Georgia State University Law Review

Volume 5
Issue 1 *Fall 1988*

Article 20

9-1-1988

CORPORATIONS, PARTNERSHIPS, AND ASSOCIATIONS Anti-Takeover Statute: Prohibit Business Combinations

C. White

CORPORATIONS, PARTNERSHIPS, AND ASSOCIATIONS

Anti-Takeover Statute: Prohibit Business Combinations

CODE SECTIONS:	O.C.G.A. §§ 14-2-236 to -238 (new)
BILL NUMBER:	HB 1571
ACT NUMBER:	829
SUMMARY:	The Act adds to the Georgia Corporation Code three sections which provide Georgia corporations with protection against hostile takeovers. The prohibitions of the Act freeze-out any type of business combination with interested shareholders unless either ninety percent of the outstanding voting shares are purchased or the Board of Directors approves the combination. The freeze-out lasts five years unless an interested shareholder reaches ninety percent ownership and obtains shareholder approval. The Act only applies to Georgia corporations which specifically incorporate its provisions into their bylaws.
EFFECTIVE DATE:	July 1, 1988

History

In 1982, the United States Supreme Court cast doubt on virtually all so-called "first generation" state anti-takeover statutes in *Edgar v. MITE Corp.*[1] In *MITE*, a plurality of the Court stated that an Illinois anti-takeover statute unconstitutionally interfered with interstate commerce.[2] Additionally, the Court found that provisions in the state statute which permitted delay in the tender offer process conflicted with the Williams Act.[3] The Court was concerned that lengthy delay would permit management to frustrate the attempts of the takeover bidder, even when the tender offer was proinvestor as intended by Congress in passing the Williams

1. 457 U.S. 624 (1982).
2. Edgar v. MITE Corp., 457 U.S. at 647.
3. *Id.* at 640. The Williams Act regulates cash tender offers, generally a transaction directly between a takeover bidder and the shareholders, in corporate acquisitions. The Act requires registration, disclosure, and general "fair play" to protect investors from management and takeover bidders. *See id.* at 633—34; 15 U.S.C. § 78M—N (1968).

Act.[4] The decision resulted in the repeal or overturn of many state anti-takeover statutes, including Georgia's.[5]

Recently, however, "second generation" anti-takeover statutes have come into favor on the heels of the Supreme Court's decision in *CTS Corp. v. Dynamics Corp. of America*.[6] The *CTS* Court held that an Indiana statute was consistent with the Williams Act, which regulates tender offers, because the statute regulated shareholder voting rights, an area traditionally relegated to state authority.[7] In distinguishing *MITE*, the *CTS* Court held that the Indiana statute protected the independent shareholder against both the management and the takeover bidder by conditioning delay with procedures for shareholder votes.[8] The *MITE* plurality's concern that "the Illinois statute considered in that case operated to favor management against offerors, to the detriment of shareholders" was thereby remedied.[9]

The Supreme Court also addressed the tender offeror's commerce clause challenge to the Indiana statute. The Court first noted that statutes are scrutinized under the dormant commerce clause to ensure that they do not "discriminate against interstate commerce."[10] In reversing the court of appeals' finding that the commerce clause was violated, the Court proffered several reasons for the state statute's constitutionality. First, the statute had equivalent effects on both in-state and out-of-state corporations.[11] Second, there was no problem of "subjecting activities to inconsistent regulations . . . [s]o long as each State regulates voting rights only in the corporations it has created."[12] Finally, the Court noted that the state was simply seeking to regulate an artificial entity which owed its very existence to the state in the first instance.[13] It appears that the Georgia statute meets both the commerce clause constitutional concern and the Williams Act federal preemption concern.[14]

HB 1571 was introduced in response to both the holding in *CTS* and

---

4. Edgar v. MITE Corp., 457 U.S. at 637—38.
5. 1977 Ga. Laws 649 (formerly found at O.C.G.A. §§ 14-6-1 to -15 (1986)).
6. 107 S. Ct. 1637 (1987).
7. CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. at 1648.
8. *Id.* at 1645—46.
9. *Id.* at 1645.
10. *Id.* at 1648.
11. *Id.* at 1648—49.
12. *Id.* at 1649.
13. *Id.* at 1649—50.
14. Interview with William Gregory, Professor, Georgia State University College of Law (Nov. 8, 1988). The constitutionality of the statute has already been challenged in conjunction with Farley, Inc.'s hostile takeover bid for West Point Pepperell, Inc. Because Farley effectively would be blocked by the anti-takeover statute, the tender offer was made contingent upon the unconstitutionality of the statute which has yet to be determined. Burritt, *Farley May Force West Point to Try a Restructuring*, Atlanta J., Dec. 9, 1988, at 1D, col. 5, D5, col. 4. West Point Pepperell, a Georgia corporation, is the nation's largest publicly traded textile and apparrel company. *Id.* at 1D, col. 5.

currently prevailing economic conditions. According to the bill's sponsor, the 1987 stock market crash created undervalued stock in many corporations, which attracted corporate raiders who intended to buy undervalued Georgia companies and then sell off all of the corporate assets once the transaction was complete.[15] Corporate raiding would prove costly to Georgia in loss of assets, tax revenues, and jobs.[16]

HB 1571

HB 1571, based on Delaware's anti-takeover statute,[17] is a two-part Act which amends the Georgia Corporation Code.[18] Part I and Part II of the bill, identical in all respects, were added to different sections of the Georgia Business Corporation Code. Part I will be repealed and Part II implemented July 1, 1989 when HB 1272, a comprehensive revision of the entire Corporation Code, is enacted.[19]

The Act, in contrast to the Indiana Control Shares Acquisition statute discussed in *CTS*, is referred to as a business combination statute.[20] The Georgia General Assembly has chosen to regulate the combination of corporations, rather than the voting rights of shareholders. This prohibition against various business combinations with interested shareholders is the Act's primary directive.[21] In order to effectuate the legislature's intent, various definitional additions and alterations, which do not otherwise apply to the Georgia Corporation Code, were determined necessary. For example, the term "business combination," designed to be all inclusive, applies to "[a]ny sale, lease, transfer, or other disposition."[22] This definition excludes a twelve-month time limit for the transfer found in the current Corporation Code,[23] and adds "associate" to the definition prohibiting

15. Telephone interview with Representative Pete Robinson, House District No. 96 (Apr. 7, 1988) [hereinafter Robinson Interview].

16. *Id. See* Elmore, *Takeover Bill Is Workable But Risky, Analysts Say*, Atlanta J., Feb. 11, 1988, at D1, col. 2 [hereinafter Elmore].

17. DEL. CODE ANN. tit. 8, § 203 (1988). The Georgia law is slightly more restrictive, however. The Delaware law requires the buyer to attain an 85% ownership interest or face three years of restrictions. In contrast, the Georgia law requires 90% ownership interest or five years of restrictions will be imposed. *See infra* notes 45—72 and accompanying text.

18. O.C.G.A. §§ 14-2-236 to -238 (Supp. 1988).

19. HB 1272 completely revises the Georgia Business Corporation Code. The new version, which will be implemented July 1, 1989, begins with § 14-2-101 in contrast to the current version which begins with § 14-2-1. *See Selected 1988 Georgia Legislation, Revised Georgia Business Corporation Code*, 5 GA. ST. U.L. REV. 285 (1988).

20. *See* O.C.G.A. §§ 14-2-236 to -238 (Supp. 1988).

21. Telephone interview with Mitchell M. Purvis, Chairman, State Bar of Georgia Corporate Banking Law Section's Corporate Code Revision Committee (Apr. 9, 1988) [hereinafter Purvis Interview].

22. O.C.G.A. § 14-2-236(2)(B) (Supp. 1988).

23. *See* O.C.G.A. § 14-2-232(5)(E) (Supp. 1988). The Corporation Code will be completely revised on July 1, 1989, and this discrepancy will be eliminated.

transfer to an interested shareholder or affiliate of any interested shareholder.[24]

The Act prohibits the transfer of equity securities with an aggregate market value of five percent of the outstanding common and preferred shares.[25] Although this language appears in the current Corporation Code,[26] the Act creates an exception for securities which are convertible into shares of stock if those securities were outstanding when the shareholder became "interested."[27] The Act includes cash transactions, which are exempted in the current Corporate Code, in the definition of business combination.[28]

Finally, the Act includes "the benefits of . . . loans, advances, guarantees, pledges, or other financial benefits or assistance or any tax credits or other tax advantages."[29] This language is a catchall designed to apply to any form of business combination not covered by the other sections which a creative mind might produce.[30]

Throughout the Act the term "resident domestic corporation" replaces the term "corporation" found in the current Corporate Code and applies only to Georgia corporations. The definition of the term has gone through several changes. The original House bill required a corporation to meet certain conditions to be considered a "resident domestic corporation."[31] The House Committee on Judiciary deleted the conditions, however, requiring only that the organization be an issuer of voting stock organized under the laws of Georgia.[32] According to the bill's sponsor, the House committee, in an effort to protect all corporations in Georgia, wanted all Georgia corporations to fall within the definition of "resident domestic corporation."[33] The Senate Committee on Judiciary, however, drafted a comprehensive set of minimum contacts designed to prevent jurisdictional challenges.[34] The Senate version is adopted in the final bill.[35] Importantly, the final version more closely tracks the Indiana statute upheld by the Supreme Court in *CTS*.[36]

The minimum contacts necessary to be considered a "resident domestic corporation" are that the issuer of voting stock must be organized under

---

24. O.C.G.A. § 14-2-236(2)(B) (Supp. 1988).
25. O.C.G.A. § 14-2-236(2)(C) (Supp. 1988).
26. O.C.G.A. § 14-2-232(5)(C) (Supp. 1988).
27. O.C.G.A. § 14-2-236(2)(C) (Supp. 1988).
28. O.C.G.A. § 14-2-236(2)(D) (Supp. 1988) ("only plan or proposal for . . . liquidation or dissolution").
29. O.C.G.A. § 14-2-236(2)(F) (Supp. 1988).
30. Purvis Interview, *supra* note 21.
31. HB 1571, as introduced, 1988 Ga. Gen. Assem.
32. HB 1571 (HCS), 1988 Ga. Gen. Assem.
33. Robinson Interview, *supra* note 15.
34. HB 1571 (SCS), 1988 Ga. Gen. Assem.; telephone interview with Senator Ed Hine, Senate District No. 52 (Apr. 8, 1988) [hereinafter Hine Interview].
35. O.C.G.A. § 14-2-236(4)(A) (Supp. 1988).
36. Hine Interview, *supra* note 34.

Georgia law, have at least 100 beneficial owners in Georgia, and meet one of the four following conditions:[37] (1) location of its principal office in this state;[38] (2) beneficial ownership by Georgia residents of ten percent of the outstanding voting shares;[39] (3) Georgia residency of ten percent of the holders of outstanding voting shares;[40] or (4) ownership or control of "assets which represents the lesser of substantially all of its assets or assets having a market value of at least twenty-five million dollars."[41]

The original House bill required only five million dollars in assets in order to be a "resident domestic corporation."[42] The Senate Committee on Judiciary, however, felt the five million dollars requirement was not sufficiently substantial to insure minimum contacts.[43] In addition, the committee felt that minimum contacts which included a requirement of twenty-five million dollars in assets could withstand any constitutional challenge charging an impermissible interference with interstate commerce.[44]

The Act prohibits any business combination between an interested shareholder and a resident domestic corporation for a five-year freeze-out period after the shareholder becomes "interested."[45] While an outside interest may freely purchase shares of a resident domestic corporation, the purchaser may not engage in any practice resulting in a business combination.[46] Thus, although a company may be acquired, the acquiring company may not sell off assets, borrow money from the acquired corporation or engage in any other prohibited activity during the five-year freeze-out period. The freeze out is designed to discourage corporate raiders who seek a quick profit.[47]

There are, however, three exceptions to this provision. First, the combination will be permitted if approved by the resident domestic corporation's board of directors.[48] This is a logical provision since not all takeovers are hostile. Second, the combination will be approved if, at the time of becoming "interested," a shareholder becomes the beneficial owner of

37. O.C.G.A. § 14-2-236(4)(A) (Supp. 1988).

38. O.C.G.A. § 14-2-236(4)(A)(i) (Supp. 1988). This provision differs from the original House version which required location of the executive office in Georgia. HB 1571, as introduced, 1988 Ga. Gen. Assem.

39. O.C.G.A. § 14-2-236(4)(A)(iii) (Supp. 1988).

40. O.C.G.A. § 14-2-236(4)(A)(ii) (Supp. 1988).

41. O.C.G.A. § 14-2-236(4)(A)(iv) (Supp. 1988). The Act defines "substantially all of the corporate assets" as "either one-half of the value of the assets of the corporation or the assets of the corporation located in this state which generate more than one-half of the total revenues of the corporation, all on a consolidated basis." *Id.*

42. HB 1571, as introduced, 1988 Ga. Gen. Assem.

43. Hine Interview, *supra* note 34.

44. *Id.*

45. O.C.G.A. § 14-2-237(a) (Supp. 1988).

46. Purvis Interview, *supra* note 21.

47. Robinson Interview, *supra* note 15.

48. O.C.G.A. § 14-2-237(a)(1) (Supp. 1988).

at least ninety percent of the voting stock of the resident domestic corporation.[49] This exception remedies abuse present in many "two tier" tender offer takeover pricing schemes in which the acquiring corporation pays a premium above the market price until a majority number of shares are purchased.[50] The minority shareholders who are unable to avail themselves of the premium "first tier" price are then forced to sell shares at a depressed "second tier" price.[51]

In determining whether the ninety percent requirement has been met, several classes of shares are excluded. First, shares owned by "directors or officers, their affiliates, or associates . . ." are excluded.[52] Initially, the bill applied only to directors and officers.[53] The Senate committee substitute, by expanding the exception to include all officers or directors,[54] intended to exclude interested shareholders with a job interest at stake.[55] For the same reason, the Senate Committee on Judiciary excluded subsidiaries who own shares of the resident domestic corporation.[56] Finally, employees with shares in employee stock plans are excluded in cases where the employee is not permitted to determine confidentially whether to accept a tender offer.[57]

The third exception to the prohibition against business combinations applies to "creeping acquisitions."[58] If a shareholder achieves beneficial ownership of ninety percent of the outstanding voting stock after becoming "interested," a combination may be approved at an annual or special meeting of shareholders.[59] Without this approval, the five-year freeze-out is applicable.[60] In order to achieve a vote of only disinterested shareholders,[61] the Act excludes from the vote interested shareholders and officers or directors.[62]

Finally, the Act excludes shareholders who inadvertently become "interested."[63] The shareholder must divest sufficiently to fall below the ten percent threshold level "as soon as practicable."[64] Additionally, the interested shareholder must not have been an interested shareholder in a busi-

---

49. O.C.G.A. § 14-2-237(a)(2) (Supp. 1988).
50. CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637, 1646 (1987).
51. *Id.*
52. O.C.G.A. § 14-2-237(2)(A) (Supp. 1988).
53. HB 1571, as introduced, 1988 Ga. Gen. Assem.
54. HB 1571 (SCS), 1987 Ga. Gen. Assem.
55. Hine Interview, *supra* note 34.
56. O.C.G.A. § 14-2-237(a)(2)(B) (Supp. 1988).
57. O.C.G.A. § 14-2-237(b)(2)(C) (Supp. 1988).
58. Purvis Interview, *supra* note 21.
59. O.C.G.A. § 14-2-237(a)(3) (Supp. 1988).
60. Purvis Interview, *supra* note 21.
61. Hine Interview, *supra* note 34.
62. O.C.G.A. § 14-2-237(a)(3)(A)—(C) (Supp. 1988); *see supra* notes 53—57 and accompanying text.
63. O.C.G.A. § 14-2-237(b)(1) (Supp. 1988).
64. O.C.G.A. § 14-2-237(b)(2) (Supp. 1988).

ness combination other than the inadvertent acquisition in the previous five years.[65]

Significantly, the Act is applicable only when all of its terms are specifically incorporated into the corporation's bylaws.[66] This was done to avoid unilateral imposition of decision making and because many combinations are friendly.[67] In addition, the Act specifically prohibits director liability for adopting or failing to adopt the Act's provisions.[68]

Finally, if incorporated into a corporation's bylaws, the Act's provisions can be repealed only after certain procedures are satisfied. There must be an affirmative two-thirds vote of continuing directors as well as a majority of voting shares other than those beneficially owned by an interested shareholder.[69] Any other amendment procedures provided for in the bylaws must also be met.[70] Once the bylaw is repealed, it cannot be readopted at a later time.[71] This limitation on readoption is to prevent companies from attempting to manipulate stock prices by vacillating between adoption and repeal of the provisions.[72]

Although HB 1571 appears to protect investors and the state, there is concern that in the long run the stockholders will be harmed. It is argued that through management entrenchment, efficiencies are lost.[73] Arguably, management is at its best when the threat of takeover is present.[74] In addition, many fear stockholders are being deprived of opportunities to sell shares at a market premium.[75] Whether or not these criticisms are true, Georgia, through the enactment of HB 1571, has joined a host of other states in providing protection against unwanted takeovers.

C. White

---

65. O.C.G.A. § 14-2-237(b)(3) (Supp. 1988).
66. O.C.G.A. § 14-2-238(a) (Supp. 1988).
67. Robinson Interview, *supra* note 15.
68. O.C.G.A. § 14-2-238(a) (Supp. 1988).
69. O.C.G.A. § 14-2-238(b) (Supp. 1988).
70. O.C.G.A. § 14-2-238(d) (Supp. 1988).
71. O.C.G.A. § 14-2-238(b) (Supp. 1988).
72. Robinson Interview, *supra* note 15.
73. Elmore, *supra* note 16.
74. *Id.*
75. Gard, *U.S. Supreme Court Ruling Spurs Push For Anti-Takeover Bill*, Fulton County Daily Rep., May 1, 1987, at 3, col. 1.