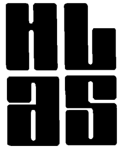

House Legislative Analysis Section
House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

BUSINESS CORPORATION ACT: CONTROL SHARES ACQUISITION

House Bill 4764 (Substitute H-3)
First Analysis (6-5-03)

Sponsor: Rep. Bill Huizenga
Committee: Commerce

THE APPARENT PROBLEM:

In 1988, the legislature enacted the Stacey, Bennett, and Randall Shareholder Equity Act, sometimes referred to as the Michigan Control Shares Acquisition Act. According to analyses at the time, the aim of the act was to help Michigan public corporations ward off hostile takeover attempts, which then seemed a very real threat. The act was modeled on an act from Indiana that had just been upheld as constitutional by the U.S. Supreme Court. Under the act, stockholders can limit the power of shares ("control shares") whose acquisition would give the acquirer a certain specified amount of voting power in the election of directors of the corporation. The act applies each time an acquisition would provide the acquirer with any of three threshold levels of control: one-fifth of all voting power, one-third, and a majority. Unless a corporation's articles of incorporation or bylaws say that the act does not apply, the shares in a control share acquisition have only those voting rights conferred upon them through a vote of the other (disinterested) shareholders at a meeting subsequent to the acquisition.

The statute has become the focus of attention due to a recent set of federal district court decisions growing out of litigation related to an attempted takeover of a large Michigan-based real estate investment trust, Taubman Centers, Inc., by an Indianapolis-based REIT, the Simon Property Group, Inc. Both companies have substantial shopping mall holdings. Put very simplistically, the most recent federal district court decision held that the creation of a shareholder group by the Taubman family and supporters triggered the control shares acquisition act, meaning that the shares could not be voted without the subsequent approval of the other shareholders. The shares affected by the decision represent a voting stake of just over one-third of company voting shares. (A takeover would require a two-thirds vote.) The decision has been stayed by the federal district judge herself, and the case will proceed on appeal to the U.S. Court of Appeals for the Sixth Circuit. This decision was a surprise to some legal observers in that the state law in question was typically viewed as aimed at protecting Michigan companies from takeovers from outsiders but in this case the law was being applied to an in-state company that is the object of a takeover attempt and to a group of shareholders attempting to block a takeover. (On the other hand, the parties that advocated for the successful result say the control shares acquisition law should in fact apply to acquirers of stock both inside and outside the company.)

Legislation has been introduced to address this issue and some related issues regarding corporate governance.

THE CONTENT OF THE BILL:

The bill would amend the Business Corporation Act in the following ways.

• In the case of a corporation whose board of directors is divided into classes (and has staggered terms), shareholders could remove directors only for cause unless the articles of incorporation allowed removal without cause. (Currently, the act says shareholders can remove a director with or without cause unless the articles limit removal for cause only.)

• Amendments to the articles of incorporation of a corporation with publicly traded stock would have to be proposed to the shareholders by the board of directors or by holders of shares representing three-quarters of each class of the outstanding capital stock of the corporation.

• The bill would specify that the formation of a group does not constitute a control share acquisition of shares of an issuing public corporation held by members of the group.

[The last provision would amend a chapter of the Business Corporation Act added by Public Act 58 of 1988, entitled the Stacey, Bennett, and Randall Shareholder Equity Act and also sometimes referred to as the Michigan Control Shares Acquisition Act. According to analyses at the time, the chapter's aim is to provide a means for public corporations to ward off takeover attempts. Under the chapter, stockholders can limit the power of shares ("control shares") whose acquisition would give the acquirer a certain specified amount of voting power in the election of directors of the corporation. The act applies each time an acquisition would provide the acquirer with any of three threshold levels of control: one-fifth of all voting power, one-third, and a majority. Under the act, unless a corporation's articles of incorporation or bylaws say that the act does not apply, the shares in a control share acquisition have only those voting rights conferred upon them through the vote of the other shareholders (at a meeting subsequent to the acquisition).]

• As referred to in the paragraph above, the acquisition act currently says that control shares acquired in a control share acquisition have the same voting rights accorded the shares before the acquisition only to the extent granted by a resolution approved by the shareholders. The bill would allow the resolution to be approved by the shareholders "or directors".

MCL 450.1511 et al.

BACKGROUND INFORMATION:

The Stacey, Bennett, and Randall Shareholder Equity Act (Public Act 58 of 1988) applies to a public corporation that meets all of the following conditions: 1) it has at least 100 shareholders of record; 2) it has within Michigan its principal place of business, its principal office, or substantial assets; and 3) it has a minimum number of shares held by Michigan residents or a minimum number of shareholders resident in Michigan (more than ten percent of its shareholders of record resident in Michigan, more than ten percent of its shares owned by Michigan residents, or 10,000 shareholders of record resident in Michigan).

FISCAL IMPLICATIONS:

There is no fiscal information at present.

ARGUMENTS:

For:

The supporters of this legislation make the following arguments in support of the bill.

• A surprising recent federal court decision (stayed at present) has turned Michigan's anti-takeover statute on its head. The controlled shares acquisition act was designed to help Michigan companies ward off hostile takeovers. To that end, when someone acquires a certain specified number of shares (there are three thresholds), those shares cannot be voted until the disinterested shareholders pass an authorizing resolution. This prevents those from engaging in the takeover, for example, from replacing the corporation's board of directors. This provision has recently been applied by the federal court (in Simon Property Group, Inc. v Taubman Centers, Inc.) to existing shareholders who formed a group to prevent a takeover. The decision would prevent this group of stockholders, including members of the family for whom the company is named, from voting its shares without going through the control shares acquisition procedures. This is a peculiar and perverse result: it interprets the law so as to make it assist those engaged in a takeover rather than those organized to prevent it. The bill's aim is to restore the original legislative intent of the anti-takeover provisions.

• Moreover, the bill is not just about one ongoing well-publicized takeover case. The court decision weakens the law's protections for other similarly situated Michigan companies, which is why the state's business community generally supports it and why it has strong support from family-owned companies and utilities. For the legislature to fail to act, given the current circumstances, would be to demonstrate indifference to this threat to businesses incorporated in Michigan, to the local communities that depend upon them, and to Michigan workers. While takeovers can be beneficial, they also can be destructive in cases where they are intended to raid a company's assets and in cases where they result in the elimination of headquarters and management jobs in the state. Locally based ownership often produces companies that contribute more to community life, through charitable contributions and civic involvement.

• The bill also would improve Michigan's Business Corporation Act by adopting changes that make state law more like the law in Delaware, where more than half of all U.S. public corporations are incorporated. Critics say these are anti-shareholder proposals. But

these are the rules under which nearly all public corporations live. (Fewer than one percent of U.S. corporations are incorporated in Michigan.) Specifically, the bill would allow the removal of directors only for cause when the board of directors was divided into classes with staggered terms; and it would require that any amendments to the articles of incorporation be proposed by the board of directors or by holders of shares representing three-quarters of each class of stockholders before the shareholders could consider them. One supporter of the bill has said of the amendments as a whole that they "strengthen and clarify . . . laws designed to secure the stability of corporate governance and allow directors of a Michigan corporation to exercise their fiduciary responsibilities in the best interests of the corporation and its stockholders."

• To take the case of removing directors. The bill says when there are classes of directors with staggered terms, directors can only be removed for cause – unless the corporation's articles of incorporation say otherwise. This is not anti-shareholder provision but a reasonable amendment that brings Michigan into conformity with corporate governance elsewhere. Legal specialists say that where directors are elected annually, they usually can be removed with or without cause. Where a corporation has already chosen to elect directors to staggered three-year terms, it is inconsistent to then say they can be removed without cause before those terms end. It would contravene the stability chosen by shareholders in establishing a classified board (with staggered terms). Current Michigan law would allow a corporate "raider" to do away with an entire board at one meeting, even though shareholders had previously selected the stability of staggered terms. It should be noted that nothing in the bill changes the ability of shareholders to elect directors.

• The bill would not determine the outcome of the current takeover struggle between Simon Group and Taubman Centers. It would instead allow all the shareholders to vote their shares and participate in decision making about a takeover bid in a manner consistent with corporation bylaws and articles of incorporation. As matters stand now, a significant group of shareholders could be prevented from being part of the decision making due to a misreading of the intent of the 1988 anti-raiding law. Looking beyond this case, how can Michigan expect companies to incorporate here if the law protecting board of directors and management from takeovers is not only weak but unpredictable? The bill would strengthen the law and make it more predictable, in part by adopting provisions like those in Delaware, where the majority of companies go to incorporate.

Against:

The opponents of this legislation make the following arguments in opposition to the bill.

• Action is premature at best. If the passage of the bill is going to affect the outcome of the current battle between Simon Group and Taubman Centers, then legislation should be postponed until litigation is resolved. The legislature should not interpose itself in an ongoing legal dispute in a way that makes one of the parties the winner. Besides, the decisions that have upset the business community could be overturned or clarified on appeal. The courts' interpretation of Michigan law may ultimately coincide with that of the supporters of this legislation. On the other hand, if the bill will not affect the outcome (because it will not be applied retroactively), then what is the hurry? This is a complex technical issue with potentially far reaching consequences. It would be best to go slowly. Perhaps a committee from the State Bar should address the subject. Until now, there appear to have been no complaints about how the law has worked since its passage in 1988. The law in its current state seems to provide a careful balance between the interests of corporate management and shareholders.

• Note that the response in this bill to the recent federal court decision is to amend the law to say that a group formed by shareholders does not trigger the control shares acquisition law when it engages in actions that would trigger the law if engaged in by an individual or entity. This does not make sense. One critic has described the proposal as appearing to say that "it is unlawful for a single insider to evade the disinterested shareholder vote requirement, but it is not unlawful for two or more people, acting in concert, to evade it." This would make the law easy to evade. Moreover, the act now says that when a certain threshold number of shares have been acquired, the voting power of those shares is determined by a vote of disinterested shareholders. The bill would allow those voting rights to be determined instead by the board of directors. This seems to strip shareholders of the anti-takeover rights currently provided by the act. A critic of the bill, who also was involved in the drafting of the original act, has said, "The act was designed to provide shareholders of issuing public corporations an opportunity to have their voices heard when control of the corporation is at stake, so that the "control premium" for shareholders of the corporation is not appropriated by a group of inside shareholders for

their own benefit without any say-so from the other shareholders." The bill goes against that intent.

• The bill clearly is anti-shareholder. Consider that it makes it harder for shareholders to make amendments to articles of incorporation by requiring that they must be proposed by the board of directors or by a supermajority of shareholders. Labor representatives have testified that one of the tools that unions use as shareholders in order to make corporations more accountable is to exercise their rights to present proposals at annual meetings. They say that during the 2003 season of annual meetings, unions and their benefit funds have submitted between 300 and 400 proposals. The law should not be amended to prevent shareholders from submitting proposals that do not have the support of the directors (particularly in cases where boards are approving excessive executive compensation packages and making other harmful decisions). The same complaint can be made about restricting shareholders' ability to replace unresponsive directors. How does specifying in statute that directors can only be removed for cause – a high standard – work to the benefit of shareholders? Legislation should focus on strengthening shareholder rights not protecting management interests. Given some recent celebrated cases of bad behavior by corporate managements, this bill seems headed in the wrong direction.

• This bill, and legislation like it, tends to reduce the value of share prices. If it applied to the Simon/Taubman takeover case, for example, it would make it easier for the board of directors to reject an offer of $20 per share for stock previously trading at under $15 per share. (Reportedly, owners of 85 percent of the common stock have agreed to sell at the $20 price.) How is this beneficial to the majority of shareholders? Some people argue that anti-takeover laws generally reduce share prices and that mergers and acquisitions can increase the value of the shares held by pension funds and other institutional investors. One investment analyst has said, "Quite simply, impairment of shareholder rights impairs stock market value," and has concluded that "passage of this legislation is likely to be seen as a significant negative to investing in Michigan public companies."

POSITIONS:

Among those indicating support for the bill to the House Committee on Commerce at its hearing on 6-3-03 (although not necessarily for the details of the substitute as reported) were representatives of the Michigan Manufacturers Association; the Teamsters; Taubman Centers; DTE Energy; the Michigan Retailers Association; the Michigan Bankers Association; the Corporate Practice Group of the Varnum, Riddering, Schmidt, and Howlett Law Firm; the Clark Construction Company; and Compuware.

Among those indicating opposition to the bill to the House Committee on Commerce at its hearing on 6-3-03 were representatives from the Michigan Department of Consumer and Industry Services; the Michigan AFL-CIO; the SEIU State Council; Cohen and Steers Capital Management; and attorneys representing Simon Property Group.

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.