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Pennsylvania Says, Not in My House

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PENNSYLVANIA SAYS, "NOT IN MY HOUSE"

I. INTRODUCTION

On March 23, 1988 Pennsylvania enacted major anti-takeover legislation.[1] The main provisions of the act address the state legislature's concerns regarding the vulnerability of Pennsylvania corporations and their shareholders to hostile takeovers.[2] The new law is aimed at protecting Pennsylvania corporations from abusive takeover tactics which tend to weaken businesses, eliminate jobs and threaten communities built on the strength of local industry.[3] The legislation was enacted in the wake of the recent passage of anti-takeover legislation by several other states.[4]

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1. Act of March 23, 1988, 1988 Pa. Legis. Serv. 158 (Purdon) [hereinafter Pennsylvania Act] (codified at PA. STAT. ANN. tit. 15 §§ 1611, 1910 & 1911 (Purdon Supp. 1989)) (effective March 23, 1988). The act was signed into effect by Governor Casey; Senator Noah W. Werger and Representative Robert W. O'Donnell were the primary sponsors of the legislation in the Senate and House, respectively. *Governor Casey Signs Shareholder Protection Legislation Into Law*, 15 CHAMBER SPECTRUM 2 (Pennsylvania Chamber of Business and Industry) (March 28, 1988) [hereinafter *Casey Signs Shareholder Protection Legislation*].

2. *See* HOUSE OF REPRESENTATIVES DEMOCRATIC COMMITTEE, REPORT TO THE HOUSE OF REPRESENTATIVES OF 1988, at 1 (1988) [hereinafter HOUSE REPORT] (bill analysis reflects intent of legislature "to clarify and streamline certain procedures aimed at stopping hostile takeovers and to enact additional provisions having the same purpose as they relate to publicly held Pennsylvania corporations").

3. *Casey Signs Shareholder Protection Legislation*, *supra* note 1, at 2.

4. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-1221 to -1223 (Supp. 1987-88) (similar to § 911 of new Pennsylvania legislation except time limit on business combinations is three years in Arizona versus five years in Pennsylvania); DEL. CODE ANN. tit. 8, § 203 (Supp. 1988) (similar provisions to § 911 of Pennsylvania legislation requiring five-year ban on business combinations); IND. CODE ANN. § 23-1-43-19 (West Supp. 1988) (business combinations with interested shareholders limited within five years of share acquisition date); KY. REV. STAT. ANN. § 271B.12-210 (Michie/Bobbs-Merrill Supp. 1988) (five-year limitation on business combinations with some exceptions similar to § 911 of new Pennsylvania legislation); ME. REV. STAT. ANN. tit. 13-A, § 910 (Supp. 1988) (shareholders to receive fair payment for shares following "control transaction"); MINN. STAT. ANN. § 302A.673 (West Supp. 1988) (five-year general restraint on certain types of business combinations); MO. ANN. STAT. § 351.459 (Vernon Supp. 1988) (identifies permitted business combinations and exceptions to general five-year limitation period on certain business combinations similar to § 911 of new Pennsylvania legislation); N.J. STAT. ANN. § 14A: 10A-4 (West Supp. 1988) (five-year ban imposed on particular business combinations with interested shareholder); N.Y. BUS. CORP. LAW § 912 (McKinney 1986) (requirements relating to particular permitted business combinations similar to § 911 of new Pennsylvania legislation); OHIO REV. CODE ANN. § 1701.16 (Anderson 1985) (authorizing issuance of shareholder rights and options as takeover defense); WASH. REV. CODE ANN. § 23A.50.040 (Supp. 1988) (limitation placed on significant business combinations for five years); WIS. STAT. ANN. § 180.155 (West Supp. 1988) (expressly

Apparently, the majority of the state statutes have been adopted in response to the United States Supreme Court's recent decision in *CTS Corp. v. Dynamics Corp. of America*,[5] which upheld an Indiana anti-takeover statute. *CTS Corp.* reaffirmed the proposition that states may constitutionally regulate their domestic corporations.[6] Against this background, Pennsylvania enacted its anti-takeover statute.[7]

The new legislation consists of three parts. First, it adds an amendment to section 611 of the Pennsylvania Business Corporation Law (BCL)[8] which expressly permits the use of shareholder rights plans or so-called "poison pills."[9] Second, it includes an amendment to section 910 of the BCL[10] which reduces the threshold percentage of voting ownership required for a transaction to be deemed a "control transaction."[11] Third, it creates a new section 911 of the BCL which establishes the circumstances under which a publicly traded corporation may enter into a "business combination" with an "interested shareholder."[12]

ratifying use of shareholder rights plans as takeover defense); WIS. STAT. ANN. § 180.725 (West Supp. 1988) (five-year limitation on business combinations).

5. 481 U.S. 69 (1987). *CTS Corp.* involved a tender offeror, Dynamics Corporation of America (Dynamics), which brought suit to enjoin enforcement of Indiana's Control Acquisitions Chapter, a statute regulating takeovers of Indiana corporations. *Id.* at 75-76. *See* IND. CODE ANN. § 23-1-42-1 to -11 (West Supp. 1988). Dynamics contended that the Indiana statute was invalid because it was preempted by the Williams Act and violated the federal dormant commerce clause. *CTS Corp.*, 481 U.S. at 75. The Williams Act requires a purchaser to disclose information concerning the offer when the purchase will result in the purchaser owning more than five percent of a class of stock. 15 U.S.C. § 78n(d)(1) (1982). In addition, the Williams Act establishes procedural rules to govern tender offers. *Id.* § 78n(d)(5)-(7). The Indiana statute provided that the acquisition of shares in a domestic corporation which brought an individual's voting power up to or above certain prescribed voting levels would not include voting rights unless ratified by a majority of all pre-existing disinterested shareholders at the next regularly scheduled shareholders' meeting. *CTS Corp.*, 481 U.S. at 73-75. *See* IND. CODE ANN. § 23-1-42-11 (West Supp. 1988). The Supreme Court rejected the challenges by Dynamics and indicated that the statute was compatible with both the Williams Act and the dormant commerce clause. *CTS Corp.*, 481 U.S. at 94.

6. *CTS Corp.*, 481 U.S. at 89.

7. *See* Pennsylvania Act, *supra* note 1.

8. Section 611 of the BCL is codified at PA. STAT. ANN. tit. 15 § 1611 (Purdon Supp. 1989).

9. For a discussion of the amendment to § 611, see *infra* notes 13-30 and accompanying text.

10. Section 910 of the BCL is codified at PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1989).

11. For a discussion of the amendment to § 910, see *infra* notes 31-53 and accompanying text.

12. PA. STAT. ANN. tit. 15, § 1911 (Purdon Supp. 1989). For a discussion of new § 911, see *infra* notes 54-78 and accompanying text.

II. ANALYSIS

A. *Section 611: Poison Pills*

The amendment to section 611 is a reaction to case law in other jurisdictions holding shareholder rights plans or "poison pill" defenses by target corporations invalid either because of the legislature's silence regarding the validity of such provisions or because the legislature has expressly prohibited such provisions as being discriminatory.[13] In essence, the statute provides that a corporation may institute a discriminatory shareholder rights plan which creates stock rights or options that the corporation may issue as dividends to its shareholders upon the occurrence of specific events that are indicative of an imminent takeover.[14] The rights or options generally allow a shareholder to purchase additional shares or assets of his or her corporation (target corporation) at a discounted rate,[15] or to purchase shares of the acquiring corporation at

13. *See, e.g.*, Amalgamated Sugar Co. v. NL Indus., 644 F. Supp. 1229 (S.D.N.Y. 1986) (discriminatory character of "flip-in" provision of rights plan was *ultra vires* under New Jersey law proscribing discrimination among shareholders of same class and series); Ministar Acquiring Corp. v. AMF Inc., 621 F. Supp. 1252 (S.D.N.Y. 1985) (non-transferability of rights plan unauthorized by New Jersey); Asarco Inc. v. M.R.H. Holmes A Court, 611 F. Supp. 468 (D.N.J. 1985) (discriminatory nature of stock dividend which conferred voting rights on all holders except acquiring corporation invalid under New Jersey corporate law). *But see* Moran v. Household Int'l, 500 A.2d 1346 (Del. 1985) (finding implicit authorization for the creation of discriminatory rights plan under title 8, § 157 of the Delaware Code).

14. For an example of a shareholder rights plan, see Moran v. Household Int'l, 500 A.2d 1346 (Del. 1985). *Moran* involved a shareholder rights plan which provided for stock rights to be issued to shareholders if either of two events occurred: 1) the announcement of a tender offer for 30% or more of the corporation's outstanding shares or 2) an individual acquired 20% of its outstanding shares. *Id.* at 1349. The rights allowed the holder to purchase 1/100 of a share of new preferred stock for $100. *Id.* If a merger or consolidation occurred, the rights "flip-over" provision would be triggered and the holder of the rights could purchase $200 of the common stock of the tender offeror for $100. *Id.*

The relevant language of the amendment to § 611 is as follows:

> Except as otherwise provided in its articles prior to the creation and issuance thereof, a business corporation may create and issue (whether or not in connection with the issuance of any of its shares or other securities) option rights or securities having conversion or option rights entitling the holders thereof to purchase or acquire shares, option rights, securities having conversion or option rights, or obligations, of any class or series, or assets, of the corporation, or to purchase or acquire from the corporation shares, option rights, securities having conversion or option rights, or obligations, of any class or series, owned by the corporation and issued by any other person.

PA. STAT. ANN. tit. 15, § 1611(A) (Purdon Supp. 1989).

15. This is characterized as a "flip-in" provision which is designed to protect against creeping takeovers and other takeover abuses not covered by a "flip-over" provision. Richards, Brossard & Williams, *Rights Plans Developments and Recent Litigation*, 10 Nat'l L.J., May 23, 1988, at 28, col. 1. In the event an individual or entity becomes an owner of more than a specified percentage of out-

a discounted rate.[16] The amendments to section 611 allow the board of directors of a company with voting stock registered under the Securities Exchange Act of 1934 to exclude some shareholders from exercising the rights or options granted under the shareholder rights plan.[17] Therefore, an individual attempting a takeover of a corporation by the purchase of a certain percentage of outstanding shares may be barred from exercising his or her rights or options.[18] At the same time, however, the other shareholders of the corporation may exercise their rights or options at a discounted price. This results in a dilution of the equity position of the individual seeking to acquire control of the target corporation.[19]

Finally, despite the adoption of these provisions, the poison pill need not be invoked, and in some instances it may not be invoked because the board of directors usually will have the discretion to invalidate

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standing stock, the rights "flip-in" and each holder of a right is entitled to purchase stock in the target corporation at a 50% discount. *Id.*

16. This is termed a "flip-over" provision which is designed to halt two-tiered mergers. *Id.* In the event of a two-tiered merger or other specified acquisition of the target corporation, the rights "flip-over" entitles the holders of the rights to purchase stock in the acquiring corporation at, for example, a 50% discount. For an example of a "flip-over" provision, see the discussion of *Moran, supra* note 14.

17. PA. STAT. ANN. tit. 15, § 1611(D) (Purdon Supp. 1989). For the statutory language permitting such discriminatory practices, see *infra* note 18. A company which is required to register stock under the Securities Exchange Act of 1934 is a company which has shares traded on a national securities exchange. 15 U.S.C. § 78l(a) (1982). In addition, a company required to register stock under the Securities Exchange Act of 1934 includes an issuer "engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of . . . any means of instrumentality of interstate commerce," and has assets greater than $1,000,000 and equity securities held by at least 500 but less than 750 shareholders. 15 U.S.C. § 78l(g)(1)(B) (1982).

18. The relevant language authorizing a board of directors of a reporting company to create "discriminatory" terms is as follows:

> The securities, contracts, warrants, or other instruments evidencing any shares, option rights, securities having conversion or option rights, or obligations of a corporation may contain such terms as are fixed by the board of directors, *including, without limiting the generality of such authority*: . . . conditions that preclude or limit any person or persons owning or offering to acquire a specified number or percentage of the outstanding common shares, other shares, option rights, securities having conversion or option rights, or obligations of such a corporation or transferee or transferees of any such person or persons from exercising, converting, transferring or receiving such shares, option rights, securities having conversion or option rights, or obligations.

PA. STAT. ANN. tit. 15, § 1611(D) (Purdon Supp. 1989) (emphasis added).

It appears that no limits are placed upon the board of directors with respect to the terms of the rights or options other than their fiduciary duty. *Id.* § 1611(E).

19. *See, e.g.*, Facet Enters. v. Prospect Group, No. 36140 (Del. Ch. Apr. 15, 1988) (WESTLAW, States library, DE-CS file) (triggering of poison pill would cause $50 million loss by acquiring individual).

the poison pill rights or options.[20] The board of directors, however, must exercise that discretion once the takeover of the target corporation becomes inevitable.[21]

The amendments to section 611 will have a dramatic impact upon Pennsylvania corporations, foreign corporations and practitioners. Although poison pills are not a complete defense to a takeover, they significantly influence the events of any takeover scenario in which they are involved.[22]

The express validation of poison pills by the state legislature removes any fear that a target corporation's adoption of a poison pill will be held to be *ultra vires*.[23] The decision by a target corporation's board of directors to adopt a poison pill, however, will be evaluated under the business judgment rule.[24] The amendment to section 611 makes this explicit. It states that "[n]othing contained in [the] section shall be construed to effect a change in the fiduciary relationship between a director and a business corporation or to change the standard of care of a director."[25]

In Pennsylvania, a director owes a fiduciary duty to act "in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including reasonable inquiry, skill

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20. The poison pill rights or options would normally be redeemed by the issuing corporation upon approval by the board of directors.

21. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986). *Revlon* involved competing takeover bids by two corporations for Revlon, Inc. *Id.* at 175. The Delaware Supreme Court stated that the fiduciary duty of the board of directors of Revlon changed once they had realized that the takeover of the corporation became inevitable as indicated by the increasingly higher bidding for the corporation's stock. *Id.* at 182. The court held that once the takeover was inevitable, the duty of the board shifted to obtaining the highest possible price for the corporation. *Id.*

22. *See, e.g.*, *Revlon*, 506 A.2d 173. For a further discussion of *Revlon*, see *supra* note 21. Under *Revlon*, a board of directors theoretically must accept a bid for the corporation which is in the best interests of the shareholders. Therefore, a poison pill is not a complete defense to a takeover because the board of directors may be required to redeem the poison pill rights or options. However, a poison pill defensive measure would likely encourage a potential acquiror to negotiate rather than trigger the poison pill.

23. For the exact language and a discussion of the amendment, see *supra* notes 13-21 and accompanying text. For a brief discussion of the *ultra vires* defense, see *infra* note 30 and accompanying text.

24. PA. STAT. ANN. tit. 15, § 1611(E) (Purdon Supp. 1989). Courts have traditionally evaluated the conduct of a Pennsylvania corporation's board of directors in a takeover context under the business judgment rule. *See, e.g.*, Keyser v. Commonwealth Nat'l Fin. Corp., 644 F. Supp. 1130 (M.D. Pa. 1986) (in situation where board of directors agreed to "lock up option" with "white knight," court interpreted Pennsylvania law as allowing business judgment rule presumption of propriety of board of directors' actions in absence of bad faith, fraud or self-interest); Enterra Corp. v. SGS Assocs., 600 F. Supp. 678 (E.D. Pa. 1985) (interpreting Pennsylvania law as requiring presumption of business judgment rule in absence of bad faith, fraud or self-interest).

25. PA. STAT. ANN. tit. 15, § 1611(E) (Purdon Supp. 1989).

and diligence, as a person of ordinary prudence would use under similar circumstances."[26] Absent a showing of a "breach of fiduciary duty, lack of good faith or self dealing," under the business judgment rule a target corporation's board of directors' action or omission is "presumed to be in the best interests of [the] corporation."[27] Consequently, a board of directors' good faith decision to adopt a shareholder rights plan will likely be upheld. A board of directors, however, should be cautioned regarding a possible change in the fiduciary relationship in light of the Delaware Supreme Court's decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings*[28]. *Revlon* requires the target corporation's board of directors to affirmatively negotiate a takeover of its corporation once it becomes apparent that its sale is inevitable due to increasingly higher bidding.[29]

Hostile acquiring corporations and their counsel will likely be confronted with poison pill defenses in Pennsylvania target corporations. These acquiring corporations will be unable to argue that such a poison pill defense is *ultra vires*.[30] Absent a breach of fiduciary duty by the target corporation's board of directors, an acquiring corporation will have to negotiate with the target corporation.

B. *Section 910: Appraisal Rights*

Section 910 is aimed at the prevention of two-tiered takeovers.[31] In such a takeover, an individual seeks control of a corporation without giving other shareholders the right to receive the "fair value" for their shares. The amendments to section 910 of the BCL reduce the percentage of voting power which an individual or group must obtain in order to have the transaction deemed a "control transaction" from thirty to twenty percent.[32] Under the amendment, once the twenty-percent

26. 42 PA. CONS. STAT. ANN. § 8363(a) (Purdon Supp. 1989).

27. *Id.* § 8363(c).

28. 506 A.2d 173 (Del. 1986). The Pennsylvania Supreme Court has yet to explicitly adopt the *Revlon* analysis.

29. For a discussion of this change in the fiduciary duty standard, see *supra* notes 21-22 and accompanying text. It follows that the adoption of a poison pill could be a violation of a board of directors' fiduciary duty where the sale of a corporation is inevitable.

30. "Ultra vires" is defined as "[a]cts beyond the scope of the powers of a corporation, as defined by its charter or laws of state of incorporation." BLACK'S LAW DICTIONARY 1365 (5th ed. 1979). Prior to the adoption of the amendment to § 611, the Pennsylvania courts had not decided whether the adoption of a poison pill was *ultra vires*.

31. *See* HOUSE REPORT, *supra* note 2, at 2 ("[t]his would preclude two-tiered offers"). In a two-tiered takeover attempt, the acquiror initially only purchases a sufficient number of shares to gain control of the corporation. Then, in the second tier, the remaining shareholders are cashed out of the corporation at a minimum cost to the acquiror.

32. PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1989). The amendment to § 910 defines a controlling person or group as:

threshold is reached, the controlling shareholder must provide notice of the control transaction to every holder of the corporation's voting stock and the court of common pleas in the county where the corporation's registered office is located.[33] The notice must inform the noncontrolling shareholders of the opportunity to demand the "fair value" for their shares from the controlling shareholder.[34]

Prior section 910 defined a control transaction as the acquisition, directly or indirectly, of over thirty percent of the corporation's voting stock by an individual or group of individuals acting in concert.[35] The new amendment provides that those individuals currently owning twenty percent or more of a corporation's voting stock will not be affected by the amendment unless they subsequently increase their voting power by acquiring additional stock.[36] In addition, voting power over certain shares specified by section 910 will not be included in any twenty-percent calculation.[37]

> [A] person who has, or a group of persons acting in concert that has, voting power over voting shares of the corporation that would entitle the holders thereof to cast at least twenty per cent of the votes that all shareholders would be entitled to cast in an election of directors of the corporation.

Id. § 1910(B)(1).

33. *Id.* § 1910(C).

34. *Id.* The relevant language of the statute is as follows:

> Prompt notice that a control transaction has occurred shall be given by the controlling person or group to . . . each shareholder of record of the corporation holding voting shares and . . . [t]he notice must state that . . . all shareholders are entitled to demand that they be paid the fair value of their shares . . . .

Id.

35. PA. STAT. ANN. tit. 15, § 1910(B)(4) (Purdon Supp. 1988). In addition, prior § 910 of the BCL provided noncontrolling voting shareholders of a publicly-traded Pennsylvania corporation with the right to receive the "fair price" for their shares following a control acquisition under the same procedure given to dissenting shareholders under § 515 of the BCL. *Id.* § 1910(E).

36. The relevant language of the amendment states:

> [A] person or group which would otherwise be a controlling person or group within the meaning of this section shall not be deemed such a controlling person or group unless, subsequent to the later of the effective date of this amendatory act or the date this section becomes applicable to a corporation by bylaw or article amendment or otherwise, that person or group increases the percentage of outstanding voting shares of the corporation over which it has voting power to in excess of the percentage of outstanding voting shares of the corporation over which that person or group had voting power on such later date, and to at least [20% of the votes that all shareholders would be entitled to cast in an election of directors], as the result of forming or enlarging a group, or acquiring, by purchase, voting power over voting shares of the corporation . . . .

PA. STAT. ANN. tit. 15, § 1910(B)(2)(i) (Purdon Supp. 1989).

37. *Id.* § 1910(B)(2)(ii). The relevant statutory language provides that the following shares shall not be counted in order to meet the 20% minimum:

> (a) shares which have been held continuously by a natural person

Furthermore, the amendments to section 910 establish a minimum statutory fair value which a controlling shareholder must pay to noncontrolling shareholders after the control transaction.[38] This statutory fair value ensures that the amount paid to a dissenting shareholder in a control transaction will be at least equal to the highest price per share paid by the controlling shareholder within ninety days of the date that the controlling shareholder acquired his twenty-percent interest.[39] The statutory fair value requirement appears to be aimed at protecting dissenting shareholders from the abuses of two-tiered mergers sometimes used by those seeking control of a target corporation.[40] Corporate raiders will no longer be able to cash out minority shareholders at less than a fair price in the second tier of two-tiered mergers.[41]

The amendments to Section 910 also expand the requirements for notice which a controlling shareholder must give following a "control

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> since January 1, 1983, and which are held by such natural person at such time; or
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> (b) shares which are held at such time by any natural person or trust, estate, foundation or other similar entity to the extent such shares were acquired solely by gift, inheritance, bequest, devise or other testamentary distribution or series of such transactions, directly or indirectly, from a natural person who had acquired such shares prior to January 1, 1983; or
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> (c) shares which were acquired pursuant to a stock split, stock dividend, reclassification or similar recapitalization with respect to shares described under [these three subclauses] that have been held continuously since their issuance by the corporation by the natural person or entity that acquired them from the corporation, or that were acquired, directly or indirectly, from such natural person or entity, solely pursuant to a transaction or series of transactions described in paragraph (b) [above], and that are held at such time by a natural person or entity described in such paragraph (b).

Id.

38. *Id.* § 1910(E). The statute provides in pertinent part:

> For the purposes of this subsection, fair value means a value not less than the highest price paid per share by the controlling person or group at any time during the ninety-day period ending on and including the date of the control transaction plus an increment representing any value, including without limitation any proportion of any value payable for acquisition of control of the corporation, that may not be reflected in such price.

Id. § 1910(E)(1).

39. *Id.*

40. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (first tier of tender offer was under-priced cash offer, followed by second tier which was low-value junk bonds to remaining shareholders).

41. The preclusion of less than fair-priced second tiers is embodied in the mandated statutory fair price provision. Under the amendment to § 910, an acquiror is required to pay in cash at least the highest amount paid per share during the 90-day period ending on the date of the control transaction. PA. STAT. ANN. tit. 15, § 1910(E) (Purdon Supp. 1989). This statutory fair price provision prevents an acquiror from cashing out minority shareholders at a lower price during the second tier. For the relevant statutory language, see *supra* note 38 and accompanying text.

transaction."[42] In addition, the appraisal procedures which allow a shareholder to dissent from a control transaction and demand fair value for his shares have been significantly changed.[43] Prior section 910 did not expressly require the appraisal procedure to occur within a specific time period following the shareholder's demand for an appraisal remedy.[44] Section 910 now requires that the acquiror pay at least the statutory fair value to the dissenting shareholders within a reasonable time after a control transaction.[45] In addition, new section 910 provides that the controlling shareholder must pay all costs and expenses of the court-conducted appraisal procedure, regardless of whether the court-appraised value is the same or less than the value previously offered by the controlling shareholder.[46]

Importantly, a corporation may opt out of the new amendments to section 910 by an amendment to its articles of incorporation prior to the date of the control transaction.[47] Unless the board of directors of the corporation approves the amendment to the articles, it requires the approval of eighty percent of the shareholders entitled to vote to become

42. *See* PA. STAT. ANN. tit. 15, § 1910(C) (Purdon Supp. 1989). In addition to all shareholders of record, notice must now be given to the court of common pleas in the county of Pennsylvania where the registered office of the corporation is located. *Id.* Importantly, the content of the notice must include the fact that (1) all shareholders are entitled to demand the fair value of their shares; (2) the minimum value that the shareholder can receive is the value indicated in the statute; and (3) if the shareholder believes the fair value of the shares is higher, he or she can pursue the appraisal remedy provided under the statute. *Id.*

43. *Id.* § 1910(D). Prior § 910 allowed shareholders to make written demand on a controlling shareholder for the fair value of their shares, "taking into account all relevant factors," and pursue the appraisal remedy for shareholders dissenting from particular mergers. PA. STAT. ANN. tit. 15, § 1910(E) (Purdon Supp. 1988).

44. *See* PA. STAT. ANN. tit. 15, § 1515 (Purdon Supp. 1988) (procedure for appraisal remedy for dissenting shareholders concerning particular mergers).

45. PA. STAT. ANN. tit. 15, § 1910(E) (Purdon Supp. 1989). The amendments to § 910 require the court to appoint an appraiser within 30 days after receipt of the share certificates of a dissenting shareholder. *Id.* The appraiser's duty is to determine the fair value of the shares "as soon as reasonably practicable." *Id.*

46. *Id.* Under the old appraisal proceeding provided in prior § 910, the costs of the appraisal proceeding would normally be paid by the controlling shareholder. PA. STAT. ANN. tit. 15, § 1515(H) (Purdon 1967). However, unlike new § 910, the court had the power to assess costs and expenses against a dissenting shareholder if his refusal of the controlling shareholder's offer was "arbitrary or vexatious or not in good faith." *Id.*

47. PA. STAT. ANN. tit. 15, § 1910(A) (Purdon Supp. 1989). In addition, the new amendment to § 910 allows two other ways for a corporation to opt out of its provisions. First, it could have amended its bylaws either by March 23, 1984 or within 90 days after the effective date of the amendments, i.e., March 23, 1988. *Id.* Secondly, § 910 does not apply if the corporation's articles originally indicated that § 910 was inapplicable or an article amendment to that effect was adopted prior to the date of the control transaction and prior to or subsequent to the effective date of the new amendments, March 23, 1988. *Id.*

effective.[48]

The amendments to section 910 significantly affect the form of corporate takeovers. The fair price and streamlined appraisal proceeding provisions will essentially preclude one of the most abusive takeover tactics, the two-tiered tender offer.[49]

Counsel must alert their clients to the fact that under the amendments to section 910, an acquiring corporation is required to pay a dissenting shareholder an amount at least *equal to the highest price per share* paid by the controlling shareholder within ninety days of when the controlling shareholder acquired his twenty-percent interest.[50] A controlling shareholder may no longer "freeze out" dissenting shareholders by paying them less than a truly fair price for their shares following the controlling shareholder's purchase of his or her interest.[51]

The target corporation's shareholders must now be advised of the streamlined appraisal remedy which requires *all* costs to be paid by the controlling shareholder.[52] Thus, there is no apparent reason for shareholders not to demand payment for their shares through the statutory appraisal remedy. This would especially be true of shareholders that are being advised by fearful or hostile management.

It should be noted that a target corporation's board of directors' decision to opt out of coverage under the amendments to section 910 will likely be evaluated under the business judgment rule. Consequently, absent a lack of good faith, the board of directors' decision will be upheld.[53] In addition, like section 611, section 910 in the final analysis is designed to encourage friendly takeovers.

C. *Section 911: Business Combination Moratorium*

Section 911, which had no counterpart in the old BCL, significantly affects the circumstances under which a corporation may enter into "business combinations" with "interested shareholders."[54] An "interested shareholder" is defined under the section as any individual who directly or indirectly is the beneficial owner of at least twenty percent of the shares entitled to vote in the election of directors.[55] "Business com-

48. *Id.*

49. For a discussion of the fair price provisions and appraisal remedy, see *supra* notes 38-46 and accompanying text.

50. PA. STAT. ANN. tit. 15, § 1910(E) (Purdon Supp. 1989). For the text of this provision, see *supra* note 38.

51. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (second tier of merger consisted of low-value junk bonds to remaining shareholders).

52. PA. STAT. ANN. tit. 15, § 1910(E) (Purdon Supp. 1989).

53. For a discussion of the application of the business judgment rule in Pennsylvania, see *supra* notes 26-29 and accompanying text.

54. *See* PA. STAT. ANN. tit. 15, § 1911 (Purdon Supp. 1989).

55. *Id.* § 1911(A)(11). Section 911 excludes from the 20% calculation: (1) shares held continuously by a "natural person" since January 1, 1983 up to

binations," on the other hand, are broadly defined by the new section.[56]

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the present; (2) shares held by a "natural person or trust, estate, foundation or other similar entity to the extent such shares were acquired solely by gift, inheritance, bequest, devise or other testamentary distribution" from a "natural person" who had obtained the shares prior to January 1, 1983; or (3) shares obtained through a "stock split, stock dividend, reclassification or similar recapitalization" held continuously since their issuance or that were obtained pursuant to (2) described above. *Id.*

56. *See id.* § 1911(A)(5). The pertinent language of § 911 is as follows:

> "Business Combination," when used in reference to any business corporation and any interested shareholder of such business corporation, means:
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> (i) any merger or consolidation of such business corporation or any subsidiary of such business corporation with (a) such interested shareholder or (b) any other corporation (whether or not itself an interested shareholder of such business corporation) which is, or after such merger or consolidation would be, an affiliate or associate of such interested shareholder;
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> (ii) any sale, lease, exchange, mortgage, pledge, transfer or other disposition (in one transaction or a series of transactions) to or with such interested shareholder or any affiliate or associate of such interested shareholder of assets of such business corporation or any subsidiary of such business corporation (a) having an aggregate market value equal to ten per cent or more of the aggregate market value of all the assets, determined on a consolidated basis, of such business corporation, (b) having an aggregate market value equal to ten per cent or more of the aggregate market value of all the outstanding shares of such business corporation, or (c) representing ten per cent or more of the earning power or net income, determined on a consolidated basis, of such business corporation;
>
> (iii) the issuance or transfer by such business corporation or any subsidiary of such business corporation (in one transaction or a series of transactions) of any shares of such business corporation or any subsidiary of such business corporation which has an aggregate market value equal to five per cent or more of the aggregate market value of all the outstanding shares of such business corporation to such interested shareholder or any affiliate or associate of such interested shareholder except pursuant to the exercise of option rights to purchase shares, or pursuant to the conversion of securities having conversion rights, offered, or a dividend or distribution paid or made, pro rata to all shareholders of such business corporation;
>
> (iv) the adoption of any plan or proposal for the liquidation or dissolution of such business corporation proposed by, or pursuant to any agreement, arrangement or understanding (whether or not in writing) with, such interested shareholder or any affiliate or associate of such interested shareholder;
>
> (v) any reclassification of securities (including, without limitation, any split of shares, dividend of shares, or other distribution of shares in respect of shares, or any reverse split of shares), or recapitalization of such business corporation, or any merger or consolidation of such business corporation with any subsidiary of such business corporation, or any other transaction (whether or not with or into or otherwise involving such interested shareholder), proposed by, or pursuant to any agreement, arrangement or understanding (whether or not in writing) with, such interested shareholder or any affiliate or associate of such interested shareholder, which has the effect, directly or indirectly, of increasing the proportionate share of the outstanding shares of any

Section 911 forbids interested shareholders from engaging in the specified business combinations with the corporation for five years from the time that the interested shareholders acquired their twenty-percent interest.[57] Significantly, the moratorium on business combinations is lifted only if the transaction meets one of three exceptions. First, there is no time limit on the business combination if it is approved by the board of directors prior to the date the shareholder became an interested shareholder.[58] Second, the moratorium is lifted if the business combination is approved by all of the holders of the corporation's outstanding common shares.[59] Third, the ban is inapplicable if a majority of the disinterested shareholders entitled to vote in an election of directors approve the transaction at a meeting called specifically for this purpose, no earlier than three months after the meeting to elect directors.[60] In addition, at the time of the meeting, the interested shareholder must be the beneficial owner of at least eighty percent of the outstanding stock.[61] To come under the third exception, the transaction must also meet other specific price and equity acquisition conditions outlined in section 911.[62] Realistically, the exceptions are likely to be extremely

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class or series of voting shares or securities convertible into voting shares of such business corporation or any subsidiary of such business corporation which is, directly or indirectly, owned by such interested shareholder or any affiliate or associate of such interested shareholder, except as a result of immaterial changes due to fractional share adjustments; or

(vi) any receipt by such interested shareholder or any affiliate or associate of such interested shareholder of the benefit, directly or indirectly (except proportionately as a shareholder of such business corporation), of any loans, advances, guarantees, pledges or other financial assistance or any tax credits or other tax advantages provided by or through such business corporation.

Id.

57. *Id.* § 1911(B).

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.* One such condition for transactions involving common shares deals with price and essentially provides as follows: the amount of cash and the fair market values of property received by each common stock shareholder in the business combination must be at least equal to the higher of either (i) the highest price paid by the interested shareholder at a time when he owned five percent or more of the corporation's voting stock during the five years preceding the announcement date of the business combination or the five years ending on and including the date the shareholder became an "interested shareholder" plus, in either case, interest minus dividends paid or (ii) "market value," defined in the statute as the highest closing price for publicly traded stock or the fair market value for stock not publicly traded during the thirty days preceding the announcement date of the business combination or the date when the shareholder became an "interested shareholder" plus interest, minus dividends paid. *Id.* Preferred shareholders have a slightly different method for determining fair price. *Id.* It is determined by the highest preferential amount per share in the event of a voluntary liquidation, dissolution or winding up of the corporation,

difficult to meet in the environment of a hostile takeover.

After the expiration of the statutory five-year period, a corporation may engage in business combinations approved by a majority of the disinterested shareholders at a meeting on the proposed combination.[63] Additionally, a corporation may engage in a business combination if that business combination meets the specific fair price acquisition restriction conditions outlined in section 911.[64]

A corporation may choose to opt out of section 911 by amending its articles.[65] An amendment to opt out of section 911 requires among other things, approval by a majority of the disinterested shareholders entitled to vote in an election of directors.[66] In addition, the amendment will not become effective until eighteen months after the vote, and it will not apply to any business combination with a shareholder who became an interested shareholder on or prior to the effective date of the amendment.[67]

Moreover, section 911, by its terms, is not applicable in certain situations. First, it does not apply to corporations that do not have a class of voting shares registered under the Securities Exchange Act of 1934.[68] Second, section 911 is inapplicable where the corporation had no voting shares registered under the Securities Exchange Act of 1934 on the effective date of an amendment to the articles subjecting the corporation to section 911, and where the interested shareholder acquired his "interested share percentage" prior to the effective date of such an amendment to the corporation's articles.[69] Third, section 911 is not applicable

plus the aggregate amount of any dividends declared or due. *Id.* An interested shareholder also must provide all shareholders in a class or series with cash or the same form of consideration that he previously used to acquire the largest number of shares of that class or series. *Id.* Also, all disinterested shareholders are entitled to receive the price determined under § 911. *Id.* In addition, an interested shareholder is forbidden, except for limited exceptions, from making other stock acquisitions for less than the fair price requirements of section 911.

63. *Id.* § 1911(B)(3). The statutory language is as follows:

> A business combination approved by the affirmative vote of the holders of shares entitling such holders to cast a majority of the votes that all shareholders would be entitled to cast in an election of directors of such business corporation, not including any voting shares beneficially owned by such interested shareholder or any affiliate or associate of such interested shareholder, at a meeting called for such purpose no earlier than five years after such interested shareholder's share acquisition date.

Id.

64. *Id.* For a discussion of these specific conditions, see *supra* note 62.

65. PA. STAT. ANN. tit. 15, § 1911(C)(3) (Purdon Supp. 1989). Also, a corporation may have chosen to opt out of § 911 by an amendment to the bylaws of the corporation within 90 days of March 23, 1988, the effective date of § 911. *Id.*

66. *Id.*

67. *Id.*

68. *Id.* § 1911(C)(1). For a discussion of the corporations required to register under the Securities Exchange Act of 1934, see *supra* note 17.

69. PA. STAT. ANN. tit. 15, § 1911(C)(2) (Purdon Supp. 1989). "Interested

where the original articles of incorporation explicitly so provide.[70] Fourth, section 911 does not apply if the interested shareholder both inadvertently acquired his or her "interested share percentage" and would not otherwise have been an interested shareholder within the five-year period prior to the announcement date of the business combination, and the interested shareholder divests himself or herself of ownership to a point below the twenty-percent ownership needed to be classified as an interested shareholder.[71] Fifth, section 911, on its face, does not apply where the interested shareholder owned at least fifteen percent of the corporation's voting stock prior to the effective date of section 911 and maintained that percentage until the interested shareholder's twenty-percent share ownership was reached.[72] Lastly, section 911 does not apply when the corporation is a subsidiary of another corporation on March 23, 1988, the effective date of section 911.[73]

Section 911 has a major impact on a hostile acquiror's ability to finance a takeover of a Pennsylvania corporation. Section 911's five-year moratorium on certain "business combinations" limits tender offers which are financed through high-yield securities or "junk bonds," because such financing usually requires a break-up of the target corporation to pay off the acquisition debt.[74] The five-year moratorium makes it difficult to arrange financing that will accommodate the five-year delay before a target corporation may be liquidated or its revenues are available to pay off the debt.[75] In addition, the statutory fair price provisions of section 911 prevent an acquiring entity which has been able to finance

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share percentage" is the direct or indirect ownership by a shareholder of at least 20% of the shares entitled to vote in the election of directors. *See id.* § 1911(A)(11).

70. *Id.* § 1911(C)(3). The statute states that § 911 does not apply if "the articles . . . explicitly provide that this § [911] shall not be applicable to the corporation by a provision included in the original articles." *Id.*

71. *Id.* § 1911(C)(4). The relevant statutory language states that § 911 does not apply to a business combination with an interested shareholder if

> such interested shareholder . . . divests itself of a sufficient amount of the voting shares of such business corporation so that it no longer is the beneficial owner, directly or indirectly, of shares entitling such person to cast at least twenty per cent of the votes . . . entitled to [be] cast in an election of directors of such business corporation, and . . . would not at any time within the five-year period preceding the announcement date with respect to such business combination have been an interested shareholder but for such inadvertent acquisition . . . .

Id.

72. *Id.* § 1911(C)(5). The statutory language states that § 911 does not apply "to any business combination with an interested shareholder who was the beneficial owner . . . of shares entitling such person to cast at least fifteen per cent of the votes," in an election of directors "on the effective date of this section and remain so to such interested shareholder's share acquisition date." *Id.*

73. *Id.* § 1911(C)(6).

74. For a discussion of the five-year moratorium provisions, see *supra* notes 57-62 and accompanying text.

75. Lipton, *Takeover Expert Proposes Uniform State Statute*, 199 N.Y.L.J., Mar.

the initial stages of a takeover from cashing-out minority shareholders at a minimum cost.[76]

A possible weakness of section 911 is the ability of a hostile individual to acquire less than the twenty-percent interest required to trigger a five-year moratorium. A hostile acquiror may acquire less than a twenty-percent interest and then wage a takeover battle by proxy seeking approval by a majority of the disinterested shareholders. In addition, a hostile acquiror may obtain less than the twenty-percent ownership in the corporation and seek to obtain a new election of directors to approve the business combination.[77] The hostile individual may do so knowing that the target corporation will react by either restructuring, selling the corporation at a higher price or allowing itself to be acquired by the hostile individual.[78]

Constitutional attacks on similar legislation have proved unsuccessful.[79] Litigants have generally challenged such statutes on preemption and dormant commerce clause grounds, only to be rejected by the courts under the analysis of *CTS Corp. v. Dynamics Corp. of America*.[80] Consequently, an acquiring individual must either negotiate with the target corporation or attempt to circumvent the legislation by acquiring less than a twenty-percent interest and waging a costly proxy contest.

III. CONCLUSION

In conclusion, the new legislation enacted by Pennsylvania appears

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21, 1988, at 21, col. 1 (indicating structuring of financing over five-year period is difficult but not impossible).

76. For a discussion of these fair price provisions, see *supra* note 38 and accompanying text.

77. Centaur Partners attempted this tactic in its battle to achieve control of Pennwalt Corporation, a Pennsylvania corporation. Philadelphia Inquirer, Feb. 17, 1989, at C15, col. 4. Carl Icahn attempted a similar tactic in his battle to achieve control over Texaco, Inc., 10 Nat'l L.J., May 23, 1988, at 16, col. 2.

78. Lipton, *supra* note 75, at 21, col. 1 (discussing New York takeover statute where hostile individual acquires less than 15% ownership and then "puts the target in play").

79. *See, e.g.*, RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988) (rejecting plaintiff's arguments that Delaware statute with three-year ban on certain business combinations was either preempted by Williams Act or was in violation of federal dormant commerce clause); BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988) (court denied preliminary injunction because it found no reasonable probability of eventual success in litigation because Delaware takeover statute would likely be upheld as constitutional in face of preemption and federal commerce clause challenges).

80. 481 U.S. 69 (1987). For a discussion of *CTS Corp.*, see *supra* notes 5-7 and accompanying text. It is possible, however, with the growing number of stricter takeover statutes at the state level, that a reviewing court would find a statute unconstitutional. Pennsylvania's legislation, though, appears roughly parallel in restrictiveness to the Delaware legislation, which was recently upheld in *RP Acquisition Corp.*, 686 F. Supp. 476.

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to parallel recent similar anti-takeover statutes in other states.[81] Each section of the new legislation is aimed at particular aspects of hostile takeovers. First, the amendments to section 611 provide a board of directors with a powerful bargaining tool with a hostile bidder.[82] Next, the amendments to section 910 provide a shareholder with a mechanism to obtain a fair price in the event of a change in control of the corporation.[83] Finally, the adoption of section 911 helps to protect minority shareholders from being cashed-out of the corporation while deterring takeovers deemed harmful to the corporation.[84] Thus, this legislation, like that in other states, seeks to significantly alter the balance of power in corporate law in Pennsylvania. It statutorily creates defenses to hostile takeovers which are increasingly seen as having a pernicious effect on the Commonwealth's economy. At the same time, the statute preserves the corporation's ability to reap the benefits of a profitable takeover bid.[85] In the final analysis, a hostile acquiror is confronted with effective legislation if it intends a takeover of a Pennsylvania corporation.

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81. For a list of similar enactments, see *supra* note 4 and accompanying text.

82. For a discussion of the amendments to § 611, see *supra* notes 13-30 and accompanying text.

83. For a discussion of the amendments to § 910, see *supra* notes 31-53 and accompanying text.

84. For a discussion of new § 911, see *supra* notes 54-78 and accompanying text.

85. Governor Casey indicated that the new legislation "is designed so that it does not prevent takeovers that breathe new life into moribund businesses, dislodge poor management, or otherwise result in economic benefits in the opinion of impartial shareholders." *Casey Signs Shareholder Protection Legislation*, *supra* note 1, at 2.