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Shareholders with large voting positions that seek to increase their holdings may trip up state control share acts which deny shares their voting rights when certain ownership thresholds are crossed. This is true, despite the fact that control share statutes were enacted as antitakeover measures, and the additional share purchases may be designed to stop a hostile takeover attempt.

The recent case of Simon Property Group, Inc. et al. v. Taubman Centers, Inc., et al. Nos. 02-74799 2003 and 02-75120, 2003 U.S. Dist. LEXIS 7435 (E.D. Mich., May 1, 2003; as amended May 8, 2003), highlights the importance for existing large shareholders of companies (including private equity funds and hedge funds) incorporated in states with control share acts to be mindful of the possibility of triggering the provisions of these statutes.

The case involved Taubman Center, Inc.'s ("Taubman") attempt to prevent a $1.7 billion hostile takeover bid by Simon Property Group Inc. ("Simon"). The Taubman family owned 30.7% of the outstanding voting stock of the company and entered into voting agreements to gain voting power over an additional 2.9%, giving them voting control over 33.6% of the voting stock. Robert Taubman filed a Schedule 13D/A that stated that the voting agreements were entered into "for the purposes of preventing an unsolicited takeover of the Company." Simon sued Taubman in the U.S. District Court for the Eastern District of Michigan, arguing that the formation of the group by the Taubman family and other shareholders who entered into voting agreements to vote a 33.6% controlling block, 30.7% of which was held by the Taubman family, was a "control share acquisition" under the Michigan Control Share Acquisition Act that required the approval of disinterested shareholders for the group to exercise voting power. The group constituted a blocking position because Taubman's bylaws required the offer to be approved by 2/3 of the company's shareholders. The issue raised was whether the Michigan statute was triggered only to the extent of the "acquisition" of shares by the Taubman family, amounting to 2.9%, or whether it also applied to their existing shares.

Control share acts have been adopted in at least 18 states, a number of which, including Michigan's, were modeled on the Indiana Control Share Acquisitions Act whose constitutionality was upheld by the U.S. Supreme Court. Many of the control share acts were enacted in the 1980s to regulate the accumulation of voting power by potential acquirers of local companies, with the effect of serving as a protective measure for companies to block hostile tender offers.

The Michigan Control Share Acquisition Act defines "control shares" as those shares that "would have voting power with respect to shares of an issuing public corporation that, when added to all other shares of the issuing public corporation owned by a person or in respect to which that person may exercise or direct the exercise of voting power, would entitle that person, immediately after acquisition of the shares, directly or indirectly, alone or as part of a group, to exercise or direct the exercise of the voting power of the issuing public corporation in the election of directors within any of the following ranges of voting power: (a) 1/5 or more but less than 1/3 of all voting power; (b) 1/3 or more but less than a majority of all voting power; (c) a majority of all voting power."

The Michigan Act provides that "control shares" triggering the threshold levels of 20%, 33% or 50% of voting power, if acquired in a "control share acquisition," will be denied their voting rights, which will only be restored by the approval of both a majority of the disinterested shareholders and a majority of all shareholders. Under the statute, a "control share

acquisition" is defined as "the acquisition, directly or indirectly, by any person of ownership of, or the power to direct the exercise of voting power with respect to, issued and outstanding control shares."

The District Court judge in Simon determined that the Michigan Act was triggered by the Taubman family when they entered into voting agreements to obtain an additional 2.9% of the voting power and that the Taubman family had violated the rights of other shareholders under the Michigan Act because they had not obtained the consent of disinterested shareholders when they established the shareholder group to block Simon's offer. The judge held that the Michigan Act defined "control share acquisition" not only in terms of the "acquisition" of shares, but also in terms of "the power to direct the exercise of voting power" with respect to shares. In addition, the judge, citing similar provisions of the Indiana Act, found that a group formed for the purpose of a control share acquisition is a "person" within the meaning of the Michigan Act, and concluded that "no actual purchase of shares is necessary to trigger the Control Share Act when a group forms for the purpose of directing the exercise of voting power."

The Taubman family together with the other shareholders that formed the voting alliance therefore constituted a group under the Michigan Act, which "acquired" control shares representing 33.6% of the voting power of the company, which included the 30.7% of existing shares held by the Taubman family as well as the 2.9% held by other shareholders. As a result, none of the control shares could be voted, unless voting rights were conferred by a majority of the disinterested shareholders in accordance with the Act. (Emphasis supplied) This decision effectively enabled Simon to proceed with its takeover attempt.

The precedential value of Simon remains unclear because on May 20, 2003 the judge issued an injunction pending an appeal to the Sixth Circuit. Although a court date was set for October 28, 2003, the appeal was never heard due to the timely enactment of new legislation by the Michigan legislature which essentially reversed the District Court ruling, and resulted in Simon withdrawing its tender offer.

Control share acts were enacted by states with the intention of protecting companies from hostile takeover attempts, rather than preventing existing large shareholders of such companies from defending against hostile takeover attempts. However, in light of the District Court's interpretation of the Michigan Act in Simon, large shareholders in companies that are incorporated in states with control share acts should be mindful of the possibility of tripping up the provisions of such statutes when seeking to increase their position. Simon has put target companies on notice (as legislative intervention cannot be relied on) that the actions of shareholders with large voting stakes may be scrutinized by the courts in their application of state control share acts.

Should you have any questions about the matters addressed in this issue of *M&A Notes*, please contact the following Kirkland & Ellis authors or the Kirkland & Ellis partner you normally contact.

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