Senate Counsel & Research
SUITE G-17, STATE CAPITOL
ST. PAUL, MN 55155
(612) 296-4791

Short Subjects

TITLE: CORPORATE TAKEOVER LAW DATE: 12/10/87

AUTHOR: Kathleen Pontius, Senate Counsel PHONE: 296-4394

I. INTRODUCTION

The 1987 special session and the publicity surrounding the threatened takeover of Dayton Hudson by the Dart Group focused the attention of the legislature on the issue of hostile corporate takeovers. This reflects a growing level of concern and controversy in Minnesota and around the country over the increase in corporate takeover activity. Given the importance of this issue, this short subject provides an overview of the issues and recent state and federal activity in response to the problem. Included are the following topics:

* History of Minnesota Corporate Takeover Law
* Summary of 1987 Special Session
* Corporate Takeover Laws in Other States
* Recent Federal Activity
* Policy Questions and Future Direction

II. HISTORY OF MINNESOTA CORPORATE TAKEOVER LAW

Minnesota's original control share acquisition statute, Section 302A.671, was passed in 1984 to address the problem of hostile corporate takeovers. The statute was one of several around the country that are referred to as the "second generation" of corporate takeover statutes. These are statutes that were enacted after the 1982 decision of the U.S. Supreme Court in Edgar v. Mite Corporation, in which the Court struck down the Illinois business takeover act, holding that it was preempted by the federal Williams Act and violated the commerce clause of the U.S. Constitution. In response to that case, states attempted to enact corporate takeover acts that might survive a constitutional challenge.

The control share acquisition statute required shareholder approval before a "control share acquisition" could take place. A "control share acquisition" means the acquisition of at least 20 percent of the voting power of a corporation, or the acquisition of additional shares that would put a person in a new voting power range. Acquiring persons also were required to deliver an information statement to the target company. Once this was delivered, the company would call a special meeting to vote on the proposed control share acquisition.

Minnesota also has regulated takeovers under the Minnesota Takeover Act in chapter 80B. This originally was passed in 1973. Although it does not directly affect whether a takeover may take place, it requires certain practices to be followed when there is a tender offer to acquire more than ten percent of the shares of a company. The offeror must file a registration statement with the commissioner of commerce along with its solicitation materials. It may not engage in certain fraudulent and deceptive practices, and other miscellaneous limitations are put on tender offer activity.

Both the control share acquisition statute and the tender offer statute become effective when the target company has certain ties to the state of Minnesota, based on shareholders who are residents and assets held in the state (these tests were modified in the 1987 Special Session). In addition, the control share acquisition statute only applies to Minnesota corporations that are incorporated under chapter 302A. Chapter 80B applies to any corporation, as long as it has the minimum ties to the state of Minnesota and the tender offer is directed to one or more Minnesota residents.

III. 1987 SPECIAL SESSION

In April 1987, the decision of the U.S. Supreme Court in the C.T.S. Corporation case opened the door for additional state activity in the area of corporate takeovers by resolving some of the questions regarding the constitutionality of state statutes. The Supreme Court upheld the portion of an Indiana law regulating control share acquisitions, finding that it was not preempted by the Williams Act and did not impose an undue burden on interstate commerce. Although this case did not resolve all of the constitutional questions regarding state regulation of corporate takeovers, it led to a flurry of activity in Minnesota and around the country.

The Minnesota Legislature could have been expected to take action on corporate takeovers during the 1988 regular session in response to the C.T.S. Corporation case. However, the imminent takeover of the Dayton Hudson Corporation prompted a special session in 1987 to deal with the corporate takeover issue. The law added new provisions to Minnesota corporate takeover law, while at the same time conforming portions of the existing control share acquisition statute to the Indiana statute that was upheld by the U.S. Supreme Court. Following is a summary of its major provisions (Laws 1987, First Special Session, Chapter 1).

Changes in Minnesota Takeover Act
(Chapter 80B)

The threshold requirements for determining whether a takeover directed at a particular target company is subject to the registration and reporting requirements of this act are modified. The Minnesota Takeover Act now applies to target companies that meet the following two-pronged test:

1. Have a principal place of business or principal executive office located in this state, or control assets with a fair market value of at least $1 million in this state, and

2. Have more than ten percent of security holders resident in Minnesota, more than ten percent of securities owned by Minnesota residents, or more than 1,000 Minnesota residents who are security holders.

Changes in the Control Share Acquisition Statute (Section 302A.671)

With some exceptions, the amendments to the control share acquisition statute conform Minnesota law to the Indiana law that was upheld by the Supreme Court in the C.T.S. Corporation case.

Minnesota corporations with at least 50 shareholders that meet the same two-pronged test described above for the Minnesota Takeover Act come under the scope of the control acquisition statute. In addition, the target company must be incorporated in Minnesota, as required under prior law. Note that these same tests are used to determine whether a corporation is covered by the business combination statute discussed in the next section. These corporations are referred to as "issuing public corporations."

The information statement requirements under the control share acquisition statute were expanded. For example, the acquiring person would have to reveal any intention to change materially its charitable or community contributions or its policies, programs, or practices related to community contributions. Along with the information statement, the acquiring person would have to deliver a definitive financing agreement describing any financing of the control share acquisition not to be provided by its own funds.

The time for calling a special shareholder meeting to consider whether to grant voting rights to the control share acquisition shares is increased from 20 to 55 days. In addition, the acquiring person must make a bona fide written offer for the control share acquisition before a meeting must be called.

While prior law prohibited an acquiring person from making a control share acquisition without shareholder approval, the new law allows the person to acquire the shares but denies voting rights to the excess shares. The acquisition must be approved by a majority vote of all shares and a majority vote of disinterested shares.

The control share acquisition statute automatically applies to issuing public corporations, unless a corporation's articles or bylaws provide otherwise, until July 31, 1989. After that time, the corporation must elect to opt into its provisions.

Business Combination Statute (Section 302A.673)

The new business combination statute limits a series of business transactions (such as sales, leases, mergers, and stock transactions) that may be made between an issuing public corporation and interested shareholders and their affiliates and associates. "Interested shareholders" are persons who own ten percent or more of the corporation's shares, or an affiliate or associate of the corporation that owned ten percent or more during the preceding five years. The focus of the statute is to prevent the use of the assets of the target company to finance a corporate takeover. Although the law is modeled after similar statutes in New York and Indiana, the constitutionality of this type of statute was not decided by the Supreme Court in the C.T.S. Corporation case.

In general, a corporation may not enter into a business combination with an interested shareholder within five years of the time the person becomes an interested shareholder, unless either the business combination or the acquisition of shares that made them an interested shareholder was approved by the board of directors prior to the time they became an interested shareholder. Board votes on business combinations must be made by a committee of disinterested directors. After five years, they may engage in a business combination with prior board approval, if approved by a majority vote of disinterested shareholders, or if the price offered is at least as high as the highest of certain levels specified in the statute.

Prior to August 1, 1989, this statute applies to issuing public corporations that are publicly held unless the corporation opts out of its provisions. After that time, it applies only to those corporations who opt into its provisions.

If an issuing public corporation is not publicly held, the statute does not apply unless the corporation opts into its provisions.

Directors' Standard of Conduct
(Section 302A.251, Subdivision 5)

In making corporate decisions, directors are allowed to consider a number of interests outside of the corporation and its shareholders, such as employees, customers, suppliers, creditors, the economy, the community, and society.

Special Shareholder Meetings
(Section 302A.433, Subdivision 1)

If a special shareholder meeting is called for the purpose of facilitating or effecting a business combination, 25 percent, instead of 10 percent, of the shareholders are required to call the special meeting.

"Green Mail" and "Golden Parachute" Provisions
(Sections 302A.553, Subdivision 3, and 302A.255, Subdivision 3)

The "green mail" statute prevents publicly held corporations from purchasing their shares from persons who owned more than five percent of the voting power for less than six months at an amount above the average market price, unless the purchase is approved at a shareholder meeting or the corporation makes an offer to buy all shares of the same class or series for at least the same amount.

The "golden parachute" provision prohibits a publicly held corporation from entering into or amending agreements increasing the compensation of corporate officers or directors during a tender offer.

Effective Dates

With the following exceptions, most of the law was effective retroactive to June 1, 1987. The golden parachute section was effective the day following final enactment (June 26, 1987), and the green mail provision will be effective March 1, 1988.

IV. CORPORATE TAKEOVER LAWS IN OTHER STATES

Minnesota was not the only state to respond to an immediate takeover threat with legislative action. Of the ten states that have enacted laws since the C.T.S. Corporation case, five, including Minnesota, responded to takeover threats to specific companies. Those other states are North Carolina (Burlington Industries, Inc.), Florida (Harcourt Brace Jovanovich, Inc.), Arizona (Greyhound Corporation), Washington (Boeing Company), and Wisconsin (Heilemann Brewing Company). In addition, Louisiana, Missouri, and Nevada have enacted statutes. This brings the total number of states that have enacted corporate takeover laws within the past five years to 26.

The most popular type of takeover law is a fair-price statute, which sets up strict approval requirements for bidders who do not meet fair-price criteria. Fourteen states have fair-price laws. Business combination statutes such as Minnesota's new law, which are modeled after a New York statute adopted in 1985, are a variation of fair-price statutes and have been enacted in eight states. Control share acquisition statutes are rapidly gaining in popularity, having been adopted in at least 14 states. Some states provide for appraisal rights and a "cashout" when a control share acquisition takes place, instead of requiring shareholder approval.

V. FEDERAL ACTIVITY

The C.T.S. Corporation case and increased state activity, along with insider trading scandals, prompted a surge of congressional activity this summer and fall. On the one hand, modest proposals were introduced that involved technical changes and a tightening up of the existing requirements under the Williams Act, relating to improved tender offer disclosures and refinements in the tender offer process. Other proposals involved more sweeping changes and increased federal regulation of the types of corporate activity that traditionally are handled by the states.

The debate in Congress focused on the appropriate role of the federal government and issues of state versus federal control over matters of "corporate governance," rather than the substance of the particular proposals. Organizations such as the National Conference of State Legislatures lobbied strongly in favor of states' rights and against any federal preemption. Their efforts appear to have been successful; while modification of disclosure rules under the Williams Act appears likely, the chances of major tender offer reforms passing in Congress this session are slim.

VI. POLICY QUESTIONS AND FUTURE DIRECTION

The question of whether the regulation of corporate takeovers is a desirable or legitimate government function is hotly debated on both sides of the issue. The debate focuses on whether hostile corporate takeover bids are good or bad for the economy. In addition, the appropriate role of states and the federal government is a contested issue.

Arguments Against Corporate Takeover Regulation

Opponents of corporate takeover regulations argue that hostile takeovers are good for the economy, and the marketplace should be allowed to operate with as few restrictions as possible. They point out that corporate takeovers overwhelmingly result in a greater return to the shareholders of the target company. Corporate takeovers can clean out inefficient and incompetent management and provide the needed resources to improve corporate productivity. Antitakeover laws are seen as operating primarily for the benefit of the top level managers of target firms at the expense of all other interests. While hostile takeovers may appear to be an unattractive way to resolve efficiency problems in corporations, the government should not hamper the ability of the market to use takeovers without a more effective alternative in place to deal with corporate inefficiency and mismanagement.

Arguments in Favor of Corporate Takeover Regulation

Proponents of government regulation of corporate takeovers note that a significant amount of time and money is spent on takeover-related activity that is essentially nonproductive and places a significant drain on the economy. While corporate takeovers may result in increased returns to the shareholders of the target company, this is usually done at the expense of a number of other constituencies. The fact that stock prices rise does not necessarily mean that economic efficiency increases. Frequently the corporate raiders help themselves and the target shareholders by redistributing wealth from the company's employees and customers. In addition, they forego expenditures in areas such as research and development and other investments that might result in long-term growth in order to show short-term profits. Many takeover bidders have no intention of controlling the target company, but instead seek a quick profit through the use of a takeover threat. Target companies may be broken up or burdened with substantial debt that leaves them insolvent after a takeover.

Proponents of the regulation of corporate takeovers also reject the theory that takeovers solve problems of managerial incompetence. They note that there appears to be a concentration of hostile takeovers in regulated industries, industries that are subject to a lot of foreign competition, industries that are highly unionized, and industries that have frequently experienced adverse price shocks. Because these industries are not run solely for the benefit of shareholders, they may be targets of hostile takeovers. They are not necessarily mismanaged, but rather spread problems across a number of different constituencies, resulting in less return to shareholders.

State versus Federal Regulation

In addition to the debate over whether or not hostile takeovers are bad and therefore justify government regulation, another fundamental question that must be addressed is whether action should be taken by state or federal government or by both acting jointly. The decision of the Supreme Court in the C.T.S. Corporation case removed some of the potential constitutional questions concerning the legitimacy of state activity in this area. Traditionally, states have retained broad powers and responsibility for regulating the internal operations of corporations in matters relating to shareholder rights and the relationships between shareholders, directors, and officers. Federal regulation has focused on securities regulation and tender offer disclosures and procedural activities in the tender offer process to increase investor knowledge when changes in corporate control are proposed.

Future Direction

Although major tender offer reform at the congressional level is not likely this year, the issue probably will not go away. If corporate takeovers are seen as creating a significant problem in the marketplace, policymakers must decide if this is best dealt with on a state-by-state basis or if uniformity is desirable to facilitate a national marketplace for corporate control. Opponents of any federal preemption are concerned that this may be the "foot in the door" that could lead to increased federal regulation in a number of areas of corporate control traditionally handled by the states.

States probably will continue to adopt or modify their corporate takeover laws. Because all of the constitutional issues have not been resolved, additional court activity can also be expected. As long as corporate takeovers are a significant force in the economy, lawmakers can anticipate continued interest and activity in all areas.

KP:mc