1994

The Listing of Daimler-Benz Securities on the NYSE: Conflicting Interests and Regulatory Policies

J. William Hicks

*Indiana University Maurer School of Law*, hicks@indiana.edu

Follow this and additional works at: [https://www.repository.law.indiana.edu/facpub](https://www.repository.law.indiana.edu/facpub)

Part of the [International Business Commons](https://www.repository.law.indiana.edu/facpub) and the [Securities Law Commons](https://www.repository.law.indiana.edu/facpub)

**Recommended Citation**

Hicks, J. William, "The Listing of Daimler-Benz Securities on the NYSE: Conflicting Interests and Regulatory Policies" (1994). *Articles by Maurer Faculty*. 2699. [https://www.repository.law.indiana.edu/facpub/2699](https://www.repository.law.indiana.edu/facpub/2699)

This Article is brought to you for free and open access by the Faculty Scholarship at Digital Repository @ Maurer Law. It has been accepted for inclusion in Articles by Maurer Faculty by an authorized administrator of Digital Repository @ Maurer Law. For more information, please contact rvaughan@indiana.edu.
The Listing of Daimler-Benz A.G. Securities on the NYSE: Conflicting Interests and Regulatory Policies

By J. William Hicks

Introduction

The scene in front of the New York Stock Exchange ("NYSE") on 5 October 1993, resembled a giant showroom. Broad Street, outside the stock exchange, was lined with red carpets and white kiosks festooned with German and American flags. Featured prominently on this public stage was a display of Daimler-Benz products: fire engines, helicopters, Mercedes-Benz cars, including a prototype sports coupe, and models of Eurofighter jets, high-speed trains and Ariane space rockets. The spectacle attracted public dignitaries, such as Arthur Levitt Jr., the chairman of the US Securities and Exchange Commission ("SEC"), captains of industry, including NYSE officials and Daimler executives, German and US television camera crews and journalists, and hundreds of office workers, tourists and curiosity seekers. It was a celebration worthy of attention. For inside the stock exchange Daimler-Benz was making its trading debut on the Big Board.¹

The importance of that October day in lower Manhattan was not limited to the Stuttgart-based corporate conglomerate whose equity securities began trading on the floor of the NYSE under the "DAI" symbol.² Dr. Gerhard Liener,

¹ See Ferdinand Protzman, Ferdinand Protzman With Grand Rollout on Wall St., Daimler Flies in Face of Bad News, N.Y. Times, 6 October 1993, D8; Germany's Daimler-Benz Finds Parking Spot on NYSE, L.A. Times, 6 October 1993, D2; Daimler-Benz Cheers Being 1st German Firm to be Listed on NYSE, Chicago Tribune, 5 October 1993, C3; Dave Pettit, Daimler may lead other firms onto NYSE, Atlanta Constitution, 6 October 1993, C3; Anita Raghavan / Michael Sesit, Foreigners Fall in Love With US, The Financial Post, 6 October 1993, A9.

² Daimler-Benz, A.G. is the holding company of four corporate units: Mercedes-Benz (passenger cars and commercial vehicles), AEG (rail systems, automation and energy distribution), Deutsche Aerospace (aviation, space systems, defense and civil systems and propulsion systems), and debis (information technology services). Daimler's total revenues of $57.8 billion in 1992 reflected the following percentages of revenue from the four corporate units: Mercedes-Benz (66%); AEG (11%); Deutsche Aerospace (17.6%); and debis (5.4%). As of 31 December 1992, the Daimler group had 376,467 employees, 80% of whom were employed in Germany; Daimler had approximately 400,000 stockholders. Daimler-Benz Form 20-F, as filed with the SEC on 17 September 1993, 2, 8, 20, 26, 35, and F-2 (hereinafter cited as "Daimler Form 20-F").
Daimler’s chief financial officer, said of the listing, “This is the greatest thing I’ve done in my career.” Richard C. Breeden, the former chairman of the SEC who for more than three years had actively participated in negotiations leading up to the listing, described it as “an event of immense significance” and “a new beginning in the world of corporate finance.” William H. Donaldson, the Chairman of the NYSE who officiated at the October 5th ceremony, echoed the sentiments of Richard Breeden. These testimonials to the importance of the Daimler listing are understandable in part given the historical context of that occurrence. Daimler-Benz, A.G., the largest industrial group in Germany and the third largest group in Europe, had become the first German company to obtain a full listing on a US stock exchange. To fully appreciate the immensity of that event, however, requires a close look at the three years of struggle, bitter accusations, and, eventually, compromise that preceded the public relations extravaganza on Wall Street. Such an inquiry is informative in at least two respects. First, it provides a framework for evaluating the decisions of Daimler, the NYSE, and the SEC in connection with an event which, according to representatives of all three interested parties, was truly momentous. Second, and more importantly, an examination of the history behind Daimler’s decision to list abroad provides insights to the broader issue of international regulatory competition with respect to investment securities and the desirability of harmonizing disclosure standards.

Part I of the Article begins with an overview of US securities law, which reflects public policies that both limit and encourage international securities transactions. It then examines the public and private interests which were at stake during the three years preceding Daimler’s decision to list its ordinary shares on the world’s largest stock exchange. As this discussion demonstrates, the Daimler listing represented more than one company’s business judgment about the location of its next trading market. Part I closes with an evaluation of that historic event and the

3 Germany’s Daimler-Benz Finds Parking Spot on NYSE (note 1).
6 See, e.g., David Waller / Martin Dickson, Daimler Discloses DM4bn of Reserves, Financial Times, 25 March 1993, 23, quoting William Donaldson as saying that Daimler’s decision to list stemmed from a “breakthrough compromise that we have sought for a long time.”
7 The rankings are based on 1992 revenues. Daimler Benz Prospectus, dated 27 January 1994, 3. Daimler was also the eighth largest group in the world in terms of 1992 revenues. Fortune, 26 July 1993, 191. Dresdner Bank AG had been listed on the National Association of Securities Dealers’ NASDAQ market in the US but did not meet US disclosure standards. Dresdner Bank was included on NASDAQ prior to the adoption of SEC disclosure rules which provided an exemption for foreign companies previously admitted to NASDAQ.
likely consequences for those persons who were particularly interested in it. In Part II the Daimler listing serves as the proxy for exploring a fundamental issue that continues to challenge securities regulators and public policy makers: whether regulators should apply national law to a foreign person who enters their domestic securities markets irrespective of the custom, practice, and law of the home country in which that person is based. The issue is important in view of the increasing interdependence and competition among world securities markets, in both economics and regulation. The October 1987 market break, which began in the US securities markets but sent shockwaves to markets throughout the world, is proof of how interdependent global securities markets have become. Evidence of international regulatory cooperation can be found in the bilateral and multilateral enforcement assistance agreements which many nations have entered into to police cross-border securities transactions. But transnational interdependence has not reduced the forces of competition. National markets continue to respond to competitive forces, for example by reducing transaction costs or increasing trading hours, in order to retain or attract foreign business. And securities regulators are not immune to these pressures. When Daimler sought entry to the NYSE, representatives of government and industry inside and outside the United States urged the SEC to dispense with domestic law and to apply German disclosure regulations with which Daimler was familiar. The SEC refused to do so and Daimler submitted to "national treatment" under US securities law. Part II examines the wisdom of this regulatory response to the forces of internationalization of the financial marketplace. The Article concludes with the judgment that the SEC acted properly when it insisted that German companies seeking to list their securities on American stock exchanges abide by US securities laws.

I. The Listing of Daimler-Benz

1. US Securities Law

For companies that list their securities on the NYSE, or any US stock exchange, the benefits of an auction market are not without costs. One of those costs is US securities regulation which, as structured by Congress under federal statutes, is a collaborative effort. The authority to administer and interpret these statutes

\footnote{8}{For example, as of 1992, memoranda of understanding existed between the SEC and fifteen countries including Brazil, Canada, France, Italy, Japan, Switzerland and the United Kingdom.}

rests with the SEC which directly regulates certain companies (referred to as "issuers" of securities) and key persons associated with them. It also directly regulates certain organizations that perform critical roles in the trading and settlement of securities. Some of the industry organizations that are subject to SEC oversight are partners with the Commission in the regulation of the securities business. Included within this category are the so-called self-regulatory organizations (SROs), such as the eight active registered securities exchanges (including the NYSE) and the National Association of Securities Dealers (NASD), each of which adopts rules and imposes sanctions on its members. But because the SROs are subject to the supervision of the SEC, any rules or modifications to those rules must receive SEC approval. As an SRO, the NYSE has adopted an assortment of rules, entitled the NYSE Listed Company Manual, which set forth the conditions for companies desiring to list their securities. Some of these stock exchange rules are required by the Securities Exchange Act of 1934 (the "Exchange Act" or "the 1934 Act") and others reflect policy judgments by the Board of Governors of the NYSE with which the SEC has concurred.

The Exchange Act provides that any company seeking to have its securities listed for public trading on a national securities exchange must file a registration application with the exchange and the SEC. Commission rules, reflected in the NYSE Listed Company Manual, prescribe the nature and content of these registration statements and require certified financial statements prepared in accordance with SEC accounting principles and auditing standards. Following the registration of their securities, these so-called 1934 Act registrants must file annual and other periodic reports to update information contained in the original filing. All of the information that is filed with the exchange and the SEC under these continuous disclosure requirements is available for public inspection. Another provision of the 1934 Act governs the solicitation of proxies (votes) from holders of registered securities for the election of directors and for the approval of other corporate action. Solicitations by management or other persons must be accompanied by disclosure documents, filed first with the SEC, which are required to contain all material facts concerning items of business on which holders are asked to vote. Finally, whether or not an issuer's securities are registered under the 1934 Act, the issuance, trading, holding, and voting of securities are subject to anti-fraud provisions of the statute, as interpreted by SEC rules and judicial caselaw.

§§ 80b-1 to 80b-21 (1988). Although beyond the scope of this Article, securities transactions in the United States are also regulated at the state level.

13 The Exchange Act of 1934 contains many provisions which outlaw fraud. One provision, which the US Supreme Court has decided gives ordinary investors a private action for
Under the 1934 Act all of the regulations regarding registration, periodic reporting, proxy solicitation and honest trading practices apply regardless of the nationality of the corporate issuer. However, the statute authorizes the SEC to waive or modify federal regulations provided that investor protection will not be materially diminished. Acting pursuant to this authority, the SEC in 1987 authorized the NYSE to amend certain of its listing standards for foreign securities based on the laws, customs, and practices of the company’s home country. Shortly thereafter, the Exchange modified its rules for foreign companies. Although the changes to the exchange’s listing requirements were relatively minor, the Commission’s action in 1987 indicated that it might be willing to consider again whether certain listing regulations were an unnecessary and unfair burden on competition and, therefore, proper candidates for modification or elimination. It was against this backdrop of US securities regulation and SEC authority to adapt federal law to changing circumstances that the history of Daimler’s listing application unfolded.

2. Background: The Conflicting Interests

The decision by Daimler to list its equity securities on the NYSE was important to the company’s management, its shareholders and creditors. But, as the following discussion indicates, the listing had far-reaching consequences for other persons in both the public and private sectors.

a) Interests Outside the United States

aa) Daimler-Benz

Prior to 24 March 1993, when Daimler announced its intention to list on the NYSE, the company had steadily expanded its presence on global stock markets. In 1990 Daimler listed its securities in Tokyo and London and in 1991, it listed them in Vienna and Paris. The US market, many financial analysts observed, was the logical next step. But in deciding whether to list on the NYSE, Daimler

---


15 Exchange Act Release No. 24634, 23 June 1987. The SEC approved proposals by the NYSE and the American Stock Exchange which would permit an exception or waiver from otherwise applicable listing standards in the following areas based on a home country practice: (1) quarterly reporting of interim earnings; (2) composition and election of the board of directors; (3) shareholder approval requirements and voting rights; and (4) quorum requirements for shareholder meetings. In approving the proposals the SEC concluded that they “adequately protect the public and will not result in a material reduction in investor protection.”
carefully weighed the advantages and disadvantages of entering the US securities markets. The advantages were clear.

(1) Most business executives want access to every attractive capital market. The US capital market historically has been the largest and in the early 1990s, compared to many other sources of funds, it was the cheapest and most liquid in the world. Listing on the NYSE offered the possibility of a new capital market at a time when Daimler needed another source of funds. In 1992, Daimler had to cancel a DM 2 billion rights issue when its share price fell on the Frankfurt stock exchange and by 1993, with its sales and earnings in a deep slump, Daimler was searching for new capital.\footnote{Daimler Plays Ball, The Economist, 27 March 1993, 76.}

(2) Listing abroad expands an issuer's equity base and, thereby, expands its fund-raising choices. If, for example, a publicly-held company with shares broadly owned is confronted with negative changes in national tax law or in local economic conditions that discourage domestic investment, it can turn for help to equity owners in other parts of the world who are less affected by local factors. Alternatively, a publicly-held company might choose to sell securities in a foreign market because it operates in an industry that a foreign investor base might understand more readily. For Daimler, the US securities markets offered two particularly enticing categories of investor to add to its diversified shareholder base: individuals and institutions. Unlike Germany where only six percent of households invest in stocks,\footnote{\textquoteleft\textquoteleft Equity? Was ist das?,	extquoteright\textquoteright Euromoney, July 1994, 82; Wendy Cooper, Germany Discovers The Foreign Investor, Institutional Investor, July 1993, 37. The low household interest in equities in Germany is due partly to the practice by German companies of retaining a large portion of their earnings, keeping dividends low and making them no more attractive than bond coupons.} in the United States approximately thirty percent of households own shares.\footnote{Id.} A NYSE survey of shareownership, conducted in mid-1990, indicated that fifty-one million individual investors in the United States owned stock in a publicly traded company or in a stock mutual fund.\footnote{NYSE, Fact Book, April 1994, 89 (the household sector, defined as including nonprofit organizations, reported as owning fifty-one percent of US equities). The SEC believes that the share of US equities owned by individuals fell below fifty percent in 1992. Market 2000: An Examination of Current Equity Market Developments Division of Market Regulation, US Securities and Exchange Commission, January 1994, AI-1 (hereinafter cited as "Market 2000 Study").} By listing American depositary shares (representing ordinary shares of Daimler stock)\footnote{An American Depositary Share ("ADS") represents the right to receive an ordinary share of a foreign issuer. An ADS is evidenced by an American Depositary Receipt (or "ADR"). An ADR is a negotiable receipt that is issued by a depository, usually a bank, representing shares of a foreign issuer that have been deposited and are held, on behalf of}
settle and pay dividends in US dollars, Daimler could make its equity a popular investment for individuals. Depository receipts would also allow Daimler to expand its shareholder profile to match that of its US operations. In 1993, Daimler had twenty-seven companies in the United States which employed more than 13,000 people, a figure that represented almost four percent of its total global staff. In addition to individual investors, institutional investors — insurance companies, mutual funds, public and private pension plans, banks and trust companies — are an important and growing segment of the US equity market. In many countries, including Germany, the opposite is true. There are few funded pension schemes in those countries and domestic institutional investors prefer bonds. The depth of the institutional investor market in the United States does not always translate into availability for issuers, whether domestic or foreign. Some institutions are limited by State law to prescribed categories of investment grade securities. But a listing on the NYSE virtually guarantees that an issuer’s securities have the requisite investment quality for these institutions. Because of the size and wealth of these two potential groups of equity holders, Daimler’s strategy in early 1993 was for US investors, which then held only three percent of its shares, to increase, as a result of listing, to ten percent.

(3) Listing on certain foreign stock exchanges enhances a company’s international image. Association with the prestigious NYSE would most certainly raise Daimler’s international profile. It would also provide, as Daimler CFO Gerhard Liener explained, “a cornerstone of our globalization strategy on the financial side.”

---

22 As of September 1993, US institutions held 43.6% of US equities outstanding, the majority of which was held by private and public pensions. NYSE, Fact Book (note 19), 89. In 1970, the figure was 26.7%. Id. During the 1980s, the public participants in the equity markets moved increasingly toward indirect ownership, through institutions such as mutual funds and pensions. For example, mutual funds owned 2.7% of all equities in 1980; their share increased to more than 9% in the early 1990s. During this same time frame, the percentage of all equities held by public pension plans increased from 2.8% in 1980 to 9.1% in 1992, while the percentage held by private pension plans rose from 14.2% to 20.5%. Market 2000 Study (note 19), AI-1.
23 Cooper (note 17), 37.
25 Daimler-Benz Drops The Veil, id., 52. On the first day that Daimler securities traded on the NYSE, Gerhard Liener was quoted as saying that the listing “now places us in a position where we can consider ourselves global players.” Reuters, Ltd., “Daimler-Benz ADR’s Begin Trading on NYSE,” 5 October 1993 (Financial Report).
Foreign listings provide benefits to a company’s securities holders. Additional trading markets increase the number of potential purchasers and sellers which, in turn, produces more competition and better securities prices. A Daimler listing on an American stock exchange would undoubtedly please the company’s largest shareholder. It was widely reported during 1993, that Deutsche Bank, which then owned approximately 28% of Daimler, was planning to capitalize on a NYSE listing by reselling 3% of the Daimler stock in the US secondary markets.26

Listed securities provide a foreign company with host-country assets that it can use to implement a business acquisition plan in that country. Should Daimler decide to expand its business operations in the United States by acquiring a company in an exchange of stock, it would clearly enhance its bargaining position with a prospective acquisition candidate if it were able to offer stock that was listed on the NYSE.

Listing its securities abroad allows a foreign company to offer equity incentives, denominated in local currency, to its host-country employees. Stock options, stock bonus plans and other equity incentives which are created by a foreign employer are more attractive to local employees if reports of trading activity in the employer’s securities are widely available in familiar settings. In 1993, Mercedes-Benz announced the opening of a $300 million assembly plant in the United States and the creation of new jobs for many US citizens.27 For these and other American employees the listing of Daimler securities would be important if either Daimler or its automobile manufacturing subsidiary were to institute employee equity incentive plans.

A foreign listing helps a company to cultivate investors among foreign customers of its products, and, through sales of equity to them, to solidify their loyalty as consumers. Gerhard Liener, the finance director of Daimler, alluded to this interrelationship between good customers and good investors, when he observed in March, 1993, “We have 300,000 Mercedes drivers in the United States, and about two-thirds of them are wealthy.”28

Counterbalanced against these advantages to Daimler of listing its securities on the NYSE was the burden of disclosure under the Securities Exchange Act of

26 See, e.g., Daimler Plays Ball (note 16).
27 In late September 1993, Daimler announced that it planned to build a $300 million factory near Tuscaloosa, Alabama, to produce a new sport utility vehicle that was aimed at affluent American consumers. Protzman (note 1). Although the new factory would create new employment for US workers, Daimler had previously announced plans to cut 45,000 jobs by late 1994, with most of the job cuts to occur in Germany. Floyd Norris, Daimler Says Profits Fell in First Half, N.Y. Times, 18 September 1993, A 19; John Schmid, Daimler-Benz Reports First-Even Loss, Reflecting New Accounting, Lower Sales, Wall Street Journal, 20 September 1993, A 10.
28 Raghavan / Sesit (note 1).
1934. In order to enjoy the privilege of listing, Daimler was faced with a statutory requirement of registering its ordinary shares with the SEC. Under the US disclosure regime, Daimler's financial information would have to be reported in accordance with SEC rules and US generally accepted accounting practices (GAAP). These disclosure obligations called for important changes in Daimler's course of business. German accounting policies permit companies to establish secret reserves into which assets can be placed in prosperous times, lowering reported profits, and removed in less successful years, increasing reported profits. US GAAP prohibits such hidden reserves. Daimler faced the prospect of disclosing publicly the full extent of any operating losses. Furthermore, under German law Daimler made no quarterly disclosure of earnings and revealed divisional results only yearly. SEC rules require a registered company to disclose its financial results quarterly by division. Daimler's usual accounting methods were not applied uniformly to its subsidiaries. Under US securities law, that practice would have to change. Aside from the potential embarrassment that these disclosures might produce, the cost to Daimler of converting its corporate books to GAAP would prove to be substantial. But all of these burdens could be avoided if Daimler were able to persuade the SEC and the NYSE that because of Daimler's status as a world-class company or for other reasons, it ought to be permitted to disclose financial information in accordance with German practices. It was with this goal in mind that Daimler executives in 1990, together with officials of other German companies, opened up discussions with representatives of the SEC.

bb) German Politicians, Business Executives, Public Shareholders, and Labor Unions

The cost of German reunification in the early 1990s and the lingering recession in the United States, Western Europe and Japan forced German corporate executives to look for sources of capital beyond government, banks, and their own reserves. Although US capital was among the cheapest in the world, German

---

Daimler described the economic problems in Germany during 1992-1993 as follows: The year 1992 was difficult and competitive for many industries worldwide, as the low level of demand for consumer and capital goods continued in most industrial countries. The global economy remained adversely affected by the slow economic recovery in the United States and the recessionary trends and economic downturn in Western Europe and Japan, the economic and social crises in the Central and Eastern European countries and the uncertain conditions in the new Commonwealth of Independent States.

Sharply reduced export opportunities exacerbated the problems facing German manufacturers as a result of the drastic decline in domestic demand which began in mid-1992. Beginning in early 1992, the German economy decelerated substantially as a consequence of the growing public deficit caused by the high costs of German reunification. High interest rates have curbed investment activities in Germany and the rise in the value of
business was adamantly opposed to disclosing financial information under US GAAP as the price for accessing American securities markets. Many German companies had tapped US capital markets by selling securities in private placements, where disclosure rules were quite different, but none had broken ranks and listed securities on an American stock exchange. During discussions which began in 1990 and continued regularly thereafter, SEC Chairman Richard Breeden and his staff openly encouraged German business to enter US securities markets. These overtures, however, were accompanied by a tough defense of US disclosure policies and repeated criticism of the German practice of building up hidden reserves. German corporate officials defended their disclosure policies as fair and appropriate in an environment where the interests of creditors take precedence over those of shareholders and where only 650 or so of Germany’s nearly 3,000 public limited companies are listed on the stock market, with the vast majority of these under the control of families or banks. The officials pointed to the mandatory two-tier board structure of German corporations — the supervisory board (Aufsichtsrat) and the managing board (Vorstand) — as an effective protection for investors. They explained that the tax code, which, unlike its counterpart in the United States, made no distinction between tax accounts and published accounts, clearly approved of the principle of hiding reserves, or Rückstellungen, and that provisioning was a cornerstone of prudent German accounting. The Americans were also told that German industry’s interlocking financial structure made it extraordinarily difficult and expensive for some German companies, especially banks, to satisfy SEC standards. For example, in order for Deutsche Bank, which owns a substantial stake in many large German companies, to meet US listing standards it would have to incorporate the financial statements of all of those companies into its own. For all of these reasons, the German business establishment decided that negotiations over the standards of disclosure to be applied to German companies seeking trading privileges in the United States called for a united front. It was a bargaining strategy that did not allow any one German company to sacrifice traditional national principles for its own corporate goals.

the mark within the European Monetary System . . . has made the price of German products in the European Community . . . considerably less competitive.

Daimler Form 20-F (note 2), 5-6. See also Cooper (note 17), 35.

See text accompanying notes 54-60 below.


Cooper, id., 36. Hidden reserves under German accounting serve valid business reasons. One of the reasons that these reserves have developed is to permit German companies to finance pension fund obligations. Roberta S. Karmel, Living With US Regulations: Complying With the Rules and Avoiding Litigation, Fordham Int’l L. J., vol. 17, 1994, S152, S155.

See, e.g., Duffy / Murray (note 31).
At least two groups within Germany parted company with German business over the issue of US disclosure requirements. Many public shareholders in Germany, a significantly less powerful force than equity holders in the United States, saw the SEC’s listing and continuous reporting requirements as the key to acquiring greater rights within German corporations. US disclosure obligations would require German companies listing in the United States to eliminate the practice of hidden reserves, which either understated or overstated assets and profits and thereby distorted shareholder value. Once these companies began reporting under US GAAP, it was argued, other German companies would feel compelled to do the same. Similarly, German labor unions stood to gain from regulations, whether domestic or foreign, that forced corporate employers to expose true profits. Although neither group was represented in the discussions between the SEC and the German business community, their interests were nonetheless important.

cc) Securities Industry Professionals and Regulators

As discussions between the SEC and representatives of German companies wore on, and debate among interested parties reached the media, the securities industry professionals outside the United States assessed the implications of a possible victory by Wall Street and the SEC. Such a scenario would not have been welcomed by most market intermediaries in Europe who prospered under a system where German corporate securities did not trade on US stock exchanges. But for some market professionals, especially those in Germany, the listing of German corporate securities on US stock exchanges was seen as an opportunity for new business. In Germany, unlike in the United States, the banks are the underwriters of securities. Primary securities offerings by German companies are generally made by means of offerings of rights to existing shareholders to subscribe for additional shares. A syndicate of German banks orchestrates a rights offering. Should German companies list their equity securities on US stock exchanges,

34 Id. One securities analyst in N.Y. found in 1993 that shareholders’ equity at Mannesmann, a German engineering company, as of the end of 1989 would have been at least forty percent higher if presented under US GAAP, while net profits would have been 50 and 36 percent higher in 1988 and 1989, respectively. Cooper (note 17), supra, 36.

35 Cooper (note 17), supra, 40.

36 According to then SEC Chairman, Richard Breeden, some of the attention given by the media to the SEC’s position vis-à-vis German companies was orchestrated by interested persons in Europe. See, e.g., the article in note 38. In a speech in the United States in November 1992, Breeden stated that “[w]hen the SEC told them [German companies] that we would be happy to work with them to help meet US standards as flexibly as possible, their response has been public calls in Germany and the European Community for “pressure” on the SEC.” Remarks of Richard C. Breeden at the American Stock Exchange Perspectives Conference, Washington D.C., 4 November 1992, 7. (hereinafter “Breeden 1992 Speech”).
German banks would be well positioned to lead or participate in a syndicate of underwriters involving a distribution of German securities in the United States.\(^{37}\)

Many securities regulators and policy makers feared a total victory by the SEC on disclosure standards for German companies.\(^{38}\) For years the International Organization of Securities Commissions and the International Accounting Standard Committee had been working with the world’s securities regulators to make national listing requirements more compatible. A rigid SEC approach to listing requirements for German businesses might provide better protection for investors but it would also frustrate efforts to establish uniform international listing standards.\(^{39}\)

b) Interests Within the United States

In the early 1990s both the SEC and the NYSE shared the belief that it was in the American interest to recruit as many German companies as possible as candidates for listing their securities on US stock exchanges. For more than three years they discussed the advantages of the US auction market with top executives

---


\(^{38}\) Private and public foreign regulators proclaimed their support for liberalization of US listing standards. See, e.g., the views of Rüdiger von Rosen, executive vice chairman of the Federation of German Stock Exchange:

The SEC should move toward the more liberal approach, used in Europe, where exchanges acknowledge companies home documents. While the SEC argues it is protecting investors by insisting on a uniform standard the Germans and others believe that protection results if investors can trade foreign stocks at home, where rules and regulations are familiar, rather than abroad.

The more liberal standard has not eroded market supervision and regulation of German exchanges by the Federation of German Stock Exchanges. Certain dubious practices like the violation of internal bank rules and faulty tax returns brought some traders on the Frankfurt Stock Exchange under investigation recently, resulting in the dismissal of certain bank employees. And recommendations will be made this fall for further improvements in exchange regulations. . . . While the [NYSE] proposals are welcome, they do not sufficiently lift restrictions. The question, therefore, is whether the SEC is genuinely ready to capitalize on today’s globalization of financial markets. . . .

The experience in the European Community has shown that mutual recognition of national reporting requirements allows the rapid and simplified opening up of securities markets. United States investors deserve the same rights to purchase international securities as investors in Europe.


of Germany’s leading public companies. But the common ground between the SEC and the NYSE was overshadowed by the conflicting definitions that each party gave to the goal of “American interest.” The NYSE, espousing views shared by most US stock exchanges, investment bankers and broker-dealers, perceived these discussions as an opportunity for the SEC to modify or eliminate “anachronistic” accounting standards which, it insisted, were strangling American markets and doing “irreversible harm to the United States as the world’s dominant financial center.” The SEC saw these discussions as an occasion for protecting its rigorous disclosure standards which, it believed, were responsible for the “strongest, deepest, most open, efficient and successful” securities market in the world.

aa) The NYSE

In January, 1991, Daimler and other German companies anxious to gain access to US equity markets, found an ally in American businessman William Donaldson, who had just been selected as chairman of the NYSE. For several years the NYSE had been facing increasing competition for business from electronic, regional and international exchanges, notably those in London. Almost immediately Donaldson took aim at the SEC’s listing rules, calling them the primary reason that foreign issuers were avoiding US markets. Admittedly, Donaldson was most concerned about protecting the interests of the NYSE and promoting that organization as the leading international stock market but his criticism of the SEC’s requirements for accounting and disclosure was also principled. First, Donaldson challenged the underlying premise of the SEC’s view which, in his opinion, implied that foreign regulation was inferior and inadequate. He argued for recognition of “the obvious,” namely, “that not all the quality companies in the world are US companies, nor are all US accounting standards and practices necessarily the only way of approaching disclosure.” The standards followed by foreign companies, he noted, are often “every bit as good, if not better than ours.” Furthermore,

40 William C. Freund, That Trade Obstacle, the SEC, The Wall Street Journal, 27 August 1993, A8 (Mr. Freund was chief economist of the NYSE, 1968-85).
42 Foreigners Fall In Love With US (note 1).
44 See, e.g., Floyd Norris, A Look Ahead For the Bid Board, N. Y. Times, 7 January 1992, C8, where William Donaldson reportedly announced at a celebration of the NYSE’s bicentennial year that the Exchange was becoming “the centerpiece of a global securities market.”
45 NYSE Chair Suggests Experiment to Allow Foreign Entities to List on US Markets (note 43).
46 Id. Donaldson also warned that foreign issuers were not going to change their accounting practices to accommodate SEC standards, adding that “[i]f we wait until the Deutsche Bank
as *Donaldson* explained in testimony before a Committee of the US House of Representatives, US GAAP may actually be flawed:

[T]here are those in other parts of the world who would say that our accounting systems aren’t all that great. If you talk to the German banks who are accused of having excess or hidden reserves or silent reserves, as they call them, out of conservatism, and a national attitude toward lenders to corporations as opposed to equity holders, the Germans would say, you think our system is so bad, how about your system that caused the kind of writeoffs that occurred in our bank system in the last 5 years? Who has the best accounting systems, they would say?47

Second, *Donaldson* argued, the SEC’s listing rules in practice were counter-productive. US investors were increasingly interested in foreign investments but, as he perceived it, US securities regulation was forcing them into two choices, one worse than the other. One option for US investors was to trade in the home country market of the issuer. Under this approach, he contended, Americans would operate through one or more intermediaries outside the United States and “arrive in a foreign market in Frankfurt or London or Tokyo, pay the wide spreads, deal in a relatively unregulated market; and as a result, we estimate that they are paying some 8 to 10 times the commissions, fees, and spreads in order to buy the stock.”48 The only alternative to trading in the home-country market of the issuer, he noted, was to trade foreign securities in the least regulated over-the-counter market in the United States. *Donaldson* believed that investors in that market, the so-called automated “pink sheets” of the NASD, face high costs, minimal information about the issuer, and no real-time quotations or trade reporting.49

changes its accounting to be like Citicorp, I think we’re going to be waiting for a long, long time.” *Id.*


48 *Id.*, 106.


During the last decade SEC requirements have continued to push more and more trading of foreign shares into these less regulated markets. Currently, there are 722 unregistered American Depository Receipts (ADR’s) traded over-the-counter in the United States, compared with 492 foreign “reporting” (or registered) companies. But the more telling statistic is what has happened since October 6, 1983. On that date the SEC amended Rule 12g3-2 to provide that both securities traded on a national exchange and those traded in the NASDAQ over-the-counter quotation system must be registered. Prior to that time the securities of foreign firms could be traded on NASDAQ without section 12 registration by availing themselves of the “information-supplying” exemption of Rule 12g3-2(b). In the seven years preceding the elimination of this exemption, from 1977 to 1983, the number of foreign securities traded on NASDAQ tripled, growing from 85 to 294. Since the exemption was eliminated in 1983, the number of foreign securities traded on NASDAQ
To solve these problems, the NYSE suggested an experiment which, if approved by the SEC as a rule change, would allow 200 or 300 "world class" foreign issuers to list on the NYSE without meeting the same requirements as domestic companies. Under the proposal, foreign issuers would have to satisfy the exchange's capital requirements but they would not have to file financial information prepared on the basis of US GAAP. Instead, these world class issuers would be permitted to use their home country's accounting standards in preparing financial statements and other disclosures.

Donaldson and the NYSE envisioned the "world class" issuers listing standard as an interim solution to a larger international regulatory problem. Harmonization of disclosure standards might be the preferred answer. But, the NYSE contended, "despite efforts by regulators and markets around the world, including our own, it appears that harmonized standards are not on the near horizon." In the meantime, the NYSE proposal was intended to open the exchange market to the strongest and most stable foreign companies and thereby permit US investors to purchase foreign securities in a more regulated and more transparent market. It was also hoped that the proposal, once implemented, would be a start at bringing investment securities business "back to the United States and keeping our central marketplace the global marketplace."

has declined to 213 (as of the end of 1991). In contrast, since 1983 the number of foreign securities traded in the Electronic Bulletin Board ("EBB") or pink sheets, where the SEC exemption still applies, has grown noticeably. As of the end of 1991, 376 foreign, unregistered, companies were traded in the over-the-counter EBB or pink sheets.

Clearly, US investors are already trading unregistered foreign securities both in the United States and in foreign countries in markets in which there is less regulatory oversight and where transactions costs are considerably higher. . . . Transactions costs are significantly lower in the United States than in either the United Kingdom or Japan, where most of the trading of foreign securities by US investors occurs. . . . The SEC registration requirement, therefore, does not protect US investors by preventing them from trading foreign securities, but rather forces this trading to take place in more costly and less regulated markets.

Id. [footnotes omitted].

NYSE Chair Suggests Experiment to Allow Foreign Entities to List on US Markets (note 41). See also NYSE Drafting Plan to Boost Listings by Foreign Firms, Despite SEC Opposition, 23 Sec. Reg. & L. Rep. (BNA) 1754, 20 December 1991. The NYSE proposal defined "world class" as a company with revenues of $5 billion, a market capitalization of $2 billion and an average weekly trading volume outside the US of at least $1 million or 200,000 shares.

Witnesses Urge Senate Panel to Ease Listing for Foreign Securities, 25 Sec. Reg. & L. Rep. (BNA) 727-28, 21 May 1993. The NYSE identified more than 2000 companies around the world that met NYSE standards of size, share ownership and earnings. The top 10% of those were alleged to have had a median market capitalization of $4 billion, 20 times the median of US prospects for listing. Id.

SEC policy is determined by the federal agency’s five appointed commissioners. During the early 1990s, the chairman of the SEC, Richard Breeden, was the spokesman for a majority of commissioners who were unwilling to alter the SEC’s policy on foreign issuer listing requirements. It was this view that Breeden communicated to representatives of German business who, together with William Donaldson and the NYSE, urged the Commission to ease its listing standards. Breeden’s defense of the status quo rested on the belief that domestic regulation, in the form of disclosure and accounting standards, serves as a magnet for investors and companies seeking to raise capital and trade their securities and that to be effective it had to apply equally to foreign and domestic participants in US markets. As support for his belief, he pointed to a study of foreign listings during the period 1990 to 1993, which revealed that the total number of foreign issuers listing in the United States had increased by 120 while the total number of foreign issuer listings for London and Tokyo had declined by forty and ten, respectively. Breeden’s defense also rested on two policy considerations: investor protection and the need to avoid a disclosure system that would discriminate against US issuers.

53 Id. The letter expressed concern that the lack of uniform standards would damage the competitive position of the United States, and “one of our most competitive of all US products and services, the marketplace, will be eroded by foreign companies.” Id., 646.

54 Two SEC Commissioners were publicly critical of Richard Breeden’s position on listing standards. Edward Fleischman, a Commissioner from 1986 through March, 1992, agreed in principle with William Donaldson of the NYSE that world-class foreign issuers wanting to be listed on American exchanges should be allowed to comply with the disclosure and accounting requirements of their home countries. See, e.g., E. Fleischman, The S.E.C. Must Keep on Deregulating, N. Y. Times, 12 April 1992. Commissioner Richard Y. Roberts stated that it was “incumbent on the Commission to seriously consider” an alternative to the NYSE proposal and that until such an effort was made “I remain unconvinced that there exists no middle ground between full US GAAP reconciliation and no reconciliation requirement at all.” Remarks of Richard Y. Roberts, “Commission Initiatives in International Corporate Finance,” 14th Annual Northwest State Federal Provincial Securities Conference, Seattle, Washington, 26 February 1993.

55 The SEC’s Open Door Policy (note 41). After Richard Breeden resigned from the Commission in mid 1993, SEC Commissioner Mary L. Schapiro continued the defense of SEC standards, by challenging the NYSE contention that US investors were being left behind in international investment opportunities. In remarks before the Institute of International Bankers in March 1994, Ms. Schapiro noted that as of the end of 1993, there were 588 companies throughout the world trading publicly in the US and complying with US disclosure and accounting requirements. She contended that these figures compared favorably with those of every other major international market. For example, she observed that Tokyo had 110 foreign listings, the Paris Bourse had 205, and Frankfurt had about 350. The US market had even surpassed the London market, which had approximately 550 foreign listings. Schapiro Examines Foreign Issuer Access, Fed. Sec. L. Reps. (CCH), No. 1601, 7, 23 March 1994.
Investor protection is at the heart of US securities regulation.\textsuperscript{56} Breeden focused on two dangers to US investors that he predicted would accompany any relaxation of listing standards for foreign issuers. He argued that if foreign firms were exempted from disclosing the same information that US issuers provided to the public, US investors would be at a disadvantage in attempting to determine the accurate value of foreign companies. This point was made by an SEC staff member who asked rhetorically: Without required disclosure of hidden reserves “how will an investor be able to compare the performance of, for example, German auto maker Daimler Benz with General Motors, or Deutsche Bank with Citibank?”\textsuperscript{57}

The issue, Breeden insisted, was not whether US GAAP was better than German accounting principles. The question was whether US investors could translate German financial statements into the language of the securities markets. As Richard Breeden observed, the German accounting principles have many strong points, but “they were not designed to provide the public capital markets with the level of information concerning financial results, cash flows, internal rates of return and other types of data used by investors today to compare investments in companies in dozens of countries.”\textsuperscript{58} Furthermore, partial disclosure would result in some mis-pricing of foreign shares. Some investors might pay too much, and others too little. The SEC’s second concern about the absence of equivalent disclosure and its impact on investors was that US markets would become less “fair.” US investors in foreign companies would be subject to more “insider trading,” because insiders of these companies, who possess superior knowledge about their firms, would have the opportunity to trade on material non-public information. For example, at one time almost forty percent of the entire balance sheet of Daimler was represented by the single line item “provisions.”\textsuperscript{59} The materiality of such an amorphous asset is obvious.

Richard Breeden addressed this potential problem in the context of the request by German companies for special treatment under US law:

The heart of the dispute involves the use of what are called “hidden reserves” in German accounting. Under the hidden reserves system, a company can report the net income it would like to show, not what it really made. Withdrawals from an off-balance sheet slush fund are used to add to real earnings if they don’t look good enough. Alternatively, if earnings look very good, income is taken out of real earnings and added to the slush fund.

\textsuperscript{56} See, e.g., the preamble to the 1933 Act which states: “An Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails and to prevent fraud in the sale thereof, and for other purposes.” Securities Act of 1933, Pub. L. No. 22, § 1, Ch. 38, 48 Stat. 74 (Preamble).


\textsuperscript{58} Breeden 1993 Speech (note 5), 6.

\textsuperscript{59} Foreign Companies and US Securities Markets in a Time of Economic Transformation (note 4), S91.
Thus, with hidden reserves investors and creditors may be told that a company had a net profit of a billion marks. In reality, the company might have lost 5 billion or made 10 billion. The company officers, its bankers and a favored few know the truth, but the public investor does not know anything more than the company decides to tell. Since insider trading isn't yet illegal in Germany, this stark disparity in knowledge among market participants may not be a problem for law enforcement authorities there. Nonetheless, the system is tantamount to institutionalized insider trading, something that is a crime under our laws.\textsuperscript{60}

The SEC's second policy concern was that under rules that reduced listing standards for foreign issuers, American companies would be prejudiced by a two-tiered disclosure system — one for US firms and another, less onerous, for foreign firms. The German companies described the system they wanted as "reciprocity," but according to \textit{Breeden}, "what they really want is a preference . . . In essence, they want to play baseball in America, but they want seven strikes, no umpire and a right to cancel the game any time they don't like the reaction of the crowd."\textsuperscript{61} Such a system would give foreign companies a competitive advantage, he argued, because they would be excused from the substantially greater disclosure, accounting and auditing requirements applicable to domestic companies. In addition to being more costly for US companies, unequal disclosure standards might eventually drive domestic firms seeking capital to foreign markets in order to avoid the more onerous US disclosure regulations.

3. Listing and its Consequences

The discussions between the SEC and German companies and banks, which had begun in 1990, reached an impasse by the middle of 1992. The major area of contention was the issue of reflecting hidden reserves in the balance sheet and income statements.\textsuperscript{62} However, Daimler's need for capital and its plan for a global presence led its chief financial officer, Dr. \textit{Gerhard Liener}, into private negotiations with the SEC's chairman, \textit{Richard Breeden}. On 24 March 1993, Daimler announced its decision to become the first German company to list on the NYSE. Six days later, \textit{Gerhard Liener} joined the SEC's chairman in New York City to disclose the terms of the listing agreement. Under the accord Daimler was to file a Form 20-F with the SEC in which it would publish financial information prepared in accordance with US GAAP, together with its traditional reports under German procedures. Although Daimler was obligated to meet the basic financial disclosure requirements of the SEC, it gained a few small concessions with respect to the disclosure of historical financial information and periodic reporting obliga-

\textsuperscript{60} \textit{Breeden} 1992 Speech (note 36), 6-7.

\textsuperscript{61} Id., 7.

\textsuperscript{62} SEC Seeks to Balance Goals in Regulating Foreign Issuers (note 57).
tions. The basic registration statement under the 1934 Act for a foreign issuer, Form 20-F, required five years of financial information. However, the SEC decided to ease Daimler's transition to US disclosure standards by requiring reconciliation of its financial information to US GAAP for the two most recent fiscal years, rather than for five years. Also, the SEC agreed that Daimler would not be required to provide quarterly earnings statements as US companies are, but would only have to report annually.

For Daimler, the decision to accept SEC disclosure requirements meant that it had finally achieved “access to the world’s largest and most dynamic stock market.” Gerhard Liener characterized the culmination of discussions with the SEC as a “compromise” and “a very satisfactory solution.” The real cost to Daimler became obvious when it published its financial statements as reconciled to US GAAP. Daimler’s income statement, under German GAAP, reported adjusted net income in the six months ended 30 June 1993, of DM 117 million ($68 million), down from DM 1157 million ($759 million) in the comparable period a year earlier. But because US GAAP does not permit hidden reserves, Daimler’s financial statement for these six month periods, as reconciled, communicated an entirely different picture — a net loss 1993 of DM 949 million ($556 million), in contrast to net income of DM 965 million ($633 million) in the comparable period in 1992. For the first time, Daimler disclosed that it had dipped into its reserves to report a profit under the German standards. Although some US financial analysts described Daimler’s half-year results as “abominable,” they expressed confidence that investors were more interested in the long-range prospects for the company, which they considered to be generally positive. Indeed, the market price of the Daimler securities on the NYSE remained strong enough for Deutsche Bank to sell 1.5 million ordinary shares in a registered offering to US investors on 27 January 1994. As further evidence of its global strategy, Daimler announced that in 1994 it intended to seek approval to list its securities on the stock exchanges in China and Singapore.

---

63 Breeden 1993 Speech (note 5).
65 Id.
66 Daimler Form 20-F (note 2), F-2. The differences in accounting treatment were not limited to the use of hidden reserves. Daimler’s financials were also affected by the differing approach toward acquisitions, divestitures, foreign currency changes, and deferred taxes. Id., F-8 to F-11.
67 Protzman (note 1).
68 Daimler’s shares opened for trading on 5 October 1993 at $47 per share. Deutsche Bank sold 15 million American Depositary Shares, representing 1.5 million ordinary shares, at $46.75 per share pursuant to a Prospectus, dated 27 January 1994, for total proceeds of approximately $674 million.
Daimler’s decision to list on the NYSE won the company few friends at home. Corporate Germany was shocked by Daimler’s decision to break ranks with its business friends and by its “capitulation” to the SEC. Although Daimler shareholders were pleased with the listing, one European shareholder-rights activist predicted “there’ll be no stampede to follow Daimler to New York.” In fact, no other German company has sought listing privileges with any US stock exchange.

Although both the NYSE and the SEC expressed their delight with Daimler’s listing, neither group could describe the event as a victory. Daimler was a welcomed addition to the NYSE but unless other German companies followed Daimler’s lead, the stock exchange would continue to experience lost opportunities. In the meantime, William Donaldson and other industry representatives continue to press the SEC for flexible registration requirements for world-class non-US securities. The SEC described the Daimler listing as a “win-win” development: Daimler got direct access to US capital markets and public investors continued to receive disclosure in conformance with US GAAP. But the SEC failed too. Although successful with Daimler, its original goal was to persuade all of corporate Germany to accept the wisdom of US disclosure requirements. Arthur Levitt, who succeeded Richard Breeden as chairman of the SEC, appears to be another strong supporter of traditional SEC listing requirements. In his opinion, the SEC must demonstrate an appropriate level of flexibility in attracting foreign issuers but it must stand on principle when any compromise of standards equals a compromise in the quality of disclosure and the protection of investors. For these reasons the SEC

69 Cooper (note 17), 40 (comment attributed to Helmut Löhr, the chief financial officer of Bayer). Duffy / Murray (note 31), who explained corporate Germany’s shock at Daimler’s concessions to the SEC by quoting a German executive as saying that the conversion to US GAAP is “a very political issue because German CEOs have invested time arguing that our accounting is better than US accounting.” See also Daimler-Benz Drops the Veil (note 24).

70 After Daimler announced its decision to list on the NYSE, Gerhard Liener was quoted as saying, “We can no longer treat our shareholders as if they were cheeky and dumb — dumb for buying shares and cheeky for expecting something in return.” Cooper (note 17), 34.

71 Id., 35.

72 German banks, however, have been more aggressive. Following Daimler’s decision to list, the banks sought and received concessions from the SEC in order to act as distribution participants in future offerings in the United States by high quality German companies. Sec. Act Release No. 7021, 6 October 1993 (note 37). The exemptions granted to the banks are from SEC trading rules which preclude persons participating in a securities distribution in the United States from artificially maintaining or increasing the security’s price during the distribution, generally by prohibiting or limiting bidding and purchasing activity.

73 Breeden 1993 Speech (note 5), 2.

has extended the concessions it made to Daimler to other foreign companies seeking participation in the US markets but it is unlikely to propose major changes in US listing requirements in the foreseeable future.

II. International Regulation: Conceptual Framework

Under international law jurisdiction to prescribe jurisprudence a State has the authority to apply its regime to any transaction in securities that is carried out on an organized securities market in that State irrespective of the nationality of the issuer of the securities involved. The issue raised by the Daimler listing is whether a State which exercises such authority should dispense with its own rules under certain circumstances and recognize as controlling law the regulation of the foreign State in which the issuer resides. This approach to regulatory reach is not the only method for addressing conflicts of law in international business. For example, the International Organization of Securities Commissions has been working for years with securities administrators around the world to create uniform regulatory standards. As a practical matter, however, international regulatory conflicts in the near future are likely to raise the same issue of choice that confronted the SEC and Daimler. For this reason it seems appropriate to ask when the policy of reciprocity should replace the policy of national treatment.

---


76 See, e.g., what is sometimes referred to as the “American” view of jurisdiction to prescribe, Sections 402, 403, and 416(1)(b)(i) of the Restatement (Third) of Foreign Relations Law of the United States (1987), which is considered an authoritative statement of the general US view of international law.

The answer to that question, as developed in the following discussion, supports the position that the SEC took in its negotiations with Daimler and the other German companies during the early 1990s.

In order for a securities law policy of reciprocity to be practical and fair to issuers, market intermediaries, and investors in the reciprocal States, the areas of mutual recognition must be carefully defined to reflect comparable disclosure standards with comparable regulatory support. This prerequisite for a successful policy embodies two conditions: the presence of minimum standards of disclosure and supporting regulation, both public and private, in the less demanding State(s) and the differentiation of regulation in the more demanding State(s). The reciprocal securities law agreement between the United States and Canada, which became effective in 1991 as the multijurisdictional disclosure system (MJDS), is illustrative and demonstrates the importance of these two conditions.\(^78\)

The cooperative arrangement between the SEC and securities regulators in Canada grew out of efforts by the SEC to remove unnecessary impediments to transnational capital formation and securities trading. For years the Commission had distinguished between governance matters, such as rules pertaining to shareholders meetings, from which it exempted many foreign issuers,\(^79\) and disclosure matters which it tended to apply to all persons regardless of their nationality. In the 1980s, however, the SEC began accommodating various foreign disclosure policies and business practices. With increasing US interest in and holding of foreign securities, the SEC sought a broader-based solution to the problems posed by multinational offerings. It envisioned a multijurisdictional disclosure system under which foreign issuers would register securities using their home jurisdiction disclosure documents instead of using disclosure documents prepared in accordance with 1933 Act and 1934 Act specifications. As contemplated the SEC would not independently review the filings made by foreign issuers but would rely on the review conducted in the foreign jurisdiction. A transnational offering or stock exchange listing under the proposal would become effective in the United States upon clearance by the foreign authorities and filing with the SEC.\(^80\) Although Canada was the logical first partner of the United States in such an initiative,\(^81\) that prospect presented some difficulties.

---


\(^79\) See, e.g., 17 C.F.R. § 240.3a12-3 (1993).

\(^80\) Release No. 6841 (note 77), 80, 288-80, 289.

\(^81\) Canadian companies had a significant presence in the US trading markets. For example, of the 463 foreign issuers filing periodic reports with the SEC under the 1934 Act in 1990, more than 240 were Canadian. The next most numerous group of reporting issuers was from the United Kingdom (49 foreign issuers). Release No. 6902 (note 77), 81, 865.
Unlike its neighbor to the south, Canada has neither a federal securities commission nor a comprehensive federal statute governing the Canadian capital markets. Securities regulation in Canada falls primarily under the legislative authority of that country’s ten provinces and two territories. Each provincial legislature has enacted its own securities laws and regulations. Disclosure principles and practices vary among the twelve jurisdictions and even in the most demanding provinces, such as Ontario and Quebec, disclosure obligations for issuers lack the detail and scope of their American counterparts. Despite these differences in the securities laws of the two countries, mutual recognition of the disclosure standards was achieved.

Canada overcame most of the SEC’s concerns about standards when the Canadian Securities Administrators, which is a group comprised of all of the securities regulatory authorities in Canada, adopted a set of uniform disclosure policies for use by Canadian issuers in connection with the program. Additional doubts were eliminated because of the sophistication of the Canadian markets, the close resemblances between US and Canadian underwriting and marketing procedures and accounting principles and auditing standards, and the similarities between US and Canadian securities laws, “in terms of both their investor protection mandate and the structure of the regulatory scheme established to effect that mandate.”

For its part as the regulator of the more exacting disclosure standards, the SEC was careful in committing the United States to mutual recognition with Canada to limit the scope of the agreement. Because the arrangement contemplated that Canadian issuers would be able to prepare a disclosure document according to less stringent standards and to have that document accepted for securities transactions in the United States, it was clear that the SEC would be forced to retreat from the principle of equal national treatment. Under this approach US investors regularly receive information on essentially equal terms from both domestic and foreign issuers and all issuers regardless of nationality incur the same regulatory costs for the privilege of accessing US securities markets. Any policy of mutual recognition with Canada would result in a sacrifice for US investors who usually enjoy comparability of information from issuer to issuer and country to country. It would also provide Canadian issuers with a competitive advantage over US issuers to the extent that Canadian securities regulation proved to be less costly. The task for the SEC was to realize the benefits of mutual recognition without undermining US investor protection or discriminating against US issuers and intermediaries. It sought to accomplish these objectives in several ways.

Under the reciprocal recognition system between the United States and Canada not every Canadian issuer is eligible. The MJDS imposes transaction eligibility requirements which include conditions as to the nature of the issuer. In order to
register securities under the MJDS for a public offering in the United States a Canadian issuer must either qualify as "substantial" or it must have had a continuous three-year reporting history with Canadian securities regulators. Under MJDS an issuer is "substantial" if it has been subject to the periodic reporting requirements of a securities regulatory authority in Canada for a period of at least twelve months and has a total market value for its equity shares of at least $75 million. The purpose of the "substantial" designation, according to the SEC, was to single out issuers whose size is such that there is a large market following for them and the marketplace can be expected to have set a price for their securities based on all publicly available information. 83 As the SEC explained in a comparable situation, "[b]ecause these registrants are widely followed, the disclosure set forth in the prospectus may appropriately be limited, without the loss of investor protection, to information concerning the offering and material facts which have not been disclosed previously." 84 For smaller Canadian issuers registration of public offerings is available under the MJDS but only for specified exchange offers, business combinations, and rights offerings and only then if the issuer has had at least a three-year history of reporting with a Canadian securities regulatory authority. The broader availability of the MJDS for these types of offerings reflects the SEC's concern for the interests of US investors in not being excluded from transactions that will affect the value of their existing holdings. 85 The MJDS also encompasses registration and reporting under the Exchange Act of 1934 by Canadian issuers wishing to list securities on a US stock exchange. Home country filings are accepted by the SEC for these purposes where the Canadian issuer is "substantial" in the same sense as required under the MJDS for certain registered securities offerings. 86 As a result of these and other restrictions, the SEC was able to conclude that permitting certain Canadian issuers to register securities and to report periodically under the MJDS using their home jurisdiction disclosure documents instead of using disclosure documents prepared in accordance with US securities law specifications and standards was "in the public interest and fully adequate for the protection of US investors." 87

Conclusion

Daimler's decision to list its shares on the NYSE was, according to former SEC Chairman Richard Breeden, "a new beginning in the world of corporate

83 Id.
85 Release No. 6902 (note 77), 81, 865.
86 Id., 81,866. See text accompanying note 83 above.
87 Id., 81,865.
finance,\textsuperscript{88} The rebirth referred to in Breeden's remark related in part to the enhanced stature that the NYSE would soon experience in international markets. Daimler-Benz, the largest corporate group in Europe, was about to become the first German company to have its shares traded in public securities markets of the United States, the largest in the world. But Breeden's comment also was directed at the importance of Daimler's decision for US securities policy. Having failed to persuade the SEC to recognize German disclosure standards as applicable law for its securities transactions in the United States, Daimler had chosen to be governed by US securities law. In no small measure this meant that SEC disclosure standards had demonstrated that they could compete successfully in an international market of regulation where less stringent disclosure standards were the norm.

The regulatory approach that was embodied in the SEC's agreement with Daimler did not receive universal support. Critics of that policy, including the NYSE, some members of the SEC, and many important German companies, argued for a policy of mutual recognition. Under this regulatory scheme the SEC would have exempted Daimler and other German issuers of securities from the SEC disclosure requirements, including financial reporting under US GAAP, and would have recognized as controlling authority the disclosure standards of Germany. But as the MJDS between the United States and Canada indicated, the SEC was not opposed to this approach in principle. The issue was whether the conditions for a policy of mutual recognition were met in the early 1990s with respect to German companies.

For the SEC to have adopted a securities law policy of reciprocity with Germany, it had to be convinced that both of the following conditions were satisfied: (1) German companies seeking to enter US securities markets under the policy were subject to certain minimum standards of disclosure and supporting regulation in Germany, and (2) any diminution in the quantity or quality of disclosure by German issuers to US investors, which would result from the SEC's decision to recognize German disclosure standards as controlling for German issuers involved in securities transactions in the United States, would not undermine investor confidence in the quality of the US securities market or discriminate unfairly against US issuers and intermediaries. Although recent legislative reforms in securities regulation have brought German regulation closer to US policy,\textsuperscript{89} in the early 1990s both of these conditions raised serious problems for the SEC.

\textsuperscript{88} Breeden 1993 Speech (note 5).

\textsuperscript{89} On 26 July 1994 the Bundestag adopted the Federal Law Concerning the Promotion of the Capital market which establishes an effective body to supervise the trading of securities with supervisory functions known as the Federal Authority for Trading in Securities (Bundesaufsichtsamt für den Wertpapierhandel). Zweites Finanzmarktförderungsgesetz, Bundesgesetzblatt (BGBl) 1994 I, 1749 in §§ 3 et seq. One of the main functions of this authority
The SEC’s concern with a policy of reciprocity involving Germany was not directed at the quality of companies whose disclosure obligations would have been determined by German law. German companies that were seeking to gain access to the US trading markets, such as Daimler, were large, well-respected corporations that had listed their shares for trading in the German securities market. If necessary the SEC could have restricted the scope of reciprocity with Germany as it had done with Canadian securities regulators, so that only “substantial” German issuers would have been eligible. The real problem that reciprocity presented for the SEC was the regulatory scheme under which German companies did business at home.\footnote{90}

Germany’s eight stock exchanges, the most important of which was located in Frankfurt, were highly deregulated. There was no general statute regulating the issuance and trading of securities which was analogous to the US federal securities laws. Regulation of these companies and of transactions in their securities came from the German corporation law, from securities market-related statutory rules, and from self-regulatory rules promulgated by the industry. A federal securities supervisory agency, such as the SEC, did not exist. German underwriting and marketing procedures differed significantly from those used in the US. Disclosure obligations of German companies, as mandated by EC Directives and as implemented in Germany, were not as stringent as those found in US securities law. Public investors did not receive the same information that German issuers shared with their major debt and equity holders. Important financial information, of a type which had to be disclosed under US generally accepted accounting principles, could be withheld from the public under German rules. Finally, private and governmental prosecution of securities fraud by German issuers and investors did not compare favorably with the US investor protection scheme. Indeed, the practice by corporate insiders of trading securities on the basis of material non-public information, which is a crime under US law, was not illegal in Germany. In view of these important differences between US and German securities regulation in the early 1990s, the conditions for adopting a policy of mutual recognition were not met. For this reason the SEC was right to insist that world-class issuers based in Germany should be subject to American disclosure policy for securities transactions in the United States.

is to take measures to prevent and uncover prohibited insider dealing. §§ 12 et seq. The law requires that any significant sale or purchase of shares of a company listed on the Stock Market, identified as a transaction that changes the previous ownership so that it falls to or is brought above 5, 10, 25, 50 or 75% of the total shares, must be reported within 7 days to the company and the federal authority. §§ 21 et seq. See Klaus Hopt, Recent Problems of Securities Regulation in Germany: Insider Dealing and Early Disclosure, European Financial Services Law (EFSL), vol. 1, 1994, 3.