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. 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.

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. The challenges to regulation include bitcoin’s rapid growth and the anonymity surrounding bitcoin.

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2. Burks, supra note 1.
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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. In contrast, high regulatory standards and oversight for companies in the United States have made it a secure place to invest. However, foreign companies may cross-list their shares on a U.S. exchange if they subject themselves to American regulatory standards, including disclosure and legal requirements.

There are many reasons for foreign companies to cross-list their shares in the United States. Benefits include exposure to an international capital market, which can create changes in corporate governance and improve investors’ perception of the quality of governance. 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. Among the principle considerations that drive a company’s decision to cross-list its shares are: financial gains, increased


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).


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).


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

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). 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.”

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.” 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.” 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.

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

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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.


17. Id.

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

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.  

Although cross-listing has traditionally been credited with these various benefits, the globalization of financial markets and instantaneous electronic communications may make such explanations dated. 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.” In other words, firms are choosing to “rent” the securities laws of other countries.

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.” Bitcoin is a cryptocurrency, which is a digital currency issued electronically by a computer program. Bitcoin has a predetermined cap of 21
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). 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.” Owners store their bitcoin in a “digital wallet,” which exists either in the cloud or on a user’s computer.

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. The volatility of Bitcoin’s price has discouraged many investors. Bitcoin is neither intrinsically valuable, like gold, nor is it rooted in a commodity expressing a certain purchasing power. There might be some value resulting from its scarcity, but it is an artificial scarcity. Generally, bitcoin as a currency is not regulated like stocks and futures, and this lighter regulation allows price manipulation. 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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31. See, e.g., Christopher, supra note 30.
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. This all contributes to bitcoin’s price volatility.

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. Historically, the legitimizing effect of regulation has brought some value.

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. Furthermore, there are separate critiques regarding the over-regulation of the business environment. 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

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].


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).


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.