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I wish to reaffirm a simple message: European and other non-U.S. market players are welcome and encouraged to participate in the U.S. markets. The SEC has facilitated foreign participation in the past and will continue to do so, all within the framework of protecting investors through our existing securities regulation.[1]

The Securities and Exchange Commission ("SEC") has long adhered to a policy of promoting foreign participation in U.S. securities markets while maintaining sufficient regulatory standards to ensure the protection of U.S. investors.[2] In practice, however, these dual goals are often in conflict, as over-regulation may cause foreign market participants to exit the domestic marketplace.[3] In the wake of the Enron collapse and the accounting scandals of 2001, there has been increasing fear that the SEC will begin to regulate foreign participation in U.S. markets more stringently.[4] While the SEC itself has reaffirmed its commitment to these dual policy concerns,[5] one federal district court has recently chosen to disregard this balancing act, inappropriately favoring domestic investors over foreign market participants.

In *Tracinda Corp. v. DaimlerChrysler AG*, the United States District Court for the District of Delaware considered whether Daimler-Benz AG, as a German domestic corporation, was entitled to an exemption from liability imposed under U.S. securities laws.[6] Securities law generally prohibits issuers of publicly traded stock in the United States from printing materially misleading statements in their proxy materials,[7] but provides exemptions from these requirements for certain corporations meeting the definition of "foreign private issuers."[8] In *Tracinda*, plaintiff Tracinda Corporation challenged the 1998 merger of Chrysler Corporation with Daimler, alleging common law fraud and violations of various securities laws related to purported oral and written misrepresentations made by the corporation and its officers.[9] The court held that Daimler, while technically meeting the definition of a "foreign private issuer," was not

1. Roel C. Campos, Comm'r, U.S. Sec. & Exch. Comm'n., Embracing International Business in the Post-Enron Era, Address Before the Centre for European Policy Studies (June 11, 2003), *available at* http://www.sec.gov/news/speech/spch061103rcc.htm.

2. Anupama J. Naidu, *Was its Bite Worse than its Bark? The Costs Sarbanes-Oxley Imposes on German Issuers May Translate into Costs to the United States*, 18 EMORY INT'L L. REV. 271, 272 (2004).

3. *Id.*

4. *See* Campos, *supra* note 1. Commissioner Campos, who is addressing European industry leaders, notes that "[t]he title of my speech, 'Embracing International Business in the Post-Enron World,' was chosen deliberately. Indeed, I believe that the Commission's history has been, and continues to be, one of welcoming a diversity of participants to the U.S. markets." *Id.*

5. *See id.*

6. 364 F. Supp. 2d 362, 394–95 (D.Del. 2005).

7. 17 C.F.R. § 240.14a-9 (2005). Proxy materials include both the "form of proxy" through which registered shareholders vote their shares, as well as the accompanying prospectus containing corporate financial statements and officer and director discussion of key corporate policies and events. *Id.*

8. 17 C.F.R. § 240.3a12-3 (2005).

9. *Tracinda*, 364 F. Supp. 2d at 365, 395–416.

permitted to benefit from the exemption specifically designed for such parties.[10] The court's ruling narrowed the exemption for foreign corporations and is contrary to the broad interpretation of the exemption found by the Ninth Circuit in *Batchelder v. Kawamoto*[11] and the Southern District of New York in *In re Vivendi Universal, S.A.*[12] This case comment contends that while the court correctly held that defendant Daimler did not violate U.S. securities laws,[13] it erroneously failed to recognize that Daimler was a "foreign private issuer," and thus exempt from the laws entirely.

Tracinda, a corporation organized for the purposes of investing in publicly traded entities, was a major shareholder of Chrysler common stock prior to Chrysler's merger with Daimler.[14] Through a series of negotiations with Chrysler management in the years prior to the merger, Tracinda obtained the right to elect a representative to the board of directors.[15] When members of the board began preliminary talks in February and March of 1998 concerning the possibility of a business combination with Daimler, the management of Tracinda initially supported the proposal.[16] When the potential business combination was presented to Chrysler's shareholders for a vote, the prospectus disclosed that both Daimler and Chrysler were to have equal representation on the board of the newly merged entity DaimlerChrysler AG.[17] The prospectus repeatedly described the business combination as a "merger of equals."[18]

The shareholders approved the merger on September 18, 1998, and the new corporation instituted the governance structure as described in the prospectus.[19] However, on October 1, 1999, DaimlerChrysler issued a press release stating that the board would be reduced in size, with all the positions lost to be those of former Chrysler directors, including Tracinda's representative.[20] In an interview with the London Financial Times, Juergen Schrempp, Chairman of the DaimlerChrysler Board and former Chairman of the Daimler Board, admitted that the current management structure was one that he had always intended.[21]

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10. *Id.* at 394–95.
11. 147 F.3d 915 (9th Cir. 1998).
12. 381 F. Supp. 2d 158 (S.D.N.Y. 2003).
13. *Tracinda*, 364 F. Supp. 2d at 406–12.
14. *Id.* at 367.
15. *Id.* at 369.
16. *Id.* at 371.
17. *Id.* at 377–78.
18. *Id.* at 378–79.
19. *Id.* at 380–81.
20. *See id.* at 383.
21. *Id.* at 387.

In effect, he claimed he had never intended the business combination to be a "merger of equals," but rather a Daimler acquisition of Chrysler.[22]

On November 27, 2000, Tracinda sued DaimlerChrysler, Daimler, and three current DaimlerChrysler Board members in the United States District Court for the District of Delaware.[23] The complaint alleged a series of violations of the Securities and Exchange Act of 1934, including Section 14(a) and Rule 14a-9 promulgated thereunder for material misrepresentations on the defendant's proxy statement. On April 7, 2005, the court granted DaimlerChrysler's motion for summary judgment, and dismissed all of Tracinda's claims, holding that Tracinda failed to establish the elements of its claims for common law fraud and securities laws violations.[24] Even though the court ruled that Daimler did not violate the Exchange Act or any rules promulgated thereunder, the court nevertheless held that it was *subject to* the Act's regulations and not entitled to any exemption.[25]

Under the Exchange Act, Congress granted the SEC the authority to directly regulate issuers of securities in the United States.[26] Pursuant to its legislative mandate, the SEC promulgated Rule 14a-9 requiring proxy statements (or any form of communication accompanying a proxy) to be free of material misrepresentations or omissions of fact.[27] The SEC did, however, create an exemption to Rule 14a-9 under Rule 3a12-3(b), which states that "[s]ecurities registered by a foreign private issuer[28] shall be exempt from [the proxy rules] . . . of the [Exchange] Act."[29]

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22. *Id.*

23. *Id.* at 365.

24. *Id.* at 417.

25. *Id.* at 394–95.

26. In the case of proxy regulation, section 14(a) of the Exchange Act broadly grants the SEC power over the regulation of proxy solicitations stating, "[i]t shall be unlawful for any person . . . in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit . . . any proxy . . . registered pursuant to section 12 of this title." 15 U.S.C.A. § 78n (2005).

27. 17 C.F.R. § 240.14a-9 (2005).

28. Rule 3a12-3 references Rule 3b-4 for the definition of a "foreign private issuer." Rule 3b-4, 17 C.F.R. § 240.3b-4(c) (2005), details the requirements for classification as a "foreign private issuer." According to the regulation:

    The term foreign private issuer means any foreign issuer other than a foreign government except an issuer meeting the following conditions:

    (1) More than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and

    (2) Any of the following:

        (i) The majority of the executive officers or directors are United States citizens or residents;

        (ii) More than 50 percent of the assets of the issuer are located in the United States; or

        (iii) The business of the issuer is administered principally in the United States.

29. 17 C.F.R. § 240.3a12-3 (2005).

In reaching its decision that Daimler was not exempt from Rule 14a-9 of the Exchange Act, the *Tracinda* court performed a purely textual analysis of the rules, disregarding previous decisions which held for a much broader interpretation of the foreign private issuer exemption.[30] The court did not dispute Daimler's contention that it met the definition of a "foreign private issuer,"[31] but despite this acknowledgment held that under a "plain language" reading of Rule 3a12-3(b), the exemption only applied to securities *registered*[32] by a foreign private issuer, and not to foreign private issuers generally.[33] The court held that because the proxy materials in question were sent to shareholders of pre-merger Chrysler common stock, which was registered by Chrysler and not Daimler, the foreign private issuer exemption did not apply.[34] Under this approach, the court incorrectly narrowed the existing view of Rule 3a12-3(b) as presented in *Batchelder*[35] and *Vivendi*,[36] wherein the courts ruled broadly to exempt all "foreign private issuers" from Rule 14a-9, regardless of who registered the securities.[37] The *Tracinda* court acknowledged the precedential value of these rulings but failed to properly distinguish its case from either.[38]

In *Batchelder*, the United States Court of Appeals for the Ninth Circuit ruled that Honda Motor Company, a Japanese corporation, was exempt from Rule 14a-9 under the foreign private issuer exemption simply because it met the definition of a foreign private issuer.[39] Batchelder, a holder of Honda American depository receipts ("ADRs"),[40] claimed that Honda had distributed proxy statements that were materially misleading with respect to the qualifications of nomi-

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30. *See Tracinda*, 364 F. Supp. 2d at 394.

31. *Id.*

32. Registration is the process of filing a registration form and prospectus with the SEC. The SEC requires that the filings include a description of the corporation's business, a description of the securities being offered for sale, information regarding the corporations management, and certified financial statements. Unless the corporation qualifies for an exemption, no securities may be offered to potential investors until the registration statements are approved by SEC staff. JEFFREY D. BAUMAN ET AL., CORPORATIONS LAW AND POLICY 297 (5th ed. 2003).

33. *Tracinda*, 364 F. Supp. 2d at 394.

34. *Id.*

35. Batchelder v. Kawamoto, 147 F.3d 915 (9th Cir. 1998).

36. *In re* Vivendi Universal, S.A., 381 F. Supp. 2d 158 (S.D.N.Y. 2003).

37. *See Batchelder*, 147 F.3d at 922–23; *Vivendi*, 381 F. Supp. 2d at 171.

38. *Tracinda*, 364 F. Supp. 2d at 394.

39. *Batchelder*, 147 F.3d at 922–23.

40. ADRs are investments in foreign securities indirectly through a U.S. institution, termed a depository. The depository, usually a bank or trust company, purchases and holds shares of the securities in the foreign country. The depository then issues to U.S. purchasers a negotiable instrument called an ADR which represents shares in the depository's foreign holdings. While the holders of ADRs only indirectly hold the common stock of the foreign corporation, they are still entitled to all the benefits of being a shareholder including receiving voting rights through proxies. HAL S. SCOTT, INTERNATIONAL FINANCE: TRANSACTIONS POLICY AND REGULATION 81 (12th ed. 2005).

nated directors.[41] The *Batchelder* court held that as long as a foreign corporation met the definition of a foreign private issuer, the exemption would apply. The court reiterated the breadth of their ruling, stating that "Rule 3a12-3(b) is clear with regard to [Honda's] obligations under . . . [the proxy section of] the Exchange Act and the rules promulgated thereunder — it has none."[42]

The *Tracinda* court agreed with the holding in *Batchelder*, but attempted to distinguish its case on a factual basis. The court noted that the securities in *Batchelder* were Honda ADRs which were registered by Honda, the foreign private issuer, whereas the securities in *Tracinda* were Chrysler common shares registered by the domestic corporation.[43] While this distinction is factually accurate, it is immaterial. The *Batchelder* court placed no emphasis on who registered the securities at issue; rather, the court focused solely on whether the defendant met the definition of a foreign private issuer under Rule 3a12-3(b).[44] If a defendant met this definition, as Honda did, it would be exempt without further inquiry. In *Tracinda*, the plaintiff conceded that Daimler met the definition of a foreign private issuer, but the court held that simply meeting the definition was not sufficient to be entitled to the exemption.[45] Thus, by failing to apply the exemption to Daimler, the court refused to follow the broad *Batchelder* standard and instead favored a much narrower interpretation.

The *Tracinda* court likewise failed to follow the broad interpretation of the foreign private issuer exemption rendered by the court in *Vivendi*, a case factually similar to *Tracinda*. In *Vivendi*, shareholders of Seagram Company, Ltd., a U.S. domestic corporation, received a proxy statement in anticipation of the merger between Seagram, Vivendi Universal, S.A., and Canal Plus, S.A.[46] Shareholders of Seagram common stock filed suit alleging that the proxy statement sent by Seagram and Vivendi contained material misrepresentations in direct violation of Rule 14a-9 of the Exchange Act.[47] The court found that Vivendi was a corporation organized under French law, and therefore "undisputedly" met the definition of a foreign private issuer.[48] Utilizing the broad rule of *Batchelder*, the *Vivendi* court held that, "because Vivendi is a foreign private issuer, plaintiff's [proxy rule] claim against Vivendi must be dismissed."[49]

41. *Batchelder*, 147 F.3d at 922.

42. *Id.* at 923.

43. *Tracinda*, 364 F. Supp. 2d at 394.

44. *See Batchelder*, 147 F.3d at 923 (noting that "Batchelder has failed to put forth any argument as to why Honda . . . should not be considered a 'foreign private issuer' under Rule 3b-4(c)").

45. *See Tracinda*, 364 F. Supp. 2d at 394.

46. *Vivendi*, 381 F. Supp. 2d at 164.

47. *Id.*

48. *Id.* at 171.

49. *Id.*

The *Tracinda* court made no attempt to distinguish its case from *Vivendi*. The court instead attacked the analysis performed in *Vivendi*, noting that "[i]n *Vivendi*, the court did not analyze this question in detail and held that Vivendi was organized under French law and therefore a 'foreign private issuer.'"[50] In summarily dismissing the examination performed in *Vivendi*, the *Tracinda* court failed to recognize that the *Batchelder* rule does not require a detailed analysis. If a corporation meets the definition of a foreign private issuer, it is simply exempt, with no further analysis necessary.

The holdings of *Batchelder* and *Vivendi* cannot be reconciled with *Tracinda*. *Batchelder* and *Vivendi* held that all issuers meeting the statutory definition of a foreign private issuer were exempt from federal proxy rules. In contrast, the *Tracinda* court endorsed a more narrow exemption, requiring corporations to meet the definition of a foreign private issuer *and* to have also registered the subject shares.[51] The question remains, however, as to whether the *Tracinda* court had good reason to narrow the exemption.

The *Tracinda* court's strict textual analysis fails to recognize the purposes of the SEC in drafting the foreign issuer exemption. While the text of the exemption indicates that "securities *registered* by a foreign private issuer . . . shall be exempt . . .," textual interpretation should not be the absolute end of the analysis.[52] The SEC drafted the federal proxy rules and their exemptions and therefore, it is to this agency's purpose and communications with the public that one must look for the "drafter's intent."[53] The SEC is widely recognized for its primary mission of protecting the interests of U.S. investors.[54] As a result, one

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50. *Id.*

51. *See Tracinda*, 364 F. Supp. 2d at 394.

52. Legal scholars and Justices alike have continually recognized that textual analysis has its limitations, particularly when society has changed since the drafting of a statute, but the text has not. For example, see ROBERT G. MCCLOSKEY, THE AMERICAN SUPREME COURT 15 (3d ed. 2000) (1960), in which McCloskey discusses how the actual text of the Constitution has remained constant since ratification, but its meaning has continually altered:

> The Constitution means whatever the circumstances of the future will allow it to mean. But since those circumstances were almost sure to vary, the result was that alterability became the law of the Constitution's being: it might mean one thing in 1855, something else in 1905, and something different in 1955, depending on what circumstances, including popular expectations, warranted.

See also Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 635 (1952) (Jackson, J., concurring), where Justice Jackson downplayed the importance of text with regard to interpretation of the Constitution. He stated that "[t]he actual art of governing under our Constitution does not and cannot conform to judicial definitions of the power of any of its branches based on isolated clauses or even single Articles torn from context."

53. Generally courts will look to the congressional record, including floor debates and committee notes, in order to determine legislative intent. Rules promulgated by the SEC, however, are not subject to the standard legislative process and thus traditional sources for deriving legislative intent are not available.

54. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976), where the Court describes the Exchange Act, which the SEC was created to enforce, as being "intended principally to protect investors against manipulation of stock prices through regulation of transactions upon securities exchanges and in over-the-counter

might argue that all exemptions from rules intended to protect investors should be interpreted narrowly, so as to best serve the SEC's mission. However, the SEC admits that it has an important, often unstated, secondary mission of fostering the growth of the U.S. capital markets and investor wealth.[55] These two goals are often in conflict because regulations designed to benefit investors necessarily place some burden on corporate freedom.[56] While corporations are willing to accept some level of regulation in exchange for the vast benefits of access to U.S. capital markets, regulations that are unduly burdensome may lead to corporate flight to jurisdictions with less stringent regulatory schemes.[57] With respect to foreign corporations, the SEC is faced with the inherent conflict between maximizing investor protection from the potential abuses of foreign corporations and maximizing investor access to foreign markets.[58] Increasing the disclosure requirements for foreign corporations allows the SEC to protect U.S. investors, but also limits their investment opportunities, as these requirements discourage foreign corporations from seeking access to U.S. capital markets.[59]

As result, the "legislative intent" of the SEC's rules with respect to foreign issuers is clearly one of balancing competing policy goals.[60] Therefore, the most appropriate interpretation of the foreign private issuer exemption is one that reflects this duality. The narrow interpretation of *Tracinda* serves one of the policy goals, providing the maximum level of protection for U.S. investors. However, the holding effectively removes the exemption from any foreign issuer that seeks to merge with a publicly traded U.S. corporation, as such a merger will generally require a proxy vote by the shareholders of the domestic corporation. Without the exemption, the foreign corporation will face liability for any inaccu-

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markets, and to impose regular reporting requirements on companies whose stock is listed on national securities exchanges."

55. Integrated Disclosure System for Foreign Private Issuers, Securities Act Release No. 677, Exchange Act Release No. 6360, Trust Indenture Act Release No. 18,274, 24 SEC Docket 3 (Nov. 20, 1981). In this press release, the SEC discusses how the rules affecting foreign private issuers were created to balance these competing interests. The press release states that

> the Commission must evaluate two competing policies. One is the recognition that the investing public in the United States needs the same type of basic information disclosed for an investment decision regardless of whether the issuer is foreign or domestic. This view suggests that foreign registrants be subject to exactly the same requirements as domestic ones. The other is that the interests of the public are served by an opportunity to invest in a variety of securities, including foreign securities. An implication of this policy is that the imposition on foreign issuers of the same disclosure standards applicable to domestic issuers could discourage offerings of foreign securities in the United States, thereby depriving United States investors of the opportunity to invest in foreign securities.

56. *Id.*

57. *See generally id.*

58. *See id.*

59. *See id.*

60. *See id.*

rate information in the accompanying prospectus.[61] While this may have some positive effect by increasing shareholder protection, the negative effects on the competing goal of increasing investor access to foreign markets would be devastating. In the context of a merger, shareholders who are entitled to vote on the transaction will generally receive a prospectus that contains information on *both* corporations. To protect themselves from liability, foreign acquirers may be required to ensure the accuracy of not only their statements but also the statements of the target corporation. The time and due diligence required to ensure this accuracy is costly,[62] and even if all precautions are taken, the foreign corporation may still be found liable.[63] Such costs and potential for liability will greatly diminish the attractiveness of U.S. corporations as merger targets, thus limiting U.S. investor's potential for maximum growth and access to foreign corporations.[64]

Alternatively, the broad holdings of *Batchelder* and *Vivendi* preserve the attractiveness of U.S. corporations as merger targets, without sacrificing the goal of shareholder protection. Foreign corporations would receive protection from suits related to misstatements on merger proxies, thus enticing greater foreign investment in U.S. corporations. Furthermore, shareholders of the domestic target corporation who are harmed by misleading proxy statements would not be left without remedy. The domestic corporation, as joint issuer of the offending proxy statements would continue to be liable to its shareholders under the federal proxy regulations.[65]

The ideal of balancing the dual policy goals of investor protection and the growth of foreign participation in U.S. securities markets is not revolutionary, but neither is it widely recognized. In a generation of corporate scandals it is easy to push investor protection to the forefront at the expense of competing interests — and cases such as *Tracinda* exemplify the dangers of this phenomenon. Longstanding traditions should not be ignored simply because current events indicate a weakness in effective regulation. Instead, "reaffirmations" must be made

61. 17 C.F.R. § 240.14a-9 (2005).

62. *See* Naidu, *supra* note 2, at 302–14 (discussing the costs that German issuers face when they choose to cross-list their securities on an American exchange).

63. As drafted, section 14(a) of the Securities and Exchange Act does not require the issuer to *knowingly* issue a materially misleading proxy statement. By its simple terms, any person who solicits, or permits the use of his name to solicit, any proxy in contravention of the rules promulgated by the SEC has acted "unlawfully."

64. *See* Naidu, *supra* note 2, at 315 (discussing generally that the additional costs associated with over-regulation in the United States may discourage some German issuers from seeking out the U.S. capital markets). While the author does not specifically discuss how over-regulation will affect mergers between U.S. and foreign corporations, it is implicit that any transaction which leads to additional costs due to regulation, such as a merger, will be viewed as less attractive to a foreign acquirer. *See id.*

65. Client Memorandum, Fried, Frank, Harris, Shriver & Jacobson LLP, Public Communications in the Context of a Merger Transaction ¶ 8 (Oct. 1, 2001), *available at* http://www.ffhsj.com/cmemos/100101.htm#_ednref35.

in order to calm fears and reassure those affected that the status quo will be maintained. Commissioner Campos' reminder was a good one, but was perhaps spoken too softly.