STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF GRAND TRAVERSE

CHARLES D. DAVIS,
Plaintiff/Counter-Defendant,
vs

File No. 90-8278-CK
HON. PHILIP E. RODGERS

SUPERIOR TELECOM OF TRAVERSE CITY, INC., Michigan Corporation, JOSEPH F. ELMHIRST, DIANE M. ELMHIRST, WALLACE D. STEINHOFF and MICHAEL HENDRICKSEN,
Defendants/Counter-Plaintiffs.

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DECISION AND ORDER

Plaintiff has filed a Motion for Partial Summary Disposition under MCR 2.116(C)(10) with respect to Count VI of his First Amended Complaint. The Plaintiff supports his motion with the pleadings, the depositions of Defendants Wallace D. Steinhoff and Joseph F. Elmhirst, and both a brief in support of the motion and a reply brief. The Defendants oppose the motion and have filed a brief in opposition, together with attached exhibits. Both parties agree that there are no material factual issues and the resolution of Plaintiff's motion involves solely a legal determination.

Plaintiff and the individual Defendants each own twenty-five percent of the shares of stock of Defendant Superior Telecom of Traverse City, Inc. (Superior). Superior is one of five affiliated corporations owned by the Plaintiff and individual Defendants, all of which are involved in the telephone long distance resale business. They are collectively referred to as "Superior Telecom."

Superior was formed in 1986 and it is undisputed that during the period 1986 to 1989, the four stockholders actively participated as shareholders in operating Superior. Plaintiff alleges that on March 7, 1990, the three Defendant stockholders took certain actions to deprive him from receiving any income or having any say in the operation of Superior. The Defendants argue that the Plaintiff was not fulfilling his duties as a corporate officer and deny any allegations of wrongdoing.

The Plaintiff further alleges that Defendants are attempting to force him out of Superior. Among other things, the First Amended Complaint alleges shareholder oppression, breach of fiduciary duty, breach of reasonable expectations, and a failure to provide information. The Defendants allege that Plaintiff entered into an option agreement to sell his stock to one of Superior's major competitors, i.e., Teledial America, Inc. (Teledial). Upon learning of this agreement, Superior took action intending to restrict the sale of shares of common stock to an individual or entity which is an actual or potential competitor of Superior.

Superior is closely-held, and one individual Defendant has estimated its fair market value at $6,000,000.00. It is undisputed that there is no available market for the sale of its common stock shares.

Plaintiff's Motion for Partial Summary Disposition is directed at Count VI of the First Amended Complaint. The subject matter of Count VI is a resolution passed by Superior's Board of Directors on June 11, 1990. A copy of the resolution and associated stock warrant are attached to Plaintiff's brief as Exhibits A and B.

It is further admitted that neither Superior's By-Laws nor its Articles of Incorporation restrict the transfer of outstanding shares of common stock. It is further admitted that there is no stockholder agreement or purchase agreement associated with the initial sale of shares which restricts their transfer. Finally, the parties recognize that the affect of the resolution upon the sale of Plaintiff's shares of stock in Superior to an actual or potential competitor (assuming the exercise of the stock warrants) would be to reduce the interest in Superior purchased by the competitor from twenty-five percent to two percent of Superior's outstanding stock.

Portions of the depositions of Mr. Steinhoff and Mr. Elmhirst were cited at pages 4 - 6 of Plaintiff's brief. Those sections acknowledged the admitted intent on the part of

Superior's board to restrict the sale of Superior's common shares to any individual or entity who is an actual or potential competitor of Superior.

The Plaintiff argues that this restriction violates both MCLA 450.1472 and MCLA 450.1301(3). The latter provision provides as follows:

"Subject to the designations, relative rights, preferences and limitations applicable to separate series, each share shall be equal to every other share of the same class".

Plaintiff argues that the aforementioned resolution and stock warrant dilute both the equity and voting rights of an actual or potential competitor who purchases shares in Superior. The effect, then, is an alleged improper discrimination among shares of the same class. In support of this proposition, Plaintiff cites The Amalgamated Sugar Co v NL Industries Inc, 664 F Supp 1229 (SDNY 1986) (New Jersey Law); Minstar Acquiring Corp v AMF, Inc, 621 F Supp 1252 (SDNY 1985) (New Jersey Law) and Bank of New York Co Inc, v Irving Bank Corp, 536 NYS2d 923 (NY S Ct 1988).

The Defendants argue that the restrictions adopted by Superior, also commonly called "poison pills," do not illegally discriminate among shares of the same class. The Defendants rely principally upon Harvard Industries, Inc v Tyson, CCH Fed Sec Law Rep, paragraph 93,064 (US DC ED Mich, 1986); and Moran v Household International, Inc, 500 A2d 1346 (Del 1985) and the fact that the action taken by the board in adopting these restrictions was a reasonable exercise of business judgment which inures to the benefit of all shareholders.

A review of the authorities cited to the Court indicates that not all restrictions on the transfer of shares are illegal. Both the Moran and Harvard cases cited by Defendants contained "poison pill" restrictions which were approved by the Courts. In Moran, the restrictions involved a "flip-over" rights provision which allowed shareholders of an acquired corporation to purchase common stock of the acquirer at one-half its prevailing market price, i.e., the right holder would be entitled to purchase $200.00 worth of the acquirer's common for $100.00. Moran, supra, at p 1060.

The restrictions in the case at bar are more analogous to those discussed in Harvard. They have been referred to as "flip-in" rights provisions which dilute voting rights and equity in the acquired company. In a decision without any specific reference to statutory authority or specific precedent, the Harvard Court held that such rights plans do not violate section 301(3) of the Michigan Business Corporations Act, MCLA 450.1301(3). The Harvard Court wrote as follows:

"The antidiscrimination provision of the Michigan Business Corporations Act requires that each share be equal to every other share of the same class. Harvard argues that the rights plan discriminates by subjecting an unapproved acquirer of more than twenty percent of [the] stock to a dilution of both voting rights and equity.

"The Court agrees with Defendant, however, and adopts the position of the better-reasoned cases that such a rights plan does not discriminate among shares but, rather, among shareholders, which is not forbidden. The take-away provisions of the rights plan only affects shareholders who acquire twenty percent or more of the outstanding stock becoming an acquiring person. Discrimination among shareholders as a tactical means of defending against hostile take overs does not violate Section 301(3) of the Michigan Business Corporations Act". Harvard, supra.

This Court agrees with the holding of the Harvard Court but does not adopt its analysis. Rather, it is this Court's conclusion that a "flip-in" restriction on the transfer of common shares to an actual or potential competitor does not violate Section 301(3) of the Michigan Business Corporations Act for the reason that it prohibits, in fact, the transfer of common shares to a designated person or class of persons, which designation is not contrary to public policy. MCLA 450.1473(D).

While the Harvard Court chose to analyze the "flip-in" sales restriction as one that discriminates among shareholders rather than among shares, this Court feels it is preferable to analyze the restriction for what it is; i.e., a lawful corporate restriction on the sale of common shares to an actual or potential competitor. In this Court's opinion, such a restriction can be in the best interests of common stock shareholders and is implicitly permitted by Section 473(D) of the Michigan Business Corporation Act. MCLA 450.1473(D) In. relevant part, Section 473 provides as follows:

"In particular and without limitation of the generality of the power granted by subsection (1) of Section 472 to impose restrictions, a restriction on the transfer or registration of transfer of bonds or shares of a corporation is permitted if it does any of the following: ...(D) Prohibits the transfer of the restricted instruments to designated persons or classes of persons, and the designation is not contrary to public policy".

It is this Court's opinion, then, that the resolution and stock warrant described in Exhibits A and B to Plaintiff's brief do not violate the antidiscrimination provisions of Section 301(3). MCLA 450.1301(3) and MCLA 450.1473(D).

The analysis of Plaintiff's motion, however, does not end here. Plaintiff argues that even if the restrictions on his transfer of shares is not an illegal discrimination among shares of the same class prohibited by Section 301, it is nevertheless inapplicable to him through the operation of Section 472(1). MCLA 450.1472(1). The parties agree that the implementation of the resolution and exercise of the stock warrant would dilute the purchase of Plaintiff's twenty-five percent stock interest to a two percent interest. Plaintiff argues that the transfer restriction was imposed after his shares were issued and without his agreement. The parties further acknowledge that neither the Articles of Incorporation nor the By-Laws impose any restriction on the transfer of common shares to actual or potential competitors or otherwise. They further acknowledge that there is no agreement among the shareholders to restrict transfer. MCLA 450.1472(1) provides as follows:

"A restriction on the transfer or registration of transfer of a bond or share of a corporation may be imposed either by the articles of incorporation or by the by-laws or by an agreement among any number of holders or among the holders and the corporation. A restriction so imposed is not binding with respect to bonds or shares issued before adoption of the restriction unless the holders are parties to an agreement or voted in favor of the restriction". (Emphasis added)

Plaintiff argues that the restriction at issue is a clear violation of Section 472(1) and cites Joseph E. Seagram & Sons, Inc v Conoco, Inc, 519 F Supp 506(D) (Del 1981) in support of his position. There, the Delaware Supreme Court held that a restriction on the transfer of shares could not be imposed against non-consenting shareholders under Section 202 of the Delaware Business Corporation Act. As cited in Plaintiff's brief at p 8, fn 1, this provision is substantially similar to Section 472(1) of the Michigan Business Corporation Act. The Defendants respond by noting the distinctions between the factual situation in Seagram and those in the case at hand and by advising the Court that the relevant Delaware corporate law has been changed. The change was not discussed, and this Court does not see how a subsequent change in Delaware law is relevant to the interpretation of a then-applicable statutory provision, especially since Michigan has not changed its statute.

The Defendant distinguishes Seagram by drawing a distinction between a direct and an indirect restriction on the transfer of shares. Seagram involved a by-law which restricted the percentage of the corporation's stock which could be owned by an alien. This, says Defendant, is a direct restriction. The case at bar, Defendant then argues, is an indirect restriction only triggered by the sale of shares to an actual or potential competitor.

This Court does not find this distinction useful. No distinction between direct or indirect restrictions is made in Section 472(1) of the Michigan Business Corporation Act, nor has any case been cited to the Court which has adopted such a rationale when interpreting similar statutory language.

Rather, the Defendants cite Moran v Household International, Inc, supra, and an analysis which avoided invalidating a "flip-over" restriction plan under an analogous provision of Delaware law in favor of a holding supporting the rights plan through an analysis of the business judgment rule.

Plaintiff correctly points out that the Moran Court did not address whether the "flip-over" restrictions were an unlawful restriction on transfer. The issue was not discussed and apparently has never been discussed in any published decision. Defendants further argue that the business judgment rule, even if applicable, cannot permit Defendants to violate a statutory provision which prohibits them from enforcing such a restriction on shares issued before its adoption where the shareholder disagrees with the restriction.

In this Court's opinion, a resolution of Plaintiff's motion turns on whether an otherwise valid restriction on the transfer of shares can be asserted against shares issued and continuously held by a shareholder who has neither agreed to nor voted for it. An important element in this analysis is the recognition that Superior is a closely-held corporation with no ready market for the transfer of common shares.

In reviewing the cases provided to the Court, they all involve decisions concerning publicly-traded shares. In both of the cases principally relied upon by Defendants, Moran and Harvard, supra, the corporation's common stock was publicly traded. The "flip-in" and "flip-over" restrictions on the transfer of shares, in part, were rationalized as reasonable exercises of business judgment which protected the rights of all shareholders to maximize the sales value of their stock. In Harvard, the Court commented upon additional efforts to locate other buyers, and the Board of Directors' determination that it was an inopportune time to sell. The Harvard Court further recognized that the common shares were publicly traded. Here, there is no ready market for Plaintiff's stock.

Nevertheless, the Defendants would have the restriction apply to Plaintiff because of the disruption the sale to a competitor would have on the conduct of Superior's business. Although the three remaining individual shareholders would own seventy-five percent of Superior's stock and clearly retain control, the Defendants argue that the sale of Plaintiff's shares to a competitor may allow it to gain corporate information of a confidential nature pursuant to Section 487 of the Michigan Business Corporation Act or, in effect, grant a competitor a right of first refusal on the sale of the corporation's assets, thereby decreasing Superior's value to other potential bidders.

The Defendants recognize that they may attempt to restrict the information that would be available to a competitor which could be used to the Superior's competitive disadvantage. While this issue is not before the Court, Michigan law would clearly support reasonable measures in this regard.

The Defendants argue that the sale of Plaintiff's shares to a competitor would grant it a right of first refusal over any sale of the corporation's assets due to the competitor's ability to demand an appraisal as a minority shareholder. The Defendants argue that by combining its rights to information as a shareholder and its rights to demand an appraisal, a competitor would be in a position to bid more than any other potential bidder for the assets of the company. It is not clear that the Defendants' conclusion follows from its factual premises.

First, one would expect the Defendants, as principal shareholders and officers of the corporation, to exercise their fiduciary duty and ascertain the corporation's true value and, thereby, avoid a sale at too low a price. An appraisal may be necessary for this purpose. A competitor, as minority shareholder, may not be entitled to that information. Again, this question is not before the Court.

Second, the Defendants cannot seriously be concerned with the prospect of a competitor who owns its shares bidding more than the offer of any other bona fide purchaser. Any effort that Superior makes to sell its assets should be one designed to maximize the return to shareholders.

While the Defendants' concerns are legitimate and would certainly have supported a decision to include restrictions on sales of shares to competitors in the Articles of Incorporation or By-Laws or to secure such agreements at the time shares were issued, Superior did not take such action in this case. To the extent the Court finds any ambiguity in Section 472, it is whether a shareholder may unilaterally prevent the restriction from applying to his shares or whether he or she is bound by a restriction approved by a majority vote (or other plurality described in the corporation's Articles and By-Laws) of all other shareholders of record. Again, no precedent has been provided to the Court to assist it in interpreting this agreement.

In the absence of a ready market for the transfer of Plaintiff's shares and in the absence of a restriction on transfers to competitors in the Articles, By-Laws or in any agreement associated with the issuance of 'those shares, and in view of Plaintiff's objection to the restriction, it is this Court's determination that the Legislature did not intend a shareholder such as Plaintiff to be involuntarily bound by a restriction such as that at issue here. While the decisions of the board of directors need not be unanimous and while an individual's election to the board need not be unanimous and, indeed, while most decisions in this country affecting the rights of individuals are subject to a majority vote, such democratic principles cannot apply to retroactively restrict common shares held by a shareholder who has no ability to exercise his disagreement with management policy by otherwise selling his shares in a public market. The parties acknowledge that no such avenue is available to the Plaintiff in this case.

For all the foregoing reasons, it is this Court's opinion that the restrictions and warrants at issue may not be applied to the Plaintiff. MCLA 450.1472(1). Plaintiff's Motion for Partial Summary Disposition as to Count VI of the First Amended Complaint is granted.

IT IS SO ORDERED.

HON. PHILIP E. RODGERS, JR.
Circuit Judge
Dated: 5/14/91