

What Were We Thinking?

Understanding the CCC/CGC Reverse Triangular Merger, its Provisions and Protections

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The genesis of the ultimately successful merger/consolidation discussions between Charbonneau Country Club (CCC), and Charbonneau Golf Club, Inc. (CGC) began in the late spring of 2018 and continued through the signing of the Agreement and Plan of Merger effective May 5, 2020, and the finalization of the merger effective June 18, 2020. The three authors served in leadership positions in the separate entities and played primary roles in both the negotiation and the consummation of the merger. The purpose of this paper is simply to document our thinking, our mutual understandings, and our intentions as we moved through the negotiation and consummation process.

After informal discussions began in the late spring of 2018, the first concrete step in the process was the development and agreement in principle to three governing “Interests to be Protected”. These were adopted by CGC in November of 2018, and thereafter by CCC.

1. As a planned unit development community, the golf course/open space needs to be maintained for the benefit of the community culture, ambience, and property values.
2. The golf course needs to be managed and preserved for the benefit of the Men’s and Women’s Golf Clubs/Associations, as well as the neighborhood and informal resident golf groups, events, and casual play.
3. As a private for-profit corporation, the Golf Club has to abide by certain legal requirements that ensure that its current shareholders are being treated fairly, which will require that they receive fair value unless they agree otherwise.

Through the nearly two years of discussions, negotiations, approvals, and finalization of the resulting reverse triangular merger, these “Interests to be Protected” guided the way and formed the basic principles for the resulting governance terms and agreements. Many questions arising now, or in the future, can be correctly answered by pondering and giving credence to these identified and adopted “Interests to be Protected”.

Interest #3 was satisfied with the CGC shareholder vote to approve the merger, and the shareholder trust that was established to hold funds for shareholders who have not yet been found. Interests #1 and #2 guided the development of the Agreement and Plan of Merger, as well as the Amended and Restated Articles of Incorporation and the Amended and Restated By-Laws for the surviving merger sub, which then became the new and ongoing Charbonneau Golf Club, Inc. These “Interests” continue to live through the terms of these governing documents.

We are frequently asked why the merger effort was successful this time after failing so many times before. We feel the answer is in the alignment of, and allegiance to, these “Interests to be

Protected”. In any negotiation, focusing on interests can erase lines in the sand that might otherwise be imposed by arbitrary positions. In simple terms, focusing on interests prevents the discussions and negotiations from devolving into a zero-sum game where someone must lose for anyone to win. We believe these “Interests to be Protected” set the stage for a future premised on “compatibility of interests,” which will hopefully drive and support true voluntary collaboration between CCC, the primary representative of the community, and CGC, the primary representative of the golfing organizations and golfing participants. Balancing these “Interests to be Protected” in the resulting governing documents, created an operating format where both parties are limited in their ability to effectively “control” the other.

Stated more generally, the identified interests established that the community’s main priority or interest lies in retaining the golf course as a well-maintained open space for ambience purposes—for *visual rather than actual use*. This is critical for protecting livability and property values throughout the community. *Actual use* is the main (and exclusive) priority of the Men’s and Women’s golf clubs/associations, and of the other golfing residents. Bifurcated and viewed in this manner, the interests are entirely compatible (Win-Win rather than Win-Lose or Lose-Win). Therefore, the governance structure was established with an independent board of directors effectively controlled by the Men’s and Women’s golf clubs/associations. The assumption was and is that effective management for golfing use should assure acceptable continued visual use/ ambience and resulting vital protection of property values. There is mounting evidence that both CCC and CGC are better understanding and acknowledging, even if not yet fully embracing or accepting, the reality of this operational control structure.

Occasionally, someone will ask why the golf course (including both the land and the golf course operating business) remained in a separate corporation with its own board of directors. The first answer to that question is simple. Without that separation, the merger would have failed like it did every time before. Neither the golf club’s board nor its shareholders would have consented to the merger if the usage interests of the Men’s and Women’s golf clubs/ associations were not directly protected. The negotiations would have died as they did all those prior times. The separation was driven by compliance with that primary “Interest to be Protected.” But there is more to the story. There were (and are) legal and tax implications.

CCC is a Homeowner’s Association governed by the Oregon Planned Community Act found in Oregon Revised Statutes (ORS) Chapter 94, and more specifically ORS 94.550 to 94.783. It is also a non-profit corporation, and as such is also governed by the Oregon Non-Profit corporation act found in ORS Chapter 65. For federal tax purposes, Homeowners Associations are subject to regular corporate tax unless they meet the requirements under one of the subsections of Internal Revenue Code (IRC) Section 501 or qualify for and make an election under IRC Section 528. Currently CCC makes an annual election under IRC Section 528 to avoid taxation of dues not expended in the year collected (Reserves, etc.). Directly owning and operating our golf course could disqualify CCC from electing under IRC Section 528.

CGC is a private for-profit corporation organized and operated under the provisions of ORS Chapter 60. It is taxed as a regular corporation under Subchapter C of the IRC. As a *separate legal entity, independently managed*, its income and expenses are not attributed back to CCC. Attribution back to CCC could be disqualifying under IRC section 528.

The “Merger” was a complex legal process. Both CGC and CCC retained legal tax counsel in addition to their general legal counsel. In the case of CGC, they traded in their prior general legal counsel for a transaction specialist attorney, as well as retaining legal tax counsel and a corporate law specialist (who now serves as their ongoing general counsel). **The Agreement and Plan of Merger, along with the new CGC Amended and Restated Articles of Incorporation and Amended and Restated By-Laws are complicated legal documents. The interpretation of the language contained in these documents may further be impacted by the application of Oregon case law and statutes. Specific questions about these documents and their impact on operations/decisions should be addressed through a careful review of the actual documents and applicable state and federal law. Consultation with competent legal counsel is also strongly recommended.** In general, however, it may be helpful here to highlight our *intentions* regarding certain terms and conditions.

The start of any analysis of governance provisions regarding CGC and its interaction with CCC, its sole shareholder should begin with ORS Chapter 60, and specifically ORS 60.301 (2), which provides: “All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, the board of directors....” Shareholders, acting as shareholders, do not manage the affairs of the corporation. Those responsibilities are handled primarily by the board of directors and its officers. Certain major actions (for example mergers, liquidations, etc.) cannot be taken without the consent of the shareholder(s).

The primary power of shareholders regarding general operations of the corporation is election of the board of directors unless that is modified by governing corporate documents. CGC’s Amended and Restated Bylaws cover the election of directors in Article III. In the case of CGC, the shareholder (CCC) has the right to approve or not approve the election of any director, but only those that have been nominated by the golf clubs, in the case of club directors, or the CGC board of directors in the case of shareholder directors as those terms are defined in Article III. CCC, even as the sole shareholder of CGC, cannot nominate their own candidate(s) for election to the board, and therefore cannot dictate the selection of a sympathetic board. The make-up of the CGC board will be discussed at greater length below. And there are other restrictions on CCC’s powers as related to CGC. The best place to begin this analysis is in the Agreement and Plan of Merger, Section 5.09 (page 19 of the Agreement and Plan of Merger).

Section 5.09 (a) sets out governance provisions that are incorporated into the CGC Amended and Restated By-Laws. Again, these will be discussed below. Section 5.09 (b) provides that CCC will not take any action or cause any other party to take any action that breaches or undermines the Governance Obligations. This language is intended to preclude CCC from taking, promoting, or condoning any action that could directly or indirectly influence or limit the management rights of the CGC board of directors, or the effective rights of the Men's and Women's golf clubs to control (or at a minimum strongly influence) CGC board membership. 5.09 (b) goes on to require that CCC use its commercially reasonable efforts to operate the Surviving Corporation's (CGC) facilities as a golf course for not less than 20 years from the date of the merger. We intend and believe that both provisions are critical elements that made the merger possible, and that deserve to be jealously guarded and protected by all parties to the agreement. And Section 5.09 (c) goes even further by providing a specific enforcement methodology and source of funding for enforcement.

Pursuant to Section 5.09 (c), Each member of the CGC Board (then current member) is classified as a third-party beneficiary (under the Agreement and Plan of Merger) with the authority to enforce Parent's (CCC) covenants under Section 5.09. It further provides that any member of the CGC Board who exercises his or her rights under 5.09 (c) may pay for any costs or expenses arising in connection with enforcing Section 5.09 from CGC's \$1,000,000 Restricted Fund.

Most of us have heard statements or rumors of statements saying, "We own the golf Club, why can't we just tell them what to do". The simple answer is that CCC does not own the golf club. CCC is the sole shareholder in the corporation that owns the Golf Club (including the land, the operating business and the water company), but its position as a shareholder does not give it operational control (or even dominate influence) over the Golf Club regarding normal operations. In fact, it was our intention that such operational control be specifically restricted. To have done otherwise would have been inconsistent with the established "Interests to be Protected". And again, it would have also doomed any prospect of completing the merger, just as it did in the past.

As mentioned earlier, Article III of the Amended and Restated Bylaws of CGC covers many aspects of the formation and operation of the board of directors. It specifically provides that "All corporate powers will be exercised by or under the authority of, and the business and affairs of the Corporation will be managed under the direction of, the Board, subject to each limitation set forth in the Articles of Incorporation or these Bylaws." See, Article III Section 3.1.

The CGC Board is to consist of 7 members. One of these is to be nominated by the board of the Charbonneau Ladies' Niners. One is to be nominated by the board of the Charbonneau Women's Golf Association. And one is to be nominated by the board of the Charbonneau Men's Club. These are referred to as the "Club Directors". Four are to be nominated by the then current CGC board. These are referred to as the "Shareholder Directors". All CGC board nominees must be a resident and voting member of CCC by reason of property ownership (not by proxy or power of attorney), and all nominees must be approved by both the CGC board and

the Shareholder (CCC). If a nominee is not approved by either the CGC board or the CCC board, then the nominating entity will submit a new nominee. This process is to be followed until all seven directors are seated. Each board member serves for a two-year term, and there are no term limits. 3 members are to be elected at one annual meeting and 4 at the following annual meeting so approximately half of the board is selected or reselected each year. It was our intention through this structure and selection process to place operational control, or at least strong operational influence, in the hands of the golf clubs/associations to protect their *actual use interest*. We felt this would also protect the *visual use interest* of the community by keeping the golf course well maintained.

These interests are further protected by the restrictions included in Section 3.13.1 of Article III which preclude:

- (a) Amending the Articles of Incorporation or these Bylaws,
- (b) Liquidating or dissolving the Corporation,
- (c) Selling or transferring all or substantially all the Corporation's assets, or
- (d) Merging, consolidating, or otherwise reorganizing the Corporation with or into another corporation, limited liability company, or other entity without the approval of 6 of the 7 directors. Most of these restrictions *can* be eliminated after 10 years, or earlier failure of CGC to comply with certain financial performance metrics, but the amendment of the bylaws (think changing the method of choosing directors or changing the number of directors, etc.) would still require the approval of 5 of the 7 directors. See Article VIII Section 8.1.

Also keep in mind the provisions of Section 5.09 (b) of the Agreement and Plan of Merger, referenced above, that precludes CCC from taking any action that breaches or undermines the Governance Obligations set forth in the Agreement and Plan of Merger, and commits CCC to use its "commercially reasonable efforts to operate the Surviving Corporation's facilities as a golf course for not less than 20 years from the Closing Date.

It is possible that at some future date, CCC could elect to liquidate CGC and take direct possession and control of the golf club, but doing so could generate catastrophic tax consequences, both at that time as well as into the future. Such an action or attempted action might also be challenged under the provisions of Section 5.09 (b) of the Agreement and Plan of Merger.

So, in summary, what do the authors feel was gained by negotiation and consummation of the Reverse Triangular Merger? First and foremost a troublesome cloud that has been hanging over our community almost from its beginning has been lifted, at least well into the foreseeable future, if not indefinitely.

The golf course/open space is being maintained for the benefit of the community culture, ambience, and property values. At the same time, the golf course is being managed and preserved for the benefit of the Men's and Women's Golf Clubs/Associations, as well as the neighborhood and informal resident golf groups, events, and casual play.

For the first time in our community's existence there is no longer a risk that the golf course property can be sold to an outside interest with priorities inconsistent with the community's priorities. No sale or other disposition of the golf course property can take place without approval of the community's governing body.

Although CGC is currently performing well financially, elimination of private ownership of the golf club removed certain roadblocks that impaired CCC's ability to provide financial assistance if necessary and/or desired.

Also, as was suspected earlier, but clearly evidenced in the merger approval process, the shares of the old golf club were widely scattered, and in many cases, owners were deceased, and the share(s) had not been appropriately transferred. Although the golf club vote in favor of the merger was almost unanimous (315 in favor, 6 against, 1 abstention), it took extreme effort on the part of golf club board members and other volunteers to locate enough legal shareholders to meet the percentage threshold for a quorum, in person or by proxy, for lawful approval of the transaction. Even another year or two and it would have likely required an expensive and very time-consuming legal process for the old golf club to gain approval for *any* major corporate action.

The above protections were achieved while still maintaining the golf club in a separate legal entity, independently managed, thus enabling CCC to continue to qualify for preferable tax consequences by electing to report for tax purposes under IRC Section 528.

During the negotiation and consummation of this transaction, the authors donated time, effort, and expertise. It was at least the equivalent of a full-time job that continued for more than two years. Many other members of both boards also donated many, many hours reviewing thousands of pages of documents and records for "due diligence" compliance, not to mention spending countless hours trying to track down former golf club shareholders.

It is clear to us that the success of this project rested on the early identification of the three "Interests to be Protected". Their simplicity and clarity brought consensus, dedication and the motivation that can only rest on a clear, common goal. It is our sincere hope that these identified "Interests" will be remembered, and will continue to guide our community leaders, and the ongoing collaboration of CCC and CGC within our community.