

3-1988

Corporate Takeovers: A Recommendation For a California Policy

Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions

Follow this and additional works at: http://digitalcommons.law.ggu.edu/caldocs_senate



Part of the [Business Organizations Law Commons](#), and the [Legislation Commons](#)

Recommended Citation

Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions, "Corporate Takeovers: A Recommendation For a California Policy" (1988). *California Senate*. Paper 219.
http://digitalcommons.law.ggu.edu/caldocs_senate/219

This Committee Report is brought to you for free and open access by the California Documents at GGU Law Digital Commons. It has been accepted for inclusion in California Senate by an authorized administrator of GGU Law Digital Commons. For more information, please contact jfischer@ggu.edu.

CORPORATE TAKEOVERS

A Recommendation for a California Policy

By Senator Dan McCorquodale

*California Legislature
Senate Commission on Corporate Governance
Shareholder Rights and Securities Transactions
March, 1988*

DEPOSITORY

MAR 28 1988

RECEIVED

KFC
345.A2
C34

323-S

KFC
345, AB
C34

EXECUTIVE SUMMARY

The Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions having studied the issue of corporate takeovers, submits the following conclusions and recommendations to the Legislature:

Conclusions:

- A California corporate takeover law would be an ineffective protection of corporations, workers and shareholders since it would apply to a minimal number of corporations having business contacts in the State.
- A national law requiring minimal standards of conduct for corporations, bidders and investors would reduce jurisdictional competition and claims among states.
- Without jurisdiction the Legislature cannot adequately address and resolve conflicts between management and owners of corporations.

Recommendations:

- The California Legislature should support federal preemption of state takeover laws.
- The California Legislature should support state legislative proposals which will add to the protection of shareholders and pension investments.
- The California Legislature should support state legislative proposals relating to takeover activities when there is a potential for economic hardship to small corporations and their shareholders.
- Problems associated with corporate takeovers such as depletion of assets and resources, debt burdens to corporations and other dislocations to the State's economy should be resolved as issues separate from tender offer legislation.

Dan McCorquodale is Chairman of the Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions and represents the San Jose and Modesto areas in the California legislature.

1

THE RECOMMENDATION

Thirty-seven states have passed some form of legislation to restrict hostile corporate takeovers. Twenty-seven have restricted tender offers. California has not and should not.

A California takeover law will effect relatively few corporations, since few have either chosen to incorporate in the State or have sufficient business contacts to come under the jurisdiction of the State's Corporation Code Section 2115. A law will neither abet nor deter raids of most corporations. The passage of takeover legislation at this time would be an ineffective protection of shareholders, workers and the state's economy, as well as a deception of public policy.

The preemption . . . should be limited to takeover activities and not infringe upon the appropriate state interests of corporate governance and internal affairs.

Without addressing specific legislative proposals, the Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions recommends federal preemption of all states' laws relating directly to takeover activities. The preemption as described by the Commission should be limited to takeover activities and not infringe upon the appropriate state interests of corporate governance and internal affairs.

A line should also be drawn to separate internal management affairs of a corporation from takeover issues of corporate control. In addition, problems often associated with takeovers, such as plant closings or depletion of assets and resources, should be resolved as separate issues. This is not to diminish the seriousness of these issues or their impact on California's economy, resources and workers.

This recommendation is limited to federal preemption through amendment to the Williams Act, applicable to all corporations with a class of equity securities registered under Section 12 or subject to Section 15(d) of the Securities Exchange Act of 1934 for the following standards:

- (a) Voting rights based on percent of ownership;
- (b) Voting rights based on duration of ownership;
- (c) Poison pills;
- (d) Second step "cash out" transactions;
- (e) Greenmail;
- (f) Prohibitions of equitable remedies;
- (g) "Fair price" for cash out mergers;
- (h) "Drop and sweep" purchases, and
- (i) Disclosure rules for stating an intent to control a corporation.

The recommendation is not intended to be prescriptive. California should have a voice in determining federal standards, but it is presumptuous to assume the actions of Congress and contradictory to circumscribe the rules for other states. Corporate takeovers are a national or perhaps, an international problem that cannot and should not be resolved by fifty separate state laws.

2 LACK OF JURISDICTION

In most issues of corporate control, California is effectively preempted by other states, such as Delaware, by virtue of a corporation having the ability to select a choice of law through incorporation. Even if a corporation had a majority of its property, payroll, sales, shareholder and its headquarters located in California, it would not exclusively come under California laws should it choose to incorporate in another state.

The shocking reality is that despite having the sixth largest economy in the world, California can claim authority over only three Fortune 500 companies and less than four percent of New York Stock Exchange listed companies. Corporate laws affecting Times-Mirror, Wells Fargo or Atlantic Richfield for example are made not in Sacramento or Washington, D.C., but in Dover, Delaware. The merits of takeover legislation matter little, if California does not have jurisdiction over corporations.

Despite having the sixth largest economy in the world, California can claim authority over only three Fortune 500 companies.

It is also quite clear that California cannot enact corporation laws even if predisposed to do so, which would become as attractive to corporate management as the laws of Delaware or other states competing for incorporations.

It should be clear that not all of Delaware's laws adversely affect shareholders' interests. In some instances such as the declaration of dividends or valuation of acquisitions, Delaware law is quite favorable to shareholders.

However, California should not enter into a competition for incorporations which it cannot win without substantially redirecting state law. The State should have the freedom to determine laws based upon economic, social, cultural and historical justification rather than a response to coercive competition between states. Delaware as an example, has a free hand to enact corporate laws which have relatively little effect on their own citizens except to provide additional revenue in franchise taxes and a disproportional effect on other states ability to regulate corporations.

As a small state with a modest economy, Delaware is the overwhelming choice of incorporation for corporations having their principal business contacts in other states. In addition, Delaware courts have established a body of case law unrivaled by other states. The incentives for Delaware incorporation are not likely to be reversed by the passage of a California takeover law. A law which would likely reverse past state policy.

California laws do not protect Delaware corporations.

Other states such as New York that have passed takeover laws with less balance and equity than the Delaware takeover law at the behest of their business lobbyists with such features as a five year prohibition on the divestiture of assets, lengthy disclosures and long tender periods have not experienced a return of corporations from Delaware. In most instances, state legislatures have reacted to the intimidation of a single corporation's threat to leave for Delaware, by immediately enacting protective legislation. This has been the case in Arizona (Greyhound), Minnesota (Dayton-Hudson), New Jersey (Singer), Washington (Boeing), and Ohio (Goodyear) to name just a few examples.

The California Legislature, much to its credit, has resisted overreaction despite takeover attempts on some of the major corporations in the state. Perhaps that is due to a recognition of the inefficacy of a state takeover law.

***Other states... that have passed takeover laws...
have not experienced a return of corporations from
Delaware.***

Although California would like to provide a better business climate, that goal is unlikely to be realized by legislation that has a narrow application of relatively few corporations incorporated in California. California laws do not protect Delaware corporations.

3 CALIFORNIA ALTERNATIVES

California has three alternatives: (1) do nothing and continue to abrogate authority over large corporations with substantial business contacts, (2) pass a takeover law which applies only to a relatively few corporations, or (3) assert jurisdiction through federal preemption of state laws by virtue of its Congressional representation. In light of these facts, the best alternative is to attempt to assert jurisdiction through federal preemption of state laws. Preemption would set a floor for shareholder protections and a ceiling for management prerogatives in the governance of corporations. States would be free to set additional standards above the floor or below the ceiling. With such a minimum federal standard, even set at a base approximating existing Delaware law (which is not being advocated), states would be free to decide an appropriate standard for governance of corporations with the certainty that Delaware or some other state would not continue the downward spiral of shareholder rights.

There is nothing innately wrong with states having different standards for corporate behavior. What is divisive is the competition to lower standards in the “race to the bottom”. Minimal federal preemptive standards would establish a finish line for the race to the bottom.

Minimal federal standards would establish a finish line in the race to the bottom.

In addition, the significance of multi-state claims and disputes over choice of law would be minimized as the disparities in state laws are restricted. This position is not contrary to the states’ rights claim which was a major point of contention in the Indiana takeover case. To the contrary, such a proposal would promote states’ rights. Differences in governance standards should reflect regional anomalies, not

state entrepreneurialism. To restate the earlier question: Would California be better served being preempted by Congress or preempted by the Delaware Legislature? The current system in which a post office drop determines political and corporate behavior is totally irrational. It is an unimaginable metaphor for democracy.

Differences in governance standards should reflect regional anomalies, not state entrepreneurialism.

What is a more reasonable alternative?

A federal takeover law recognizing two precepts:

(1) Regulation limited to the changes in corporate control. Responsibilities for corporate law traditionally vested with states should remain with states.

(2) Neutrality among shareholders and contending parties vying for ownership as presumed by the Williams Act.

The purpose of any law should be to allow the shareholders to make an informed decision regarding the ownership of a corporation free from coercive offers from both bidders and management. With the changes in ownership of corporations due to a shift of corporate equity to large pension funds perceptions of bias may have changed. This is but another reason to reexamine federal law.

4

A FINAL PERSPECTIVE

California has been affected by the loss of jobs, resources and disruptions to the economy as much if not more than other states due to corporate takeovers of the last few years. Some of this disruption can be considered the price for the free movement of capital.

Number and Value of Mergers and Acquisitions, 1968-1986 a/
(\$ millions)

Year	Number of Transactions	Total Value	Base b/	Current Dollars	Average Value 1982 Dollars c/	Transactions Valued at Over \$100 Million
1968	4,462	\$43,609.0	1,514	\$28.8	\$76.4	46
1969	6,107	23,710.9	2,300	10.3	25.9	24
1970	5,152	16,414.9	1,671	9.8	23.3	10
1971	4,608	12,619.3	1,707	7.4	16.7	7
1972	4,801	16,680.5	1,930	8.6	18.5	15
1973	4,040	16,664.5	1,574	10.6	21.4	28
1974	2,861	12,465.6	995	12.5	23.1	15
1975	2,297	11,796.4	848	13.9	23.4	14
1976	2,276	20,029.5	998	20.1	31.9	39
1977	2,224	21,937.1	1,032	21.3	31.6	41
1978	2,106	34,180.4	1,071	31.9	44.2	80
1979	2,128	43,535.1	1,047	41.6	52.9	83
1980	1,889	44,345.7	890	49.8	58.1	94
1981	2,395	82,617.6	1,126	73.4	73.4	113
1982	2,346	53,754.5	930	57.8	57.8	116
1983	2,533	73,080.5	1,077	67.9	65.4	138
1984	2,543	122,223.7	1,084	112.8	104.5	200
1985	3,001	179,767.5	1,320	136.2	122.2	270
1986	3,337	173,300.0	1,274	117.9	103.0	339
1987 d/	927	93,100.0	440	211.6	180.5	166

a/ Reported transactions valued at \$500,000 or more

b/ The number of transactions for which the price was disclosed

c/ Measured by the gross national product implicit price deflator

d/ Figures as of June 1987

Source: W.T. Grimm & Co.

Considering the state has long been a net importer of capital, California has profited from a total increase in jobs and other benefits to the overall economy. Some measures providing for the protection of natural resources or sudden economic adjustment are warranted, but they would be ineffective if their application is limited to California corporations. Protection of California's resources must apply to all corporations doing business in our state regardless of their charter.

Often the economic problems associated with takeovers are a result of poor business judgement and tactics in gaining or maintaining control of a corporation. The State cannot correct problems of business judgement and often lacks the authority to restrain harmful tactics.

California has been affected by the loss of jobs, resources and disruptions to the economy as much if not more than other states...

The State's policy should be to unveil the myth of legal control over corporations and restore jurisdiction to California. That can only take place through federal legislation. Just as in the story of the Emperor's New Clothes, California bills itself as the sixth largest economy in the world without any control over the governance of the largest corporations doing business in the State. This recommendation should advise the state of the nakedness of its authority and debunk the myth of state jurisdiction and endorse federal preemption of state takeover laws.

5 THE GOVERNANCE COMMISSION

The California Senate created the Commission on Corporate Governance, Shareholder Rights and Securities Transactions in 1986 to evaluate laws relating to and practices of corporate management, investment managers and investors, with particular concern to reconciling the need to establish stability for corporations operating in or desiring to locate in California with the fiduciary obligations of investment managers and pension fund trustees to prudently invest shareholder funds. The Commission's membership represents prominent members of the business, academic, investment and political communities. The Commission sponsors legislation and its members are often called upon for consultation or testimony on corporation and securities law issues before the Legislature.

**Senate Commission On Corporate Governance,
Shareholder Rights and Securities Transactions**

Senator Dan McCorquodale, Chairman

Senator Robert Beverly
Senator William Campbell
Senator Barry Keene
Senator Nicholas Petris
Senator Alan Robbins
Senator Rose Ann Vuich

Peter Barker
Goldman, Sachs

Willie Barnes
Manatt, Phelps, Rothenberg & Tunney

Christine Bender
Commissioner of Corporations

Ted Brewer
New York Stock Exchange

Richard Buxbaum
U.C. School of Law

Lee Eckel
Columbia Savings and Loan

Alan Emkin
Wilshire Associates

Hugh Friedman
University of San Diego Law School

Marz Garcia
Fundamental Economics

Ronald Gilson
Stanford Law School

Michael Halloran
Pillsbury, Madison & Sutro

Susan Henrichsen
Deputy Attorney General

Dennis Hensley
National Association of Securities Dealers

Janice Hester
State Teachers' Retirement System

Bill Holden, Counsel
Secretary of State

Mary Jo Jacobi
Drexel, Burnham, Lambert

Benjamin Krause
American Stock Exchange

William Lerach
Milberg, Weiss, Bershad, Spechtrie & Lerach

Jack Loveall
United Food and Confectionary Workers

John Mackey
Henry Swift & Co.

Robert Monks
Institutional Shareholder Services

John Pound
Harvard University

L.S. Prussia, Retired Chairman
Bank of America

Gilbert Serota
Orrick, Herrington & Sutcliffe

James Shaffer
Norris Industries

Peter Slusser
Paine, Webber

Harry Snyder
Consumers Union

Franklin Tom
Parker, Milliken, Clark & O'Hara

Thomas Unterman
Morrison & Forrester

Richard Damm
Peter Szego
Consultants

Virginia Daley
Secretary