

# HOUSE BILL REPORT

## HB 2387

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**As Passed House:**

February 9, 1998

**Title:** An act relating to shares and distributions under the Washington business corporation act.

**Brief Description:** Regulating shareholder rights under the Washington business corporation act.

**Sponsors:** Representatives Sheahan, Constantine and Costa.

**Brief History:**

**Committee Activity:**

Law & Justice: 1/15/98, 1/20/98 [DP].

**Floor Activity:**

Passed House: 2/9/98, 90-0.

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### HOUSE COMMITTEE ON LAW & JUSTICE

**Majority Report:** Do pass. Signed by 13 members: Representatives Sheahan, Chairman; McDonald, Vice Chairman; Sterk, Vice Chairman; Costa, Ranking Minority Member; Constantine, Assistant Ranking Minority Member; Carrell; Cody; Kenney; Lambert; Lantz; Mulliken; Robertson and Sherstad.

**Staff:** Edie Adams (786-7180).

**Background:** A corporation is a form of business entity governed by statute. A corporation's articles of incorporation must set forth the classes of shares that may be issued by the corporation and the number of shares of each class that may be issued. If a corporation's articles of incorporation authorize the issuance of more than one class of shares, the articles must give each class a distinguishing designation and the preferences, limitations, and relative rights of each class must be set forth in the articles.

Several provisions govern the preferences, limitations, and relative rights of shares within a specified class. Two provisions allow the preferences, limitations, and relative rights of shares within a class to vary: one by allowing the preferences, limitations, and rights to be made dependent on facts ascertainable outside the articles of incorporation; and one by authorizing the board of directors to determine the preferences, limitations, and rights of a class of shares or a series within a class prior to their issuance. Another provision

states that all shares of a class must have preferences, limitations, and relative rights that are identical to other shares.

A corporation may issue rights, options, or warrants for the purchase of the corporation's shares. The board of directors determines the terms under which the options, rights, and warrants may be issued.

The ability of corporations to adopt different preferences or limitations for shares and the ability to issue options, rights, and warrants for the purchase of shares enable corporations to adopt "shareholder rights plans," which are also referred to as "poison pills."

Many corporations have implemented shareholder rights plans as an anti-takeover mechanism. These plans enable a company to ward off hostile takeovers by making it difficult and more costly for the entity seeking to acquire the targeted corporation. Shareholder rights plans might, for example, change the voting powers of certain shares within a class or series or issue more shares to its shareholders at a substantial discount, if a person or entity attempting to gain control of the targeted company obtains a certain percentage share in the targeted company.

There is the potential for uncertainty as to the validity of shareholder rights plans under Washington law because of a lack of sufficient cross-references between the provisions that authorize a class of shares to have different preferences, limitations, and relative rights, and those provisions that state that all shares of a class must have identical preferences, limitations, and relative rights.

**Summary of Bill:** A clarification is made by adding cross-references to provisions of the corporations act that the preferences, limitations, voting powers, and relative rights of a class of shares or a series within a class, must be identical except as otherwise provided in law.

"Facts ascertainable outside the articles of incorporation" is defined to include, but not be limited to, the existence of a condition or the occurrence of an event, including a determination or action by any person or body, including the corporation, its board of directors, or an officer, employee, or agent of the corporation.

The board of directors is given specific authority to determine the terms and conditions relating to the exercise of share options, rights, or warrants, including the time or times, the conditions precedent, and the holders by whom the options, rights, or warrants may be exercised. These terms or conditions may preclude or limit the exercise of the options, rights, or warrants. In addition, they may be made dependent on facts ascertainable outside the documents relating to the creation of the options, rights, or warrants.

**Appropriation:** None.

**Fiscal Note:** Not requested.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Testimony For:** This is a technical bill to clarify the relationship between two existing sections of law to prevent a misinterpretation that could jeopardize a corporation's authority to adopt shareholder rights plans, also known as poison pills. Poison pills are used by corporations to ward off hostile takeovers, and they are based on the ability of a corporation to provide different rights to different shares within a class, based on some event or occurrence. Poison pill plans have been invalidated in some other states that have similar language as a result of the technical reading of those statutes.

**Testimony Against:** None.

**Testified:** John Steel, Washington State Bar Association (pro).