themselves increasingly open to regulation.[41]

41. Coffee, *supra* note 22, at 1757.