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News Release

# ACQUISITIONS AND TAKEOVERS: WHAT LIES AHEAD FOR SHAREHOLDER RIGHTS?

Remarks of

Richard C. Breeden, Chairman
U.S. Securities and Exchange Commission

Twelfth Annual Institute on
Acquisitions and Takeovers
April 26, 1990

New York City

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## Introduction

As we enter the 1990s, I would like to give you my thoughts on some important issues facing the Securities and Exchange Commission and relating to acquisitions and takeovers. One such issue, which surely will arise again in the near future, is the exclusion of United States security holders from foreign tender offers. Another involves the strong federal interest in the vitality of our national securities markets and recent state law developments limiting shareholder rights.

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1 The views expressed herein are Chairman Breeden's and do not necessarily represent the views of the Commission, other Commissioners or the Commission staff.

International Tender Offers

Foreign bidders have been choosing not to extend multinational tender offers to U.S. shareholders. Evidently, this choice is driven by the additional costs of compliance with our regulations. I view the right of a U.S. shareholder to dispose of his shares, along with all other holders in a multinational transaction, as one of the most important attributes of stock ownership. It should not be denied on the basis of nationality.

As I am certain you are aware, within the past six months, the Commission has issued exemptive orders concerning two multinational tender offer transactions. In both transactions, the Commission acted to assure that U.S. shareholders could participate without vitiating the basic protections that our laws contemplate. The Ford Motor Company offer for Jaguar plc, a British company, was a cash offer for any and all of Jaguar's ordinary shares, over 25 percent of which were held in this country through ADSs. Ford split the offer into two separate transactions in the U.S. and U.K. and applied for exemptive relief from certain of the Commission's tender offer rules.

Despite differing withdrawal rights under the U.S. and U.K. systems, the Commission's order[2] allowed Ford's U.S. offer to proceed on the same timetable as the U.K. offer conducted in compliance with the U.K. City Code on Takeovers and Mergers, the U.K.'s equivalent to our tender offer rules. Shareholders in both the U.S. and U.K. were paid at the same time and were given an equal amount of time in which to tender. This was accomplished by applying our rules so that withdrawal rights remained available in the U.S. only until the bid became unconditional in the U.K.

In the second transaction, the Volvo/Pharmacia tender offer, the Commission went to even greater lengths to assure that all U.S. shareholders would be included in the transaction. Two Swedish companies, Volvo and Procordia, a company controlled by the Swedish government, wanted to make cash and exchange offers for all shares of another Swedish company, Pharmacia, without including U.S. shareholders. At the time, U.S. persons held over 7 percent of Pharmacia's shares. Following inquiries by the Commission staff, the offerors agreed to extend the offers into the United States. Exemptions were granted to permit separate U.S. offers to be conducted simultaneously with and on the same terms as those made

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[2] In the Matter of the Ford Motor Co. Ltd., Release No. 34-27425 (Nov. 7, 1989).

outside the United States.[3]

The exemptive relief was broader in the Volvo/Pharmacia transaction than that granted in Ford/Jaguar. Without describing every detail, I will note that exemptive relief was granted from the tender offer withdrawal provisions, the All-Holders Rule, and Rules 10b-6 and 10b-13. In addition, the bidders were permitted to use a less comprehensive method of reconciliation to U.S. Generally Accepted Accounting Principles (GAAP) than could otherwise have been required in the financial statements contained in registration statements covering the U.S. exchange offer. Reconciliation of selected financial data for the years 1985 and 1986 was foregone entirely.

Discriminatory treatment of U.S. shareholders was prevented in the Ford/Jaguar and Volvo/Pharmacia transactions. I anticipate that similar Commission action to encourage the inclusion of U.S. security holders in multinational tender or exchange offers will be taken in the future. However, I also recognize that cost considerations may lead to the exclusion of U.S. shareholders from those offshore offers, where their holdings are insignificant in comparison to the overall market value of the transaction and

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[3] In the Matter of Procordia Aktiebolag and Aktiebolaget Volvo, Release No. 34-27671 (Feb. 2, 1990).

jurisdiction could be avoided.

When U.S. shareholders are excluded from an offshore offer, they are denied the premium on their shares. Even worse, without any disclosure at all, they must choose to sell into the market below the offering price, or remain minority shareholders subject to a possible freeze-out. The problem we face is this -- should U.S. shareholders be left to fend for themselves without the protection of either foreign or U.S. tender offer regulation? Or should they be allowed to participate on an equal basis with non-U.S. shareholders and given whatever disclosure documents and other safeguards that are provided by the home country?

To address this problem, I have asked the Division of Corporation Finance to develop a concept release to be issued for public comment. The concept release would explore the possibility of permitting foreign tender offers to be extended to U.S. holders, wholly on the basis of the home country disclosure and procedural requirements, in cases where the U.S. ownership is merely incidental to the transaction. The civil liability and antifraud provisions would, of course, still apply.

The concept release would invite suggestions on how to define the threshold of U.S. share ownership that could be deemed sufficiently low to justify reliance on foreign regulatory provisions to protect U.S. investors. In the Commission's

multijurisdictional proposal issued last summer, which would set the threshold as high as 20 percent, acceptance of foreign disclosure would turn on comparability of the U.S. and foreign regulatory schemes. Here, where the approach would not be based on comparability, we might ask commenters if the threshold should be 10 percent or 5 percent. And further if there should be an absolute dollar threshold, for example, $1 billion or $500 million? Or a higher threshold for cash offers, as compared to registered exchange offers? We would look to commenters to suggest if and how these lines can be drawn.

Perhaps, the approach I have described should be permitted for all tender offers only where the home country provides such core shareholder protections as mandated disclosure, time to evaluate the offer, and equal treatment -- whatever form these protections might take. Registered exchange offers clearly present more difficult issues. How far should the Commission go in relying on foreign financial statements when securities are being offered to the public? Can the approach encompass all exchange offers without regard to the home country? Or should it be limited to those jurisdictions with which the Commission has familiarity and a minimal level of confidence in the reliability of the accounting standards? Should the approach be limited to countries where auditing standards are deemed generally adequate?

I envision the concept release as an important complement to the multijurisdictional proposal. As with the multijurisdictional proposal, the concept release would be designed to deal on a very practical level with the realities of today's global securities markets -- realities that with every new day include a rising number of cross-border acquisitions and tender offers aimed at a multinational shareholder base. From a philosophical standpoint, both projects reflect the Commission's commitment to sound regulation in an international market. That commitment is demonstrated in other Commission activities to promote a global approach to problems such as improving the clearance and settlement system, maintaining capital adequacy and harmonizing accounting and auditing standards.

## The Vitality of our National Securities Markets and Shareholder Rights

Another facet of today's global securities markets that cannot be ignored is the dramatic change in the competitive position of the U.S. equities markets vis-a-vis the Japanese and European markets over the past decade. Our equity markets performed well in that time period, with an increase in market capitalization during the decade of over 140 percent. However, the Japanese and U.K. markets did even better. Market capitalization in the European Community rose by more than 400 percent during the 1980s; in Japan, by 1140 percent. The bottom line performance for the

U.S. was a nosedive in the percentage of global equity market capitalization from 51 percent in 1980 to 30 percent in 1989.

While this relative decline may be accounted for partially by the loss of our capital base due to going-private transactions during the 1980s, what these figures tell us is fairly simple -- in the 1990s, we must make every effort to make our capital markets more liquid and efficient. We can no longer simply assume that investors both here at home and from around the world will want to participate in our markets. They will have major alternatives in Europe and Japan that may offer greater liquidity and lower transaction costs. Artificial impediments to the transferability of shares and a lack of accountability of management to the shareholders make our markets less liquid and efficient and, accordingly, less attractive. Who will want to invest in a U.S. company with management or directors who believe they have a lifetime tenure with the company regardless of performance, or that they are not otherwise accountable to the shareholders?

We cannot ignore the need to address the competitive position of the U.S. markets for another compelling reason. Notwithstanding the interest of the states in the substantive law of corporations, there is a federal interest -- a compelling one at that -- in a national capital market. We must remember that America's economic future is dependent upon our creating and maintaining the most efficient possible process for raising capital. Making savings and

investments attractive is not merely desirable -- it is essential to our future in a competitive world economy. That is a national interest worthy of our protection. The Commission should be vigilant in making certain that barriers are not erected to a national capital market. We must ensure that our markets are broad, deep and attractive to investors.

For some time now, actions have been taken in some states to reduce the accountability of management and directors to shareholders or to make equity ownership less desirable by curtailing the free transferability of shares. The most obvious recent example is the proposed Pennsylvania legislation, which contains a novel provision that could do enormous damage to the shareholders' well-established, and guaranteed by federal law, right to use the proxy machinery to replace the board of directors. My views on the Pennsylvania statute have been aired in the press. Unfortunately, they have not been heeded by the Pennsylvania legislature.

State legislatures, apparently in response to pressure from local management and labor groups, have enacted other measures designed to diminish shareholder rights. The shareholder's right to call a special meeting[4] or to propose amendments to corporate

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[4] See, e.g., Ind. Code Ann. sec. 23-1-29-2 (Burns Supp. 1989); 15 Pa.C.S.A. sec. 2521(a) (1989).

charters[5] have both been eliminated by statute in some states. Some state laws permit corporate boards to treat the interests of non-shareholder groups as paramount when the corporation is facing a change of control.[6] Still others insulate boards from liability for impeding an offer by refusing to rescind a poison pill.[7] I must say, in their zeal to foreclose unsolicited changes in the control of Pennsylvania corporations, the legislature may have succeeded in creating serious problems of conflicting duties and constituencies.

Regrettably, recent state court decisions also have created uncertainty as to the ability of shareholders to make tender decisions in connection with unfriendly acquisition offers. I am referring in particular to the opinion of the Delaware Supreme

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5 See, e.g., 15 Pa.C.S.A. sec. 2535 (1989).

6 See, e.g., Ind. Code Ann. secs. 23-1-35-1(d-g) (Burns Supp. 1989); Pa. S.B. No. 1310, sec. 2 (as amended April 3, 1990); see also Conn. Gen. Stat. sec. 33.313(e) (1989). At least 20 other states have adopted laws that permit the board of directors to consider the interests of non-shareholder groups in responding to a hostile bid.

7 See, e.g., Ind. Code Ann. sec. 23-1-35-1(f) (Burns Supp. 1989); Pa.S.B. No. 1310, sec. 4 (as amended April 3, 1990); see also Ohio Gen. Corp. Law sec. 1701.59 (C)(1) (Anderson Supp. 1987).

court in Paramount, Inc. v. Time, Inc.[8] Whether that opinion may be interpreted as endorsing the most extreme applications of the "just say no defense," leaving the decision to sell the company entirely in the board's discretion, is far from clear. Paramount leaves in its wake many unresolved questions as to the standard that will be applied in Delaware to the conduct of the board. However, one aspect of the decision is clear -- the resulting uncertainty as to the right of shareholders to realize the full value of their shares may make equity investment in U.S. companies much less desirable.

Creating balkanized markets rather than a unified national market system will cause serious economic costs for the United States. In just two years, the European Community will eliminate barriers to cross-border transactions among 12 separate sovereign nations in Europe. The contrast to the path we are on in the U.S. is stark. We have 50 sets of blue sky laws, and 50 different professional licensing, corporate governance and takeover regulatory schemes. Moreover, our ability to compete effectively against the Japanese and a unified European market in the 1990s will suffer immeasurably if other state legislatures make our current fragmentation even worse. This negative trend will be amplified if other states follow the lead of Pennsylvania in

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[8] [Current] Fed. Sec. L. Rep. (CCH) Para. 94,938 (Del. Feb. 26, 1990).

limiting the shareholder's rights in the company he or she owns.

In my view, the states should not be erecting unnecessary barriers to capital raising or to changes of control. Focusing the states' resources on enforcement of the antifraud provisions would make a far greater contribution to investor confidence in and, thus, the health of, the American capital markets in the 1990s.

Conclusion

In conclusion, let me repeat that we do not want to see U.S. shareholders left out in the cold in international tender offers. Nor do we want the U.S. capital markets to be in third place, or even second place. Shareholder confidence and participation in the U.S. capital markets is key to maintaining the vitality of those markets, job creation, the health of our economy and ultimately a stronger America in the 1990s. The Commission will do everything it can to promote strong and vital U.S. capital markets. Shareholder rights should be strengthened, not curtailed. If we do these things and do them well, we will face the 1990s and the decades to come with confidence.

Thank you.