A BROAD APPROACH TO TAKEOVERS, TEMPERED BY TYSON: TENNESSEE'S CORPORATE TAKEOVER STATUTE

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I. INTRODUCTION

The 1980's will be remembered as the decade in which corporate takeovers again returned to the American scene.[1] Initially viewed as a means of disciplining management and creating the highest and best use of resources, it quickly became obvious that the real result of this new wave of takeovers was loss of jobs, customers, civic leaders, and corporate charities, with no corresponding improvement in either corporate management or efficiency.[2] In fact toward the end of the decade, it became obvious that the exact opposite was occurring.[3] That is, corporate raiders were ignoring the truly inefficiently managed companies and concentrating their resources on taking over those that were profitable and well managed. Subsequently, in too many cases, because of the debt incurred through the junk bonds which were used to finance the takeovers, the merged companies struggled under the debt and began to take on the characteristics of the inefficiently managed company.[4]

As a result, the states and local communities were confronted with the same sorts of problems which had plagued them before the Sherman Act[5]

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1 Proxmire, What's Right And Wrong About Hostile Takeovers?, 88 WIS. L. REV. 353, (1988) at 357. 1986 saw the largest number of mergers in American history until 1987 which dwarfed 1986.

2 *Id.*

'*Id.*

4 *Id.*

1 Sherman Act, 15 U.S.C sec 12 et seq.

and the Clayton Act[6]; that is, the loss of local jobs,[7] the return in some instances of monopolistic prices,[8] and the loss of corporate headquarters with its civil leaders and contributors.[9]

II. TAKEOVER STATUTES GENERALLY

The response of Tennessee, like many states during this period was to amend its antitakeover statute in an attempt to bring some order and control to what had become an ever more chaotic and destructive area of corporate law.[10] Tennessee's act may properly be called a fourth generation takeover

‘Clayton Act, 15 U.S.C sec 1-7.

[1] Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes After CTS Corp.* 29 WM. AND MARY L. REV. 699 (1988) at page 726; Alio see Johnson and Millon, *Does the Williams Act Preempt State Common Law in Hostile Takeovers'f* 18 SEC. REG. LJ., 339 (1989) at page 364-5;

Also see WSJ, Jan 4,1990, A1 col 6, Following Tyson Foods takeover of Holly Farm the nations chicken farmer's income went down as they found themselves in the position of selling their birds to a company which could now pay whatever price it wished because of the resultant monopoly situation.

•*id.*

'*Id.*

[10] T.C.A. 48-35-101 to 48-35-505. Note that many legal scholars questioned the right of the states to engage in any type of regulation of takeover activity. They opposed these laws for three general reasons: (1) because they believed that the Williams Act preempted all state regulation which may in any way affect right of takeover, (2) because they held that it was bad economic policy, and (3) their belief that takeovers was a matter of interstate commerce and should only be regulated by federal law. *See* Kozyris, *Corporate Takeovers at the Jurisdictional Crossroads: Preserving State Authority Over Internal Affairs While Protecting the Transferability of Interstate Stock Through Federal Law* 39 UCLA L. REV 1109 (1989). At 1114 and 1162, also 1155-59; Johnson and Millon, supra note 7 at 341, 345-47, and 350; Howard, *State Takeover Legislation; The extent of the States Rights in the Creation of Control Share Acquisition Statutes,* 42 SW LJ. 865 (1988) at 886; Easterbrook and Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer,* 94 HARV. L REV. 1161 (1981). at 1164

Also See CTS Corp. v Dynamics Corp. of America, 107 S. Ct. 1637 (1987) (hereinafter CTS); Butler, *State Takeover Legislation, the Market for Corporate Charters, and the Scope of Federal Intervention,* 27 AMER BUS. LJ., 291 (1989) at 293 and at 369, 376; Murphy, *State Antitakeover Legislation: Unconstitutional Economic Folly,* 20 ARIZ. ST. LJ. 475 (1988) at 477; J. Johnson, *Antitakeover Legislation: Not Necessary, Not Wise,* 35 CLEV ST L. REV 303 (1988) at 331.

The belief is based on the economic theory that takeovers serve to discipline management by providing a market mechanism for removing inefficient or incompetent management and by increasing investor wealth by giving them a higher price for their stock. This theory of the takeover as a management disciplinary tool became the staple for an avalanche of law review articles, notes, and comments throughout most of the 1980's which supported the vast number of takeovers which were occurring almost daily during that period. *Also see Forst, The Arizona Corporate Takeover Act,* 25 ARIZ. ATTY 22 (1989); Hackl and Testani, *Second Generation Stale Takeover Statutes and Shareholder Wealth: An Empirical Study* 97 YALE LJ 1193 (1988).

statute.[11]

Antitakeover statutes did not exist for the most part of American history.[12] Virginia was the first state to have some form of antitakeover statute.[13] Inspired by Virginia, by 1979 thirty seven states had adopted some form of antitakeover measure.[14] These statutes were modeled in many ways on the Williams Act, a 1968 Federal law which regulated takeovers. These statutes are commonly referred to as the first generation of antitakeover legislation.[13] Because many of these statutes went beyond Williams in regulating nondomestic corporations, they were overturned by the decision in *Edgar* v. *Mite Corp* (Hereinafter *Mite).[16]*

After *Mite,* nineteen states between the years of 1981 and 1986 redrafted and adopted some type of antitakeover statute.[17] These were the second generation statutes.[18] These were upheld in the *CTS Corp. v. Dynamics Corp. of America.* (Hereinafter referred to as *CTS).[19]* Following *CTS* during an eight month period, April 1987 - December 1987, thirteen more states adopted antitakeover statutes.[20]

Subsequently a third generation of statute was developed which was directed at local corporations and limited the ability of a raider to vote the shares bought for purposes of taking control of the company without the

Yet former Senator William Proxmire in an article confirmed that most companies in real trouble will be avoided for takeover purposes. Penn-Central, before bankruptcy, and Chrysler, before it was bailed out by the Federal government could not give themselves to a corporate raider. These and many other totally mismanaged or troubled companies in need of new management usually could not sell themselves at any price. Proxmire, *supra* note 1 at 355: Coffee, *The Uncertain Cast for Takeover Reform: An Essay on Stockholders, Stakeholders, and Bust Ups,* 88 WIS. L. REV. 435 (1988) at 441 at 441; Booth, The Promise *of Stale Takeover Statutes,* 86 MICHL. REV. 1635 (1988) at 1651-56, *also see* Bebchuk, The Case for Facilitating Competing Tender Offers 95 HARV. L. REV 1028 (1982) at 1039-40, *also see* Baysinger and Butler, *Antitakeover Amendments, Managerial Entrenchment and the Contractual Theory of the Corporation,* 71 Va. L. REV. 1257, 1273 (1985).

[11] Pinto, *supra* note 7, at 763. This type of statute is similar to that of most state long arm statutes. However the constitutionality of this type of statute is still subject to debate although it would appear to be unconstitutional as it regulates interstate instead of intrastate activity.

[12] Bradford, *Protecting Shareholders From Themselves? A Policy and Constitutional Review of a State Takeover Statute,* 67 NEB. L. REV. 459 (1988) at 461.

"*Id.*

[14] *Id.*

[15] *Id.*

“ 102 S. Ct. 2629 (1982).

[17] Hackle *supra* note 10 at 1196-7, 1202-3.

[1]* Coffee, *supra* note 10 at 453.

“ CIS, *supra* note 10.

[20] Coffee, *supra* note 10 at 435.

approval either of the remaining shareholders or of management.[21]

Tennessee attempted the more daring fourth generation of antitakeover statutes which not only incorporated aspects of the second and third generation statutes, but also directed itself at nondomestic corporations which had substantial and significant contacts with the governing state.[22]

Tennessee, like most states during the eighties was placed in a position of having to make laws governing takeovers because the Federal government during this period had abandoned the field of corporate takeover and monopoly regulation.[23] This paper will review the Tennessee statute as an example of the various types of legislation enacted to regulate these problems. It will also examine the various section of this statute and identify their purposes. Finally this paper will look at the limits placed on state statutes by the courts.

III. BACKGROUND

The Federal government's interest in regulating takeover activity was developed over time as a reaction to clearly perceived contemporary problems. As a result, the law in this area developed in four stages in response to four separate periods of takeovers which have occurred in American History.[24]

The first occurred after the American civil war during the era of the robber barrons and was characterized by a period of brutal takeovers, which lead to crushing financial burdens being placed upon the consumer through monopoly prices.[25] This resulted in the enactment of the Sherman act,[26] the Clayton act[27], and the decision in the *Standard Oil Case.*[2]* The purpose of these laws was to guarantee competition within a market and thus assure that the consumer would not be injured by being held hostage to monopoly

[a] Booth, *supra* note 10 at 1670-77; Pinto *supra* note 7 at 735; Howard, *supra* note 10 at 872; For a state by state description of existing antitakeover statutes *see* Hook, *What is Wrong With Takeover Legislation* 8 N. ILL. U.L. REV. 293 (1988) at 311-12.

Note, Type and generation of takeover statute are not necessarily the same as a generation of statute may combine elements from several type.

[22] T.CA. 48—35-101 to 48-35-505.

Kozyns, *supra* note 10; Proxmire, *supra* note 1 at 362, Senator Proxmire says that the states are well equipped to police security law, contrary to what many believe. Each one of the 50 states have their own administration office to police corporate transactions, while the Securities and Exchange Commission has only 10 regional offices.

Coffee, *supra note* 10, Coffee also attacks the arguments in favor of takeovers by pointing out the fact that if their purpose was to protect investors from incompetent management then takeovers would be constant and not cyclical. *Also see* J. Johnson, supra note 10 at 303-4

[25] *Id.*

* Sherman Act, *supra* note 5.

[27] Clayton Act, *supra* note 6.

" *U.S. v. Standard Oil of New Jersey* 221 U.S. 1 (1910) (hereinafter Standard Oil).

prices.[29]

The second period occurred during the 1920's.[30] This time, instead of outright purchases and takeovers, the raiders of this era hid behind a cloud of holding companies which were used to sell stock to the general public.[31] A few men used this technique to build huge empires,[32] but most were merely peddling watered stocks to the public.[33] This situation contributed to the stock crash of 1929.[34]

The governmental response to the frauds perpetrated on the public during this period was the enactment of the Securities Exchange Act of 1934.[35]

The third period began after World War II and was encouraged by business schools which began to praise the virtues of nonhomogeneous combinations or conglomerates.[36]

There was some virtue in this idea especially for those companies subject to regular cycles of plenty followed by poverty.[37] If a company expanded into an area with a different business cycle, or into one not subject to widely fluctuating cycles, then the company could solve the cash flow problems caused in cyclical businesses. At the same time, the corporation could grow without fear of violating the antitrust laws because such a takeover would not come under the immediate scrutiny of the United States Justice Department, as there was no concentration of power in any one field.[3*]

However, this type of takeover was characterized by a practice called the two tier takeover.[39] That is the takeover usually began with a tender offer to the shareholders of the target company on very short notice.[40] The raider would offer a premium for enough shares to gain control of the company.[41] This was the first tier.[42] Then when control was obtained, the remaining shares would be bought at basically whatever price the raider wished to pay

»*Id.*

[30] M. Josephson, THE MONEY LORDS. AT 35 (1972).

"*Id.*

[32] *Id.* at 36-43; at 43-48.; at 48-79.

"*Id.*

[34] *Id.* at 80-105; at 130-136.

[35] The Securities and Exchange Act of 1934,15 U.S.C. sec. 78 et seq. *Also see.* Josephson, *supra* note 30 at 173-176, the general plan in drafting the Securities and Exchange Act was to adapt in this country the provisions of the old British Companies Act.

* Booth, *supra* note 10 at 1651-56.

[37] *Id.*

* *Id*\ Josephson, supra note 30 at p. 347-8.

* Booth, *supra* note 10 at 1651-56.

[40] *Id* at 1640-2.

[41] *Id.*

[42] *Id., also see* Bebchuk, *The Case for Facilitating Competing Tender Offers* 95 HARV L. REV 1028 (1982) at 1039-40, *also see* Baysinger and Butler, *Antitakeover Amendments, Managerial Entrenchment and the Contractual Theory of the Corporation,* 71 VA L. REV. 1257 (1985).

for them. [43] This later ss was the second tier which is called corporate eminent domain.[44]

The shareholder was then placed in the position of either selling at the higher price of the tender offer or risk being forced to sell at a lower price later by corporate eminent domain. [45] This lead to a stampede of the shareholders of the target companies to sell, so as to get the premium price offered for their stock during the initial tender offer.[46] However, if the payment for the shares was to be in shares of the raiding company, the target's shareholders faced a dilemma.[47] There was literally no time to investigate the value of the stock or the company that was making the offer.[44] If one waited to investigate either the advisability of a takeover, the credit worthiness of the raider, or the true value of their stock, then some other shareholder who did not bother to take these precaution would have already sold their stock and consumed the premium.[49] On the other hand, if the shareholder raced to the front and sold their stock for the premium, then, if that premium proved to be worthless, then the shareholder would not only have given up good stock for bad,[50] but would place a good company, as happened in some cases, in the hands of an incompetent.[51]

This lead to the federal government's passage of the Williams Act in 1968.[52] The purpose of this act was to provide both information to the shareholders and time for them to consider the information.[53] This was to eliminate the panic and stampede method which raiders were then using to force takeovers.[54]

The fourth wave of takeovers began in the early 1980's when the Justice Department decided to allow companies to again merge within the same field because it was determined that in many areas, as a result of the new international markets, there would still be competitors for consumers to

"*Id.*

[44] Baysinger, *supra* note 42 at 1260-61.

[45] *Id.*

»*Id.*

4/*Id.*

-*Id.*

»*Id.*

"Baysinger and Butler, *Race for the Bottom* v. *Climb to the Top AU Project and Uniformity in Corporate Law,* 10 J. OF CORP L. 431 (85) at 446, *also see supra note* 42.

[51] Brooks, J., THE GO-GO YEARS, (1973) at 165-81.

[52] Williams Act. Securities Exchange Act of 1934, Secs. 13 (d)(1), 14(d)(U-7), (e) as amended 15 U.S.CA. secs. 78m(d)(l), 78n(d)(l, 5-7)^e).

[53] Baysinger *supra* note 42, at 1261; J. Johnson *supra* note 10 at 305.

[54] Hook, *supra* note 21 at 296.

choose from even if there was only one domestic company in a field.[35]

The problems created by the takeovers of the 1980's were more localized in nature than in previously eras. During the 19th century, the major problem with takeovers was the price gouging by the monopolist of the farmer and consumer.[57] However, during the 1980's, international competition helped to avoid this particular type of consumer problem by maintaining a constant supply of goods at reasonable prices.[58] Instead, the damage was more localized in the loss of local jobs, civil leaders, and charitable giving."B However because the U.S. government saw none of the traditional dangers cause by a takeover, it did not pass legislation or regulations to end it. Thus for the first time in American corporate history, the local governments were being put in the position of having to deal with the negative aftershocks of corporate takeovers.[60]

IV. THE TENNESSEE CORPORATE TAKEOVER STATUTE

The Tennessee statute is unusual ti that it attempts to incorporate the elements of every type of corporate takeover statute ever developed, and there are at least six different types which have been enacted by various states;[61]

Registration and Disclosure statutes - these laws are called "little Williams Acts" because they enact many of that law's principles into state law.[62]

Fair Price Statutes - This type of statute requires that those shareholders who attempted to tender their shares during a two tiered takeover, but whose stock was not bought because the acquirer had obtained enough stock to

[55] William Baxter, the Assistant Attorney General in charge of antitrust litigation in the Reagan White house, stated that he did not subscribe to the belief that big was by necessity bad. This position was reflected in the fact that in the First quarter of 1981 mergers went up 46% and in the second quarter 36% over the same period for 1980. Further, each month saw new records as the size of the combinations became increasingly larger. *Big Shift in Antitakeover Policy* DUN REV, Aug, 1981 at 37.

[54] 85 Johnson, *supra* note 10 at 364-6, Coffee, *supra* note 10 at 447-8.

[57] M. Josephson, ROBBER BARONS, at 387-388 (1932).

[51] Trustbusters Busted, Economist, Ap 18,1981 at 17.

*' Baysinger, *supra note* 50.

[40] *California v. American Stores Co.* 110 S. Ct. 1 (1989). In this case the stale of California brought an action to block a merger between two large grocery chains on grounds that it would have a monopolistic effect on the state's food prices. This was an action usually associated with the U.S. Justice Department, however, the Court here permitted the action, finding that the term "person" in the Clayton Act 15 U.S.C Sec. 16 is broad enough to include a state as a party entitled to relief. *Also see* Pinto *supra* note 7 at 726; CTS, *supra* note 10.

, " Booth, *supra* note 10 at 1670-77; Pinto *supra* note 7 at 735; Howard, *supra* note 10 at 872; For a state by state description of existing antitakeover statutes Hook, *see supra* note 54 at 311-

[a] ld.

control the corporation, still be paid a fair price for their stock, even if the purchaser neither wants nor needs their shares for control.“

Director Approval statutes - These statutes allow management to approve or disapprove of any takeover which radically changes the corporate structure, either through a merger with another corporation, the sale of major assets, or any other form of liquidation. This "White Knight" statute does little more than codify what happens in most friendly takeovers, that is, it allows an immediate takeover when management agrees to be purchased by a friendly buyer, but allows them to oppose or delay a hostile one.[64]

Controlled Share statute - Here a purchaser who has not been accepted by management cannot vote their shares even if this represents controlling interest in the company unless a majority of the outstanding independent shares vote to allow the controlling shares to be voted.[65]

Asset Freeze - this statute prohibits the buyer from selling corporate assets to pay for the purchase of the company. In effect the statute forces a would be buyer to use their own money to buy the company rather than allow him or her to buy on credit and then sell assets of the company to repay the loan which in effect causes the acquired company to pay for its own takeover.[66]

Appraisal statute - This statute allows a shareholder, who did not sell during the initial tender offer, to sell their shares later to the acquirer for the highest price paid during the initial stages, provided that the actual control of the corporation is transferred to the acquirer.[67]

Antigreen mail statute-these discourage corporate raiders from bluffing a takeover by buying large blocks of stock, only to sell them back to a frightened corporation which pays a price greatly inflated over market value simply to avert a takeover.[6]®

A. The Investor Protection Act

The Tennessee Investor Protection Act enacts into law a version of the Williams act as well as a Fair Price Statute.[69]

[a] *Id.*

" *Id.*

« *Id.*

[44] *Id.*

[4/] *Id.*

“ Carney, *Controlling Management Opportunism in the Market for Corporate Control: an Agency Cost Model,* 88 WIS. L. REV. 385 (1988) at 397.

[44] T.CA. 48-35-101 et seq.

1. Little Williams Act

The Williams Act was an amendment to the Securities Exchange Act of 1934 and was passed in 1968.[70] The act was a direct response to the pressure placed upon shareholders during the late 1950's and the 1960's to make practically an on the spot decision as to keep or sell their shares after a tender offer was made. Shareholders were given little opportunity to examine their options, the character of the buyer, or the real value of the buyer's consideration.[71] The Williams Act was a limited response to this two tier take over problem in that its purpose was to provide information to the shareholders.[72]

The act was meant to be neutral, favoring neither management nor buyer.[73] It was to encourage shareholder autonomy and to allow them to make a reasoned decision as to whether the takeover would be wise and prudent.[74] Some scholars also believed that this gave the shareholder a chance to use their own judgment rather than rely, under pressure, exclusively on management's judgment as to whether the tender offer be accepted or rejected.[75]

Sections (d)(l)(A)-(E) of the Williams Act requires anyone who obtains 5% or more of the shares of a company, for the purpose of acquiring control to provide specific information including the identity, residence, citizenship, and nature of the beneficial ownership on whose behalf the interest is bought. It also requires the purchaser to identify the source of funds used to buy the stock and to identify any loans if they come from other than an ordinary bank loan. Finally this section requires any plans to sell, merge, or liquidate any major assets of the corporation be disclosed.

The Tennessee act incorporates many of these principals. T.C.A. 48-35-103(a) applies to any person that acquires beneficially 5% or more of a company's stock within one year of a proposed takeover.

T.C.A. 48-35-104 (b)(l)-(7) then requires such purchaser to provide specific information including the identity, residence, citizenship, and nature of beneficial ownership, on whose behalf the interest is bought. It too requires the purchaser to identify the source of funds used to buy the stock and to identify any loans if they come from other than an ordinary bank loan. Finally it requires disclosure of any plans to sell, merge, or liquidate any major asset of the corporation.

[10] Williams Act, *supra* note 52. [n] Johnson and Millon, *supra* note 7 at 345-7.

[/1] *Id.*

[73] Kozyris *supra* note 10 at 1114 and 1162; Butler *supra* note 10 at 367; J. Johnson, *supra* note 10 at 331; *also stt* Howard, *supra* note 10 at 867.

" *Id.*

[/5] *Id.*

2. Fair Price Statute

T.C.A. 48-35-103(b)-(c) represents the second kind of antitakeover legislation, that is a fair price statute which is to protect investors from the undue pressures of the two tier takeover.[76]

It should be noted that many legal and economic scholars have opposed any state regulations which limit takeovers based upon the legal-economical theory that management operates a corporation for the benefit of the shareholders, and that takeovers maximize shareholder wealth.[77]

These theorist limit their measure of a shareholder's wealth solely to the value of their stock.[7]* Therefore if anything could be done to increase the value of the company's stock over its present value, then this was good and should be promoted.[79] Since a tender offer increased stock prices, then these scholars believed that such offers should be encouraged and anything which hindered a takeover be opposed.[80]

However in the two tiered takeover procedure, the acquirer only pays the highest price or premium to that percentage of shareholders required to get controlling interest in the corporation.[81] It was only those shareholders who tendered their stock during the initial stages of the takeover and whose stock was necessary for control that made a windfall profit for their shares. Once the acquirer had control, they could pay whatever they wished for the remaining shares, or they could refuse to buy them altogether.[82] Therefore, instead of maximizing shareholder wealth, many takeovers in reality only maximized the wealth of certain shareholders, who in most cases were arbitrageurs[83] or large institutional investors.^This process forced a stampede to sell, even by those investors who may have had no interest in selling, by subjecting them to the risk being frozen out later.*[5]

To prevent this the Tennessee statute in T.C.A 48-35-103(b) prohibits any offer to buy shares from Tennessee shareholders that is not equal to the offer made to shareholders residing outside the state.

T.C.A.48-35-103(d) holds that during the first ten days after an offer has gone into effect, if the number of shares tendered is more than the offeror wants, the purchaser must buy all shares on a pro rata basis.

[/4] *Supra* note 61.

[77] Butler, *supra* note 10, at 293, *also see* Bradford *supra* note 7 at 500-1

[71] *Id.*

[n] *Id.*

[K] *Id.*

[n]

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° Booth, *supra* 10 at 1640-2,1647-8,1651 and 1655.

[14] Proxmire, *supra* note 1 at 355; Booth,

supra note 10 at 1654 " *Id.*

Finally T.C.A 48-35-103(e) requires an offeror who increases the consideration paid to any shareholder during that period to pay that same increase to all shareholders, even though the seller had previously accepted a lower price.

This statute is to be administered by the Tennessee Commissioner of Commerce and Insurance.[86] Further, injunctive and civil relief, if necessary is also provided.®[7] Finally the code provides that if the law is knowingly violated, then it shall be a misdemeanor punishable by not less than 30 days nor more than 180 days in jail, and by a fine of not less than $50.00 nor more than $2500.00, or both find and imprisonment.“ However, if fraud is also involved, the crime becomes a felony punishable by one to five years in the penitentiary and a fine of not less than $50.00 nor more than $2500.00 or both find and imprisonment.[89]

This section prohibits an acquirer from making a private deal with a few large holders of stock, all of who could reside outside the state of Tennessee but who would receive the entire premium, while no Tennessee shareholders would receive anything. It guarantees that any shareholder who wishes to participate in the tender offer and share in the premium is able to do so.[90]

B. Business Combination Act.

T.C.A. 48-35-201 et seq. is entitled the "Business Combination Act." This act is in fact two takeover laws. It is a Director approval statute, and an Asset Freeze statute.

1. Director Approval Statute

This type of statute preserves power in a corporation’s managers and board of directors and allows them to play a major role in determining the form and direction of a takeover. This legislation contradicts modern legal theory which opposes directors and officers taking any action which might retard or prevent a takeover.[91] Indeed some scholars have gone so far as to advocate that officers and shareholders be required by law or charter provision to be neutral and inactive in a takeover as soon as one is

“ T.CA. 48-35-102(4) and T.CA. 48-35-108.

ʳ T.CA. 48-35-110, and T.CA. 48-35-112.

■ T.CA. 48-35-111.

" T.CA. 48-35-111.

*° *Supra* note 86.

" Kozyris, *supra* note 10; Butler, *Corporate Specific Antitakeover Statutes and the Market for Corporate Charters,* 88 WIS L. REV. 365 (1988); Macey, *State Antitakeover Legislation and the National Economy,* 88 WIS. L REV. 467 (1988); Johnson, *Antitakeover Legislation. Not Necessary, Not Wise,* 35 CLEV. ST. L. REV. 303 (1988); Bradford, *supra* note 12 at 459.

announced.[92]

However, the theory is flawed in that it fails to recognize the discrimination among shareholders caused by the two tiered tender offer, and it failed to recognize the problems caused in a community when a takeover turns disastrous as a result of debt or subsequently poor management.

The Tennessee law addresses this by first stating that it is the public policy of the state not to limit the beneficiaries of the corporation to shareholders, but to expand those represented by the corporation to include employees, customers, suppliers, and local communities and their economic welfare.[93]

lliis section then gives management the right to evaluate a takeover and the right to oppose it if they believe that such a merger, exchange, tender offer or significant disposition of assets would adversely affect the beneficiaries of the corporation.[94] The statute only allows an immediate takeover, merger, or sale of assets if approved by the board of directors of the corporation. Otherwise the asset freeze comes into effect.[95]

2. Asset Freeze

An asset freeze is precisely that. It is a requirement that where a takeover occurs but is not approved by management, the corporation, for some minimum period of time, usually five years, is prohibited from merging the corporation into another company, or selling major assets; and thus guarantees that the company will continue to operate as is for that period.[96] The Tennessee statute incorporates all of these elements.[97]

Tennessee then goes a step further and requires that after the five year period has passed, the acquirer, in order to change the essential form of the corporation, must also get a two-third vote of the outstanding neutral shares, that is, shares not controlled by management or directors.[9*]

In the alternative, that section also provides that all outstanding shareholders who choose to sell their shares receive in cash or substantial assets, payment for their shares equal to the highest value paid by the acquirer to obtain controlling interest.[99]

This statute does not apply to any corporation that is not traded on a national stock exchange; or which,through its charter, prior to beginning trade on a national stock exchange, chooses not to be covered by the statute, i.e.

"*ld.*

" T.CA 48-35-202.

* T.CA. 48-35-205 (1); T.CA. 48-35-204.

* *Id.*

"*Id.*

"*Id.*

" T.CA. 48-35-206(1).

" T.CA. 48-35-206(2).

"opts out"; or is a holding company for a domestic insurance company.[100]

C. Controlled Share Acquisition Statute

A controlled share acquisition statute is a peculiar invention of american corporate law. It prohibits one who otherwise has purchased enough shares to control a corporation from being able to vote or use those shares to elect board members or dictate corporate policy, unless the shareholders, excluding interested shares, vote to give power to the acquirer's shares.[101] If the shareholders vote against allowing the acquirer to vote these shares, then for corporate control purposes, they have a value of zero.[101]

1. Control Share Acquisition Act

Tennessee enacted a Controlled Share Statute in T.C.A 48- 35-301 et seq. First the statute defines what is meant by control share, and to whom it covers. Note that this section applies not only to corporations incorporated in Tennessee, but to any corporation with principal offices or assets within the state or with substantial shareholders in the state.[103] It also defines interested shares for purpose of voting as those of the acquirer,[104] those of any officer of the corporation,[105] or those of any employee of the company who is also a director of the company.[106]

Next, it states in no uncertain terms, that the right to vote shares by one who has made a control acquisition shall be only those as provided for by statute.[107] The act then further requires that anyone who has made a control acquisition or who holds 10% or more of the outstanding stock, deliver to the corporation, a control share acquisition statement.[10]® This part of the act also requires that the acquirer give the identity of the acquiring parties,[1W] and the terms and conditions of the takeover.[110] The statute then gives the acquirer the right to call a special board meeting for purpose of taking a vote as to whether to give the acquirer voting rights.[111] If the acquirer does call for a special meeting for this purpose, they must pay for all of the ordinary

[100] T.CA. 48-35-207.
[l"] T.CA. 48-35-303; T.CA 48-35-307.
[m] *Id.*
[105] T.CA. 48-35-302(5)(C)(i).
T.CA. 48-35-302(6)(A).
[1B] T.CA. 48-35-302(6)(B).
*" T.CA. 48-35-302 (6)(C).
T.CA. 48-35-303.
"* T.CA. 48-35-304.
T.CA. 48-35-304 (1).
[110] T.CA 48-35-304(6).
[111] T.CA 48-35-305.

expenses so incurred in holding such a special meeting, but not including expenses incurred in opposing such a resolution.[112]

If the acquirer chooses not to demand a special meeting, then the matter would come up at the next meeting of the shareholders following the company's receipt of the control share acquisition statement.[113] This of course could mean that if notice of the annual meeting has already been sent, an acquirer might have to wait for the next annual meeting in order to get his or her request to receive power for their shares before the shareholders for a vote; and the wait could be over a year.

T.C.A. 48-35-307 is the key section of this law. It states that control shares will have the same voting rights as all other shares of the same class or series only if approved by resolution of the shareholders of the corporation at an annual or special meeting convened to consider such approval. All except interested shares can vote. If the vote is not granted, then those shares will have no value unless they are sold or transferred to someone not subject to the Act. While there is no prohibition here against the acquirer demanding another vote, there is no provision in the law which provides for it either, nor is there some provision for automatic rights being granted at some distant time. That is, the denial of voting rights appears to be permanent.

2. Appraisal Statute

Finally under the Controlled Share Acquisition Act, T.C.A. 48-35-309, Tennessee enacted an appraisal statute. Under this section, any shareholder who dissents to the approval of granting power to the control shares may demand that their shares be appraised for their market value.[114] However, for the shares to be considered, the shareholder must make a specific demand in writing prior to the vote.[113] Then five days after a positive vote is taken, the number of shares wishing to be appraised shall be deliver to the acquirer.[116]

Note that while there is a provision in this section for the appraisal, there is not a mandatory provision that the acquirer purchase these shares as required earlier in the fair price statute. However, that appears to be the intent of the statute as it appears to offer relief for shareholders who have made their opposition to the acquirer obvious and who wish to sell their shares in the corporation without having to do so at a great loss. Its major importance is that allows a fair market sale of shares well after the initial tender offer and removes the pressure on a shareholders to be the first to sell

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[113] T.CA. 48-35-307(c).
[1.4] T.CA. 48-35-307(e).

by providing them a later opportunity to sell without fear of market conditions after the takeover, or by corporate imminent domain.

3. The Tennessee Greenmail Act

The final protection provided under the Tennessee Statute is the Greenmail statute, T.C.A. 48-35-501 et seq. Greenmail was a forced selfhelp method of warding off a takeover exercised by a number of corporations during the 1980's.[117]

Greenmail was little more than the paying of money extorted by a buyer who threatened to takeover a company and fire the current management, often with no real intention of doing so. Instead, the raider counted on the fear caused in upper management who, in order to save their jobs, would pay far in excess of market value for the raiders stock, and far more than the raider paid for it.[11*] This results in no economic value to the company or to society.

This statute makes it unlawful for the corporation to buy the shares of any person owning more than three percent of the outstanding shares of a corporation if held for less than two years unless the repurchase is either approved by a majority vote of all outstanding shares of stock, or unless a similar offer is made to all other shareholders of the same class of stock.[119]

The statute also provides that any person who sells any stock to a corporation in violation of the statute shall be liable for damages equal to double the excess profit made on such a sale,[120] and reasonable attorney's fee at the discretion of the court.[121] It is curious however that the statute specifically refers to sale to a corporation but does not include a prohibition against selling to an individual, especially since corporate raiders have been identified more as individuals than as corporations. This may be an oversight in the law.

[117] 5m WSJ Je 28, 1990 A1 col 4, Paul Bizerian made millions in greenmailing companies before he actually tookover Singer, the sewing machine giant. His management left the company in shambles and himself under indictment.

A partial list of other takeover methods would include the poison pill - an offer to repurchase outstanding stock at outrageous prices which would greatly benefit officers of the company, self tender - an offer of the corporation to top the raider's offer; lockup - a contract with another company to buy the controlling shares of a company if threatened with a takeover, and selling the crown jewels - the sale of the companies major assets to another company in the event of a takeover attempt. See Carney, *supra* note 68 at 394-400.

[11*] Proxmire, *supra* note 1 at 355.

T.CA. 48-35-503(a).

[130] T.CA. 48-35-504(a).

[13] T.CA. 48-35-504(b).

V. THE COURTS RESPONSE - CONSTITUTIONAL LIMITATION

The Tennessee law as drafted is probably one of the most extensive antitakeover statutes in the country. Its constitutional limits was tested in *Tyson Foods Inc* v. *McReynolds.*[m] In this case, Tyson Foods, a Delaware corporation, by tender offer, attempted to takeover the Holly Farms, another Delaware corporation. Holly Farms also had subsidiaries incorporated in ten states and did business in twenty two others. Holly Farm's corporate headquarters was in Memphis, Tennessee and it attempted to protect itself from the takeover by exercising its rights under the Tennessee Authorized Corporation Protection Act.[123]

The district court enjoined the enforcement of the act and the Sixth Circuit upheld the injunction. At issue was T.C.A. 48- 35-102(7) which defined companies covered by the act as; "a corporation or other issuer of equity securities which is incorporated or organized under the laws of this state or has its principal office in this state, which has substantial assets located in this state, and which is or may be involved in a take over..."

This would allow the statute to apply to Holly Farms, because its headquarters was in Tennessee. However, it was incorporated in the state of Delaware, and for purposes of Tennessee law, was a foreign corporation. The Sixth Circuit held that Tennessee had no interest in protecting non-resident shareholders of non-resident corporations.[124] Indeed, the court found that Tennessee had no more interest in regulating Holly Farms than did twenty other states.[125] Only the state of incorporation held regulatory authority over tender offers for the corporation it creates. Thus to the extent that the Tennessee statute applied to such corporations, the Court held that the Tennessee statute was unconstitutional as a violation of the commerce clause.[126]

As a practical matter T.C.A 48-35-102(7) should now be read to refer only to corporations incorporated in the State of Tennessee. Since no other issue was raised which called into question the constitutionality of any other section of the statute, and because Tennessee has merely passed laws adopted in other areas of the country which have so far withstood court challenge, it seems that, barring any further improper regulation of interstate commerce, this statute will pass constitutional scrutiny.

[122] 865 F. 2d 99 (6th Cir. 1989).
[125] *Id.* at 100.
[1"] *Id.* at 102.
[125] *Id.*
'»*Id.*

VI. CONCLUSIONS

The state of Tennessee, in responding to a crisis caused by the takeover binge of the 1980's, passed an antitakeover statute that was composed of almost every type of antitakeover legislation developed during this period. However, the state erred by then attempting to extend the coverage of that statute to non Tennessee corporations. This was held to be unconstitutional as a violation of the commerce clause.

To the extent that the statutes applies only to Tennessee corporations, the law will help bring a little order to an area of corporate law that certainly got out of hand during the latter part of the eighties. Hopefully takeovers in the future will concentrate more on the economic benefits of a takeover, and not just the quick profits possible by "putting a company into play." [127]

[127] A popular term of the period meaning launching a takeover bid, generally hostile.