

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Judiciary

BILL: CS/SB 602

INTRODUCER: Commerce and Tourism Committee and Senator Burgess

SUBJECT: Business Organizations

DATE: March 1, 2021

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Harmsen</u>	<u>McKay</u>	<u>CM</u>	<u>Fav/CS</u>
2.	<u>Davis</u>	<u>Cibula</u>	<u>JU</u>	<u>Pre-meeting</u>
3.	_____	_____	<u>RC</u>	_____

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/SB 602 amends several sections of the Florida Business Corporation Act (FBCA), contained in ch. 607, F.S., and several related statutes. These changes address concerns raised by corporations and the legal community pursuant to a complete revision of the FBCA in 2019.¹ Specifically, the bill:

- Narrows the circumstances under which a shareholder may assert his or her appraisal rights;
- Modifies the market out exception to accommodate privately-held corporations whose stock is not traded on an organized market, but who do have a comparable trading process;
- Addresses appraisal arbitrage, wherein disinterested parties abuse the appraisal rights afforded under Florida law to churn additional profits from the process;
- Makes clarifying and conforming changes to fix minor errors in the 2019 and 2020² FBCA legislation;
- Revises the timeframe for eligible entities to be able to use the name of a dissolved corporation; and
- Clarifies the application of corporation not-for-profit statutes in ch. 617, F.S., to the operation of condominiums, cooperatives, homeowners associations, timeshares, and mobile homeowners associations organized under chs. 718, 719, 720, 721, and 723, F.S.

¹ Chapter 2019-90, Laws of Fla. CS/CS/HB 1009 was signed into law on June 7, 2019, and took effect on January 1, 2020.

² Chapter 2020-32, Laws of Fla. CS/SB 838 was signed into law on June 18, 2020, and took effect upon becoming law.

II. Present Situation:

In 2019, the Legislature substantially amended ch. 607, F.S., the Florida Business Corporation Act (FBCA), to reflect changes to the Model Business Corporation Act³ and ch. 605, F.S., the Florida Revised Limited Liability Corporate Act (FRLCA). In 2020, the Legislature made several clarifying and conforming changes to the FBCA.

Since the 2019 update of the FBCA, the Florida Bar Business Law Section (Business Law Section) has identified three additional areas of concern.⁴ This bill, drafted with input from the Business Law Section and other community stakeholders, modifies the FBCA's provisions to address perceived abuses and fairness issues.

Further discussion of the present situation is discussed below in conjunction with the Effect of Proposed Changes.

III. Effect of Proposed Changes:

Appraisal Rights

Minority shareholders may dissent to corporate or majority shareholder action by asserting their appraisal rights, pursuant to ss. 607.1301-607.1340, F.S., which requires a corporation to buy the minority shareholders' stock at its "fair value."⁵ This remedy is one of the few protections against actions that "... fundamentally change the nature of the shareholders' investments without the check and balance of informed shareholder approval, and [provide] the opportunity for dissenters to withdraw from the corporation."⁶

A minority shareholder may assert his or her appraisal rights, but only in specific instances. These instances occur when a fundamental corporate change occurs, including (and subject to substantial restrictions and limits) the "domestication or conversion to another type of business entity, a merger, a share exchange, a disposition of all or substantially all of the corporation's assets, an amendment to a corporation's articles of incorporation that creates fractional shares, and in other cases involving a corporation's articles of incorporation, bylaws, or a resolution of its board of directors."^{7,8}

³ American Bar Association, *Model Business Corporation Act* (2016), available at https://www.americanbar.org/content/dam/aba/administrative/business_law/corplaws/2016_mbca.authcheckdam.pdf (last visited Feb. 22, 2021).

⁴ Florida Bar Business Law Section, Chapter 607 Drafting Subcommittee, *White Paper for S.B. 602 & H.B. 339: An Act Relating to Corporations and Other Entities*, 1-2 (Feb. 2021) (on file with the Senate Committee on Judiciary).

⁵ Section 607.1302(1), F.S. Section 607.1301(5), F.S., defines "fair value" as the value of the corporation's shares immediately before the effectiveness of the corporate action in question, using commonly-used valuation concepts and techniques, without discounting for lack of marketability or minority status of the shares.

⁶ Gregory Yadley and Christina Nethero, *Florida Corporate Practice: Appraisal Rights* s. 11:1 (2020); see also, *South End Improvement Group, Inc. by & through Bank of New York v. Mulliken*, 602 So. 2d 1327, 1332 (Fla. 4th DCA 1992).

⁷ Section 607.1302(1), F.S.

⁸ Gregory Yadley and Christina Nethero, *Florida Corporate Practice: Appraisal Rights* s. 11:2.C (2020).

The appraisal process is effectuated through a judicial hearing, where a court appraises the fair value of the shareholder's interests and assesses the corporation for payment of both the fair value and any accrued interest, calculated according to s. 55.03, F.S.

Triggers of a Minority Shareholder's Appraisal Rights

Section 3 amends s. 607.1302, F.S., to narrow the instances that trigger a minority shareholder's appraisal rights. Section 607.1302(1)(g), F.S., currently entitles shareholders to assert appraisal rights where an amendment to the articles of incorporation or bylaws adversely alters or abolishes the shareholder's voting rights or other rights. The Florida Bar received input that this entitlement could lead to unnecessary and superficial filing of charter amendments that do not actually alter the fundamental corporate governance for the purpose of unjust assertion of appraisal rights.⁹ To prevent such frivolous charter amendments, the bill deletes the broader entitlement in s. 607.1302(1)(g), F.S.

Section 3 also amends current s. 607.1302(1)(i), F.S., to allow minority shareholders who experience specific fundamental corporate changes to assert appraisal rights. This right extends only to shareholders in a corporation with 100 or fewer shareholders, whose shares were authorized on, or after October 1, 2003.

Minority shareholders may still assert their appraisal rights under several other bases enumerated in s. 607.1302(1), F.S.

Market Out Exception to Appraisal Rights

Thirty-eight states, including Florida, operate under the "market out exception," which restricts the appraisal rights available to shareholders of stock in large or publicly traded corporations. "[P]ublic shareholders presumptively have an available market. ... [W]hen a public market exists..., public shareholders must employ market price instead of court-appraisal as the measure of their interests."¹⁰

In Florida, the market out exception excludes shareholders from asserting appraisal rights if their shares are a covered security; are not a covered security, but are traded in an organized market; or are issued by an open end management investment company that is registered with the Securities and Exchange Commission.¹¹

Section 3 broadens the market out exception found in s. 607.1302(2), F.S., by prohibiting appraisal actions that are asserted in connection with a corporation's merger, share exchange, or disposition of corporate assets (as permitted by the corporation's articles of incorporation or bylaws), or those that adversely affect a shareholder of a closely held corporation or a shareholder who holds shares issued prior to October 1, 2003.

This amendment will limit a minority shareholder's ability to assert his or her appraisal rights, if made pursuant to s. 607.1302(1)(f) or (h), F.S., if the shares can be sold on an organized market

⁹ Florida Bar Business Law Section, Chapter 607 Drafting Subcommittee, *supra* note 4, at 3-4.

¹⁰ Gil Matthews, *The "Market Exception" in Appraisal Statutes* (March 30, 2020), available at <https://corpgov.law.harvard.edu/2020/03/30/the-market-exception-in-appraisal-statutes/> (last visited Feb. 22, 2021).

¹¹ Section 607.1302(2)(a), F.S.

that is liquid and where the value of the shares is reasonably calculated to arrive at a price that reflects an arm's length transaction.

Section 3 also amends the market out exception to apply where the shares held are not a covered security, and therefore are not traded in an organized market, but are subject to a "comparable trading process." The bill defines a "comparable trading process" as one where: (1) the share's market price is determined at least quarterly based on an independent valuation and by following a formalized process that is designed to determine a value for the corporation's shares that is comparable to the value of a comparable publicly traded company; and (2) the corporation repurchases the shares at pricing set by its board of directors based on the independent valuation and subject to established terms and conditions that have been provided to the shareholders. This will permit companies that meet these requirements to prohibit appraisal actions by their minority shareholders, and to instead apply the market out exception.

Section 607.1302(2)(b), F.S., outlines the point in time at which a minority shareholder's right to assert appraisal rights is determined. Section 3 of the bill clarifies that, in cases in which the corporate action in question will be approved by shareholders' signed, written consent, the corporate qualities must be scrutinized at the point at which the record date was fixed to determine the shareholders entitled to sign the consent.

Abuse of Appraisal Rights

The Florida Bar Business Law Section has perceived an abuse of the appraisal rights provisions in Florida.¹² Appraisal arbitrage is when activist investors buy up shares of a corporation merely for the purpose of gaining earnings on any possible upside to the corporation's shares, and asserting appraisal rights to earn interest off of the action.¹³ This bill seeks to address the arbitrage issue by:

- Involving courts in the determination of the appropriate interest to award in appraisal matters, and giving them leeway to award no interest;
- Giving corporations the right to prepay their interest; and
- Requiring the shareholder to acquire a beneficial ownership of shares prior to the initiation of the applicable corporate action that gave rise to appraisal.

Award of Accrued Interest in an Appraisal Action

Section 2 amends s. 607.1301, F.S., to update the definition of "accrued interest" as it applies to a shareholder's appraisal rights. Currently, interest on payments made pursuant to an assertion of one's appraisal rights is calculated at the statutory judgment interest rate as described in s. 55.03, F.S. The bill requires the parties in an appraisal action either to agree to an interest rate between themselves, or to accept a rate determined by a court to be equitable. The court's rate may not exceed the statutory judgment rate described in s. 55.03, F.S. Additionally, this section permits a

¹² Florida Bar Business Law Section, Chapter 607 Drafting Subcommittee, *White Paper for S.B. 602 & H.B. 339: An Act Relating to Corporations and Other Entities*, 6 (Feb. 2021) (on file with the Senate Committee on Judiciary).

¹³ American Bar Association, *Appraisal Arbitrage* (May 14, 2020), available at https://www.americanbar.org/groups/business_law/publications/the_business_lawyer/find_by_subject/buslaw_tbl_mci_appraisal/#:~:text=In%20the%20controversial%20practice%20of,the%20price%20of%20the%20deal.&text=Thus%2C%20awards%20that%20are%20skewed,practices%20likely%20encourage%20appraisal%20arbitrage. (last visited Feb. 25, 2021).

court to prohibit the payment of interest where it finds that the shareholder who asserted his or her appraisal rights acted arbitrarily or not in good faith in doing so.

Sections 6, 7, and 8 make conforming changes to ss. 607.1322, 607.1326, and 607.1330, F.S., respectively, to reflect both that the rate of interest is variable, and that a court may choose not to award accrued interest pursuant to the amended definition of the term in section 2 of the bill.

Prepayment of Interest

Section 7 amends s. 607.1326, F.S., to give corporations the option to prepay the fair value of the shares that are subject a shareholder's appraisal action. Such prepayment shortens the amount of time during which interest can accrue, and therefore mitigates risk to the corporation. Specifically, the bill allows the corporation to prepay all, or any part of the amount, that it determines is due to the shareholder. If the corporation makes the prepayment within 90 days after the appraisal notice, then the corporation may only be liable for the accrued interest on any amount above what it prepaid to the shareholder. If the corporation makes a payment after the 90-day period, but before a judicial determination of the interest due, then the corporation must prepay at the statutory judgment rate provided for in s. 55.03, F.S., and may be liable for additional interest on any excess payment due, calculated from the date the corporate action became effective.

Section 8 makes conforming changes to s. 607.1330, F.S., to acknowledge the prepayment options provided for in section 7 of the bill.

Beneficial Ownership Required by Record Date

Sections 4 and 5 amend ss. 607.1303 and 607.1321, F.S., respectively, to require a shareholder who wishes to assert his or her appraisal rights to have a beneficial ownership of his or her shares in the corporation by the record date established for the triggering corporate action. Additionally, the bill now requires the shareholder to assert his or her appraisal rights as to all of the shares he or she owns.

Section 5 also amends s. 607.1321, F.S., to require shareholders to have beneficially owned shares in the corporation on the date a tender offer for purchase was made pursuant to s. 607.11035, F.S.

Clarifying and Conforming Changes

Section 1 makes a grammar change from the use of the disjunctive "or" to the conjunctive "and" in s. 605.0410, F.S. According to The Florida Bar Business Law Section, this change is made to correct a glitch that was not caught in previous legislation.¹⁴

Sales in dissolution were transferred to ss. 607.1401-607.1410, F.S., by the 2019 FBCA legislation. **Section 3** removes a reference to a sale in dissolution from s. 607.1302(1)(d), F.S., to conform to prior changes. This section also makes a nonsubstantive grammatical change to s. 607.1302(1)(c), F.S.

¹⁴ The Florida Bar Business Law Section, Chapter 607 Drafting Subcommittee, *supra* note 4, at 9.

SB 892 (2019) inadvertently changed the period of time from 120 days to 1 year that a dissolved entity's name is unavailable after the effective date of its dissolution. **Section 9** reverts to the 120-day period and makes a separate, non-substantive conforming change.¹⁵

Section 12 clarifies that ch. 617, F.S., regarding corporations not-for-profit, applies to ch. 718, F.S., regarding condominiums, ch. 719, F.S., regarding cooperatives, ch. 720, F.S., regarding homeowners associations, ch. 721, F.S., F.S., regarding timeshares, and ch. 723, F.S., regarding mobile homeowners associations, only to the extent that there is a conflict between the chapters. The bill further clarifies that chs. 718-721 and 723, F.S., control where a conflict arises between those chapters and ch. 617, F.S.

Section 617.0725, F.S., requires not-for-profit corporations to meet specific quorum or voting requirements in order to amend their articles of incorporation's or bylaw's quorum or voting requirements. **Section 10** amends s. 617.0725, F.S., to clarify that a corporation that is an association, as defined in s. 720.301(9), F.S., or any corporation regulated under ch. 718 or 719, F.S., is exempt from this requirement. Generally, chs. 718-720, F.S., govern homeowners' associations, condominium boards, and cooperative boards.

Section 11 updates a cross-references and corrects a scrivener error.

Effective Date

Section 13 of the bill provides that the bill takes effect upon becoming law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. State Tax or Fee Increases:

None.

E. Other Constitutional Issues:

None identified.

¹⁵ Department of State, *Senate Bill 602 Agency Analysis* (January 28, 2021) (on file with the Senate Committee on Judiciary).

V. Fiscal Impact Statement:**A. Tax/Fee Issues:**

None.

B. Private Sector Impact:

Several changes will impact certain shareholders negatively; this may be counteracted by the reduction of inflated payments to appraisal arbitrageurs. Additionally, corporations and shareholders will need to familiarize themselves with the changes made to their rights and responsibilities.

C. Government Sector Impact:

CS/SB 602 deletes the provision that defined the interest applicable in appraisal proceedings. As a result, courts may be called on more frequently to determine the interest rate and accrued interest due in such cases.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 605.0410, 607.1301, 607.1302, 607.1303, 607.1321, 607.1322, 607.1326, 607.1330, 607.1405, 617.0725, 617.0825, and 617.1703.

IX. Additional Information:**A. Committee Substitute – Statement of Substantial Changes:**

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Commerce and Tourism on February 15, 2021:

Clarifies that associations and corporations governed by chs. 718-720, F.S., (e.g., homeowners associations, condominium boards, and cooperative boards) are exempt from the restriction in s. 617.0725, F.S., that prevents not-for-profit corporations from amending the quorum or voting requirement in articles of incorporation or bylaws without approval from the prior-established quorum or voting requirement.

B. Amendments:

None.

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
