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**INTERNATIONAL MERGERS AND ACQUISITIONS:  
A VIEW FROM THE UNITED STATES**

**Prepared for the**

**Conference on International Mergers and  
Acquisitions in the 1990's**

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**The views expressed herein are those of the authors and do not necessarily represent those of the Commission, other Commissioners, or Commission staff.**

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INTERNATIONAL MERGERS AND ACQUISITIONS:  
A VIEW FROM THE UNITED STATES\*

Conference on International Mergers and  
Acquisitions in the 1990's

I. Foreign Acquisitions in the United States

- A. Foreign investment in the United States has increased dramatically in the last ten years. In 1972, total foreign investment in the United States was only \$162 billion. By 1987, however, total foreign investment in the United States had increased to \$1.54 trillion. Total investment by United States persons (both individuals and corporations) abroad, meanwhile, totals \$1.16 trillion. See The International Investment Position of the United States in 1987, 68 Survey of Current Business No. 6, at 76 (June 1988).
- B. Foreign direct investment--foreign investment that involves ten percent or more ownership of a U.S. business--has increased in an even more dramatic fashion from less than \$15 billion in 1972 to almost \$262 billion by the end of 1987. Id.
- C. The volume of corporate acquisitions by Japanese buyers has increased at a particularly rapid pace, from 37 in 1985 to 81 in 1986 and 92 in 1987. As a result, Japan now has \$33.4 billion in direct investments in the United States, the third largest amount of any foreign country. (The United Kingdom is first with \$74.9 billion of direct investment in the United States; the Netherlands is second with \$47.0 billion.) See Foreign Direct Investment in the United States: Detail for Position and Balance of Payments Flows, 1987, 68 Survey of Current Business No. 8, at 69 (Aug. 1988).

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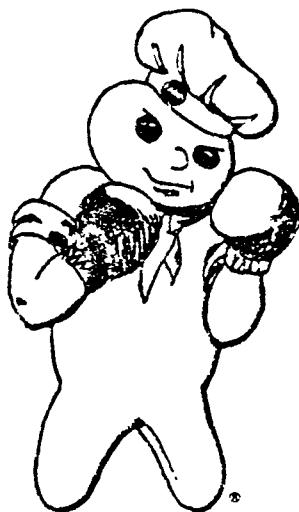
- D. These trends have caused policymakers to question whether the developing level of foreign investment benefits the U.S. economy.
1. The fundamental policy of the Reagan Administration with respect to foreign investment has been neutrality. Under the Reagan Administration, the United States has sought neither to block nor to encourage foreign investment in the U.S., but simply to allow market forces to determine the appropriate level of such investment. See, e.g., Testimony of Robert Ortner, Under Secretary for Economic Affairs, Department of Commerce, Before the Subcommittee on International Economic Policy and Trade of the House Committee on Foreign Affairs (Sept. 22, 1988) (hereinafter "Ortner Statement").
  2. One group of observers argue that by allowing foreigners to purchase massive equity interests in U.S. industry, "we are losing control of our own economic destiny." Pearl Harbor II: The Shocking Sequel, Washingtonian, Nov. 1988, at 168, 173. Fear of foreign ownership is also used as a debating point in hostile takeover battles. For example, in attempting to fend off Grand Metropolitan PLC's hostile takeover bid, Pillsbury Co. declared that "we're not going to sit idly by while an opportunistic British liquor and gambling company takes advantage of a weak U.S. dollar and tries to buy respectability with the purchase of a classic American company." Wall St. J., Oct. 19, 1988 (attached hereto as Exhibit A). These analysts have also asserted that particular acquisitions or types of acquisitions would endanger U.S. national security.
  3. Other analysts suggest that increased foreign investment creates new and better jobs, promotes valuable technology transfers that improve U.S. productivity, reduces the flow of merchandise imports, keeps interest rates low, and allows financing of the budget and trade

# **Grand Met Must Have Had One Too Many If They Thought We Wouldn't Put Up A Fight.**

Pillsbury is known throughout the world for its commitment to quality products.

We have the same commitment when it comes to protecting our shareholders' interests.

We are now the target of a hostile takeover. And we're not going to sit idly by while an opportunistic British liquor and gambling company takes advantage of a weak U.S. dollar and tries to buy respectability with the purchase of a classic American company.



Pillsbury's Board of Directors has rejected Grand Metropolitan's tender offer as being inadequate and not in the best interest of Pillsbury's shareholders. Our Board recognized that Pillsbury has the potential to grow and prosper and to generate substantial returns to our shareholders. We also understand that the Pillsbury family of employees is the most critical factor in our future growth and we intend to see that their interests are protected.

In response to our duty to all of our constituencies, we have put the gloves on the Pillsbury Doughboy. And we're taking other steps necessary to protect our employees, our communities, and the trust the consumer has placed in us for so many years.

And that's a very sobering thought.



THE PILLSBURY COMPANY

deficits at a lower cost. These observers have suggested that "[f]oreign investment in the United States is not a burden, it is a great benefit to our economy." Written Statement of Elliot L. Richardson Before the Subcommittee on International Economic Policy and Trade of the House Committee on Foreign Affairs (Sept. 22, 1988) (hereinafter "AIFA Statement").

4. As a result, many analysts believe that, rather than arguing over the trade deficit, "[t]he battle of the future will be over investment issues." Japan Investment in U.S. Seen Causing Conflict, Reuters, Oct. 12, 1987.
- E. Foreign investment in the United States even became a major issue in the recent U.S. presidential campaign. Although neither candidate proposed explicit restrictions on foreign investment, Michael Dukakis stated that "[f]oreign investors own 10 percent of our manufacturing base, 20 percent of our banking industry, and a third of the commercial real estate in our nation's capital," and charged that the policies of the Reagan Administration were leading to "the fire sale of America." Ex-Rival Revives Gephardt's Economic Message, N.Y. Times, Oct. 14, 1988, at A23.
- F. As a result, renewed focus has been placed on monitoring foreign investment in the United States and on prohibiting certain foreign investment that might prove detrimental to U.S. interests. To counter this pressure, a lobbying group, the Association for Foreign Investment in America, was formed earlier this year with Elliot Richardson as its chairman to address this specific issue.
- G. A Personal Assessment
  1. In the current environment, foreign investment in the United States does more good than harm. Although foreign investment has increased dramatically over the past decade, foreigners hold a relatively small percentage of the U.S. asset base. Those holdings are primarily in the form of portfolio investments, such as

Treasury securities, stocks and bonds, and simple bank deposits, and not in the form of direct investments. See, e.g., Ortner Testimony (foreigners hold four to five percent of total U.S. assets and less than one percent of U.S. land; only 17% of foreign holdings are in the form of direct investment and those enterprises employ about three million workers, or 3.5% of the business workforce).

2. Increased foreign ownership of the U.S. asset base is a symptom of U.S. budget and trade deficits and a low domestic savings rate. Foreign investment is also fueled by dollar exchange rates that are low in comparison with recent experience and a favorable investment climate in the U.S. marketplace. If U.S. policymakers want to reduce foreign ownership of U.S. assets, the most effective means to that end is to reduce the twin deficits and increase domestic savings. Other policy measures are likely to be self-defeating because they increase the cost of capital and retard beneficial technology transfer, job formation, and merchandise exports.
3. The ultimate consequences of foreign investment for U.S. "economic sovereignty" also depend on how the U.S. uses foreign investment. If foreign investment supports productive improvements in the U.S. capital base that expand the U.S. economy (e.g., British investments in the early U.S. railroads), then foreign financing can, in the long run, promote greater U.S. economic independence. However, if foreign financing simply promotes consumption--particularly consumption of foreign manufactured goods--then foreign investment can have serious adverse consequences for U.S. economic sovereignty.
4. The U.S. manufacturing sector has lost a significant portion of its international comparative advantage, and foreign direct investment can re-invigorate that sector. Consider the example of Honda Motors, which

operates a plant in Marysville, Ohio that is now exporting automobiles from the United States to Japan. Such plants create jobs for U.S. workers, reduce the U.S. merchandise trade deficit, and facilitate technology transfer into the United States. Surely the United States would prefer that plant to be owned by General Motors, Ford, or Chrysler, but if the choice is Honda or nothing isn't Honda better?

5. The largest present risk created by foreign investment is the extent to which U.S. policymakers must give weight to foreign financial demands in setting domestic economic policy. Monetary policy must, for example, be sensitive to the rates of return demanded by foreign investors who hold large amounts of U.S. government debt. Policies that drive these investors from the U.S. market will only increase the burden of financing and refinancing past and future deficits. This constraint is not trivial, but it is best addressed by a policy that reduces the need to rely on foreign capital to finance consumption-generated deficits, not by a policy that restricts foreign investments.
  6. In sum, given the current state of economic affairs, we would cast our lots with Alexander Hamilton, who according to "The Economist" said, "[r]ather than treating the foreign investor as a rival, we should consider him a valuable helper, for he increases our production and the efficiency of our businesses." See Jean-Jacques Revisited, Economist, Oct. 22, 1988, at 73.
- H. This outline discusses significant existing legal provisions that regulate or require disclosure about foreign investment in the United States, and explores some recent failed proposals that would require increased disclosure about the level of foreign investment in the United States. It also discusses barriers to foreign acquisition activity in countries such as Japan and Switzerland, and the

political pressures generated by such a lack of effective reciprocity.

II. Examples of Foreign Acquisitions in the United States  
(With Particular Emphasis on Recent Acquisitions by  
Japanese Corporations)

A. Investment Banking

1. Credit Suisse/First Boston. In October 1988, Credit Suisse and First Boston Corporation announced that First Boston would merge with Financiere Credit Suisse-First Boston ("FCS-FB"), a joint venture formed in 1978 that is 60% owned by Credit Suisse and 40% owned by First Boston. The total value of the transaction will be \$1.1 billion. FCS-FB already owns 40% of First Boston. After the proposed transaction Credit Suisse will increase its ownership position in First Boston from 24% to 44.5%. The two companies also announced that they would attempt to sell an additional 30.5% of First Boston to foreign investors in Japan or elsewhere in the Pacific Basin.
2. Sumitomo/Goldman Sachs. In November 1986, the Sumitomo Bank, Ltd. purchased a 12.5% non-voting stake in Goldman, Sachs & Co., a U.S. investment banking organization. Sumitomo's interest was structured as a non-voting interest in order to satisfy the Federal Reserve Board's concerns that the affiliation of Goldman, Sachs with Sumitomo Bank of California, a subsidiary of Sumitomo, would violate provisions of the Glass-Steagall Act.
3. Nippon Life Insurance/Shearson Lehman. In March 1987, Nippon Life Insurance Co. purchased a 13% interest in Shearson Lehman Brothers Holdings Inc. for \$538 million.
4. Yasuda Mutual Life/PaineWebber. In December 1987, Yasuda Mutual Life Insurance Co. purchased an 18% stake in PaineWebber Group Inc. for \$300 million. The transaction also



provided Yasuda with convertible preferred stock which, if converted, would give Yasuda voting control of 25% of PaineWebber's stock. Yasuda also entered into a 20-year standstill agreement that prevents Yasuda from increasing its ownership interest in PaineWebber above 25%.

5. Nomura/Wasserstein, Perella. In July 1988, Nomura Securities Co. agreed to purchase a 20% stake in Wasserstein, Perella & Co. for \$100 million.
6. Primary Dealers in U.S. Government Securities. Fifteen of the 46 primary dealers in United States government securities are owned by foreign corporations: seven by Japanese corporations, five by British corporations, and one each by Canadian, Australian, and Hong Kong corporations. Six other foreign firms also have acquisitions pending to become primary dealers. 2 Added to Fed List of Dealers, N.Y. Times, Sept. 30, 1988, at D17.

B. Commercial Banking

1. Hongkong & Shanghai/Marine Midland. In 1979, Hongkong & Shanghai Banking Corp. increased its stake in Marine Midland Banks Inc.--the holding company for what was at the time the 13th largest commercial bank in the United States--to 51%. In order to reach this level of ownership, Hongkong & Shanghai paid \$62 million for 25% of Marine Midland's stock and agreed to contribute, through a combination of subordinated debt and equity, another \$200 million.
2. Mitsubishi Bank/Bank of California. In 1983, Mitsubishi Bank Ltd. of Tokyo bought the Bank of California for \$282 million. In 1988, Mitsubishi announced plans to merge the Bank of California with its other California subsidiary, Mitsubishi Bank. The resulting entity will have combined assets of \$6.4 billion.

3. Bank of Tokyo/California First Bank/Union Bank. In February 1988, Bank of Tokyo, through its California subsidiary, California First Bank, agreed to purchase Union Bank of California from Standard & Chartered PLC for \$750 million. California First was the sixth largest bank in California, and Union Bank the fifth largest, at the time. Bank of Tokyo later announced plans to merge the two California banks into what would be one of the twenty largest banks in the country.
4. At present, five of the eleven largest banks in California are Japanese-owned.

C. Manufacturing

1. Bridgestone/Firestone. In May 1988, Bridgestone Corp., the world's third largest manufacturer of tires, agreed to purchase Firestone Tire & Rubber Co., the world's fifth largest tire company, for \$2.65 billion. This deal came on the heels of an attempted \$1.93 billion takeover of Firestone by Pirelli S.p.A., an Italian tire-maker.
2. Seagram/DuPont/Tropicana. In 1981, Seagram Co. Ltd., a Canadian corporation, acquired 22.55% of the stock of E.I. du Pont de Nemours & Co. in exchange for \$2.6 billion of shares of Conoco Inc. Seagram had been engaged in a bidding war with DuPont for Conoco. At the same time, Seagram entered into a standstill agreement with DuPont under which it agreed not to acquire in excess of 25% of DuPont's stock. In return, Seagram was given two (since raised to six) seats on DuPont's 29-person board of directors. In addition, in April 1988, Seagram's U.S. subsidiary acquired Tropicana Products, Inc. from Beatrice U.S. Food Corp. for \$1.2 billion.
3. Royal Dutch/Shell. In 1981, Royal Dutch-Shell, the world's second largest oil company and the majority shareholder in Shell Oil Co., the United States' seventh largest oil company,

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acquired all of the remaining shares of Shell for \$5.67 billion.

4. Dainippon Ink and Chemicals/Reichhold Chemicals. In August 1987, Dainippon Ink & Chemicals, Inc. launched a successful \$535 million hostile bid for Reichhold Chemicals. Previously, in November 1986, Dainippon had purchased Sun Chemical Corp.'s graphic arts group for \$550 million. This transaction is one of the rare instances in which Japanese firms have mounted hostile bids.

D. High Technology

1. Nippon Mining/Gould. In October 1988, Nippon Mining Co. acquired Gould, Inc. for \$1.1 billion. In order to preserve Gould's status as a defense contractor, Nippon Mining agreed to split off those operations requiring a security clearance and to place the stock with respect to such operations into a voting trust. The trustees of the voting trust will be three former Pentagon officials, including a former Chairman of the Joint Chiefs of Staff.

E. Food Services

1. Grand Met/Pillsbury. In October 1988, Grand Metropolitan PLC launched a hostile \$5.2 billion bid for Pillsbury Co. Pillsbury has announced that it would oppose Grand Met's proposal. As of the date of this outline, the transaction is still in progress.

F. Entertainment

1. Sony/CBS Records. In November 1987, Sony agreed to purchase the CBS Records Group from CBS Inc. for \$2 billion. Sony and CBS are also partners in a 20-year old joint venture in Japan that now has annual profits of over \$100 million.

G. Hotels

1. Seibu/Grand Met. In October 1988, Seibu Saison, a Japanese conglomerate, announced that it had reached an agreement to purchase the Inter-Continental Hotel chain from Grand Metropolitan PLC for \$2.27 billion. Grand Met had previously purchased the Inter-Continental chain from Pan Am. In announcing the agreement with Grand Met, Seibu Saison indicated that it would take on other partners, as yet unidentified, to help it manage the Inter-Continental chain.
2. Aoki/Westin. In October 1987, Aoki Corporation and the Robert M. Bass Group, Inc. agreed to purchase the Westin Hotel Co. from Allegis Corp. for \$1.35 billion in cash. Aoki and Bass also agreed to assume \$180 million in debt in connection with the purchase. Aoki invested \$1.1 billion in exchange for an 81% interest in Westin, with Bass contributing and receiving the remainder. Aoki also owns the Algonquin Hotel in New York and a one-third interest in the Beverly Wilshire hotel in Los Angeles.

H. Real Estate

1. According to an August 1987 study, foreign investors own more than 13.5% of the top 15 downtown real estate markets, including 46% of Los Angeles; 39% of Houston; 32% of Minneapolis; 21% of New York; 19% of Denver; 18% of Atlanta; 18% of Miami; 17% of Dallas; 17% of San Francisco; and 12% of Washington, D.C. See Study Says Foreigners Buying Up U.S. Skyline, U.P.I., Aug. 18, 1987.
2. During the first eight months of 1988, Japanese real estate investment was estimated to be \$8.96 billion. Total Japanese real estate investment in the United States now exceeds \$35 billion. See Japanese Investment in U.S. Real Estate Rising to Record Level in '88, Study Says, Daily Report for Executives

(BNA), Oct. 13, 1988. In total, Japanese investors now own more than \$12 billion in non-office building real estate in the United States. Japanese Changing Nature of Investments in U.S., Wash. Post, May 14, 1988, at E24.

3. Many of the highest profile real estate sales have involved Japanese investors. For example, Japanese investors have purchased the Exxon Building in New York for \$610 million (the most ever paid for a building in Manhattan); the Arco Plaza Complex in Los Angeles for \$620 million; and the Tiffany Building in New York for \$94 million (\$945 per square foot), the most ever paid for U.S. retail space. The Japanese Buying Binge, Fortune, Dec. 7, 1987, at 77. British, Dutch, and Canadian investors are also very active in the U.S. real estate market.
4. Most Japanese investment in U.S. real estate has involved direct equity purchases, but Nomura Securities, Morgan, Stanley & Co., and Trammell Crow have begun marketing syndicated real estate partnerships. Trammell Crow recently packaged 16 scattered small shopping centers, office buildings, and warehouses in nine states with a combined value of \$180 million into \$10 million units that Morgan Stanley placed privately with various Japanese institutional investors. These syndications could unlock a vast Japanese market of small institutions and wealthy individuals who have not previously invested heavily in U.S. real estate. Id.

I. Explanation of Recent Phenomena. From an economist's perspective, increased foreign investment is a by-product of the budget and trade deficits combined with the low savings rate that the United States has experienced in the 1980s.

1. These deficits led to an accumulation of dollars abroad that can be reinvested in the United States, particularly at exchange rates

that are now low in comparison with rates observed earlier this decade. Because the dollar is currently so cheap relative to the yen, Japanese have been buying real estate, art, gold, securities, etc. in record quantities. Direct investment and control of U.S. businesses is just the next logical step; many observers have thus concluded that "[Japan's] next great export will be capital." The Japanese Are Here To Stay, Money, May 1987, at 140.

2. The strong yen has also forced Japanese exporters to set up overseas production lines to compensate for losses in export competitiveness. Strong Yen Fuels Japanese Foreign Takeovers, Reuters, July 25, 1988.
3. Politics may also play an important role in current acquisitions. For example, some observers claim that "[the Japanese want] to buy access to countries where growing sentiment for trade protectionism threatens to shut them out." Japan's New Goal: U.S. Companies, N.Y. Times, Apr. 27, 1988, at D1. Japanese are now able to make foreign direct investments because of the lifting of exchange controls in Japan in 1980.
4. There is a perception (and that perception is probably accurate) that, to be a major player on a world-wide scale in many markets, you have to participate in the U.S. market. Many foreign companies seem to believe that the best way to participate in the U.S. is to acquire a U.S. company.
5. To keep these matters in perspective, however, it is worth remembering that, in 1987, when the book value of foreign direct investment in the United States was \$262 billion, the book value of U.S. direct investment abroad was \$309 billion. See The International Investment Position of the United States in 1987, 68 Survey of Current Business No. 6, at 76 (June 1988). In terms of market value this

difference is even more dramatic. Much foreign direct investment in the U.S. is relatively new, while the bulk of U.S. direct investment abroad was made before recent rises in U.S. stock prices. As a result, it has been estimated that, in terms of market value, U.S. direct investment abroad exceeds foreign direct investment in the U.S. by \$200 billion. AIFA Statement, supra, at 9. This balance could, however, soon shift if foreign direct investment continues at its recent pace.

III. Obstacles to Foreign Acquisitions of U.S. Companies--  
Prohibitions on Acquisitions That Might Impair National  
Security

- A. Prior to 1988, the United States government lacked the power to block foreign takeovers (either friendly or hostile) of domestic corporations on the general grounds of national defense.
1. In certain industries, foreign investment historically has been either severely restricted or prohibited entirely:
    - a. Atomic Energy. No foreign controlled person or entity may receive a license from the Nuclear Regulatory Commission to engage in any of a wide array of activities connected with atomic energy. 42 U.S.C. § 2133(d).
    - b. Broadcast Communications. No broadcast or common carrier license may be granted to or held by any foreign person or any corporation of which any officer, director, or 20% shareholder is a foreign person. 47 U.S.C. § 310. Because virtually all radio, television, and other broadcast communication media require such a license, foreign participation in the broadcast communications industry is essentially precluded.

- c. Air Transportation. No foreign air carrier (or any controlling person thereof) may acquire control in any manner of any United States organization substantially engaged in the business of aeronautics without the approval of the Department of Transportation. Such approval need not be granted if the combination is not in the public interest. 49 U.S.C. App. § 1378.
  - d. Shipping. Transfer of a controlling interest in a U.S.-flagged vessel to a non-U.S. citizen requires approval by the Secretary of Transportation. 46 U.S.C. App. § 808. Such approvals routinely are granted, however, absent extraordinary circumstances such as a proposed transfer to an Eastern bloc nation or to a person engaged in illegal activity, such as drug smuggling.
2. CFIUS. In addition, the United States government--in particular, the Department of Defense--has on occasion successfully interposed objections to a proposed foreign takeover with the help of the Committee on Foreign Investment in the United States ("CFIUS").
- a. CFIUS was formed in 1975 by President Ford in the wake of the Arab oil embargo. See Executive Order No. 11858, 40 Fed. Reg. 20,263 (1975). CFIUS is an inter-agency panel composed of Assistant Secretaries from the Departments of Defense, Commerce, Treasury, and State, as well as representatives from the Council of Economic Advisers and the U.S. Trade Representative. CFIUS' mission is to monitor the impact of foreign investments in the United States and to investigate particular transactions; it has no power to block specific transactions, but



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instead must transmit recommendations to the Cabinet.

- b. In 1983, the U.S. Department of Defense persuaded Allegheny-Ludlum Corp. not to sell its subsidiary, Special Metals Corp., to Nippon Steel Corp. Special Metals produces alloys used in military aircraft engines. The Department of Defense argued successfully that the transfer of Special Metals to a Japanese parent would present an unacceptable risk of leakage of sensitive military information.
- c. In 1985, the proposed acquisition by Minebea Co. Ltd. of Japan of New Hampshire Ball Bearing Inc., a manufacturer of ball bearings used in gyroscopes and other military instruments, was delayed by the U.S. Department of Defense because of concerns that the acquisitions could harm national defense interests. The transaction was eventually allowed to proceed by the U.S. Department of Justice (which was reviewing the transaction on antitrust grounds) after Minebea executed a written agreement that production of ball bearings would continue at a New Hampshire-based plant.
- d. Most recently, in 1987, U.S. government agencies derailed the proposed purchase of 80% of Fairchild Semiconductor Corp. by Fujitsu Ltd. of Japan for \$200 million. Fujitsu's bid to acquire Fairchild was first delayed by the Department of Justice's claim that it required further information in order to review the antitrust implications of the transaction, and then abandoned when Secretary of Commerce Malcolm Baldrige announced in the press that he would oppose the transaction on national security grounds. (The irony of the situation is that the Defense Department raised no objections when Fairchild was purchased by

Schlumberger Ltd. N.V., a French corporation, in 1979. Fairchild was eventually sold to National Semiconductor Corp. at the reduced price of \$122 million, leaving Schlumberger the biggest loser in this battle. Why the Department of Defense is more comfortable with French than with Japanese ownership of a semiconductor producer is an interesting question, given France's withdrawal from NATO and its demonstrated proclivity for following an independent defense policy. Perhaps the objection was intended primarily to remove the influence of both the French and the Japanese over Fairchild and to bring Fairchild back into U.S. hands.)

- B. Exon-Florio. In 1988, Congress became increasingly concerned that foreign investment in certain critical areas of U.S. industry could impair U.S. national security. In order to prevent such an occurrence, Congress, as part of the Omnibus Trade and Competitiveness Act of 1988, Pub. L. 100-418 (the "Trade Act"), amended the Defense Production Act of 1950 to give the President the authority to block acquisitions of U.S. companies by foreign persons in the interests of national security. This portion of the Trade Act is commonly known as the Exon-Florio provision.
1. Presidential Power to Investigate. The Exon-Florio provision authorizes the President to examine proposed mergers, acquisitions, and takeovers "by or with foreign persons which could result in foreign control of persons [i.e., companies] engaged in interstate commerce in the United States" in order to determine whether such transactions might have an adverse effect on U.S. national security. The Exon-Florio provision does not give the President the authority to block such a transaction until his investigation is completed, however.

2. Confidentiality of Information. Any information or documents obtained by the President in conducting his investigation are confidential and exempt from disclosure under the Freedom of Information Act.
3. Presidential Power to Block Transactions. If, upon investigation, the President finds that "the foreign interest exercising control might take action that threatens to impair the national security" and that current law does not otherwise provide him with adequate authority to protect the national security if that transaction is consummated, the President may suspend or prohibit the proposed transaction. In addition, because some proposed transactions may be completed while the President's investigation is being conducted, the Exon-Florio provision gives the President the authority to seek divestment of the acquirer's ownership stake in federal court.
4. Factors to be Considered. The Exon-Florio provision indicates that the President may consider the following factors, among others:
  - a. whether the proposed transaction will affect domestic production needed for projected national defense requirements;
  - b. whether domestic industries have the capability and capacity, including the availability of human resources, products, technology, materials, and other supplies and services, to meet national defense requirements; and
  - c. whether control of domestic industries and commercial activity by foreign citizens would affect the capability and capacity of the United States to meet the requirements of national security.

However, the bill nowhere defines the crucial term "national security," leaving that term intentionally vague in order to provide the President with maximum flexibility.

5. Submission of Report to Congress. If the President determines to take action to block a proposed transaction, he must immediately transmit to Congress a written report of his investigation. This report must provide a detailed explanation of the President's findings and outline the actions that he proposes to take.
6. Judicial Review. The Exon-Florio provision fails to give a prospective acquirer, or even Congress, an explicit mechanism for challenging the President's determination. Thus, some commentators have suggested that the President's findings are final and "are not subject to judicial review." See Little-Noticed Trade Bill Provision: Potential Stumbling Block for Foreign Acquirers, Or Mere Rhetoric?, Corporate Control Alert, Sept. 1988, at 1, 8. It may be possible for frustrated acquirers to secure judicial review of the President's decision, however, at least in those instances where the President is forced to seek an order of divestment from a federal court. If judicial review is available in such circumstances, a prospective acquirer may seek to complete the proposed acquisition before the President's investigation is completed, so that judicial review will be available when and if the President seeks divestment. Because of the lack of precedent, however, predictions in this area must be treated with caution.
7. Long-term Effect. It is unclear what the ultimate effect, if any, of the Exon-Florio provision will be. While the language of the provision seems to give the President broad (and perhaps unreviewable) authority to block foreign takeovers of U.S. companies in the interests of "national security," some

commentators have questioned whether the provision will have anything more than a cosmetic effect on takeover activity. See Little-Noticed Trade Bill Provision, supra, at 1, 7. There is little doubt, however, that prospective targets will seek to invoke the Exon-Florio provision in the broadest possible range of circumstances or that the provision opens the door to potential further politicization of the foreign acquisition process.

- C. An example of the potential breadth of the Exon-Florio provision was demonstrated less than a month after the provision was enacted, when Consolidated Gold Fields PLC ("Consolidated"), a mining company based in Great Britain, asked President Reagan to block a hostile takeover bid by Minorco S.A. ("Minorco"), a Luxembourg-based company controlled by South African interests.
1. Consolidated owns 49.3% of Newmont Mining Company ("Newmont"), an American mining concern that controls major reserves of strategic minerals such as gold, platinum, rutile (used in making titanium), zircon (used in nuclear reactors and re-entry shields), and monzonite (used in radar screens and superconductors).
  2. Consolidated has argued that Minorco's proposed takeover should be blocked because, if the acquisition is consummated, these strategic metals would fall under South African control, thereby impairing U.S. national security. Interestingly, the same plea was made successfully to the Prime Minister of Papua New Guinea, who indicated that Consolidated, if taken over by Minorco, would be required to sell its gold holdings in that country. See Minorco Says It Will Sell Newmont Stake If Bid for Consolidated Is Successful, Wall St. J., Oct. 4, 1988, at A7.
  3. In order to forestall any attempt by the President to use the Exon-Florio provision to block Minorco's takeover of Consolidated,

Minorco's chairman said that Minorco would sell its stake in Newmont if its bid for Consolidated were successful. See id. As of the date of this outline, the Minorco bid was stalled pending review by antitrust regulators in Great Britain. See Minorco Says It Will Give Evidence to U.K. Probe, Reuters, Oct. 31, 1988.

IV. Generic Disclosure Requirements Under the Federal Securities Laws

- A. The U.S. securities laws require extensive disclosure of ownership information in a wide variety of merger and acquisitions involving firms with publicly-traded securities. These disclosure requirements apply equally to U.S. and foreign investors seeking to acquire or to make substantial investments in publicly-traded U.S. firms. Foreign investors, however, are often unfamiliar and uncomfortable with U.S. disclosure requirements and may therefore perceive these disclosure requirements as impediments to particular acquisitions even though the requirements are, in fact, applied on a nondiscriminatory basis.
- B. Disclosure of Beneficial Ownership of Five Percent of a Publicly-Traded Corporation. For example, all persons who become beneficial owners of more than five percent of the equity securities of a publicly-held U.S. company must disclose certain information.
1. "Passive" Acquisitions: Schedule 13G. If such a beneficial owner falls within certain specified categories of institutional investors, and if that person acquired the securities in question in the ordinary course of business, and not with the purpose or effect of changing or influencing the control of the issuer, that beneficial owner may file a short-form report of ownership on Schedule 13G. 17 C.F.R. § 240.13d-1 (1988).
- a. Timing of Filing Requirement. Schedule 13G must be filed within 45 days of the end of the year in which that person's

beneficial ownership exceeded five percent.

- b. Types of Disclosure Required. Schedule 13G requires, among other things, the disclosure of the name of the owner and the amount of securities of the issuer owned by that person.
  - c. Amendments to Schedule 13G. Changes in the information reported on Schedule 13G must be filed annually, with certain exceptions requiring more frequent amendments where the beneficial owner's aggregate ownership of the issuer's securities exceeds ten percent.
  - d. Termination of "Passive" Intent. If the beneficial owner determines that it no longer holds such securities in the ordinary course of business or not with the purpose or effect of changing the control of the issuer, that person must file a Schedule 13D within ten days thereafter.
2. Schedule 13D. Beneficial owners of more than five percent of a class of equity securities who do not hold securities in the ordinary course of business, or who hold securities with the purpose or effect of changing the control of the issuer, or who do not fit within the specified categories of institutional investors, must file a report of ownership on Schedule 13D.
- a. Timing of Filing Requirement. An investor must file a Schedule 13D within ten days of the day on which it becomes the beneficial owner of five percent or more of a class of equity securities.
  - b. Types of Disclosure Required. Schedule 13D requires beneficial owners to set forth, among other things, the following information: (i) identifying information

about the beneficial owner, such as information about the beneficial owner's identity and background; (ii) the beneficial owner's aggregate ownership interest in the securities of the issuer; (iii) the source and amount of funds to be used in making the purchases; (iv) the purpose of the transaction, including any plans or proposals with respect to either the disposition of the securities or contemplated material changes in the issuer's management, composition, operations, and policies; and (v) any contracts, arrangements, understandings, or other relationships (including voting agreements, joint ventures, loan or option arrangements, puts or calls, guarantees of profits, or division of profits or losses) with any other person that the beneficial owner may have with respect to the securities of the issuer.

- c. Amendments to Schedule 13D. Thereafter, such persons must "promptly" disclose any material changes in the information provided in Schedule 13D. An acquisition or disposition of beneficial ownership of securities in an amount equal to one percent or more of that class of securities is presumptively deemed to be material, and a lesser percentage may be material, depending on surrounding facts and circumstances.
3. Proposed Revisions to Schedules 13D and 13G. On October 19, 1988, the Securities and Exchange Commission held an open meeting to discuss whether to propose amendments to the 13D/13G reporting regime. According to the discussions at the open meeting, the Commission staff has proposed allowing all persons who acquire shares for passive investment to file on Form 13G. As a result, filings on Schedule 13D would better highlight potential changes in corporate control. See SEC Tables Action on Proposal for More Disclosure Under Williams



Act, Daily Report For Executives (BNA) Oct. 20, 1988. As of the date of this outline, the rule proposal had not yet been released.

- C. Disclosure of Beneficial Ownership of Directors, Officers, and Ten Percent Shareholders. In addition to the disclosure requirements under Schedules 13D and 13G, Section 16(a) of the Securities Exchange Act of 1934 requires that corporate insiders-- directors, officers, and ten percent shareholders-- make certain disclosures of beneficial ownership of equity securities in companies in which they are insiders.
1. Form 3. Initial statements of beneficial ownership of equity securities, as required by Section 16(a), must be filed on Form 3 within ten days after the date on which that person becomes an insider.
  2. Form 4. Thereafter, statements of changes in beneficial ownership must be filed on Form 4 within ten days after the close of each calendar month in which there has been any change in the insider's holdings.
  3. Termination of Status As a Corporate Insider. A person who is no longer a corporate insider must continue to make reports of changes in beneficial ownership on Form 4 for six months thereafter.
- D. Disclosure in Tender Offer Documents. Under Section 14(d) of the Securities Exchange Act of 1934, certain disclosures are required "as soon as practicable" after a person begins a tender offer for the shares of a publicly-traded U.S. corporation. Among other things, the rules under Section 14(d) require disclosure of information concerning: (i) the target company and its securities; (ii) the identity and background of the bidder(s); (iii) the terms of the offer; (iv) the source of funds for the acquisition; (v) the purpose of the tender offer; (vi) the plans of the bidder relating to changes in management, transfer of assets, or extraordinary corporate transactions of

the target; and (vii) any transactions and/or negotiations between the bidder and the target during the preceding three fiscal years.

- E. Disclosure of Beneficial Ownership in Registration Statements Under the Securities Act of 1933 and in Periodic Reports Under the Securities Exchange Act of 1934. Certain disclosures of beneficial ownership are required in registration statements under the Securities Act of 1933 and in all annual reports on Form 10-K under the Securities Exchange Act of 1934. These disclosure requirements are set forth in Item 403 of Regulation S-K.
1. Item 403(a). Under Item 403(a), a registrant must disclose, in tabular form, information with respect to any person (including any group) known by the issuer to be the beneficial owner of more than five percent of any class of the registrant's equity securities.
  2. Item 403(b). Under Item 403(b), a registrant must disclose, in tabular form, information about management's beneficial ownership of each class of the registrant's equity securities. This information must be disclosed with respect to each director individually, and with respect to all directors and officers as a group.
  3. Information Required Under Item 403(a) and (b). The information required under Item 403(a) and (b) includes the name and address of the beneficial owner, the amount and nature of the beneficial ownership, and the percentage of the class owned.
  4. Item 403(c). Under Item 403(c), a registrant must describe any known arrangement that may result in a change of control of the company, including any pledge by any person of the registrant's securities or of the securities of its parent.
- F. Disclosure Reports With Respect to Institutional Investors. All institutional investment managers, whether domestic or foreign, who exercise investment

discretion over accounts having an aggregate of more than \$100 million in securities that are publicly traded in the U.S. must report the aggregate security holdings in all such accounts on Form 13F within 45 days after the close of each calendar quarter. This form requires information identifying the amount of each security managed and the nature of the investment discretion and voting authority possessed by the manager. It does not, however, require disclosures about specific clients or their individual holdings.

- V. Obstacles to Foreign Acquisitions of U.S. Companies-- Potential New Disclosure Requirements Under the Failed Bryant Bill
- A. In addition to generic disclosure requirements under the federal securities laws, some members of Congress have introduced proposals to secure more specific disclosure about foreign nationals and corporations that invest in U.S. corporations and other U.S. property.
- B. On January 6, 1987, Representative Bryant and 31 co-sponsors introduced H.R. 312, entitled the "Foreign Ownership Disclosure Act." The avowed purpose of this bill is "[t]o require foreign persons to register their investments in the United States."
1. Types of Investments Requiring Registration. The bill would require every "foreign person" that wishes to make an investment that would result in the control, directly or indirectly, of five percent or more of any property in the United States or any organization located in the United States, to register that investment with the Secretary of the Treasury before making that investment.
2. Retroactivity. Under the bill, any foreign person who held a registrable investment on the date of enactment would be required to register that investment within 180 days.

3. Contents of Registration. Among other things, the bill would require a foreign person to disclose information about: (i) itself; (ii) the property or organization in which it wishes to invest; (iii) the type and size of the investment; and (iv) the terms and conditions of the investment. The foreign person would be required to update certain changes in this information within 30 days after such changes occurred, and the remainder in annual reports.
4. Disclosure of "Chains of Control." In addition, a foreign person would be required to disclose information about any person who controls, directly or indirectly, a cumulative interest of five percent or more in that foreign person.
5. Definition of "Foreign Person." As used in the bill, the term "foreign person" would include foreign corporations and other business organizations, foreign governments and agencies, and individuals who are not citizens of the United States.
6. Penalties. The bill would provide for both civil and criminal penalties.
  - a. A foreign persons who failed properly to register an investment would be subject to a civil penalty of 0.1% per week of the market value or the purchase price of the investment, whichever was greater.
  - b. If a foreign person failed to register and subsequently transferred its investment to another person, that subsequent transferee would be jointly and severally liable for payment of the penalty relating to that investment, although the transferee would have a right to recover any penalty paid from the foreign person.

- c. A foreign person who willfully failed to register would be subject to a possible criminal penalty of one year in jail and/or forfeiture of the investment in question. Separate criminal penalties would have been available against persons who knowingly or willfully aided and abetted a violation or carried out an act or practice constituting the violation.
- C. The full House of Representatives never considered the Bryant bill. Instead, a less stringent version of the Bryant bill was attached as an amendment to the Omnibus Trade and Competitiveness Act of 1988.
1. Types of Investment Requiring Registration. The amended version of the Bryant proposal would have required registration only of "significant interests" or "controlling interests."
    - a. The term "significant interest" would have included the following: (i) ownership interests of five percent or more of any United States property or business that has either assets with a market value of more than \$3 million or gross sales in the most recent fiscal year of more than \$10 million; (ii) ownership interests of five percent or more in any two or more such properties and/or businesses that have, in the aggregate, either assets with a market value of more than \$12 million or gross sales in the most recent fiscal year of more than \$40 million; and (iii) any ownership interest in a United States property or business with a market value of more than \$10 million, other than "transitory and temporary speculative holdings."
    - b. The term "controlling interest" would have included any ownership interest of 25% or more in a business that has either assets with a market value of more than \$3

million or gross sales in the most recent fiscal year of more than \$12 million.

2. Contents of Registration. In the case of "significant interests," the revised Bryant bill would require somewhat less detailed information than the original version, although the Secretary of the Treasury was given discretion to require additional disclosure. In the case of "controlling interests," however, the Bryant bill would require the following additional information: (i) an English translation of any public financial disclosure about the foreign person filed in its home country; (ii) detailed information about the businesses and management (including financial statements) of the United States business in which the foreign person has such a controlling interest.
  3. Penalties. The revised version of the Bryant proposal would also have reduced the potential penalties for violations of the registration requirement. The civil penalty would have been reduced to a maximum of \$10,000 per week, and the possible criminal penalty of forfeiture of the investment would have been dropped, substituting instead a possible \$10,000 fine. In addition, criminal penalties for persons who aided and abetted a violation or carried out an act or practice constituting a violation would have been eliminated under the revised proposal.
- D. The version of the omnibus trade bill which was eventually passed by Congress and signed into law by President Reagan did not include the Bryant proposal. However, the revised version of the Bryant bill was subsequently re-introduced as H.R. 5410 and was passed by the House by a vote of 250-170 on October 5, 1988. The Senate took no action on the bill and the bill died when the 100th Congress adjourned later in the month.

VI. Other Obstacles to Foreign Acquisitions of U.S. Companies

- A. Acquisitions of Defense Contractors. In general, the U.S. government will not give foreign companies the security clearances necessary to bid on defense contracts that involve classified information. Thus, under the applicable Department of Defense regulations, it may not be possible for a foreign person to invest in a firm that has received or that routinely bids for U.S. defense contracts.
1. The U.S. Department of Defense has adopted procedures designed to enable foreign firms to acquire U.S. firms that have security clearances without forfeiting those clearances, but these procedures generally require the foreign company to relinquish the right to exercise virtually any managerial control over the target.
    - a. For example, if a foreign investor acquires a majority of a U.S. firm's stock and the firm wishes to maintain a security clearance, the acquirer generally must enter into a voting trust or proxy agreement, effectively yielding all managerial influence to the trustees or proxies.
    - b. Where less than majority control is acquired, the U.S. firm's board of directors generally must resolve to deny the foreign owner access to any classified information or to any positions of influence within the company, although it may be possible in some instances for the foreign investor to secure representation on the target's board of directors without forfeiting the target's security clearance.

B. Regulatory Obstacles to Takeovers in Regulated Industries

1. Certain industries in the United States, such as insurance and banking, are highly regulated. Although the precise form of regulation varies from industry to industry, the regulatory authorities with supervisory authority over the industry generally have the power to restrict new competitors either from entering the industry or from acquiring an existing firm in the industry. These regulatory authorities can, either at the behest of a target or on their own initiative, delay (if not block completely) a proposed acquisition by a foreign firm.
2. For example, when BAT Industries, a British tobacco company, initiated a hostile bid for Farmers Group, a United States insurance company, Farmers asked insurance regulators in nine states to block the transaction. See Farmers and Lawyers Keep BAT at Bay, Financial Times, Aug. 1, 1988, at 19. Farmers ultimately agreed to be acquired by BAT, but only after three state insurance regulators announced that they would oppose the deal and after BAT increased its offer for the company from \$5.2 billion to \$6.2 billion. It was unclear, however, whether the opposition of the state regulators would withstand judicial challenges. See BAT Wins Battle for Farmers With Dollars 5.2 Bn Cash Bid, Financial Times, Aug. 26, 1988, at 1. Farmers was then left with the unpalatable prospect of asking the same state insurance commissioners that it had previously asked to bar the transaction to reverse their positions so that the takeover could be consummated.
3. Foreign bidders can experience problems in regulated industries even when the proposed transaction is friendly. For example, when Bank of New York Co. made a hostile bid for Irving Bank Corp., Irving asked Banca



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Commerciale Italiana ("BCI") to act as a white knight. BCI's bid was ultimately abandoned, however, when the Federal Reserve Board determined that BCI's parent, an Italian government agency, would be deemed a "bank holding company" under applicable law and would be forced to comply with certain restrictions that BCI viewed as onerous. See White Knight Drops Its Bid for Irving; Italian Bank Balks at Requirements Set by Federal Reserve, Am. Banker, Aug. 30, 1988, at 1.

### C. Antitrust Considerations

1. The Clayton Act. Section 7 of the Clayton Act prohibits takeovers the effect of which "may be substantially to lessen competition or to tend to create a monopoly" in any line of business anywhere in the United States. 15 U.S.C. § 18 (emphasis added). This provision applies to horizontal mergers (mergers of direct competitors) and vertical mergers (mergers with a supplier or a customer). Under Reagan Administration policies, the focus has been on horizontal acquisitions and the analysis has looked to narrower market definitions than relied on in the past. The absolute size of a transaction is also irrelevant under this approach, except insofar as an industry exhibits economies of scale. This approach is consistent with modern microeconomic analysis and rejects the view that the antitrust laws should be used to further social agendas or that transactions should be barred because "big is bad" per se.
2. The Hart-Scott-Rodino Antitrust Improvements Act. The Hart-Scott-Rodino Act requires a prospective acquirer to give pre-merger notification to the Federal Trade Commission and to the Antitrust Division of the Department of Justice before completing any proposed transactions that exceed a certain size. This requirement is intended to provide antitrust authorities with an opportunity to review proposed transactions--and, where appropriate,

to seek court injunctions--prior to their consummation.

a. Transactions to Which the Hart-Scott-Rodino Act Applies. The Hart-Scott-Rodino filing requirements apply if at least one of the parties to the transaction is engaged in an activity affecting interstate or foreign commerce, and if the following "size-of-person" and "size-of-transaction" tests are both satisfied.

i. Size-of-person Test. (15 U.S.C. § 18a(a)(1)).

The acquiring person has total assets or annual net sales of at least \$100 million and the acquired person is engaged in manufacturing and has assets or sales of at least \$10 million; or

The acquiring person has assets or sales of at least \$100 million and the acquired person is not engaged in manufacturing and has assets of at least \$10 million; or

The acquiring person has assets or sales of at least \$10 million and the acquired person has assets or sales of at least \$100 million.

ii. Size-of-transaction Test. (15 U.S.C. §18a(a)(3)) (as modified by the Minimum Dollar Value Exemption, 16 C.F.R. § 802.20). An acquisition is reportable only if:

The acquiring firm will hold voting securities and/or assets of the acquired firm with an aggregate value in excess of \$15 million; or

The acquiring firm will hold voting securities that confer control of an acquired firm with total assets or annual net sales of at least \$25 million.

- b. Exemptions. Among other things, the Federal Trade Commission's rules exempt an acquisition of ten percent or less of a target's voting securities, if the securities in question are held "solely for the purposes of investment."
- c. Who Must File. Both the acquirer and the target must file notifications with both the Department of Justice and the Federal Trade Commission under Hart-Scott-Rodino.
- d. Information Required Under Hart-Scott-Rodino. Under the Hart-Scott-Rodino Act, the following types of information, among other things, must be filed:
  - i. information about the companies involved, including general background information and financial statements, information about any substantial stockholders and any subsidiaries anywhere in the world, and certain financial information concerning the companies' operations in the United States;
  - ii. information about the structure of the transaction and the voting securities or assets to be acquired; and
  - iii. a description of the industries in which both companies are engaged and information about their operations in that industry, including previous acquisitions and copies of studies and reports prepared for the purpose of analyzing the proposed transaction

with respect to market shares and competition.

- e. The waiting period under Hart-Scott-Rodino. The Hart-Scott-Rodino Act requires prospective acquirers to satisfy a waiting period requirement of from 15 to 30 days before completing a proposed transaction. This waiting period may be extended if the Federal Trade Commission or the Department of Justice requests additional information about the proposed transaction. It may be possible, however, to secure early termination of the waiting period in some instances.
- f. The Relationship Between the Five Percent Filing Requirement of the Securities Laws and the Hart-Scott-Rodino Notification Procedures. As a practical matter, if a target company is large enough an acquirer is likely to reach the \$15 million Hart-Scott-Rodino pre-notification trigger before accumulating a 5% equity position that gives rise to a duty to file a 13D under the securities laws. (For a company with \$300 million in equity, the 5% threshold equals the \$15 million Hart-Scott-Rodino trigger: for all larger companies the Hart-Scott-Rodino trigger is reached before the 13D threshold is crossed.) Accordingly, the Hart-Scott-Rodino pre-notification requirements will, at times, lead to disclosure of a pending acquisition before any securities law disclosure obligations arise.
- g. Federal Trade Commission Rulemaking. The Federal Trade Commission recognizes that a \$15 million holding is often so small, on a percentage basis, that it raises no rational antitrust concern. Accordingly, the FTC has proposed amendments to the Hart-Scott-Rodino notification provisions that would, among other things, eliminate all Hart-Scott-Rodino requirements for

acquisitions of less than 10% of a target company's equity. 53 Fed. Reg. 36,831 (Sept. 22, 1988).

- D. Foreign investors must also comply with the Industrial Security Program, the Defense Production Act, the Arms Export Control Act, and laws regarding export control. See Ortner Statement, supra, at 12.
- E. Restrictions on Ownership of Real Estate

1. In addition to federal restrictions on foreign investment, 22 states reportedly impose restrictions on foreign ownership of real estate. Some states claim to prohibit nonresident aliens from buying real estate, while others claim to prohibit foreign real estate ownership unless U.S. citizens have reciprocal privileges in the foreign investor's home country. The legality of these restrictions may, however, be subject to challenge.
2. Efforts to control foreign ownership of real estate are hardly limited to the United States: Japan and Switzerland also have such restrictions. Foreign investors may not buy Japanese land that is used for farming, mining, forestry or fishing. See East Buys West: Foreign Ownership on Rise; Record Japanese Speculation in Real Estate Inflates Values, Threatens a Political Backlash, Wash. Post, May 29, 1988, at H1. In Switzerland, "Lex Friedrich" prevents foreign ownership of real estate. See, infra, VIII.C.3.
3. Other countries have also imposed restrictions on foreign real estate investment in an effort to curb what was specifically perceived to be excessive Japanese real estate investment. The Australian government, for example, began to relax restrictions on foreign real estate investment in 1983. Within the next four years, however, Japanese real estate investment in Australia increased eight-fold. Troubled by the speed with which Japanese investors were

acquiring prime Australian real estate, the Australian government quickly moved to re-impose restrictions on foreign real estate investment. See Foreign Reaction Cools Land Investment Abroad; Australia, Hawaii Citizens See Homeland Prices Rise, Nihon Keizai Shimbun, June 4, 1988, at 5.

4. Prompted by the recent enormous growth in Japanese real estate investment, the state of Hawaii has also begun to consider whether it would be appropriate to restrict such investment. The proposed law would bar the purchase of property in the state by non-resident aliens. See East Buys West: Foreign Ownership on Rise; Record Japanese Speculation in Real Estate Inflates Values, Threatens a Political Backlash, Wash. Post, May 29, 1988, at H1. The city of Los Angeles is reportedly considering a similar restriction. Id.
5. As a result, the Japanese press reports that "[s]ome Japanese investors have begun to introduce voluntary restraints on their purchasing in order to keep host countries' governments from formally restricting foreign investment in real estate." See Foreign Reaction Cools Land Investment Abroad; Australia, Hawaii Citizens See Homeland Prices Rise, Nihon Keizai Shimbun, June 4, 1988, at 5. Such reports are viewed with skepticism in some quarters.

F. Cultural Problems

1. Foreign investors may also experience difficulties with the takeover process itself, which in many ways is completely alien to the culture in which they ordinarily operate. As a result, companies from these countries may be unwilling to participate in the U.S. takeover market, even though this restraint is largely self-imposed.

2. Japanese companies are particularly reticent to launch hostile bids. Japanese business culture is grounded on the principle of achieving a consensus before a major decision is reached, and "the very idea of a Japanese company buying another company defies the traditional tenets of management in [Japan]--that the company is a family cemented by carefully nurtured corporate loyalty that produces a commitment to quality and employee flexibility." Japan's New Goal: U.S. Companies, N.Y. Times, Apr. 27, 1988, at D1. Indeed, one Japanese word for takeovers ("baishu") is synonymous with the Japanese word for "bribery," while another ("no'tori") is synonymous with the verb "hijack." See Long-Term Growth Rather Than Quarterly Profits; U.S. Leveraged Buyouts Spawn Japan-Style Strategy, Nihon Keisai Shimbun, Oct. 18, 1986, at 7. (Interestingly, the latter word ("no'tori") derives from the concatenation of the Japanese words "noru," which means "to ride," and "toru," which means "to take." In the American vernacular, many business executives would probably claim that a hostile takeover certainly does take them for a ride.)
2. Historically, Japanese firms have not chosen to acquire existing foreign companies on either a friendly or an unfriendly basis. Instead, Japanese firms have demonstrated a decided preference for establishing a presence in foreign countries through a joint venture or a "green field" investment.
3. The examples at the beginning of this outline provide evidence that the Japanese are becoming more comfortable with the concept of takeovers, and increasingly are willing to acquire foreign companies that fit in with their overall strategic plans. Some Japanese companies have even initiated hostile transactions, as Dainippon Chemicals' successful bid for Reichhold Chemicals, discussed supra, demonstrates. Nevertheless, at least insofar

as Japanese companies are concerned, the consensus opinion is that the vast majority of future deals "will continue to be friendly, reflecting the desire of most Japanese firms to avoid protracted and hostile takeover battles." Japanese Investments in U.S. Technology Should Rise, Reuters, Sept. 1, 1988.

#### VII. Acquisitions Abroad by United States Companies

- A. As noted earlier, foreign investment in the United States has increased in the last 15 years by a total of 951%. During that time period, U.S. investment abroad also has increased, but not quite as quickly, from \$199 billion in 1972 to \$1.17 trillion in 1987, a cumulative increase of 588%.
- B. U.S. direct investment abroad has also grown over the past 15 years, but the difference between the rate of growth of U.S. direct investment abroad and foreign direct investment in the United States is even more dramatic. U.S. direct investment abroad increased between 1972 and 1987 from \$89 billion to \$309 billion, an increase of 347%. Foreign direct investment in the United States grew by 1747% during that period--a cumulative rate of increase that is five times as large as the growth in U.S. direct investment abroad.
- C. Until 1981, total U.S. investment abroad was consistently larger than foreign investment in the United States. Between 1981 and 1982, however, foreign investment in the U.S. began to exceed U.S. investment abroad. This trend accelerated every year thereafter until 1987.

#### VIII. Representative Examples of Obstacles to Acquisitions Abroad by U.S. Companies and the Reciprocity Debate

- A. The United States market is probably the most open market in the world in terms of foreigners' ability to make major commercial and financial investments. Other markets often have significant sociological, legal, and economic barriers that make acquisitions by foreigners quite difficult. Japanese and Swiss companies, for example, are quite active in the U.S.



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market, but it is difficult for U.S. or other foreign persons to acquire commercial assets in Japan or Switzerland. Furthermore, when the European Economic Community breaks down trade barriers among member nations in 1992, there is concern that the deck will be stacked in favor of intra-European acquisitions and against acquisitions by U.S. or Japanese firms. This lack of effective reciprocity in certain segments of the international acquisition market has already become a source of legislative concern in the United States, and may become a more significant force as trade pressures mount. United States policymakers are often swayed by arguments that the U.S. deserves a "level playing field," and the field certainly is not level when it comes to foreign acquisitions in Japan or Switzerland.

B. Japan

1. There are no direct legal impediments to foreign takeovers in Japan. Nevertheless, corporate takeovers are extraordinarily rare in Japan, in part because takeovers are contrary to the Japanese culture.
  - a. Japanese businessmen are often averse to foreign takeovers, fearing that such takeovers may impair the welfare and job security of the company's employees. To fail to protect one's workers is considered shameful.
  - b. It is also alleged that a foreign firm seeking to acquire a Japanese company may encounter resistance from the Japanese Ministry of Finance. See Citicorp Sees Gold in Japanese Consumer Banking, Reuters, Jan. 15, 1988; Tokyo Gets Its First Taste of Greenmail, Bus. Week, Sept. 23, 1985, at 56.
  - c. Even Japanese companies have difficulty overcoming barriers to hostile takeovers. For example, when Minebea Co. Ltd., a Japanese manufacturer of ball bearings and

electronic components, attempted a hostile takeover of Sankyo Seiki in 1985, Mitsubishi Bank threatened to cut off its entire business relationship with Minebea, even though Minebea was its fourth largest customer. Japanese Takeovers; Hostility to Hostility, Economist, Aug. 24, 1985, at 80.

2. The structure of shareholdings in Japan also makes takeovers by foreign entities difficult as a practical matter.
  - a. Shares of many Japanese companies are held by friendly banks and other corporations. These holdings create a interlocking network of share ownership. In many cases, more than half of a Japanese corporation's shares may be held through such a web of cross-shareholdings. The resulting interlocked group of companies, each of which is essentially immune to a hostile takeover, strongly resembles the pre-war Japanese "zaibatsu" conglomerates and is known as a "keiretsu."
  - b. Historically, shareholders within the same keiretsu have refrained from selling shares of other members of the keiretsu without that member's consent.
3. Attracting and retaining capable managers and university graduates can be difficult even for foreign firms that manage to establish a foothold in Japan. Until very recently, Japanese employees typically worked for only one employer for their entire working lives, and thus foreign corporations have encountered difficulties in expanding their operations in Japan because they have been unable to hire experienced personnel. University graduates, meanwhile, often view foreign corporations--even those headquartered in Japan--as less desirable employers.

C. Switzerland

1. Swiss law contains no explicit prohibition on foreign takeovers of Swiss companies, and the Swiss government has no statutory power to prevent such takeovers. Nevertheless, hostile takeovers of Swiss companies have long been regarded as "well-nigh impossible." Swiss and Germans Use National 'Poison Pills', N.Y. Times, Aug. 26, 1988, at D3.
2. The Swiss corporate code provides Swiss corporations with enormous flexibility in structuring their corporate charters. Swiss corporations have used this freedom in a variety of ways to block foreign takeovers.
  - a. For example, many Swiss corporations commonly have a variety of types of ownership interests, such as registered shares (which may have preferential voting rights), bearer shares (which may have lesser voting rights), and participation certificates (which may have no voting rights at all). Foreign investors, meanwhile, may be prohibited under a Swiss corporation's articles of association from owning registered shares.
  - b. In addition, Swiss corporations have the freedom under the Swiss corporate code to refuse to register the shares of any shareholder for virtually any reason they see fit. Swiss corporations were first given the authority to refuse to register shares, a practice which is known as "vinkulierung," in 1936 as a method of preventing takeovers of Swiss corporations by interests in Nazi Germany. This authority, however, can be used to prevent a takeover by anyone, including a Swiss national. As an example, Gebrueder Sulzer AG fended off a takeover attempt by Tito Tettamanti, a Swiss citizen, by amending its articles of association to lower the

number of shares that it would register in the name of any one shareholder from 4000 to 1000 (only 0.5% of its total capital). Swiss Bid Code Riddled With Contradictions, Fin. Times, May 6, 1988, at 33.

- c. A Swiss company may also provide in its articles of association that it must remain in Swiss ownership.
3. Swiss law also contains a provision, known as "Lex Friedrich," that prevents foreign persons from buying Swiss real estate. This law has also been understood to prohibit a foreign person from acquiring control of a Swiss corporation that has the majority of its assets in real estate. Id.
4. In short, the attitude of the Swiss toward hostile takeovers is that "a [Swiss] joint-stock company is like a club: nobody is under a compulsion to buy shares, just as anybody is free to join or not join a club. . . . If the majority of the shareholders wish to strengthen a company's defences against takeovers, then it is their perfect right to do so." The Swiss Market is Still Strongly Influenced By Private Investors, Financial Times, May 10, 1988, at 23.
5. As a result of these restrictions, however, Swiss companies have encountered hostility when they have sought to acquire companies in other countries. Furthermore, the barriers to acquisitions of Swiss companies have caused foreign investors increasingly to withdraw from the Swiss markets. See, e.g., Banker Calls Swiss Bourse An Anachronism, Fin. Times, Oct. 21, 1988, at 37.
6. As a result, the Swiss Parliament has been studying a proposal to lower some (but not all) of the barriers to acquisitions of Swiss companies. For example, the Swiss government is considering a proposal to allow Swiss companies to block foreign takeovers and to

limit investment by individual investors, but only if the company is willing to buy back the shares of such investors. The Swiss Bourse is also considering a proposal to relegate to a separate part of the trading floor companies that do not have established standards for determining when it is appropriate to refuse to register a shareholder's shares. See Swiss National Bank Joins Critics of Share Restrictions, Reuters, June 2, 1988. To date, however, neither of these reform proposals has been implemented.

D. The Reciprocity Debate

1. The barriers to foreign investment in countries such as Switzerland and Japan have proved frustrating to foreign competitors whose home countries do not impose restrictions on Japanese and Swiss investment. Efforts to persuade these countries to remove existing impediments to foreign investment, meanwhile, have not proved entirely fruitful. As a result, policymakers in the United States and Europe have begun to explore imposing restrictions on investment by foreign persons whose home countries do not permit such investments within their borders. The rallying cry for these policymakers has been "Reciprocity!"
2. Practices in the Japanese Government Bond Market and Recent Developments in the United States Primary Dealer Market
  - a. The Japanese government bonds market is the second largest in the world, after the U.S. government bond market. Until recently, Japanese government bonds have been launched solely through syndicates of Japanese banks and brokers on terms fixed by the Japanese Ministry of Finance (the "MoF").

- i. Japanese government bonds ("JGB"s) are priced by the MoF inclusive of a 60 basis point commission. Syndicates traditionally have respected MoF's price in the initial distribution period, and there has traditionally been no price cutting among syndicate members. The business has been very profitable for Japanese firms privileged with the opportunity to participate in the syndicates. See, e.g., Japanese Upset at Grey Market in JGBs, Fin. Times, Sept. 11, 1988, at 21.
  - ii. In the past three years, foreign banks have been given small allocations (generally, up to 2.5%) in the syndicates. A portion of the Japanese bond issues are also now offered by auction, rather than syndicate allocation, but the vast majority of Japanese government bonds are still sold through syndicates.
- b. The entry of foreign firms into the Japanese government bonds market has given rise to allegations of price cutting.
- i. Japanese syndicate members have charged that foreign firms have set up "when-issued" markets for new Japanese government bonds and have offered to pass through a portion of the MoF commission to customers. These practices, if true, threaten the profits Japanese financial firms have long been able to earn from underwriting Japanese government bond issues. See, e.g., Japanese Security Firms Cry 'Foul' As Foreigners' Price Cutting Hits Home, Wall St. J., Oct. 13, 1988, at C1; Japanese Upset at Grey Market in JGBs, Fin. Times, Sept. 11, 1988, at 21.

ii. Ironically, Japanese firms trying to enter the United States and European markets have long been charged with setting razor-thin margins in order to buy market share. In particular, when the four largest Japanese firms initially sought to become primary dealers in the U.S. market, U.S. securities firms accused them of "dumping" issues in order to gain market share. The allegations levied against foreign firms operating in Japan are thus essentially identical to the allegations levied against Japanese firms operating in Europe and the United States. Thus, the issue of reciprocal treatment is raised once again in the Japanese market--if the Japanese can cut margins to gain market share abroad, why can't foreigners do the same in Japan?

c. Recent Developments in the United States Primary Dealer Market--the Primary Dealers Act of 1988. After repeated efforts to convince the Japanese government to open up the Japanese bond market proved unavailing, Congress took more direct steps, as part of the Trade Act, to ensure that U.S. firms would be granted access. The relevant provision of the Trade Act is entitled the "Primary Dealers Act of 1988."

i. Reciprocity Requirement. The Primary Dealers Act provides that the Federal Reserve Board may neither designate nor permit the continued designation of any foreign person as a primary dealer if that person's home country "does not accord to United States companies the same competitive opportunities in the underwriting and distribution of government debt securities issued by such country as

such country accords to domestic companies of such country."

- ii. Grandfathering Provision. Foreign companies that were designated as primary dealers before July 31, 1987 are exempted from this provision.
  - iii. Exceptions Involving Bilateral Trade Agreements. The reciprocity requirement of the Primary Dealers Act does not apply to companies located in countries that had or were negotiating a bilateral trade agreement with the United States as of January 1, 1987.
  - iv. Effective Date. The Primary Dealers Act takes effect on August 23, 1989.
- d. In the wake of the Primary Dealers Act, the Japanese government has further changed the system by which government bonds are sold. Beginning April 1, 1989, 40% of the ten-year government bonds will be sold through an auction process. The remaining 60% will be sold through syndicates, but foreign firms' percentage of the syndicated portion of each offering will increase from 2.5% to 8%. Foreign firms will also be allowed to serve as co-managers of the syndicate. It is unclear, however, whether these concessions give foreign firms "the same competitive opportunities in the underwriting and distribution of government debt securities," as required by the Primary Dealers Act. It is also unclear how the Japanese government will respond to allegations of price-cutting in the Japanese market, and whether these responses will undercut claims of reciprocity.



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3. The Reciprocity Debate in Other Countries: the European Community's Approach. The United States is not the only country that has begun to question whether it is appropriate to allow acquisitions by companies located in countries that do not allow reciprocal acquisitions in their countries. Members of the European Community (the "EC") have expressed similar concerns, and the EC as a whole has begun to take steps to ensure that foreigners may invest within the EC only on a reciprocal basis.
- a. For example, when Nestle S.A. sought to acquire the British candy maker Rowntree P.L.C. earlier this year, Sir Geoffrey Howe, the British Foreign Secretary, warned that, "[if] Swiss companies . . . expect to make takeovers in our market, . . . [t]heir Government must ensure British firms can make takeovers in theirs. . . . [I]f the away teams are going to play on a level pitch when they come to [Great Britain] we shall want to see them levelling their pitch too for the return match." Howe Gives Warning to Swiss Over Bid Barriers, Financial Times, May 12, 1988, at 7.
- b. In implementing the Single European Act, which mandates that the members of the EC shall "form an area without frontiers in which free movement of goods, persons, and services is ensured" by December 31, 1992, the EC has indicated that it may restrict investment and acquisitions by persons whose home countries do not provide reciprocal rights to companies headquartered in the EC. The possibility that the EC might build protectionist barriers that would exclude investment (and goods) from other countries has been described as "Fortress Europe." See The Growing Fear of Fortress Europe, N.Y. Times, Oct. 23, 1988, at E1.

- c. It is not entirely clear, however, what the EC means by "reciprocity." Some officials within the EC have suggested that reciprocity would permit firms to invest within the EC only if their home countries permit EC firms to invest within their borders on the same terms that such investments could be made within the EC. This approach would effectively require other countries to adopt regulatory environments identical to that of the EC if their firms are to compete within the EC. See Japan Fears Integration Will Raise Barriers, Reuters, Oct. 11, 1988. Under this approach, for example, U.S. banks would be unable to establish beachheads in the EC, because EC banks would be able to expand geographically anywhere within the EC, while U.S. banks are prohibited from establishing branches in more than one state under the McFadden Act and are restricted from acquiring banks on an interstate basis by the Douglas Amendment to the Bank Holding Company Act.
- d. The United States, however, would prefer a "national treatment" approach, which would allow a company to invest in the EC if its home country does not impose discriminatory restrictions on EC firms. Outsider's Guide to Europe in 1992, Fortune, Oct. 24, 1988, at 121. The United States has pressed this view forcefully in trade negotiations. See The Growing Fear of Fortress Europe, N.Y. Times, Oct. 23, 1988, at E1.
- e. At any rate, the possibility that the EC might impose restrictions by 1992 on the ability of foreign firms to purchase firms in the EC has reportedly caused some foreign companies--most notably, Japanese companies--to invest in EC companies now, relying on statements by EC officials that foreign investors would not be required to divest "the rights they have acquired." See The Growing Fear of Fortress Europe,

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N.Y. Times, Oct. 23, 1988, at E1. This approach has been termed "buying in as a hedge against European protectionism." Outsider's Guide to Europe in 1992, Fortune, Oct. 24, 1988, at 121.

## IX. Conclusion

- A. Increased international merger and acquisition activity is an inevitable by-product of trade imbalances, fluctuations in currency values, and changing economic fundamentals that provide economies of scale and scope to internationally integrated enterprises.
- B. Significant changes in legal regimes and economic policy, such as the changes that will take place in 1992, also provide substantial incentives for international restructuring.
- C. Increases in international merger and acquisition activity will be accompanied, however, by increasing calls for protection against foreign acquirers on national security and "economic sovereignty" grounds. These protectionist pressures will probably be most severe regarding acquisitions by foreign nationals whose countries have substantial de facto and de jure restrictions on foreign acquisitions. Japan and Switzerland are currently the clearest examples of countries with businesses active in foreign acquisition but with substantial barriers within their own countries against acquisitions by foreigners.