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SEC Brings Action Against Non-U.S. Company for False Public Statements Made During Merger Negotiations

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On September 28, 2000, the US Securities and Exchange Commission brought its first enforcement action against a foreign issuer for deliberately making false and misleading statements regarding ongoing negotiations of a business combination. The SEC brought its charges against E.ON AG, Germany's third largest industrial holding company (formerly known as Veba AG), for issuing materially false denials concerning its merger negotiations with Viag AG, another German company. E.ON has American Depositary Shares listed on the New York Stock Exchange.

In its announcement, the SEC noted that the reach of the US securities laws is not limited to US borders and that false statements made overseas can harm US investors as much as statements made in the United States. The SEC is again on record (having made a similar point in its enforcement action against Sony Corporation for misleading SEC reports) that, although it has accommodated foreign issuers on certain disclosure practices and financial statement requirements in SEC filings, when it comes to its antifraud rules, it will apply the same standards to foreign issuers that it applies to US issuers. The SEC Director of Enforcement stated that the action "reminds foreign issuers trading on US markets that they remain subject to [US] fraud laws even when speaking abroad." Although this is the first action of its kind in the merger context, it relies on a traditional theory of asserting jurisdiction, namely that liability can be imposed for both conduct in the United States, as well as conduct outside the United States that has effects in the United States.

The SEC Order

The order bringing and settling the action found that, over a period of a month (July 29, 1999 to August 31, 1999), Veba made a series of statements in which it falsely denied press reports that it was engaged in merger negotiations with Viag, when in fact the two companies had signed confidentiality agreements, retained investment bankers and legal advisors, exchanged financial forecasts and engaged in high-level talks concerning proposed deal structures, valuation methods, corporate governance and other merger issues. On September 1, 1999, Veba publicly acknowledged for the first time that it had been engaged in merger negotiations and that it had agreed with Viag on the framework for a merger.

While recognizing that disclosure practices and laws may differ in other jurisdictions, the SEC order found that the conduct in question violated US antifraud rules. In particular, it noted that:

- Veba's statements were widely disseminated in Germany and reported in the United States;

- certain denials, drafted in both German and English, were made with the expectation that the denials would be reported in US publications and read by US investors (Veba had direct contact with US publications, which published the denials in the United States);

- Veba's senior management was directly involved in drafting and approving the public statements that they knew to be false; and

- Veba's denials were made pursuant to a policy of absolute denial implemented at the direction of the CEO and Chairman of the management board.

Veba consented to the SEC order of the findings and the order to cease and desist from violating the antifraud provisions of the US securities laws.

Factual Findings

In its order, the SEC noted that throughout the month of August, Veba received 10 to 30 press inquiries per day concerning possible merger negotiations. Veba consistently denied the existence of any such negotiations and proactively responded with press releases denying the negotiations. Veba's denials caused considerable investor confusion. During the month of August, the price of Veba's American Depositary Shares fluctuated between $59 1/2 and $66 1/4. The SEC focused on the following conduct:

- On July 30, 1999, a German newspaper reported that Veba and Viag were planning a merger and had sought preliminary approval from the German Cartel Office. The article contained a Veba spokesman's comment that the story was “one of many speculations”;

- In response to the article, Veba's senior management instructed the Director of Communications to deny the existence of negotiations and to get a “common understanding” with Viag on a statement;

- Veba released a statement to the English-speaking press which stated that: “Veba denies merger talks with Viag. In the new competitive situation brought on by the liberalization of Europe's power markets, all market participants are in contact with one another. Veba is not in merger talks or negotiations with Viag or any other market player.” The *Wall Street Journal* quoted the statement on August 2, 1999;

- In response to an August 16 newspaper article, Veba issued a press release which stated that: “[w]ithin the framework of the liberalization of the electrical energy markets we, as the entire German energy branch, need to talk regularly with the Cartel Office. We know nothing of preliminary discussions about a merger between Veba and Viag.” This denial was picked up by the German Press Agency and Reuters ran a story in English;

- Veba issued a press release in response to a magazine article reporting that merger negotiations were ongoing between Veba and Viag. The press release stated that: “[w]e stand by our recent statement, Veba stays in contact with a number of market players. There are no concrete merger negotiations with Viag. We do not comment on the details of the [article].” This statement was quoted by Reuters, the German Press Agency and the *Wall Street Journal*;

- In response to an August 23 article about merger negotiations on a news organization website, Veba issued the following statement: “We are not carrying on negotiations about a merger with Viag or acquiring a stake in Viag. In the context of the coming consolidation in the German and European energy industry, we are naturally talking with many companies in order, among other things, to explore the possibilities of future cooperative agreements.”

- On August 28 Reuters reported a Veba statement that: "[t]here continue to be no merger negotiations with Viag. We do not comment on individual speculations." The statement was in response to inquiries from a Reuters reporter upon learning that a weekly magazine was going to publish an article that Veba and Viag were close to a merger.

- On August 30 Veba officials responded to inquiries about merger talks by stating for the first time that they had "no comment."

In many of the foregoing instances, the denials were approved by Veba's senior management. In addition, senior management received copies of the various articles containing the denials after their publication.

Legal Basis

The SEC cited its general antifraud rules, Section 10(b) and Rule 10b-5 under the US Securities Exchange Act, which prohibit issuers from making public statements that are false or that fail to include material facts necessary to make the statements made, in light of the circumstances under which they are made, not misleading. The SEC also cited the seminal court case in the area *(Basic v. Levinson)*, which held, among other things, that when a public company denies the existence of merger negotiations, or voluntarily makes partial disclosure of information, it is then under a duty to disclose material facts necessary to make the statements not misleading. The SEC further cited cases addressing the duty to update, which stand for the proposition that public companies have a duty to correct statements made by corporate representatives that they learn were misleading or inaccurate when made.

The "No Comment" Response

In most acquisition transactions involving public reporting companies, the issue of when to disclose the status of the transaction will arise. The issue requires a balancing of the companies' duties to disclose material events to the market, including their shareholders, against the risks of premature disclosure, which may be misleading if no deal ultimately occurs, may cause competing bids to be launched, may cause a run up in the stock price or may cause business disruptions, including employee or customer defections.

Generally speaking, absent a specific duty to make disclosures, public companies may remain silent without violating the US antifraud provisions. It is generally recognized that "no comment" responses are the functional equivalent of silence. Therefore, if a company in the midst of merger negotiations wishes to avoid public disclosure of the negotiations, it is appropriate to say "no comment"; issuing an inaccurate denial can give rise to liability. However, the "no comment" response will not be appropriate if the company has issued prior statements which were inaccurate when made (e.g., express denials of ongoing merger negotiations). Thus, when, at the end of August and into early September, Veba began issuing "no comment" responses after a month of regular public denials, the "no comment" responses were too late and, at that point, inappropriate.

In at least one SEC enforcement action, the SEC has taken the position that the "no comment" response is also inappropriate where the company has made statements that were accurate when made, but became inaccurate, misleading or incomplete as a result of subsequent events (e.g., a denial of merger discussions at a time when none were pending, followed by the initiation of such discussions). For this reason, many companies adopt a "no comment" response to all inquiries related to potential business combinations and the like, as a matter of course.

Reducing the Likelihood of Enforcement Action

Each set of acquisition negotiations involving one or two public companies with reporting obligations in the United States has the potential to raise significant disclosure issues. Each will require:

- ongoing monitoring by company spokespersons of the progress of the discussions;
- a review of press and other public statements made to date by and on behalf of the companies (including statements posted on company websites);
- ongoing monitoring of public reporting and research coverage of the companies; and
- a review of statements made, and to be made, in SEC filings.

The companies also will need to monitor the trading in their stock, and will need to consider their disclosure obligations under applicable stock exchange rules as well as how to respond to stock exchange inquiries. They will need to ensure that neither recent nor current activities or disclosures (including recent or ongoing transactions in company stock) will trigger affirmative disclosure obligations.

Managing the public relations process obviously becomes far more complicated in cross-border situations where different legal and regulatory regimes may impose different, and possibly conflicting, obligations. Global communications have made the world a smaller place, and communications issued locally are likely to be disseminated far more broadly today. Given the key role that US investors play in a growing number of non-US companies, it is not surprising that corporate communications will be issued in English with the intention and expectation that they will be disseminated, or published, in the United States.

Investor communications policies should be reviewed to ensure that they will provide the greatest flexibility in the high pressure environment that typically exists in an acquisition context. If the US shareholder base is important, particularly if the company has a US listing, the US antifraud rules, which US companies traditionally have lived with on a day-to-day basis for some time, must be considered. In the Veba - Viag situation, "no comment" responses from the outset could have been the key to avoiding investor confusion and SEC enforcement action.

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The foregoing memorandum provides only a general overview of the SEC's enforcement action. It is not intended to provide legal advice, and no legal or business decision should be based on its content.

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