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BILL ANALYSIS

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Senate Bill 357 (as passed by the Senate) *(enacted version)*
Sponsor: Senator John Pappageorge
Committee: Banking and Financial Institutions

Date Completed: 6-4-13

RATIONALE

Chapter 7A of Michigan's Business Corporation Act pertains to business combinations and includes protections against hostile takeovers of corporations. (Generally, a business combination is a corporate merger, conversion, or consolidation, a transfer outside the normal course of business of corporate assets valued at 10% or more of the corporation's net worth, an issuance or transfer of equity securities of 5% or more of the total market value of the corporation's outstanding shares, or the adoption of plan for corporate liquidation or dissolution.)

An issue concerning the voting requirements in Part 7A has been raised. Section 780 requires a two-tiered supermajority vote for a business combination: 1) approval of 90% of the each class of stock entitled to a vote, and 2) approval of two-thirds of each class of stock entitled to be voted, *except* shares owned by "interested shareholders". Section 781 sets forth conditions that, if met, exclude a business combination from the vote requirements in Section 780. If a supermajority vote is not required by virtue of Section 781, then the default voting rules apply (either a vote by simple majority or as otherwise determined by the corporation or statute). (These provisions are detailed in **BACKGROUND**, below.)

Although the supermajority requirement in Section 780 evidently was aimed at preventing shareholders who purchased corporate stock on the open market from effectuating a hostile business combination, it has been pointed out that this safeguard also prevents "friendly" business combinations (situations that involve shareholders who purchased stock from the corporation rather than on the open market). This is due to the definition of "interested shareholder" in Part 7A (described below). As a result, a minority of shareholders can block both hostile and "friendly" business combinations.

It has been suggested that the Act should exclude shares purchased from a corporation from the determination of interested shareholder status, so shareholders who purchased shares from a corporation can participate in votes for a "friendly" business combination.

CONTENT

The bill would amend Chapter 7A of the Business Corporation Act to narrow the definition of "interested shareholder" for purposes of a shareholder vote on a business combination.

Under Chapter 7A, an "interested shareholder" is a person who either is the beneficial owner of at least 10% of the voting power of the outstanding voting shares of a corporation, or is an affiliate of the corporation who, at any time within the preceding two-year period, was the beneficial owner of at least 10% of the voting power of the then-outstanding voting shares of the corporation at the time. To determine if a person is an interested shareholder, the Act provides a standard to calculate voting shares. The number of a person's shares that are considered to be outstanding includes all voting shares owned by that person, except shares that are issuable. (Outstanding shares are those that have been purchased by investors and are held by them.)

The bill would add a second factor for

determining whether a person is an interested shareholder. The bill provides that voting shares that a person acquired, either from the corporation or in a public offering by or on behalf of the corporation, would not be considered outstanding or beneficially owned by that person unless the board of the corporation determined otherwise in a resolution adopted before the person acquired the shares. (That is, shares acquired from a corporation, rather than on the open market, generally would not count toward the calculation for an interested shareholder.) This provision would apply regardless of whether a person acquired the voting shares before or after the bill's effective date.

MCL 450.1778

BACKGROUND

Under Section 780 of the Business Corporation Act, a business combination typically requires an advisory statement from the board, and a two-tiered supermajority vote: approval by at least 90% of the votes of each class of stock entitled to be cast by the shareholders; as well as approval by at least two-thirds of the votes of each class of stock entitled to be cast by the shareholders other than voting shares owned by an interested shareholder, or an affiliate, who is a party to the business combination.

Under Section 781, if certain conditions are met, the two-tiered supermajority vote under Section 780 is not required. If this exception is triggered, Section 441 controls; this section provides that an action to be taken by vote of the shareholders must be authorized by a majority of the votes cast, unless the corporation's articles of incorporation, or another section of the Act, require a greater vote.

To qualify under Section 781, the amount of any consideration that common stock shareholders will receive in the business combination must be at least equal to the higher of the following: 1) the highest per-share price that the interested shareholder paid within the two-year period immediately before the announcement date of the proposal of the business combination, or in the transaction in which the shareholder became an interested shareholder, whichever is higher; or 2) the market value per share of common stock of the same class or series on the announcement date or on the determination date, whichever is higher.

Also, the amount of any consideration to be received by holders of shares other than common stock must be at least equal to the highest of the following: 1) the highest per-share price that the interested shareholder paid within the two-year period immediately before the announcement date of the proposal of the business combination, or in the transaction in which the shareholder became an interested shareholder, whichever is higher; 2) the highest preferential amount per share to which the shareholders are entitled in the event of liquidation, dissolution, or winding up of the corporation; or 3) the market value per share of common stock of the same class or series on the announcement date or on the determination date, whichever is higher.

Any consideration must be in cash or in the same form as the interested shareholder paid for shares of the same class of stock.

Finally, specific conditions must be met after the interested shareholder becomes an interested shareholder and before the business combination is consummated. These include the following: 1) any full periodic dividends on outstanding preferred stock are declared and paid at the regular date; 2) the annual rate of dividends paid on non-preferred stock is not reduced, and the annual rate of dividends is increased to reflect changes that reduce the number of outstanding shares; 3) the interested shareholder does not receive benefits from the corporation, except proportionately as a shareholder; 4) the interested shareholder does not become the beneficial owner of additional shares except as part of the transaction that resulted in that person's status as an interested shareholder, or by virtue of proportionate stock splits or stock dividends; and 5) there are at least five years between the date of becoming an interested shareholder and the date of the business combination consummation.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The definition of "interested shareholder" in Part 7A, and its two-tiered supermajority vote requirements for a business combination, can have a negative impact on Michigan companies that are owned by majority shareholders who purchased shares from the corporation. The language is so broad that it covers "friendly" as well as hostile business combinations. Minority shareholders can block friendly business combinations to the detriment of other shareholders.

Further, these difficulties may give Michigan corporations an incentive to leave the State. Reportedly, for example, Flagstar Bank has found the Act's provisions for business combinations an impediment in transactions. Flagstar is the largest bank headquartered in Michigan, and has assets of approximately $14.1 billion, according to *Crain's Detroit Business*. Reportedly, in comparison to the law in other states, Michigan's definition of "interested shareholder" makes this State an outlier. It would be detrimental to the State's economy if companies like Flagstar relocated as a result of Michigan's unusual supermajority vote requirements.

The bill would make doing business in Michigan easier. Shareholders who acquired shares from a corporation could vote in the two-thirds vote that Section 780 requires, because their shares would not be considered outstanding or beneficially owned (unless the board determined otherwise), making them disinterested shareholders. Also, under the bill, it would be easier for some transactions to qualify under Section 781 and altogether avoid the two-tiered supermajority vote. These changes would bring Michigan into conformity with other states, which could encourage valuable companies like Flagstar to stay in Michigan.

In addition, narrowing the definition of "interested shareholder" to exclude those holding shares purchased from the corporation would maintain current safeguards against hostile takeovers. Parties who acquired shares on the open market still would qualify as interested shareholders, who are not be able to participate in the two-thirds vote for a business combination under Section 780.

Legislative Analyst: Glenn Steffens

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Josh Sefton