MODEL [STATE] CONTROL SHARE ACT

Adopted Effective April 22, 1988, Amended and Effective September 14, 1989

Preliminary Statement

This model statute and official comments ("Model Act" or "Act") is intended as a guide for states wishing to enact or amend a control share acquisition act. The Model Act was drafted by a joint committee ("Joint Committee") composed of members of the North American Securities Administrators Association ("NASAA") and members of the American Bar Association Committee on State Regulation of Securities ("ABA Committee"). Subsequent to the March 29, 1988 date, the Act was adopted by NASAA at its 1988 Spring Conference by vote of its member jurisdictions. The ABA Committee has not to date acted on or approved the Act. The Joint Committee adopted amendments to Sections 2 and 5 of the Model Act, effective August 1, 1989. The Joint Committee members have made no recommendation as to the desirability of this legislation for any particular state.

The need for this kind of Model Act resulted from the growing number of states considering control share acquisition legislation following the Supreme Court decision in CTS Corp. v. Dynamics Corp., — U.S. —, 107 S. ct. 1637 (1987) ("CTS "). In CTS, the Supreme Court held that the Indiana Control Share Acquisition Chapter ("Indiana Act") was neither preempted by federal law nor invalid as burdening interstate commerce. Indiana's law is intended to provide independent shareholders of domestic corporations meeting certain criteria the power to vote collectively on a proposed change of corporate control, by deciding whether to accord voting rights to shares held or to be acquired in excess of certain percentages. The purpose of the Joint Committee was to provide a uniform statute that comes within the constitutional limitations laid down by the Supreme Court in CTS and responds to the perceived need to modify or clarify certain provisions of the Indiana Act.

To improve the usefulness of the Model Act, Official Comments were prepared for each provision and specifically approved by the Joint Committee. The Official Comments describe the substantive decisions made in the drafting of each provision and further explain the meaning and purpose of the provision. The Model Act generally utilizes the statutory drafting principles set forth in Drafting Rules for

Uniform or Model Acts promulgated by the National Conference of Commissioners on Uniform State Laws.

In drafting the Model Act, the Joint Committee departed from the Indiana statute only for good reason. In addition, the Joint Committee attempted to adhere to four requirements which emerged from the CTS decision. First, state tender offer regulation must not conflict with the federal policy "implicit in the Williams Act … that independent shareholders faced with tender offers often are at a disadvantage" and require protection "from the coercive aspects of some tender offers." 107 S. ct. at 1646. Second, state tender offer regulation may allow " shareholders to evaluate the fairness of the offer collectively" but should not "allow the state government to interpose its views of fairness between willing buyers and sellers of shares of the target company." 107 S. Ct. at 1646 (emphasis in original). Third, state tender offer regulation must "not give either management or the offeror an advantage in communicating with the shareholders about the impending offer." 107 S. ct. at 1646. Fourth, state regulation may not impose " 'unreasonable delay'" upon a tender offer. 107 S. ct. at 1647 (emphasis in original).

The Supreme Court recognized in CTS that there is some room for state legislation regulating tender offers which "furthers the federal policy of investor protection" and is calculated to protect legitimate state interests. 107 S. ct. at 1647. The Joint Committee did not consider it to be within its province, in drafting the Model Act, to resolve all tender offer abuses and problems that states may legitimately address or to take a position on the underlying policy issue of the desirability of state take-over regulation. Rather, the Committee sought only to draft a model control share act that (i) could serve as a guide for states considering enactment or amendment of such legislation, (ii) would withstand constitutional scrutiny and (iii) would be reasonably consistent with the existing framework of state corporation law and practice.

ABA-NASAA Joint Committee on a Model Control Share Acquisition Statute

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Sec. 1. Citation

This Article is known and may be cited as the [State] Control Share Act.

Sec. 2. Application

(a) This Article applies to all issuing public corporations in existence on and after the effective date of this Article … [revisor inserts date].

COMMENTARY TO SUBSECTION 2(a). Coverage under this Act is invoked automatically with respect to those domestic corporations that meet the definitional criteria of "issuing public corporation" set forth in subsection 3(g). The voting power of a corporation's shares becomes subject to these provisions immediately upon effectiveness of the Act, unless the corporation takes the prescribed action to avoid coverage. The original March 29, 1988 form of this Section established a 12-month delayed effectiveness of the Act for the purpose of providing time for those corporations that wished to reject the statute's automatic coverage and take the "opt-out" opportunity presented in Section 4, without having to call a special shareholders meeting. However, as a result of U.S. Securities and Exchange Commission Rule 19c-4 under the Securities Exchange Act of 1934 (enacted subsequent to the March 29, 1988 completion of the Model Act) the subsection was amended by the Joint Committee effective August 1, 1989, whereby the 12-month delayed effectiveness language was eliminated and replaced with the immediate-effectiveness-upon-enactment language. The substitution was necessary to eliminate the adverse delisting-from-trading consequences that otherwise might flow to a publicly traded company under the SEC rule in circumstances where a corporation acts affirmatively to opt-into coverage of a control share statute.

(b) A domestic corporation that is not an issuing public corporation but that has one hundred (100) or more shareholders of record and meets one of the requirements set forth in subparagraph 3(g)(1)B, or an issuing public corporation to which this Article does not apply, may elect to be subject to this Article as an issuing public corporation by amending its articles of incorporation to provide that this Article shall apply to the corporation as of a specified date and filing the amendment in the [Office of the Secretary of State or other appropriate state office] on or before such date.

COMMENTARY TO SUBSECTION 2(b). This subsection provides a procedure for domestic corporations that are not automatically covered by the Act because they do not have all the elements of an "issuing public corporation" to invoke the Act's coverage by an amendment to their

articles of incorporation. Such "opt-in" also may be utilized both by an issuing public corporation that wishes coverage to begin immediately (prior to the expiration of the 12-month delay period), and by a corporation that previously opted out. Only about six of the existing state control share statutes provide an opt-in procedure.

This subsection also establishes eligibility criteria for a corporation that does not automatically qualify as an issuing public corporation. To elect coverage under the Act, a domestic corporation must have at least 100 shareholders of record and satisfy at least one of the three requirements listed in subparagraph 3(g)(1)B. That subparagraph—part of the definition of "issuing public corporation"—sets forth alternative criteria relating to the number (10,000) or percentage (10%) of resident shareholders, or the percentage (10%) of shares held by residents of the state.

The procedure to opt into the Act is that prescribed under the state business corporation law for amending a corporation's articles of incorporation—typically a board of directors resolution followed by a shareholder vote—and parallels the procedure to opt-out of the Act's application. The Joint Committee chose this approach, as opposed to an amendment to the corporation's bylaws (which can be accomplished by board action without shareholder involvement, and which some state control share statutes permit), because the Committee believes this opt-in procedure is an important corporate action that should require approval by a majority vote of shareholders. Paragraph 2(b) requires that, if the opt-in amendment to the corporation's articles is approved, it must be filed timely at the Office of the Secretary of State or other appropriate state office so as to provide public record and notice that the corporation is covered by the Act.

Sec. 3. Definitions

As used in this Article,

(a) "Acquiring person" means a person who makes or proposes to make, or persons acting as a "group" as defined in sec. 13(d)(3) of the Securities Exchange Act of 1934 who make or propose to make, a control share acquisition; but "acquiring person" does not include the issuing public corporation.

COMMENTARY TO SUBSECTION 3(a). The Model Act's definition of "acquiring person" is new. Although the term is not found in the Indiana statute, the Joint Committee found it useful, particularly with its reference to Section 13(d)(3) of the federal Securities Exchange Act of 1934 ("1934 Act") dealing with the "group" concept. Thus, wherever "acquiring person" appears in the Act, any group (partnership, syndicate or other aggregation of persons acting in concert) is implicated.

(b) "Affiliate" means a person who directly or indirectly controls the corporation. "Control," means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of the

corporation, whether through the ownership of voting securities, by contract, or otherwise. A person's beneficial ownership of ten percent or more of the voting power of a corporation's outstanding shares entitled to vote in the election of directors (except a person holding voting power in good faith as an agent, bank, broker, nominee, custodian or trustee for one or more beneficial owners who do not individually or as a group control the corporation) creates a presumption that the person controls the corporation.

<u>COMMENTARY TO SUBSECTION 3(b)</u>. The defined term is used several times in the Act to refer to persons who have an influential role in the direction of corporate management and policies, particularly with respect to the voting process. It is taken from the familiar definitions of "affiliate" and "control" found in Rule 405 under the Securities Act of 1933 ("1933 Act"), but is narrowed to suit the limited purpose to which it is put in the Act.

(c) "All voting power" means the aggregate voting power that the shareholders of an issuing public corporation would have in the election of directors, except for this Article.

<u>COMMENTARY TO SUBSECTION 3(c)</u>. This definition of "all voting power" likewise is unique to the Model Act. The phrase means the aggregate voting power that shareholders of all classes of the stock of the issuing public corporation would have in the election of directors, but for the application of the Act. The principal use of the definition is in subsection 5(g), which describes the shareholder vote taken for the purpose of determining whether or not voting power will be accorded to the shares that are the subject of a control share acquisition.

(d) "Control shares" means issued and outstanding shares of an issuing public corporation that, except for this Article, would have voting power when added to all other shares of the issuing public corporation owned of record or beneficially by an acquiring person or in respect to which that acquiring person may exercise or direct the exercise of voting power, that would entitle the acquiring person, immediately after acquisition of the shares (directly or indirectly), to exercise or direct the exercise of the voting power of the issuing public corporation in the election of directors within any of the following ranges of voting power:

(1) One-fifth ($^1/_5$) or more but less than one-third ($^1/_3$) of all voting power;

(2) One-third ($^1/_3$) or more but less than a majority of all voting power; or

(3) A majority or more of all voting power.

<u>COMMENTARY TO SUBSECTION 3(d)</u>. Although the definition of "control shares" in the Model Act is the same in all material respects as the definition in the Indiana statute (as well as most other state control share laws), the Model Act uses the definition somewhat differently. "Control shares" are equity securities of an issuing public corporation that, were it not for the Act, would permit the acquiring person voting power in the election of corporate directors in excess of any of the three thresholds specified—one-fifth, one-third or a majority. The reason for the triple threshold, according to the drafting commentary to the Indiana control share statute, is that: (i) 20% is the level of ownership at which, under equity accounting rules, a corporation may report the results of its investment in another corporation as a line item on its financial statements; (ii) 33% is generally recognized as a sufficient block of shares to constitute effective control for most, if not all, practical purposes where a public corporation's shareholders are generally dispersed; and (iii) a majority or more of voting power comprises literal control.

As used in the Model Act, "control shares" are <u>all</u> shares owned of record or beneficially by the acquiring person (including shares acquired in separate purchases over an extended period of time) that, when added to all other holdings of the acquiring person, entitle the acquiring exercise voting power in excess of one or more of the three specified thresholds of voting power. There is a difference between the Model Act and the Indiana statute with respect to the treatment of voting rights for control shares representing less than 20% of all voting power, and for control shares acquired within a range of voting power for which approval has already been obtained. See Commentary to subsections 4(b) and (c). Thus, while the Indiana statute and most of the other state control share laws emphasize the concept of the <u>acquisition</u>, the Model Act's focus is on the control shares themselves—the means of exercising control. The other statutes attempt to identify the transaction constituting the control share acquisition, and then sterilize shares involved in that transaction. For purposes of the Model Act, however, it does not matter which shares were involved in the control share acquisition transaction (so long as such a transaction occurred) and which shares were previously held. The consequence with respect to the voting rights of both kinds of shares is the same.

The definition provides that it is a person's actual ability to control the voting power over the requisite percentage of shares—and not merely record ownership—that is the key to determining whether the shares are "control shares." The definition includes both shares "owned of record or beneficially by an acquiring person" (covering the right to acquire the shares) and shares "in respect to which that acquiring person may exercise or direct the exercise of voting power." Additionally, the acquisition of control shares comes under the statute whether it occurs "directly or indirectly." Because the term "acquiring person" is defined to include a "group," an acquisition either by one person alone or by two or more persons acting cooperatively or in concert is covered. The reference to voting power "in the election of directors" is intended to deal with the situation in which the voting power of certain series or classes of a corporation's stock may be limited to specific issues. It is only voting power in electing the company's directors that is considered in the definition of "control shares."

(e)

(1) "Control share acquisition" means acquisition by any person of ownership of, or the power to direct the exercise of voting power with respect to, control shares.

[COMMENTARY TO SUBSECTION 3(e)[(1)].] Paragraph 3(e)(1) defines the phrase "control share acquisition" with language that is nearly identical to that contained in the other state control share statutes enacted to date—with the exception that the Model Act language does not include a provision establishing a conclusive presumption that shares acquired during any 90-day period are deemed to have been acquired in the same acquisition. This device for identifying the transaction (or series of transactions) that constitutes a control share acquisition is unnecessary here because the Act affects the voting rights only of control shares held in excess of the applicable percentage. Identification of the transaction in which the control shares were acquired is irrelevant. Thus, the Act allows more certainty than other state statutes in determining whether and when a control share acquisition has taken place.

(2) A person who acquires shares in the ordinary course of business for the benefit of others in good faith and not for the purpose of circumventing this Article has not made a control share acquisition of shares in respect of which that person is not able to exercise or direct the exercise of votes without further instruction from others.

[COMMENTARY TO SUBSECTION 3(e)(2).] Paragraph 3(e)(2) excludes from the definition of "control share acquisition" acquisitions made by persons, such as brokers or nominees, who acquire shares for the benefit of others in the ordinary course of business, so long as (i) the acquisition is made "in good faith and not for the purpose of circumventing" the Act, and (ii) the acquiror is not "able to exercise or direct the exercise of votes without further instruction from others" (typically, the beneficial owner). This type of provision is present in the Indiana law and in 10 of the other state control share statutes. The exclusion is designed to avoid application of the Act where, as part of normal commercial practices, record ownership of shares may be in the name of a broker or other nominee, but where actual voting power with respect to those shares is held by the broker's customer or the nominee's principal. If, however, voting power for such shares is not subject to such further instruction or direction from beneficial owners, but rather may be exercised independently by the broker or nominee, the exclusion does not apply. Morever, the exclusion cannot be used to circumvent the chapter—such as where a broker's purchases for clients are in fact being made in concert with, and as part of an effort to assist, an acquiring person's plans to obtain effective voting control.

(3) The acquisition of any control shares does not constitute a control share acquisition if the acquisition is made in good faith and not for

the purpose of circumventing this Article in any of the following circumstances:

[<u>COMMENTARY TO SUBSECTION 3(e)(3).</u>] Paragraph 3(e)(3) contains eleven express exclusions from the definition of control share acquisition. There is considerable consistency among the states that have enacted control share statutes as to what transactions should not invoke the statutes' voting rights limitations and procedures. The exclusions generally cover: (i) transactions that, as a practical matter, do not carry the threat of a corporate takeover; (ii) transactions as to which director and collective shareholder approval are already required by another corporate law procedure; and (iii) transactions as to which equitable considerations argue against application of the Act. Each of the acquisitions described must be "made in good faith and not for the purpose of circumventing" the Act in order to qualify for the exclusion.

A. At a time when the corporation was not subject to this Article.

B. Pursuant to a contract entered into at a time when the corporation was not subject to this Article.

[<u>COMMENTARY TO SUBSECTION 3(e)(3)A and B.</u>] Subparagraphs 3(e)(3)A and B exclude share acquisitions that are made, or that result from a contract entered into at a time when the Act does not apply to the corporation. For constitutional and essential fairness reasons, the statute's provisions affecting control share voting power should only cover acquisitions (and contracts for acquisitions) which occur when the corporation is subject to the Act. Investors, then, can take it into consideration as they make their investment decisions. Conversely, acquisitions occurring, or contracts to acquire entered into, at a time when the corporation was not subject to the Act (either because the acquisition occurred before the effective date of the Act or because the corporation did not satisfy the definitional criteria of an issuing public corporation or had opted out) are excluded, even if subsequent events trigger application of the Act.

C. Pursuant to the laws of descent and distribution [citation, if desired].

[<u>COMMENTARY TO SUBSECTION 3(e)(3)C.</u>] Subparagraph 3(e)(3)C excludes shares acquired pursuant to the laws of descent and distribution. This is an exclusion contained in one form or another in all of the existing state control share statutes, and is based on the rationale that the acquisition of shares in such circumstances almost never alters the basic pattern of concentration of voting power in a corporation.

D. By a donee under an *inter vivos* gift.

[<u>COMMENTARY TO SUBSECTION 3(e)(3)D.</u>] Subparagraph 3(e)(3)D excludes shares acquired by a donee under an inter vivos *gift. The exclusion is present in several of the state control share statutes, although not the Indiana statute. The Joint Committee regards this exclusion as having a similar rationale to that of the previous subparagraph. An* inter vivos *gift—from one living*

person to another—does not typically involve a change in the factors affecting corporate control. It most closely resembles (except that there is no death involved) a grantor or testator pursuant to a will or otherwise transferring shares without consideration. The effect on the corporation and its other shareholders is ordinarily nil. Of course, the "good faith" and "circumvention" language of the introductory clause apply to prevent the abuse of this exclusion.

E. Pursuant to a transfer between or among immediate family members, or between or among persons under direct common control. An "immediate family member" is any relative or spouse of a person, or any relative of such spouse, who has the same home as such person.

[<u>COMMENTARY TO SUBSECTION 3(e)(3)E.</u>] Subparagraph 3(e)(3)E is an exclusion found only in the Model Act covering transfers between or among immediate family members, or between or among individuals or entities under direct common control. Control is typically presumed upon beneficial ownership of ten percent or more of voting power. Immediate family members, as well as commonly controlled persons, almost certainly will be included in the definition of "acquiring person" by virtue of the "group" concept, and such a transfer does not change the control balance in the corporation. In other words, separate shareholdings by immediate family members or persons commonly controlled, in all circumstances contemplated by the Joint Committee, will be aggregated for purposes of determining whether a control share acquisition has occurred or will occur. Transfers between and among these individuals or entities have little or no effect. The definition of "immediate family member" comes from the definition of "associate" in Rule 14a-1 under the 1934 Act.

F. Pursuant to the satisfaction of a pledge or other security interest.

[<u>COMMENTARY TO SUBSECTION 3(e)(3)F.</u>] Subparagraph 3(e)(3)F provides an exclusion for shares acquired in satisfaction of a pledge or security interest, again with the "good faith" and lack of circumvention motivation. This exclusion is described in the commentary to the Indiana statute as being necessary and appropriate because such pledges will normally be made by one or a relatively small number of shareholders who already own shares within one of the ranges of voting power covered by the Act, and foreclosure of the pledge will normally affect no fundamental change in the pattern or the concentration of voting power. All existing state control share laws contain a form of this exclusion.

G. Pursuant to a merger or plan of consolidation or share exchange effected in compliance with [citation], if the issuing public corporation is a party to the agreement of merger or plan of consolidation or share exchange.

[COMMENTARY TO SUBSECTION 3(e)(3)G.] Subparagraph 3(e)(3)G excludes a transaction in which the control shares are acquired pursuant to a merger, consolidation or share exchange where an issuing public corporation is a party to the agreement. Present in all state control share statutes enacted to date, this provision is based on the premise that a share acquisition using such methods will either already have been approved by shareholders or would meet one of the statutory exceptions to the shareholder approval process (such as short-form mergers and parent-subsidiary mergers). The Model Act exclusion also specifically includes consolidations, not contained in the Indiana statute (although present in certain of the other states' statutes), inasmuch as a consolidation is similar in all relevant respects to a merger or share exchange.

H. From any person whose previous acquisition of control shares would have constituted a control share acquisition but for this paragraph 3(e)(3) (other than this subparagraph 3(e)(3)H), provided the acquisition does not result in the acquiring person holding voting power within a higher range of voting power than that of the person from whom the control shares were acquired.

[COMMENTARY TO SUBSECTION 3(e)(3)H.] Subparagraph 3(e)(3)H accords an exclusion for the acquisition of shares from any person whose previous acquisition would have been a control share acquisition but for application of paragraph 3(e)(3) (that is, this paragraph containing the exclusions). This "previous exclusion" provision is included in most of the other state control share statutes. The parenthetical language is new, however, and prevents the use of this exclusion in more than one transfer. The Joint Committee believes there to be little justification in allowing this exclusion to apply indefinitely to a block of control shares where the transaction in which the block is acquired does not itself qualify for an exclusion. Also new is the language limiting the exclusion to transfers that do not result in a higher (unapproved) range of voting power. (See subsection 4(c).) "Range of voting power" refers to the categories established in subsection 3(d).

I. Acquisition by a person of additional shares within the range of voting power for which such person has received approval pursuant to Section 5 or within the range of voting power resulting from shares acquired in a transaction described in this paragraph 3(e)(3).

[COMMENTARY TO SUBSECTION 3(e)(3)I.] Subparagraph 3(e)(3)I is a provision unique to the Model Act, but may simply make explicit what is implicit in other control share statutes. It accords an exclusion to the acquisition by a person of additional shares within the range of voting power for which such person has already received stockholder approval, and within the range of voting power enjoyed by someone who acquired shares in a transaction excluded from the definition of "control share acquisition" under these subparagraphs. Again, "range of voting power" refers to the categories described in subsection 3(d). As an example of the application of this provision, all

of the shares acquired by a legatee of 22 percent of the outstanding stock of an issuing public corporation who then purchases in the market an additional ten percent, retain their full voting rights by virtue of subparagraph 3(e)(3)C (with respect to the 22 percent) and subparagraph 3(e)(3)I (with respect to the ten percent). The acquisition of another 2 percent, however, bringing the total to 34 percent, would constitute a control share acquisition and, under subsection 4(c), those shares that provide voting power of $33^{1}/_{3}$ percent and more would be sterilized.

J. An increase in voting power resulting from any action taken by the issuing public corporation, provided the person whose voting power is thereby affected is not an affiliate of the corporation.

[COMMENTARY TO SUBSECTION 3(e)(3)J.] Subparagraph 3(e)(3)J is another exclusion that has no counterpart in existing statutes. It covers what might be considered "passive threshold crossing" situations. This occurs where, by reason of actions taken by the issuing public corporation, the subject shareholder's voting power is changed to an extent that it exceeds a control threshold. The Joint Committee feels an express exclusion is appropriate for this situation, in that an increase in voting power that results from acts of the corporation—e.g., a redemption of shares, changes in share voting rights or capital structure, etc.—where the person holding shares whose voting power is affected thereby does not control the corporation's actions, should not constitute a "control share acquisition."

K. Pursuant to the solicitation of proxies subject to Regulation 14A under the Securities Exchange Act of 1934 or [citation to applicable state corporation statute].

[COMMENTARY TO SUBSECTION 3(e)(3)K.] Subparagraph 3(e)(3)K is an exclusion drafted by the Joint Committee to clarify that proxy solicitations are excluded from coverage of the Act. The exclusion refers to proxy solicitations both by 1934 Act reporting companies and by non-1934 Act companies that choose to be subject to the Model Act. Without such an exclusion, ordinary proxy solicitations would regularly result in a control share acquisition by the soliciting person in acquiring the power to direct the exercise of voting power of 20% or more. Proxy contests, while certainly having implications for corporate control, do not present the same threats to shareholder well-being that share acquisitions do.

Several other exclusions from the definition of control share acquisition that are contained in various of the existing state control share laws have not been included in the Model Act. Specifically, an exclusion for issuer benefit plans (as defined) was not adopted, in that management often is in a position to control the vote of those shares. Nor was the Joint Committee convinced of the need for an exclusion for resales by securities brokers or underwriters, which is found in several of the statutes. Finally, an exclusion covering acquisitions of control shares directly from the corporation is viewed by the Joint Committee as unduly favoring management

and evidencing a "business protectionism" motivation, particularly since it can be used as a first step in a management buyout series of transactions.

Perhaps the most significant difference between the Model Act and the Indiana statute with respect to exclusions is that the Model Act does not contain an exclusion for the acquisition from another person of control shares as to which shareholders previously granted voting rights pursuant to the Act. It was the Joint Committee's determination not to include such an exclusion on the basis that the purposes of a control share statute have more to do with the identity, characteristics and plans of the specific acquiring person than with the block of stock. Accordingly, shareholders acting collectively should determine whether the new acquiring person should be allowed voting rights, based upon information contained in the disclosure statement and other facts brought to the shareholders' attention. An undisclosed transferee of such person, who did not receive approval from the shareholders for the voting rights of the block of control shares, may be as objectionable to the shareholders as the prior control shareholder was unobjectionable. Further, even though the absence of a "previous approval" exclusion may restrict somewhat the holder's ability to alienate control shares that have become, in all respects, the same as all other shares of the corporation by virtue of the shareholder approval process, such person still has an opportunity under the Act to sell blocks that will not be denied voting rights (up to 20% of a corporation's shares to a person who holds no other shares), thus reducing the hardship involved in owning a large block of control shares.

(f) "Interested shares" means the shares of an issuing public corporation in respect of which any of the following persons may exercise or direct the exercise, as of the applicable record date, of the voting power of the corporation in the election of directors, other than solely by the authority of a revocable proxy:

(1) The acquiring person.

(2) Any officer of the issuing public corporation.

(3) Any employee of the issuing public corporation who is also a director of the corporation.

COMMENTARY TO SUBSECTION 3(f). The concept of "interested shares" is used in the Act for the purpose of identifying which shares will be permitted to vote on whether an acquiring person's control shares will be accorded voting rights, and is largely unrelated to the concept of "control shares." Even control shares that have been accorded voting rights pursuant to the procedures herein are voteless "interested shares" in a shareholder vote on a subsequent control share acquisition by the holder. The language of the definition, and the three categories of persons covered, are virtually identical to most existing state control share acts (with the exception of Wisconsin, which has only one threshold at one-fifth ($^{1}/_{5}$) beyond which voting power is

diminished by 90%, and which permits all persons to vote all of their shares on the voting rights resolution).

“Interested shares” under the Model Act are those owned, or the voting power of which is exercised or directed, by (i) the acquiring person; (ii) any officer of the issuing public corporation; and (iii) any employee of the issuing public corporation who is also a director of the corporation. The Joint Committee considered suggestions to expand the definition to include holders of 10% or more of the stock and outside directors, but was not persuaded of the need to disenfranchise either of these categories. The “direct the exercise” language is intended to cover situations involving beneficial ownership and ownership by immediate family members and commonly controlled persons, as well as entities (such as employee stock option plans and voting trusts) a majority of the trustees of which are persons described in this subsection.

The major premise underlying the “interested share” concept is that the right to approve the exercise of control of an issuing public corporation should rest with owners of the corporation whose interest in the decision is solely as a pre-transaction shareholder. As is pointed out in the Indiana commentary, the acquiring person's interest in the control share vote is obvious, and the interest of officers and “inside” directors is in preserving corporate positions which might be threatened by an acquisition. Thus, the shares held by these persons are “interested shares.” The U.S. Supreme Court's decision in the CTS case specifically held that the Indiana statute's definition of “interested shares” was consistent with that statute's shareholder protection purposes in that it disqualified both the acquiror and inside management of the target corporation from voting on whether to grant voting rights to the acquiror's control shares. Moreover, this is one of the ways the Model Act “protects the independent shareholder against both of the contending parties … further[ing] a basic purpose of the Williams Act, ‘plac[ing] investors on an equal footing with the takeover bidder [citations omitted]’.” 107 S. ct. 1645.

The Model Act's definition deals with two additional items: It clarifies the point in time at which the determination is made as to whether shares are “interested shares”—the record date. Most state statutes may be read as implying that this determination is made as of the meeting date. Also, the definition excludes from the category of “interested shares” those voted solely under the authority of a revocable proxy. This proviso appears necessary to permit management and the acquiring person to solicit proxies in connection with the meeting without thereby sterilizing those shares for the critical vote.

(g)

(1) "Issuing public corporation" means a domestic corporation that has

A. any securities registered under section 12 or is subject to section 15(d) of the Securities Exchange Act of 1934; and

B. either

(i) more than ten percent (10%) of its shareholders resident in [state];

(ii) more than ten percent (10%) of its shares owned by [state] residents; or

(iii) ten thousand (10,000) shareholders resident in [state].

(2) The residence of a shareholder is presumed to be the address appearing in the records of the corporation.

(3) Shares held by banks (except as trustee or guardian), brokers or nominees are disregarded for purposes of calculating the percentages and numbers in this subsection 3(g).

COMMENTARY TO SUBSECTION 3(g). Paragraph 3(g)(1) defines which corporations are "issuing public corporations" subject to the Act. While the Model Act follows certain of the definitional provisions of the Indiana statute, the definition in the Act differs in several significant respects.

As an initial matter, the company must be a domestic corporation, which is to say that it is subject to the state business corporation statute under which the Model Act will be adopted. Whereas the Indiana statute and the majority of the other state control share statutes restrict coverage to corporations chartered in those states, several states that enacted control share statutes after the CTS decision (Oklahoma, North Carolina, Massachusetts, Florida and Arizona) include within the coverage of their laws non-domiciled corporations with a strong economic nexus to the state. The emergence of post-CTS state control share laws that extended applicability to nondomestic corporations has resulted in vigorous calls for state preemption by some members of Congress and others, on the grounds that such laws would result in a "balkanization" of state takeover regulation. Where nondomestic corporations can be regulated by a state's control share statute, it is argued, a takeover offer for a particular corporation can be subject to the laws of more than one state involving conflicting requirements and procedures and making compliance with all of the applicable laws impossible.

In the CTS decision, the Supreme Court concluded that the Indiana Act did not create the risk of inconsistent state regulation, stating: "The Indiana Act poses no such problem. So long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one state. No principle of corporation law and practice is more firmly established than a state's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders." 107 S. ct. 1649.

In November 1987, the constitutionality of a state control share statute that sought to cover nondomestic corporations was addressed by a federal district court in TLX Acquisition Corp. v. Telex Corporation (No. CIV-87-2056-R; WD Okla. Nov. 3, 1987). In its decision, the court concluded that the Oklahoma control share statute, insofar as it sought to cover nondomestic corporations,

was unconstitutional under the Commerce Clause. The result in the TLX case may have been predicted from the CTS decision in which the Supreme Court stated: "We agree that Indiana has no interest in protecting nonresident shareholders of nonresident corporations." 107 S. Ct. 1651.

It remains unclear from the language of CTS whether additional nexus criteria—beyond the requirement of being a domestic corporation—are necessary to ensure the Commerce Clause constitutionality of a control share statute, or are only "make weight" items. Clearly, the inclusion of these additional nexus criteria creates a possibility that some publicly held corporations will not automatically qualify as issuing public corporations in any Model Act states. Moreover, these tests are rarely accurate in revealing the true extent of home-state shareholdings, due to the prevalence of beneficial (nominee) ownership. Some Joint Committee members would prefer to eliminate all shareholder nexus criteria. However, the Committee determined that it is appropriate to include the resident shareholders and resident share tests in the Act because of the CTS language which indicated that the shareholder nexus criteria reinforced the Indiana Law's constitutionality for Commerce Clause purposes. The court stated at 107 S. ct. 1652: "Moreover, unlike the Illinois statute invalidated in MITE, the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana. Thus, every application of the Indiana Act will affect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting."

Thus, the Model Act definition in subparagraph 3(g)(1)B, contains the identical three alternative criteria used in the Indiana statute requiring either: (i) more than 10% of the corporation's shareholders resident in the state; (ii) more than 10% of the corporation's shares held by state residents; or (iii) 10,000 resident shareholders.

One of the substantive changes from the Indiana statute's definition which was made by the Joint Committee has to do with economic (as opposed to shareholder) nexus criteria. As a matter of policy, the Committee determined that factors relating to principal place of business, substantial assets and number of employees—criteria that are present in most of the state control share statutes enacted to date—should not be included in the Model Act. The principal reason for the Committee's decision was that those factors smack of local business protectionism, an objective that the Joint Committee sought to avoid. Moreover, the presence of such criteria raise[s] Commerce Clause questions which, after CTS, can be avoided by applying the Act with reference only to the residency of the corporation and its shareholders.

The second major departure in the Model Act from the Indiana definition is the Joint Committee's decision to base automatic eligibility under the Act as an "issuing public corporation" on the domestic corporation's status as a reporting company under the federal 1934 Act. The Committee regards the Act as a safeguard for the rights of stockholders primarily of "public" companies, and not for those of close corporations and corporations with relatively few investors. Typically, companies with a small number of shareholders have a more personal relationship with them, and those stockholders often are more active in monitoring and even participating in, the affairs of the corporation. The 1934 Act's standard for delineating between a public company and one that might be regarded as "private" is commonly understood and easy to apply. Private companies are given the authority, however, to choose to be treated by the Act like a public company.

Accordingly, subparagraph 3(g)(1)A provides that the definition covers only corporations that have securities registered under Section 12 of the 1934 Act or are subject to Section 15(d) of the 1934 Act. These companies are automatically "issuing public corporations" unless they opt out. Reference was not included to companies under Section 12(b)(2)(G) of the 1934 Act (insurance companies), although states enacting a control share statute that wish to extend automatic coverage eligibility to such companies can do so by adding the phrase "or exempted from registration by s. 12(g)(2)(G) of that Act" at the appropriate place. The Joint Committee recognizes that many companies in regulated industries (e.g., banks, utilities, communications firms, etc.) are subject to special change of control requirements that may or may not be consistent with the Act's theme.

Paragraph 3(g)(2) follows language present in most of the state control share laws, including Indiana's, establishing a conclusive presumption for purposes of determining whether a corporation meets any of the three alternative "residency" requirements in subparagraph 3(g)(1)B. For pragmatic reasons it is presumed that a shareholder's residence is the address appearing in the records of the corporation, although the Committee acknowledges that this residency test is far from perfect. Such language is also consistent with provisions in most state business corporation laws prescribing where written notice to shareholders is to be directed.

Subparagraph 3(g)(3) is also patterned after comparable provisions in other state statutes. It provides that shares held by banks (except as trustee or guardian), brokers or nominees are disregarded for purposes of calculating the percentages or numbers of shareholders in the determination of whether a corporation is an "issuing public corporation" subject to the Act. The effect of this rather arbitrary rule is to prevent what would otherwise be the case for most publicly held companies with large percentages of their stock held in "street name"—that is, New York residency for the predominance of their shares and shareholders.

(h) "Person" means any individual, corporation, partnership, unincorporated association or other entity.

COMMENTARY TO SUBSECTION 3(h). Subsection 3(h) defines "person" consistent with the standard definitional language in most state business corporation laws to mean "any individual, corporation, partnership, unincorporated association or other entity."

Sec. 4. Voting Rights of Control Shares

Unless otherwise provided in the articles of incorporation before either a control share acquisition occurs or a disclosure statement is delivered, control shares that are the subject of a control share acquisition have only such voting rights as are accorded under this Section 4.

[COMMENTARY TO SECTION 4.] The heart of this Model Control Share Act is Section 4, which has the effect of reducing or eliminating entirely the voting power of control shares acquired in a control share acquisition unless those voting rights are restored pursuant to a procedure involving

a shareholder vote. The shareholders thus are given a collective role in determining whether a newly-acquired or to-be-acquired concentration of shares of an issuing public corporation will be permitted any influence in the governance of that corporation. As a practical matter, it forces the acquiring person to (1) negotiate with the corporation's board of directors regarding a proposed change of control; or (2) persuade the corporation's shareholders (by making a sufficiently favorable offer or otherwise) to approve the acquiring person's voting power. Such a result tends to reduce the coercive aspects of a hostile tender offer, while furthering the philosophical rationale for this statute of permitting pre-transaction shareholders of the corporation to deal with the acquiring person collectively. Also, it is presumed that such an effect will encourage more equitable distribution of the control premium.

The section begins with an express "opt-out" clause permitting a corporation that would otherwise be subject to the voting rights limitations of the statute, through amendment to its articles of incorporation (by the ordinary means provided in the corporate law), to make this Article inapplicable. Such action must be taken prior to the time a control share acquisition occurs or a disclosure statement is delivered to avoid implicating the "opt-out" decision in the control share voting procedure. Most of the existing state control share laws (all but Hawaii and North Carolina) include opt-out provisions, although some of these permit an opt-out by amendment to the bylaws rather than the corporate charter. The Joint Committee believes that the decision whether this statute will or will not apply to the corporation should be made by the shareholders. See also Section 6 and Commentary thereto.

(a) Subject to subsections (b)-(d) of this Section 4, the voting power of control shares having voting power of one-fifth ($^1/_5$) or more of all voting power is reduced to zero unless the shareholders of the issuing public corporation approve a resolution pursuant to the procedure set forth in Section 5 according the shares the same voting rights as they had before they became control shares.

<u>COMMENTARY TO SUBSECTION 4(a)</u>. This is the operative subsection of the statute. It clarifies an ambiguity found in a number of the state statutes, including Indiana's, as to exactly what happens to the voting rights of control shares in a control share acquisition. Some of the statutes, cryptically, state that such control shares "have only such voting rights as are conferred" by this chapter. The Model Act makes absolutely clear that, except as otherwise provided in the Act, such shares have no voting rights, unless they are approved by the disinterested shareholders.

(b) Except as provided in subsection 5(g), the voting power of control shares representing voting power of less than one-fifth ($^1/_5$) of all voting power is not affected by this Article.

<u>COMMENTARY TO SUBSECTION 4(b)</u>. The Joint Committee chose a different approach to sterilization of control shares from that found in the Indiana statute and most other state control share laws. Rather than reducing to zero the voting rights of the shares acquired in a transaction

(or series of transactions within 90 days) that carries the acquiring person over the control share threshold, leaving the earlier acquired shares with full voting rights, this subsection provides that the voting power of all shares up to 20 percent is not affected by this Article. Thus, for example, an acquiring person under the Indiana statute who, for reasons that are entirely immaterial to the purposes of the statute, goes from 13 percent to 21 percent shareholdings within the applicable 90-day period, loses the voting power of all shares except the previously acquired 13 percent; the result for the same shareholder under the Model Act is the loss of voting power for only the last one percent. The Joint Committee believes there is very little utility in trying to identify the transaction that takes an acquiring person over the threshold and to sterilize the shares involved in that transaction. Under the Model Act, the voting power of control shares representing voting power of less than 20 percent may be exercised, except (as the introductory phrase cautions) in connection with the approval vote.*

(c) If control shares of the acquiring person previously have been accorded (pursuant to the procedure set forth in Section 5) the same voting rights they had before they became control shares, or if such control shares were acquired in a transaction excluded from the definition of "control share acquisition," then only the voting power of control shares acquired in a subsequent control share acquisition by such acquiring person within a higher range of voting power shall be reduced to zero.

COMMENTARY TO SUBSECTION 4(c). Another ambiguity the Model Act attempts to correct is whether the voting power of control shares, once restored in accordance with the shareholder vote procedure, may be again eliminated by a subsequent control share acquisition. This subsection provides that once control shares have been accorded by shareholder vote the same voting rights they had before they were originally sterilized, or if such control shares were acquired in an excluded transaction, the shares retain those voting rights even when the acquiring person exceeds another control share threshold. Thus, the shareholder approval granted with respect to the voting rights of a 26 percent holder applies up to $33^{1}/_{3}$ percent, and it is only the voting power of shares in excess of that next threshold that is then reduced to zero. Similarly, shares acquired in an inter vivos gift of 39 percent and the acquisition by the donee of up to another 11 percent retain their voting rights, even if their owner acquires additional shares beyond the majority threshold. It is only the voting rights of shares in excess of that majority threshold that are sterilized. See subparagraph 3(e)(3)I.

(d) The voting rights of control shares are restored to those accorded such shares prior to the control share acquisition in any of the following circumstances: (1) if, by reason of subsequent issuances of shares or other transactions by the issuing public corporation, the voting power of those control shares is reduced to a range of voting power for which approval has been granted or is not required; or (2) upon transfer to a person other than an acquiring person; or [(3) the expiration of three years after the date of a vote of

shareholders pursuant to Section 5 failing to approve the resolution according voting rights to those control shares].

<u>COMMENTARY TO SUBSECTION 4(d)</u>. In addition to the shareholder approval procedure as provided under Section 5 of the Model Act, the statute permits the restoration of voting power of control shares in the following circumstances: (1) Where the issuing public corporation engages in a transaction, such as the issuance of additional shares, causing the voting power of control shares to be reduced to a lower range of voting power for which shareholder approval has already been granted, or for which no approval is necessary (i.e., less than 20 percent); or (2) where the control shares are transferred to someone whose percentage of shareholdings will not exceed 20 percent; or [(3) three years have expired after a shareholder vote failing to approve the voting rights resolution with respect to those shares].

The rationale for the first of these provisions is that the issuing public corporation is entirely responsible for taking the action that reduced the voting power of control shares to noncontrol level. Indeed, if someone else were to acquire the same resulting percentage, no control share acquisition would have occurred. The second provision merely makes explicit what probably is evident anyway: Shares that constituted control shares in the hands of an acquiring person become shares with ordinary voting rights in the hands of someone who has not made and does not propose to make a control share acquisition. The third provision is entirely new. It is intended to deflect criticisms voiced as to other control share statutes to the effect that perpetual sterilization of control shares is inequitable and confiscatory.

The bracketed language in the text of subsection 4(d) reflects the Joint Committee's inability to reach a clear consensus on whether voting rights of control shares should be restored after some period of time, even where the vote of disinterested shareholders to do so has failed to gain approval. Those who favor automatic restoration after three years point to the hardship and fundamental unfairness of perpetual sterilization of the shares, noting that three years is long enough to eliminate the coercion and abuses that can accompany partial tenders and other fractional acquisitions of control. Those who do not favor the provision argue that restoration of voting rights after three years without approval of disinterested shareholders is inconsistent with the statute's fundamental purpose, and would discourage other offers during the three-year waiting period. In any event, because the Act does not affect the voting rights of control shares up to 20 percent (subsection 4(b)), acquisition of 81 percent of the outstanding stock provides voting control notwithstanding the sterilization—for three years or forever—of the remaining 61 percent, since 19.9 percent then becomes an absolute majority of the shares still capable of voting. Because the Committee was divided on this issue, it was decided to include the proposal in bracketed form. Jurisdictions considering adopting the Model Act must reach their own decision on this issue.

[*] Ohio is the oldest of the state control statutes and, in concept, served as the original model. The major difference between the Ohio law and those that followed, however, is that Ohio actually prevents the acquisition of control shares, and not just the exercise of their voting rights, unless the shareholders grant approval. This prohibition against the purchase of shares regarded as

conveying control was at the heart of the court's decision in Fleet Aerospace Corp. v. Holderman, 796 F.2d 135 (6th Cir., 1986) holding the Ohio statute to be an unconstitutional interference with interstate commerce. The Sixth Circuit Court of Appeals is now reviewing its decision in light of CTS.

Sec. 5. Approval Procedure

(a) Any acquiring person who proposes to make a control share acquisition may, and any acquiring person who has made a control share acquisition shall, publish in a newspaper of general circulation and deliver to the issuing public corporation at its principal office a disclosure statement. To be regarded as a disclosure statement, the document must set forth all of the following:

(1) The identity of the acquiring person;

(2) A statement that the disclosure statement is delivered pursuant to this Article;

(3) The number of shares of the issuing public corporation owned (directly or indirectly) by the acquiring person, the acquisition dates and the prices at which such shares were acquired;

(4) The voting power to which the acquiring person, except for Section 4, would be entitled;

(5) A form of the resolution to be considered by the shareholders hereunder; and

(6) If the control share acquisition has not yet occurred

A. a description in reasonable detail of the terms of the proposed control share acquisition; and

B. representations of the acquiring person, together with a statement in reasonable detail of the facts upon which they are based, that the proposed control share acquisition, if consummated, will not be contrary to law, and that the acquiring person has the financial capacity to make the proposed control share acquisition.

COMMENTARY TO SUBSECTION 5(a). Section 5 follows very closely the procedure for approval of voting rights of control shares found in the Indiana statute and many of the other state laws. The

Joint Committee has made few substantive changes, although certain procedural problems and ambiguities of the Indiana law have been dealt with.

The procedure begins with the publication and delivery to the issuing public corporation of a "disclosure statement" by an acquiring person. Unlike the comparable Indiana provision, in order to set the shareholder voting procedures in motion, this is made a mandatory procedure on the part of any acquiring person who has made a control share acquisition, and is optional on the part of a person who proposes to make a control share acquisition. Of course, an acquiring person who has acquired no shares but proposes to do so, and who does not publish and deliver a disclosure statement, does not invoke the shareholder voting procedures. The publication requirement (which is not found in the Indiana law) is designed to prevent an acquiring person who proposes to make, but who has not yet made, a control share acquisition from initiating the shareholder voting procedure without cost or serious consequence to the acquiring person. Such action might otherwise be employed simply to put the company "in play" without any real intent to follow through with the control share acquisition. The publication requirement is intended to invoke Rule 14d-2(b) under the 1934 Act which deems a public announcement of this type to constitute the commencement of a tender offer for purposes of Section 14(d) of the 1934 Act. The subsection goes on to identify the information (which is virtually the same as in the Indiana statute) that must be included in the disclosure statement. If the document does not contain all such information, it is not regarded as a disclosure statement and does not trigger the procedure that follows receipt of a disclosure statement. But, unlike the Indiana statute, failure to file a disclosure statement does not establish a redemption right on the part of the corporation. More generally, failures of compliance with the procedures established in this section of the Act can be remedied like any other breach of statutory corporate law—by resort to the courts.

(b) If the directors of the issuing public corporation so order, or if the acquiring person so requests at the time of delivery of a disclosure statement and gives an undertaking to pay the issuing public corporation's expenses in connection therewith, a special meeting of shareholders of the issuing public corporation must be called within ten (10) days after delivery of the disclosure statement for the purpose of considering the resolution relating to the voting rights to be accorded the shares acquired or to be acquired in the control share acquisition. Unless both the acquiring person and the issuing public corporation agree in writing to another date, the special meeting of shareholders must be held not sooner than thirty (30) days nor later than fifty (50) days after receipt by the issuing public corporation of the request or order for a special meeting.

COMMENTARY TO SUBSECTION 5(b). Delivery of a valid disclosure statement begins the shareholder voting procedure. A special meeting of shareholders for the purpose of considering a resolution according voting rights to the control shares must be called within ten days if either the acquiring person so requests when delivering its disclosure statement (provided an undertaking is

given by the acquiring person to pay the costs of the meeting), or if the directors of the issuing public corporation so order. The Joint Committee feels that the latter procedure, probably available under most state business corporation statutes anyway, ought to be explicitly applicable in these circumstances. The timing of the special meeting is designed to coordinate with time periods prescribed under the federal Williams Act. in particular, the special meeting must be held within 50 days of the request, unless otherwise agreed by the company and acquiring person, in order to fall within the 60-day period after which tendering shareholders must be granted withdrawal rights under Section 14(d)(5) of the 1934 Act. The 30-day minimum period, applicable unless otherwise agreed, permits sufficient time for the solicitation of proxies and other tasks necessary to prepare for and conduct the meeting.

Both the procedural and timing aspects of this subsection are structured to be consistent with the Indiana Act's provisions, regarding which the CTS decision observed: "Unlike the MITE statute, the Indiana Act does not give either management or the offeror an advantage in communicating with the shareholders about the impending offer. The Act also does not impose an indefinite delay on tender offers." 107 S. Ct. 1646.

(c) If no special meeting of shareholders is called pursuant to subsection 5(b), the resolution relating to the voting rights to be accorded the shares acquired in the control share acquisition must be presented to the next special or annual meeting of shareholders.

COMMENTARY TO SUBSECTION 5(c). In the absence of a request for a special shareholders meeting by the acquiring person, the directors need not call such a meeting and the voting rights resolution will be presented at the next annual shareholders meeting or special meeting called for any purpose. This assures that the issue will be considered by shareholders at the next opportunity, whether or not the acquiring person wants the process to move more slowly. Control share voting rights that are approved at one meeting cannot be affected by a subsequent vote, except as provided in subsection 5(h) involving competing control share acquisitions.

(d) If a special meeting is called, notice of the special meeting of shareholders must be given as promptly as reasonably practicable by the issuing public corporation to all shareholders of record as of the record date set for the meeting. If the special meeting was requested by the acquiring person, the directors shall set the record date on a date not later than 15 days after the request was received by the issuing public corporation.

COMMENTARY TO SUBSECTION 5(d). Notice of a special shareholders meeting must be given promptly after the meeting is called. The record date will be established on a date not later than 15 days after the request for a special meeting was received. This is the date for determination of whether shares constitute "interested shares" under subsection 3(f). It may be in the interests of the issuing public corporation to set an earlier record date, however, in order to try to reduce the drift of shares into the hands of arbitrageurs and other takeover speculators whose vote in the

approval process may be dictated solely by short-term considerations. The 15-day period is intended to facilitate, if necessary, the beneficial owner inquiry provided for in Rule 14a-13 under the 1934 Act.

(e) Notice of the special meeting, or the annual meeting if no special meeting is called, must include or be accompanied by

(1) A copy of the disclosure statement;

(2) A statement by the board of directors of its position or recommendation, or that it is taking no position or making no recommendation, with respect to the resolution contained in the disclosure statement; and

(3) A description of any dissent and appraisal rights or any redemption procedure that may accompany or result from the vote of shareholders.

<u>COMMENTARY TO SUBSECTION 5(e)</u>. The notice of the special meeting must include, in addition to a copy of the acquiring person's disclosure statement and a position statement of the board of directors, a description of any dissent and appraisal rights or any redemption procedure that may accompany of result from the shareholder vote. Although the Joint Committee determined not to include in the Model Act either of the latter provisions for the reasons hereinafter discussed (<u>see</u> "ADDITIONAL COMMENTARY"), some states may choose nevertheless to insert dissent and appraisal rights and/or a redemption procedure or may apply general corporate law procedures to this transaction. And if they do, these provisions ought to be described in the notice. Of course, if the issuing public corporation is subject to the proxy requirements of Regulation 14A (which will usually be the case), the shareholders will receive considerably more information.

(f) Any other provisions of this Article notwithstanding, a proxy relating to a meeting of shareholders to be held pursuant to this Section 5 must be solicited separately from the offer to purchase or solicitation of an offer to sell shares of the issuing public corporation.

<u>COMMENTARY TO SUBSECTION 5(f)</u>. One criticism of the Indiana statute and other state control share acquisition laws involves the strategy of soliciting revocable proxies along with a tender of the shares in the tender offer. The acquiring person's acquisition of proxies from shareholders of record who tender has the effect of undermining the basic premise of the statute—that is, facilitating a collective decision by the pre-transaction shareholders on a change of control. Subsection 3(f) excludes from the definition of "interested shares" shares in respect of which voting power may be exercised or directed solely by the authority of a revocable proxy. This is to avoid the unintended consequence of requiring all shareholders to attend in person the meeting of shareholders, in order to prevent disenfranchisement of their shares by giving their proxy to an

officer or director of the issuing public corporation. If proxies are to be solicited for purposes of the approval vote, therefore, both the acquiring person and the issuing public corporation will be on equal footing in having to make a separate solicitation.

(g) All votes cast at the meeting for or against the resolution contained in the disclosure statement must be identified as non-interested shares. To be approved, the resolution must receive the affirmative votes of a majority of all voting power, excluding all interested shares. If the resolution is not approved, the acquiring person not sooner than six months thereafter, may present a new resolution for a vote of shareholders in accordance with this Section 5 at any subsequent shareholders meeting as long as the voting power of the control shares described in the resolution is reduced.

COMMENTARY TO SUBSECTION 5(g). This subsection sets forth the vote that must be obtained to approve a resolution granting voting rights to control shares. Unlike Indiana's statute, which requires two separate majority votes in circumstances in which the control share acquisition would effectuate changes in classes of shares, the Model Act calls for one affirmative majority vote in all cases. The sole voting requirement is a majority of all voting power, excluding all shares owned by the acquiring person or any officer or director/employee of the issuing public corporation. The Joint Committee considered and rejected the inclusion of the second shareholder vote requirement provided for in the Indiana Act (consisting of a majority of all voting power—that is, all shares authorized to vote in the election of directors by whomever owned). The Committee concluded that such a requirement would give undue weight to management votes and effectively require the acquiring person to purchase the control shares, rather than use a conditional tender offer. Thus, the Joint Committee believes it appropriate to determine, by the single vote provided for in subsection 5(g), the sentiments of shareholders of the issuing public corporation who are "disinterested" in the transaction, in the sense that neither the voting rights of their shares nor their position with the company will be affected by the vote.

The vote of disinterested shareholders to determine whether voting rights will be accorded control shares is the heart of the Indiana Act which provided the shareholder protection rationale for upholding its constitutionality in the CTS case. The Court, contrasting the Indiana Act with the Illinois statute struck down in MITE, stated "… [T]he statute now before the Court protects the independent shareholder against both of the contending parties. Thus, the Act furthers a basic purpose of the Williams Act, 'plac[ing] investors on an equal footing with the takeover bidder,' " [citations omitted]. 107 S. Ct 1645. The Court went on to state: "The Indiana Act operates on the assumption, implicit in the Williams Act, that independent shareholders faced with tender offers often are at a disadvantage. By allowing such shareholders to vote as a group, the Act protects them from the coercive aspects of some tender offers." 107 S. Ct. 1646.

The theme of collective decision-making on a change of control was repeated in the CTS decision at 107 S. Ct. 1651 where the court stated: "The primary purpose of the Act is to protect the shareholders of Indiana corporations. It does this by affording shareholders, when a takeover offer

is made, an opportunity to decide collectively whether the resulting change in voting control of the corporation, as they perceive it, would be desirable."

Several states have added additional requirements to the approval of voting rights for control shares (or even convening the shareholders meeting to vote on the proposition) that the Joint Committee considered and rejected for the Model Act. Four states (Arizona, Hawaii, Minnesota and Ohio) mandate the consummation of the control share acquisition within a specified period of time following the approval vote, or else the vote becomes void. Two of these states (Arizona and Minnesota) also require that the acquiring person must have definitive financing arrangements in place at the time the disclosure statement is delivered or no special meeting of shareholders is called. The Joint Committee was not convinced of the benefits of these provisions and did not include them.

The last sentence of the subsection was added to mitigate the punitive effects of a negative vote. This provision, unique to the Model Act, permits a new voting resolution to be presented to the shareholders again, but not sooner than six months after the resolution was defeated. The Joint Committee feels this procedure accommodates changed circumstances and provides fairness to the acquiring person.

(h)

(1) For purposes of this subsection 5(h), "competing control share acquisition" means a control share acquisition or proposed control share acquisition that is the subject of a disclosure statement delivered to the issuing public corporation under subsection 5(a) not less than 25 days prior to the scheduled annual or special meeting date which has been or is required to be established under subsection 5(g) with respect to a pending control share acquisition.

(2) In the event that a competing control share acquisition is made or proposed, the issuing public corporation shall, at the option of the acquiring person making the competing control share acquisition, call for a vote of shareholders to consider the resolution relating to the voting rights of the competing control share acquisition at the same meeting as has been or is to be called to consider the voting rights of the pending control share acquisition. In the event the acquiring person making the competing control share acquisition does not elect in writing to have the resolution relating to the voting rights of the competing control share acquisition considered at the same meeting, any vote shall be held as provided in subsection 5(c) except that in such case no vote may be called on the competing control share acquisition

prior to the earlier of the vote on the resolution relating to voting rights of the pending control share acquisition or 51 days after receipt by the issuing public corporation of the request for a meeting by the acquiring person making the pending control share acquisition.

(3) If more than one resolution relating to a control share acquisition is to be considered at any meeting or at meetings scheduled for or occurring on the same day, all such resolutions relating to the voting rights of acquiring persons shall be considered by shareholders in the order in which the initial disclosure statements relating to such control share acquisitions were delivered to the issuing public corporation. However, no resolution approved by shareholders shall become effective until midnight of the date on which the respective shareholder approval occurs.

(4) If resolutions relating to two or more control share acquisitions are subject to shareholder vote under subsection 5(g), shares held by an acquiring person are considered interested shares only for purposes of a vote on a resolution relating to a control share acquisition by that same acquiring person.

COMMENTARY TO SUBSECTION 5(h). The procedure under this subsection is designed to deal with a "competing control share acquisition"—meaning a control share acquisition that invokes the shareholder voting procedure of an issuing public corporation before the voting rights of control shares that are the subject of a prior control share acquisition have been restored. This subsection was repealed and recreated by the Joint Committee, effective August 1, 1989, based on an analysis and draft language contained in a comment letter submitted in connection with the Chicago Bar Association's evaluation in early 1989 of proposed takeoverrelated legislation in Illinois. The revised provision removes a delay feature that was contained in the original version of the subsection and provides a mechanism for simultaneous consideration of multiple competing bids. Under the revised provision, once a competing control share acquisition is interjected, shareholders are given the right to vote on resolutions relating to all acquisition proposals at the same meeting, provided that any competing bid is the subject of a disclosure statement delivered to the issuing public corporation not less than 25 days prior to the scheduled date of the meeting on the pending control share acquisition.

If a bidder does not meet the 25 day deadline (thus not meeting the competing bid definitional criteria), or if the 25 day deadline is met but the competing bidder elects in writing not to have its bid considered at the same meeting, no shareholder vote can be called regarding the subsequent competing bid until after the vote on the pending control share acquisition. Then if a resolution relating to a pending control share acquisition receives the requisite shareholder vote to grant full

voting rights, actions with respect to a subsequent competing control share acquisition have no effect on the prior control shares (which had been granted full voting rights).

The language in paragraph (3) provides that multiple resolutions considered at the same meeting or separate meetings on the same day become effective simultaneously and that any procedural or timing machinations which may be attempted (adjourned meetings, late night meetings to cause the votes to occur on separate calendar days, etc.) cannot be used to cause the second acquiring person's resolution to become effective first, unless the first acquiring person's resolution has been defeated.

Under the language in paragraph (4), where two or more unconsummated control share acquisitions are pending, the shares of an acquiring person are not "interested shares" except with respect to the vote to restore that acquiring person's voting rights. They are sterilized, however, at a 20 percent or greater level.

(i) All provisions of [the state business corporations act] that are not inconsistent with the procedures set forth in this Section 5 shall apply to the meeting of shareholders of the issuing public corporation.

COMMENTARY TO SUBSECTION 5(i). It is intended that nonconflicting provisions of the state business corporation act will apply, in addition to the procedures set forth in this Section 5, to the meeting of shareholders of the issuing public corporation.

Sec. 6. Special Minority Shareholder Rights

(a) This section applies to all transactions that, but for subparagraphs 3(e)(3)A and B, would be control share acquisitions in which

(1) The acquiring person is or includes an affiliate of the issuing public corporation;

(2) The corporation has, by a provision in its articles of incorporation adopted within the prior 12 months, elected not to be subject to this Article; and

(3) The acquiring person has acquired a majority or more of all voting power.

(b) Within 30 days after a control share acquisition subject to subsection 6(a) occurs, the acquiring person must make a written offer to purchase the shares of each remaining shareholder at a price at least equal to the highest price at which the control shares were acquired by the acquiring person within the 12 months immediately preceding the offer.

<u>COMMENTARY TO SECTION 6</u>. This section, which is not found in other state control share statutes, is intended to prevent abuses of the opt-out procedure in Section 4. It was prompted by the Joint Committee's concern that those who control an issuing public corporation can deny disinterested shareholders the protections afforded by this Act and circumvent the requirement for a vote of disinterested shares by bringing about a shareholders' vote to opt out of the Act as the first step of a control share acquisition. Without such a provision in the Act, management would have the power, given its influential role in the corporate voting process, to accomplish through an amendment to the articles of incorporation that which it could not accomplish through a vote of the disinterested shareholders. Particularly where management already holds substantial voting power, the amendment to the articles opting out could be effected over the opposition of a majority of the disinterested shares. This result not only would frustrate the central purpose of the Act, it might also be viewed as giving management an unfair advantage over other potential acquirers.

To address this problem, Section 6 requires that if an affiliate of the corporation—one who controls the management and policies, such as officers and directors—alone or with others, acquires a majority or more of the voting shares within one year of a vote to opt out of the Act, the acquiring person must offer to purchase all the remaining shares at a price no lower than the highest price paid for the acquired shares by the acquiring person during the past year. The Joint Committee believes this approach safeguards the rights of disinterested shareholders without depriving the corporation of the flexibility to opt out of the Act for what might be legitimate reasons.

Sec. 7. Severability

The provisions of this Article are severable. If any provision is invalid, or if its application to any person or circumstance is invalid, such invalidity shall not affect other provisions or applications which can be given effect without the invalid provision or application.

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<u>Additional Commentary</u>

<u>Redemption of Acquired Control Shares</u>. The Model Act does not provide for the redemption of control shares by the issuing public corporation. The Indiana law permits such mandatory redemption, if authorized in the corporation's articles of incorporation or bylaws before the occurrence of the control share acquisition, within 60 days after the last acquisition of any control shares by the acquiring person if no disclosure statement has been delivered to the corporation. The Model Act, unlike the Indiana Act, makes the delivery of a disclosure statement mandatory where a control share acquisition has occurred. Thus, the Joint Committee

determined that this provision is not necessary within the framework of the Model Act to influence an acquiring person to deliver a disclosure statement and, in fact, is meaningless in that context.

Furthermore, the Indiana statute, along with those of 11 other states, permits mandatory redemption by the issuing public corporation, if authorized in the corporation's articles of incorporation or bylaws before the occurrence of the control share acquisition, of control shares which are not accorded full voting rights by the shareholders. The Joint Committee again rejected this procedure, in that a mandatory redemption provision of this kind may be regarded as providing a statutory basis for “greenmail” or “redemption premium” payments from the corporation to the acquirer which could be ethically undesirable, financially burdensome to the corporation and discriminatory to the shareholders. Alternatively, a low redemption price could be set by the corporation, for example disregarding all recent market price increases, which could be unfair or even punitive to the acquiring person, notwithstanding that the acquiring person would know, in advance, of the possibility of mandatory redemption at a price to be determined by the corporation.

Further, if the restoration provision of paragraph 4(d)(3) is adopted, acquired control shares will regain full voting rights within a three-year period under the Act. Thus mandatory redemption under such circumstances is unnecessary, and is inconsistent with that provision.

Dissent and Appraisal Rights. The Model Act does not provide any special dissenters' rights. Indiana and nine other states offer dissent and appraisal rights under which dissenting shareholders may receive “fair value” for their shares which is not less than the highest price per share paid by the acquiring person in the control share acquisition. The Indiana statute's special dissenters' rights are available, unless the issuing public corporation's articles of incorporation or bylaws provide to the contrary prior to the acquisition, if the acquiring person's control shares give it a majority or more of all voting power. Payment of the aggregate amount of such “fair value” may be an unreasonable and burdensone financial obligation on the corporation to the detriment of both the corporation and its continuing shareholders. In addition, such special dissenters' rights are not necessary to protect shareholders from a newly dominant shareholder, since the disinterested shareholders, in voting to return full voting power to the acquirer,

already will have had an opportunity to protect themselves through collective action, as envisioned by the Supreme Court in the CTS decision.

Notwithstanding the absence or presence of a special dissenters' rights provision in the Model Act, the corporation law of many jurisdictions, including Indiana, normally provides dissenters' rights of general applicability. These statutory procedures usually permit shareholders who register a dissent to certain transactions that are subject to shareholder vote to receive the “fair value” of their shares, but without the special definition of “fair value” that is contained in the Indiana control share statute's special dissenters' rights provision. Whether such general dissenters' rights provisions would apply to a control share acquisition vote, and how those rights would be enforced, is a matter for determination on a state-by-state basis. In any event the Model Act would not affect the normal operation of any state's corporation law in this regard, and general dissenters' rights would be available to the extent that the state deems such rights appropriate.